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## LEGAL NOTICE NO. 39 OF 2013

**Financial Lease Regulations, 2013**

Pursuant to section 27(1) read with 71(1) of the Financial Institutions Act, 2012<sup>1</sup>,  
I,

**DR. RETŠELISITSOE MATLANYANE**

Commissioner of Financial Institutions, make the following regulations -

**PART I - PRELIMINARY****Citation and commencement**

1. These regulations may be cited as the Financial Lease Regulations, 2013, and shall come into operation on the date of publication in the Gazette.

**Interpretation**

2. In these regulations, unless the context otherwise requires -

“Act” means the Financial Institutions Act, 2012;

“asset” means all property that is non-consumable and includes personal property, goods and equipment that can be legally sold or imported into Lesotho, that becomes the subject matter of a financial lease agreement, whether or not the asset has become a fixture to or incorporated in land, and includes immovable property, natural resources, trade-marks and copyrights or other moral rights to intellectual property, computer software, but does not include shares, investment securities, any financial instrument, government bonds and securities, or any other moveable asset whose free circulation in Lesotho is restricted by law;

“financial lease” means a contract between a lessor and lessee, having as its main purpose the conveyance of use of an asset, with or without an option to purchase all or part of the asset, as specified under regulation 5 and includes, a sub-lease, sale and lease back transaction and micro-lease.

“lessee” means a person who enters into a financial lease with a lessor and includes its successor, assignee and sub-lessee;

“lessor” means a person who enters into a financial lease with a lessee, and whose company is licensed under regulation 31 to provide a service of financial leasing;

“micro-lease” means where an asset may be a low-cost item used for micro-enterprises;

“parties” means the lessor and lessee;

“person” includes a legal, private or public entity;

“provisional licence” means an authorisation to conduct a financial leasing business as provided for under regulation 29;

“undisturbed possession” means the right of a person in possession of a property to enjoy the property without unlawful interference or disturbance;

“sale and lease back transactions” means where a lessee, in an additional capacity as ad-hoc supplier of an asset, sells the asset to a lessor and leases it back from the lessor;

“sub-lease” means where a lessee can also operate as a lessor for the benefit of a second and subsequent lessee;

“supplier” means a person from whom a lessor acquires an asset for lease under a financial lease;

“supply agreement” means an agreement under which a lessor acquires an asset for lease under a financial lease whether the acquisition is by way of sale, supply or purchase.

## **Application**

3. (1) For purposes of this regulation, “centre of main interest” means -

(a) in the case of a company, a place where the company’s

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registered office is located; and

- (b) in the case of an individual, a place of the individual's business, employment or professional practice.

(2) These regulations shall apply to -

- (a) a financial lease transaction if -
  - (i) an asset is within the territory of Lesotho;
  - (ii) the center of main interest of a lessee is within Lesotho; or
  - (iii) a lessor is placed outside Lesotho and a lessee has its center of main interest in Lesotho.

(2) A leasing transaction intended to be a financial service shall be subject to these regulations and shall be identified as a financial lease.

(3) These regulations shall not apply to a hire-purchase agreement.

## PART II - FINANCIAL LEASE SERVICE

### **Types of financial lease**

4. (1) There are two types of a financial lease -

- (a) a capital lease; and
- (b) an operating lease also known as a true lease.

(2) A financial lease becomes -

- (a) a capital lease if the rentals and other funds payable under the lease take into account the amortisation of the whole or a substantial part of the investment of the lessor; and
- (b) an operating or true lease if the rentals and other funds

payable under the lease do not take into account the amortisation of the whole or substantial part of the investment of the lessor.

### **Characteristics of a financial lease**

5. A financial lease shall, among others, have the following key features -
- (a) identity of a lessee, lessor and supplier;
  - (b) a comprehensive description of an asset to be acquired under the financial lease;
  - (c) rentals and other charges payable;
  - (d) duration of the financial lease;
  - (e) estimated residual value or the option to purchase the asset;
  - (f) terms of delivery of the asset;
  - (g) terms upon which ownership of the asset may be transferred to the lessee;
  - (h) description of general rights and obligations of the parties;
  - (i) statement that the parties have entered into the financial lease agreement;
  - (j) a warranty by a supplier that the asset is free from defect and is fit for the ordinary purposes for which the asset for that description is used;
  - (k) conditions of termination of the financial lease including damages due in the case of termination before the lease term expires;
  - (l) terms upon which rights may be transferred to a third party;
  - (m) warranty of an undistributed possession; and



- 
- (n) other necessary requirements applicable to a financial lease in keeping with best practice.

