Securities and Exchange Commission
PHILIPPINES

BAGONG PILIPINAS

OFFICE OF THE GENERAL COUNSEL

SEC OGC Opinion No. 24-13
Re: Financing Company Act of 1998, as amended; Financial Leasing

16 May 2024

PUYAT JACINTO SANTOS LAW
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Attetion: ATTY. JEWELYNN GAY B. ZARENO

Dear Atty. Zareno:

This refers to your letter[1] requesting the Commission's opinion on whether your client, Adventus IT Services (Philippines) Inc. ("Adventus"), is engaged in financial leasing activity that requires a financing company license under the provisions of Republic Act ("R.A.") No. 8556, otherwise known as the "Financing Company Act of 1998" ("FCA"), as amended.[2]

As stated in your letter, Adventus is a domestic corporation engaged in providing information and communications technology ("ICT") solutions and services, whose primary purpose is as follows:

> To carry on business as importers, exporters, distributors, wholesalers, agents of and dealers in office machines and equipments of whatever kind and description, parts thereof and accessories thereto; to rent, lease and let out for hire and sell (wholesale) or otherwise dispose of office equipments of all kinds and all component parts thereof, including software and to undertake, carry out and provide technical, support and other related services in connection therewith; to carry on all or any of the activities of importers, exporters, and general traders, and to buy, sell, import, export, manipulate and prepare for market, and deal in goods and produce of all kinds and merchandise of all descriptions, and to transact every kind of agency business, and to undertake the business of manufacturers; representatives; to carry on any other trade or activity whatsoever which can in the opinion of this corporation, be advantageously or conveniently carried on by this corporation by way of extension of or in connection with any such business as aforesaid, or is calculated directly or indirectly to develop any branch of this corporation's business or to increase the value of any of this corporation's assets, property or rights.

You likewise stated that Adventus provides managed print services, end-user computer management, data center management, and network management. To provide its services, Adventus offers to its customers a lease of office equipment under a trilateral scheme. Under the said scheme, the customer has two (2) options: (a) directly purchase the office equipment from Adventus; or (b) avail the services of a financing company which is referred to it by Adventus. In the second arrangement, the financing company will purchase the office equipment from Adventus, which now becomes the subject matter of a financial lease between the financing company and the customer.

However, you expressed that Adventus intends to offer its customers the option of directly leasing the office equipment without the intermediation of a financing company with the expectation that the office equipment will be purchased by the customer at the end of the lease period. In the attached Key Terms of Proposed Financial Lease, the customer shall, at the expiration of the lease period, return the office equipment, unless the customer opts to either: (a) enter into a new lease agreement for the same office

[1] Dated 11 May 2017.
[2] An Act Amending Republic Act No. 5980, as amended, otherwise known as the Financing Company Act.

equipment; or (b) purchase the office equipment, *provided* that, if at the expiration of the term, the fair market value shall exceed the residual value specified in Schedule 1,[3] Adventus shall pay the amount of such excess to the customer and if the fair market value shall be less than the specified residual value, the customer shall pay the amount of the deficiency to Adventus.

You submit that Adventus need not secure a certificate of authority in relation to the above financial leasing activity since it is not primarily organized for the purpose of extending credit facilities to consumers and it would undertake financial leasing only for ICT products, solutions and services, and complementary products and services needed to complete its ICT solutions and services, and not to all products of every kind and description. Further, you posit that Adventus' financial leasing would be made available only to a specific group of customers consisting of business entities and various institutions that have a need for ICT products, solutions and services, and complementary products and services, and that Adventus will utilize internally-generated capital to fund its financial leasing activity. Finally, Adventus provides an option to its customers to purchase the office equipment or ICT solution at the end of the lease period.

Hence, your query.

A. Modes of Extending Credit Facilities;
Financial Leasing: Definition and Nature.

Section 3(a) of the FCA defines ***financing companies*** as corporations that extend credit facilities to consumers and enterprises through financial leasing of movable and immovable properties, among others, to *wit:*

> (a) ***'Financing companies'*** hereinafter called companies, ***are corporations***, except banks, investments houses, savings and loan associations, insurance companies, cooperatives, and other financial institutions organized or operating under other special laws, which are ***primarily organized for the purpose of extending credit facilities to consumers and to industrial, commercial, or agricultural enterprises, by direct lending or by discounting or by factoring commercial papers or accounts receivable, or by buying and selling contracts, leases, chattel mortgages, or other evidences of indebtedness, or by financial leasing of movable as well as immovable property;***"[4]

Based on the above definition, a corporation is said to be engaged in the business of a financing company when it extends credit facilities through any of the following four (4) modes:

1. Direct Lending;
2. Discounting[5] or factoring commercial papers or accounts receivables;[6]
3. Buying and selling contracts, leases, chattel mortgages, or other evidences of indebtedness; or
4. Financial leasing.

