Securities and Exchange Commission
PHILIPPINES

BAGONG PILIPINAS

OFFICE OF THE GENERAL COUNSEL

16 July 2024

SEC OGC Opinion No. 24-20
Re: Financing Company Act of 1998, as amended; Financial Leasing

BATERINA PERETE & CASTRO LAW
1121 The One Office Building
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Attention: **ATTY. MARKK L. PERETE**

Dear Atty. Perete:

This refers to your letter[1] requesting the Commission's opinion on whether a corporation (the Corporation), which is one hundred percent (100%) foreign-owned, engaged in the business of importing, exporting, distributing, selling (on a wholesale basis), renting out and leasing machines and equipment, may enter into the following transactions without need for registration as required under Republic Act ("RA") No. 8556, otherwise known as the "Financing Company Act" ("FCA"), as amended:

1. Enter into and execute lease agreements with customers in the Philippines under any of the following conditions:
    a. The lessee shall have the option to purchase the machines/equipment at the end of the lease term; or
    b. The lessee shall have the right to cancel the lease subject to the payment of damages for early termination;
2. Enter into and execute deeds for the assignment or sale of its existing contracts with customers to duly registered financial companies, with the Corporation assuming the obligation to collect lease payments from customers for periodic remittance to the assignee companies; and/or
3. Sell machines/equipment to a registered financing company with lease back to the corporation.

Section 3(a) of the FCA defines ***financing companies*** as follows:

> (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 ***<u>primarily</u> 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***;"[2]

Hence, 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;

[1] Dated 23 January 2013.
[2] Emphasis, italics, and underscoring supplied.

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

A. First Transaction.

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."

The Supreme Court, in the case of *Beltran et. al. v. PAIC Finance Corporation, et. al.*,[5] explicitly discussed 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.***
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> 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.[6]

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[3] "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]

[4] "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)

[5] G.R. Nos. 83113 and 83256, 19 May 1992.

[6] Emphasis, italics, and underscoring supplied. Citations omitted.

Relative thereto, the Commission has previously opined[7] that a financial lease is a transaction which contemplates a trilateral relationship, thus:

> 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.
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> 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

From the foregoing, nowhere in the facts is it stated that the Corporation purchased the machines or equipment from a supplier at the instance or on behalf of the lessee, who shall rent the same after the purchase. On the contrary, consistent with its corporate business of "importing, exporting, distributing, selling (on a wholesale basis), renting out and leasing machines and equipment," it appears that the arrangement between the Corporation and its customers is not preceded by the purchase of equipment and that their relationship is bilateral, not trilateral. Hence, the first transaction is not financial leasing.

B. Second Transaction.

As to the second transaction, one of the modes of extending credit by a financing company is the buying and selling of contracts, leases, chattel mortgages, or other evidence of indebtedness. For the selling of a contract (e.g. lease contract) to be considered as an extension of credit within the purview of the FCA, the contract to be sold must be: (1) bought by the financing company; and (2) one which the financing company is not a party to.

> Under SEC OGC Opinion 24-13[8], the Commission highlighted the legislative history of the FCA, to wit:
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> We note that the progenitor of the FCA is R.A. No. 5980, otherwise known as the "Financing Company Act," 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:
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> 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.***[9]

Of equal importance is the discussion of the Supreme Court in the case of *International Harvester Macleod, Inc. v. Medina, et. al.*[10] where the petitioner's transaction therein with the private respondent differs from the financing transaction contemplated under R.A. No. 5980,[11] *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

[7] SEC OGC Opinion No. 24-13 dated 16 May 2024 addressed to Puyat Jacinto Santos Law representing Adventus IT Services (Philippines) Inc.

[8] Supra, Note 7.

[9] Emphasis, italics, and underscoring supplied.

[10] G.R. No. 53623, 22 March 1990.

[11] Now R.A. No. 8556, as amended or the FCA.

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.