### **Freedom of contract**

6. A lessor and lessee shall be free to determine the content of a financial lease and may agree upon the terms and conditions of the financial lease.

### **Rights and duties of lessee**

7. (1) A lessee shall -
- (a) specify an asset, quantity, price, mode and terms of delivery, installation and maintenance of the asset;
  - (b) select a supplier;
  - (c) receive the asset directly from the supplier;
  - (d) assume the right to use or possess the asset acquired by a lessor;
  - (e) pay to the lessor, rentals and other charges payable under a financial lease, whether or not such rentals take into account the amortisation of the whole or substantial part of the investment of the lessor;
  - (f) use and take proper care of the asset, reasonably in the light of the manner in which that asset is ordinarily used, and keep the asset in the condition in which it was delivered, subject to wear and tear; and
  - (g) fully perform all of the lessee's obligations as provided in the financial lease.

(2) When a financial lease sets forth a duty to maintain an asset or the manufacturer or supplier of the asset issues technical instructions for the use of the asset, the compliance by the lessee with such agreement or instructions shall satisfy the requirements of subregulation (1)(f).

(3) When a financial lease comes to an end or is terminated, a lessee, unless exercising a right to buy the asset or to hold the asset on a financial lease for a further period, shall return the asset to a lessor in the condition specified in subregulation (1)(f).

(4) In a capital lease, when an asset subject to a lease is damaged without fault of a lessee or lessor before the asset is delivered to the lessee, the lessee may demand inspection and either accept the asset with due compensation from the supplier for the loss in value or seek such other remedies as are provided by law.

(5) In an operating lease, when an asset subject to a lease is damaged without a fault of the lessee or lessor and before the asset is delivered to the lessee-

- (a) if the loss is total, the lease is terminated; and
- (b) if the loss is partial, the lessee may demand inspection and either treat the lease as terminated or accept the asset with due allowance from the rentals payable for the balance of the lease term for the loss in value but without further right against the lessor.

(4) The supplier shall not be liable to both the lessor and the lessee in respect of the same damage.

### **Rights and duties of a lessor**

8. (1) The lessor shall -
- (a) provide the business of financial leasing;
  - (b) upon request of a lessee, enter into a supply agreement with a supplier of an asset selected by the lessee;
  - (c) grant the use of the asset to the lessee with or without an option to purchase in exchange of the payment of rentals and other charges by the lessee;
  - (d) pay the purchase price to the supplier;

- (e) compensate all damages suffered by the lessee where the leased property is not delivered on time as a result of a breach in the supply agreement by the lessee; and
- (f) fully perform all the lessor's obligations as provided in the supply agreement.

### **Duties of supplier**

9. (1) Subject to regulation 11(2) a supplier shall deliver an asset to the lessor under terms, specifications and conditions set out in the supply agreement.

(2) A warranty by the supplier in a supply agreement to the effect that the asset, upon delivery is free from defect and is fit for the ordinary purposes for which the asset of that description is used is enforceable only against the supplier.

### **Effectiveness between the parties and as against third parties**

10. Except as otherwise provided in these regulations -

- (a) a financial lease is effective and enforceable according to its terms and conditions between the parties; and
- (b) the rights and remedies of such parties are enforceable against purchasers of the asset and against creditors of the parties, including an insolvency administrator.

### **Lessee as beneficiary of the supply agreement**

11. (1) A lessee under a financial lease shall be a beneficiary of the supply agreement.

(2) In a financial lease, the duties of the supplier set out in regulation 9 and the supply agreement shall also be owed to the lessee as if the lessee were a party to that agreement.

(3) A lessor shall, at the request of a lessee, assign his rights to enforce the supply agreement to the lessee, and if the lessor fails to assign his rights,

the lessor is deemed to have assumed the duties of a supplier.

(4) The rights of a lessee under this regulation with respect to a supply agreement that was approved by the lessee, shall not be affected by a variation of any term of the agreement unless the supply agreement is consented to by the lessee.

(5) If a lessee did not consent to the variation, a lessor is deemed to have assumed the duties of the supplier to a lessee that were so varied to the extent of the variation.

(6) A lessor and supplier shall not impose upon a lessee, the obligation to waive or vary the effect of the provisions of subregulations (2) and (3).

(7) Nothing in this regulation shall entitle a lessee to negotiate a modification, termination or rescission of the supply agreement without the consent of the lessor.

### **Acceptance of an asset**

12. (1) In a financial lease transaction, acceptance of an asset occurs when a lessee -

- (a) signifies to a lessor or supplier that an asset conforms to the supply agreement;
- (b) fails to reject the asset after a reasonable opportunity to inspect it; or
- (c) uses the asset.