Moreover, Section 3(d) of the FCA defines ***financial leasing*** as a mode of extending credit through a lease contract, thus:

> (d) 'Financial leasing' is a mode of extending credit through a non-cancelable lease contract under which the lessor purchases or acquires, at the instance of the lessee, machinery, equipment, motor vehicles, appliances, business and office machines, and other movable or immovable property in consideration of the periodic payment by the lessee of a fixed amount of money sufficient to amortize at least seventy (70%) of the purchase price or acquisition cost, including any incidental expenses and a margin of profit over an obligatory period of not less than two (2) years during which the lessee has the right to hold and use the leased property with the right to expense the lease rentals paid to the lessor and bears the cost of repairs, maintenance, insurance and preservation thereof, but with no obligation or option on his part to purchase the leased property from the owner-lessor at the end of the lease contract."

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[3] The mentioned Schedule 1 was not attached in the Letter-Request.
[4] Emphasis, italics, and underscoring supplied.
[5] "Discounting" is a type of receivables financing whereby evidence of indebtedness of a third party, such as installment contracts, promissory notes, and similar instruments, are purchased by, or assigned to, a financing company in an amount or for a consideration less than their face value. [Section 1(i), Rules and Regulations to Implement the Provisions of Republic Act No. 8556 (IRR) (The Financing Company Act of 1998]
[6] "Factoring" is a type of receivables financing whereby open accounts, not evidenced by a written promise to pay supported by documents such as but not limited to invoices of manufacturers and suppliers, delivery receipts and similar documents, are purchased by, or assigned to, a financing company in an amount or for a consideration less than the outstanding balance of open accounts. (Section 1(j), IRR of R.A. No. 8556)

B. Legislative History of the FCA.

We note that the progenitor of the FCA is R.A. No. 5980, otherwise known as the "Financing Company Act,"[7] which was enacted into law on 04 August 1969. In his sponsorship speech of House Bill No. 1095 (the bill that was enacted into the *Old* FCA), then Senator Ambrosio B. Padilla highlighted that in general, the main business of financing companies involves three (3) parties, thusly:

> Senator AYTONA. ***And in general, <u>the main business of a financing company involves three parties</u>, unlike transactions with banks which generally involved financing companies, Mr. President, we have the principal creditor, we have principal debtor, and financing companies buy the papers that I mentioned.*** So, Mr. President, the idea of applying the maximum interest rates provided for in the Anti-Usury Law does not apply to the business of financing companies, except when the financing company grants a loan. Then, Mr. President, by operation of the Anti-Usury Law, even without this bill, financing companies can be proceeded against for transactions involving loans. But with respect to the true and what should be the main business of a financing company, the limitations of the Anti-Usury Law do not apply.
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> Senator PADILLA. Your Honor, I agree perfectly with all your statements and observations. The true business of financing companies is not in the granting of loans but the discounting of the commercial papers. Therefore, they do not fall under the provisions of the Anti-Usury Law. ***And Your Honor is correct that it does not involve only the debtor and the creditor but actually three persons.***[8]

While the terms "leasing" and "financial leasing" and their definitions were not provided for in the *Old* FCA, they can be found in the implementing rules and regulations, which reads:

> "LEASING" shall refer to financial leasing which is a mode of extending credit through a non-cancellable contract under which the lessor purchases or acquires at the instance of the lessee heavy equipment, motor vehicles, industrial machinery, appliances, business and office machines, and other movable property in consideration of the periodic payment by the lessee of a fixed amount of money sufficient to amortize at least 70% of the purchase price or acquisition cost, including any incidental expenses and a margin of profit, over the lease period. The contract shall extend over an obligatory period during which the lessee has the right to hold and use the leased property and shall bear the cost of repairs, maintenance, insurance and preservation thereof, but with no obligation or option on the part of the lessee to purchase the leased property at the end of the lease contract.[9]

Significantly, to broaden the focus on financing activities, the FCA was passed in 1998 which gave equal emphasis to financial leasing. Direct lending and financial leasing of immovable properties were *included* as modes of extending credit facilities under the *revised* definition of a financing company, as elsewhere quoted in this Letter Opinion. The Explanatory Note to S. No. 1509 clearly evinces a legislative intent to characterize financial leasing as another mode of financing activity, all without distinction or change as to the trilateral relationship articulated in the *Old* FCA. Thus:

> Republic Act No. 5980 or the Financing Company Act was passed in 1969. Since then many important developments in the economy- and in the world of finance have made the FCA outdated. Changes are necessary to make financing companies more responsive to present day demands and expectations. A critical example is the industry's ability to provide adequate financial leasing to a growing economy which needs tremendous investments in equipment and capital goods. Statistics show that because of its inherent advantages, leasing can be a formidable engine of economic growth in many countries, it finances as much as 20-25% of total capital investment. In the Philippines, it accounts for less than 2% due to legal and regulatory impediments, some of which are sought to be removed in this bill.
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> ***The FCA's narrow focus on consumer financing activities of financing companies should now be broadened to give at least equal emphasis to financial leasing. Financial leasing provides medium to long term facilities by which business enterprises, especially small and medium-size firms, can favorably obtain the use of production equipment and capital goods.*** As such, it should be encouraged and promoted as it is in other countries. In Korea, for example, there is a specific law that promotes and gives incentives for leasing. In- Japan, legislation and regulation have been passed to encourage leasing to help in the modernization of economy.
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> Finally, the FCA needs to be revised to take into account recent trends in economic liberalization. The FCA was passed in an area which emphasized regulation that often restricted the growth and development of financial institutions and the economy.[10]

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[7] Hereafter, the "*Old* FCA."
[8] Emphasis, italics, and underscoring supplied.
[9] *See* Section 1(i) Revised Rules and Regulations to Implement the Provisions of R.A No. 5980, January 20, 1986 and Section 1(j), New Rules and Regulations to Implement the Provisions of R.A. No 5980, as amended, October 16, 1991.
[10] Emphasis and italics supplied.

Said legislative intent was made all the more certain when Committee Report No. 811 on the bill that eventually became the FCA contained a provision satisfactorily clarifying and illustrating the trilateral relationship contemplated under the same:

> 10. SECTION 10. Applicability of Incentives and Exemption to Financial Leases.
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> New. Under present laws and regulations, some benefits are lost to business firms or individuals when they finance their purchases or acquisitions through financial leasing rather than through borrowing. This is an unintended consequence and simply flows form the fac that most (if not all) laws or regulations only contemplate borrowing and other conventional methods of financing. E.g., BOI incentives could be lost if equipment is financed through leasing unless special case-by-case time consuming application is made with the BOI. This is simply because the lawmakers did not contemplate financial leasing when the BOI law was passed. ***For the same reason, such an <u>equipment acquirer (lessee)</u> would not be able to use the VAT input credits paid by the <u>financing company (lessor)</u>. The VAT was passed on to the financing company by the <u>manufacturer or seller</u> when the goods were purchased at the instance of the lessee. The new section will fill these unintended gaps in the law.***[11]

The final version of the bill as approved and enacted purposely had the aforementioned provision to illustrate the trilateral relationship, *viz:*

> Sec. 10. *Applicability of incentives and exemptions to financial leases.* — Any incentive, exemption or benefit, including tax credits and investment incentives granted by law or regulation to any purchaser, importer, borrower or other eligible person in connection with any purchase, importation, acquisition, or other transaction shall not be lost, diminished or impaired when the associated financing is through a financial lease rather than through borrowing or other conventional method of financing. Financing companies providing the financial lease in such cases shall be entitled to any incentive, exemption, benefit or privilege available to lenders, importers, purchasers or other eligible person in such transactions under the applicable law or regulation.

C. Supreme Court Rulings Re: Financing Activities.

The foregoing trilateral relationship is in harmony with and in conformity with the Supreme Court's pronouncements below.

The Supreme Court in *International Harvester Macleod, Inc. v. Medina, et. al.*[12] discussed that petitioner's transaction therein with the private respondent differs from the financing transaction contemplated under R.A. No. 5980,[13] ***in that there were only two (2) parties in its transaction with the private respondent.*** Thus:

> Evidently, the financing transaction that is regulated by R.A. 5980 involves the buying, discounting, or factoring of promissory notes and sales on credit or installment. IHMI did not purchase from itself the Retail Notes Analysis executed by Medina. ***IHMI only extended credit to Medina by allowing him to pay for the 24 truck engines in installment.*** While the increased price of the sale included a "financing charge," that charge was simply another name for the interest to be paid by the installment buyer (Medina) on the deferred payment of the purchase price of the vehicles sold and delivered to him by IHMI.
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> ***IHMI correctly pointed out that its transaction with Medina differs from a financing transaction under R.A. 5980, in that there were only two parties in its transaction with Medina, namely: IHMI and Medina, while in a financing transaction under R.A. 3765, there are three (3) parties involved, namely: (1) the installment buyer, (2) the seller, and (3) the financing company.*** The buyer executes a note or notes for the unpaid balance of the price of the thing purchased by him on installment. The seller assigns the notes or discounts them with a financing company which is subrogated in the place of the seller, as creditor of the installment buyer.
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> The transaction between IHMI and Medina did not involve any discounting, factoring or assignment of IHMI's credit against Medina to a finance company. ***The transaction was bilateral, not trilateral. No financing company stepped into the shoes of IHMI as assignee or purchaser of IHMI's credit against Medina. Medina himself, not a financing company, paid IHMI for the truck engines. Medina made his installment payments or amortizations to IHMI, not to a financing company.***

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[11] Emphasis, italics, and underscoring supplied.
[12] G.R. No. 53623, 22 March 1990.
[13] Now R.A. No. 8556, as amended or the FCA.