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.***

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.[12]

In the case of the Corporation, the lease contracts that it will sell or assign to duly registered financing companies are those which the Corporation itself has entered into and not purchased from other persons or entities.

Further, the Corporation's assumption of the obligation to collect and remit payments to the financing company with respect to the lease contracts sold or assigned to the latter cannot be considered an extension of credit. The Corporation will merely act as an agent of the financing company which purchased or to which the lease contracts were assigned for the collection of payments.

Hence, the second transaction is also not an extension of credit as an activity of a financing company.

C. Third Transaction.

With regard to the third transaction, the ruling of the Supreme Court in the case of *Cebu Contractors Consortium Co. v. Court of Appeals*[13] is instructive:

In Investors Finance Corporation v. Court of Appeals, the Court, applying the definition of financial leasing, differentiated between a true financial leasing and an ordinary loan with mortgage in the guise of a lease. It was explained that the definition contemplates the extension of credit to assist a buyer in acquiring movable property which he can use and eventually own. Thus, in a true "financial leasing," a finance company purchases on behalf of or at the instance of the lessee the equipment which the latter is interested to buy but has insufficient funds for the purpose. The finance company therefore leases the equipment to the lessee in consideration of the periodic payment by the lessee of a fixed amount of "rental." **However, where the client already owns the equipment but needs additional working capital and the finance company purchases such equipment with the intention of leasing it back to him, the lease agreement is simulated to disguise the true transaction that is a loan with security. In that instance, it is clear that the intention of the parties was not to enable the client to acquire and use the equipment, but to extend to him a loan.**

Going back to the case at bar, MLFC admits that the transaction with CCCC involved the purchase of already-owned equipment. Consequently, there can be no doubt that the transaction between the parties is not one of financial leasing, as defined by law, but simply a loan secured by a chattel mortgage over CCCC's equipment

The Supreme Court subsequently cited the decision rendered in the above-mentioned case and it affirmed the classification of this type of transaction in the case of *PCI Leasing and Finance, Inc., v. Trojan Metal Industries Incorporated et al.*[14], thus:

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[12] Emphasis and italics supplied.
[13] G.R. No. 107199, July 22, 2003.
[14] G.R. No. 176381, December 15, 2010.

> Thus, in a true financial leasing, whether under RA 5980 or RA 8556, a finance company purchases on behalf of a cash-strapped lessee the equipment the latter wants to buy but, due to financial limitations, is incapable of doing so. The finance company then leases the equipment to the lessee in exchange for the latter's periodic payment of a fixed amount of rental.
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> In this case, however, TMI already owned the subject equipment before it transacted with PCILF. Therefore, the transaction between the parties in this case cannot be deemed to be in the nature of a financial leasing as defined by law.
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> The Court held in *Cebu Contractors Consortium Co. v. Court of Appeals* that the transaction between CCCC and MLFC was not one of financial leasing as defined by law, but simply a loan secured by a chattel mortgage over CCCC's equipment. The Court went on to explain that where the client already owned the equipment but needed additional working capital and the finance company purchased such equipment with the intention of leasing it back to him, the lease agreement was simulated to disguise the true transaction that was a loan with security. In that instance, continued the Court, the intention of the parties was not to enable the client to acquire and use the equipment, but to extend to him a loan.

In application of the foregoing, the third transaction is the same transaction as the subject matter of the above-cited cases. More importantly, assuming that it is a financial lease the Corporation will not even be the lessor, but the lessee, and hence not the one extending credit. Thus, the participation of the Corporation in the transaction will not pertain to an activity of a financing company.

Prescinding from these discussions, we opine that the Corporation does not have to register with the Commission as a financing company considering that its activities are not activities of a financing company. Nonetheless, the Corporation is required to register as an ordinary domestic corporation or to put up and register a branch office in the Philippines in order to acquire a juridical status to legally engage in business.

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 upon the courts whether of similar or dissimilar circumstances.[15] 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

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