(2) Unless the parties agree otherwise, after a lessee has accepted an asset, the lessee is entitled to damages only from the supplier if the asset does not conform to the supply agreement.

### **Risk of loss**

13. A risk of loss passes to a lessee when a financial lease is entered into, but if an asset is not delivered, partially delivered, delivered late, or fails to conform to the financial lease and the lessee enforces its remedies under the financial

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lease, the lessee may treat the risk of loss as having remained with the supplier.

### **Irrevocability and independence**

14. (1) In a capital lease, the duties of a lessor and lessee become irrevocable and independent when an asset subject to the lease has been delivered to and accepted by the lessee.

(2) In an operating lease, a lessor and lessee may agree to make any of their duties irrevocable and independent by specifically identifying each duty that is irrevocable and independent.

(3) Except as otherwise provided in these regulations, a duty that is irrevocable and independent shall be performed, regardless of the performance or non-performance of any other party, unless the party to whom the duty is owed terminates the lease.

### **Exclusion of liability of the lessor**

15. In a financial lease, the lessor, when acting in his or her capacity as an owner within the limits of the transaction as documented under the supply agreement and the lease, shall not be liable to the lessee or third parties for death, personal injury or damage to property caused by the asset or the use of the asset.

### **Preemptive notice and registration of financial lease**

16. (1) A lessor is entitled to file, upon acceptance of a financial lease by a lessee, the following information concerning the financial lease in a record registration system duly approved by the Commissioner -

- (a) the name and identification number of the lessee;
- (b) the description of an asset, including, where applicable, a serial number or number of the corresponding plate or registration number in any other public record, such as motor vehicle registration -
  - (i) total amount of the lease receivables under the financial lease ;

- (ii) if applicable, a statement as to whether a purchase option was granted to the lessee and terms and conditions for the exercise of such purchase option.

(2) An operator of a recording system referred to in subregulation (1) shall charge such a fee for registration as may be approved by the Commissioner.

(3) The registration system shall record affidavits of default filled by the parties, in the event of default by one of the parties.

### **Remedies for delivery contrary to supply agreement**

17. In a financial lease, a capital lease or an operating lease, when an asset is not delivered, is partially delivered, is delivered late or fails to conform to the lease, the lessee may demand a conforming asset from the supplier and seek such other remedies as are provided by law.

### **Transfer of rights and duties**

18. (1) The rights of a lessor under a financial lease may be transferred without the consent of a lessee.

(2) A lessor and lessee may agree that a lessee shall not raise, against a transferee, any of its defences or rights of set-off against the lessor other than those arising from the incapacity of a lessee.

(3) Nothing in this regulation shall affect a lessee's ability to assert its rights against a lessor.

(4) The duties of a lessor under a financial lease may be transferred only with the consent of a lessee, and the consent may not be unreasonably withheld.

(5) The rights and duties of the lessee under the lease may be transferred only with the consent of the lessor, which may not be unreasonably withheld, and subject to the rights of third parties.

(6) A lessee, a lessor and a third party, may consent to the transfer

in advance.

(7) Any document containing the assignment or transfers of a financial lease receivables or rights on an asset, shall be considered as admitted assets of an insurer carrying on short term specified insurance business, for the purposes of the Insurance Act of 1976<sup>2</sup>.

### **Priority of liens**

19. Except as otherwise provided by any other law -

- (a) a creditor of a lessee and a holder of any interest in land or personal property to which an asset becomes affixed, shall respect and be subordinated to the rights and remedies of the parties to a lease and cannot impair any interest arising under the lease;
- (b) a creditor of a lessor shall respect and be subordinated to the rights and remedies of the parties to a lease, and in particular shall respect the undisturbed possession of the asset by a lessee, if the lessee is complying with its obligations under the finance lease;
- (c) the Commissioner shall determine the formalities by which a creditor of a lessor assumes a claim position in connection with the right and remedies of the parties to the lease;
- (d) in the case of insolvency, re-organisation or liquidation of a lessee, the following rules shall apply:
  - (i) the lessee, debtor in possession, or trustee under liquidation, may reject an asset on the grounds of the evidence that the asset is not necessary for the continuation of the business of the lessee;
  - (ii) where the lessee, debtor in possession or the trustee under liquidation rejects an asset under paragraph(i) the lessee, debtor in possession or the trustee under liquidation shall immediately return the asset to a lessor in the same conditions as the asset was received except for fair wear and tear;