Since IHMI's business of selling trucks in installment is not the business of a financing company under R.A. 5980, IHMI did not need SEC authorization to engage in it.[14]

Of equal importance, in *Beltran et. al. v. PAIC Finance Corporation, et. al.*,[15] the Supreme Court explicitly stated that a financing company is not an ordinary leasing company and that a financial lease must be *preceded* by a purchase and sale contract covering the equipment which becomes the subject matter of the financial lease, *viz:*

The basic purpose of a financial leasing transaction is to enable the prospective buyer of equipment, who is unable to pay for such equipment in cash in one lump sum, to lease such equipment in the meantime for his use, at a fixed rental sufficient to amortize at least 70% of the acquisition cost (including the expenses and a margin of profit for the financial lessor) ***with the expectation that at the end of the lease period, the buyer/financial lessee will be able to pay any remaining balance of the purchase price***. Generally speaking, a financing company is not a buyer or seller of goods; it is not a trading company. Neither is it an ordinary leasing company; it does not make its profit by buying equipment and repeatedly leasing out such equipment to different users thereof. ***But a financial lease must be preceded by a purchase and sale contract covering the equipment which becomes the subject matter of the financial lease. The financial lessor takes the role of the buyer of equipment leased. And so the formal or documentary tie between the seller and the real buyer of the equipment, i.e., the financial lessee, is apparently severed. In economic reality, however, that relationship remains. The sale of the equipment by the supplier thereof to the financial lessor and the latter's legal ownership thereof are intended to secure the repayment over time of the purchase price of the equipment, plus financing charges, through the payment of lease rentals; that legal title is the upfront security held by the financial lessor, a security probably superior in some instances to a chattel mortgagee's lien.***

A financing lease may be seen to be a contract sui generis, possessing some but not necessarily all of the elements of an ordinary or civil law lease. Thus, legal title to the equipment leased is lodged in the financial lessor. The financial lessee is entitled to the possession and use of the leased equipment. ***At the same time, the financial lessee is obligated to make periodic payments denominated as lease rentals, which enable the financial lessor to recover the purchase price of the equipment which had been paid to the supplier thereof.*** However, the financial lessor, being a financing company, i.e., an extender of credit rather than an ordinary equipment rental company, does not extend a warranty of the fitness of the equipment for any particular use. In the instant case, the contract of lease between PAIC and the Beltrans, in addition to expressly disclaiming any obligation on the part of PAIC to warrant the fitness of the SUN 1115 for any particular use, had specified that the equipment warranty, issued by SESCO the supplier of the equipment, "shall be passed on by [PAIC] to the lessee." In fact, as noted, SESCO issued a Certificate of Warranty to the Beltrans. Thus, the financial lessee was precisely in a position to enforce such warranty directly against the supplier of the equipment and not against the financial lessor. We find nothing contra legem or contrary to public policy in such a contractual arrangement.[16]

D. Conclusion.

Prescinding from the foregoing, the financial leasing contemplated under the FCA unequivocally envisions a trilateral relationship where ***the financial lessee*** is obligated to make periodic payments denominated as lease rentals that enable ***the financial lessor*** to recover the purchase price of the equipment that had been paid to ***the supplier*** thereof.

Applying the foregoing discussion to Adventus, the proposed activity that it intends to engage in is not the "financial leasing" contemplated under the FCA considering that: (a) the relationship between Adventus and its customers is bilateral, not trilateral as the intermediation of a financing company is removed from the transaction; (b) the arrangement between the parties is ***not*** preceded by a purchase and sale contract covering the equipment which becomes the subject matter of the financial lease as the same already forms part of Adventus' inventory or stock-in-trade; and (c) the customer, not a financing company, will pay the lease rentals *directly* to Adventus.

Thus, we answer your query in the *negative.*

It shall be understood that the foregoing opinion is rendered based solely on the facts, circumstances and documents disclosed/submitted and relevant solely to the particular issue raised therein. It shall not be used in the nature of a standing rule binding upon the Commission in other cases or

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[14] Emphasis and italics supplied.
[15] G.R. Nos. 83113 and 83256, 19 May 1992.
[16] Emphasis, italics, and underscoring supplied. Citations omitted.

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upon the courts whether of similar or dissimilar circumstances.[17] If, upon further inquiry or investigation, it will be disclosed that the facts relied upon are different, this opinion shall be rendered void.

Please be guided accordingly.

Very truly yours,

Romuald C Padilla
General Counsel

[17] Paragraph 7, SEC Memorandum Circular No. 15, Series of 2003.