- (iii) where the lessee or debtor in possession, or the trustee fails to reject a lease of the asset, then the rentals shall be payable as priority operating expenses while the business is under receivership or pending liquidation; and
- (iv) if the lessee or debtor in possession, or the trustee under liquidation fails to pay the rentals when due, the lessor is entitled to repossess the asset and dispose of the asset as set out under these regulations;
- (e) nothing in the assignment of a lease shall impair the right to undisturbed possession of a lessee, and/or increase the amount of the lessee's obligations under the lease, except in cases of default by lessee;
- (f) in the case of insolvency, re-organisation or liquidation of a lessor:
  - (i) the lessor in possession of a financial lease or the trustee shall keep the asset free of any lien;
  - (ii) a creditor of the lessor may be paid at an equal rate and pace, according to the legal priority orders, and by means of an assignment of a lease; and
- (g) all assignees of the lessor in good title shall respect the right of the lessee to keep the asset if the lessee complies with all its obligations under the lease.

### **Warranty of undisturbed possession**

20. (1) A lessor shall warrant that the lessee undisturbed possession from a person who has a superior title or right or who claims a superior title or right and acts under the authority of a court, where such title, right or claim derives from a negligent or intentional act or omission of the lessor.

(2) A lessee who furnishes specifications to a lessor or a supplier shall not hold the lessor or supplier liable against any claim of infringement that arises out of compliance with the specifications.



(3) Except as otherwise provided by these regulations, the sole remedy for a disturbance of the undisturbed possession of the lessee is an action for damages against the lessor.

(4) The lessee shall not have the right to file for an interdict or any other claim other than for damages.

### **Default or failure to perform a duty**

21. (1) The parties may agree to the events that constitute a default or otherwise give rise to the rights and remedies specified in the law and described in subregulation (2).

(2) In the absence of an agreement, default occurs when one party fails to perform a duty arising under the financial lease or these regulations.

### **Notice of default**

22. (1) An aggrieved party shall give a defaulting party notice of default, notice of enforcement, notice of termination and a reasonable opportunity to cure the default.

(2) The aggrieved party may give notice -

- (a) by means of filing an affidavit that shall be made available to the Commissioner; or
- (b) by personal delivery, certified mail, facsimile or electronic mail.

(3) The defaulting party may contest to the notice on the grounds of evidence of full compliance which shall also be filed in the registration system.

### **Damages for default**

23. Upon default, the aggrieved party is entitled to recover such damages as will, exclusively or in combination with other remedies provided by the law or the financial lease, place the aggrieved party in a position in which it would have been had the agreement been performed in accordance with its terms.

**Liquidated damages**

24. (1) When a financial lease provides that a defaulting party is to pay to the aggrieved party, a specified sum or a sum computed in a specified manner for such default, the aggrieved party is entitled to such sum.

(2) The sum may be reduced to a reasonable amount where it is grossly excessive in relation to the harm resulting from the default.

(3) The court shall, in awarding damages for default, take into account subregulations (1) and (2) and the court shall ensure that liquidated damages are not made effective for an amount which is grossly excessive.

(4) Where the court finds a violation to the restrictions set out in subregulations (1) and (2), the Commissioner may impose, to the party that benefitted from a grossly excessive amount of damages, a compensatory fine for an amount equal to the excess of damages.

**Termination**

25. (1) A financial lease may be terminated by operation of law, by operation of the default of the supplier to deliver the asset in good condition, by agreement of the parties or by an aggrieved party upon fundamental default by a lessee or a lessor.

(2) After an asset subject to a financial lease has been delivered to and accepted by a lessee, the lessee in a financial lease may not terminate the financial lease upon fundamental default by a lessor or the supplier but is entitled to such other remedies as are provided by the agreement of the parties and by law.

(3) In the event of a fundamental default by a lessor in respect of the warranty of undisturbed possession referred to in these regulations, the lessee in a financial lease may terminate the financial lease.

(4) Upon termination, all duties under a financial lease that are executory on both sides, except for duties intended to take effect upon termination, are discharged but any right based on prior default or performance survives.

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**Possession and disposition at end or termination of possession**

26. (1) After a financial lease comes to an end or is terminated, a lessor has the right to take possession of an asset and a right to dispose of the asset.

(2) In the event that a lessor has filed an affidavit of default and the affidavit is not contested, then the lessor may take possession of the asset without resorting to judicial process, and can immediately dispose of the asset.

(3) No claim or injunction to limit these rights shall be admissible by any court of law.

(4) A lessor shall have an absolute right to dispose of an asset without prejudice and without delays.

(5) In the case where a lessor has taken possession of an asset with a clerk of court, or if the lessor failed to comply with the obligation to give notice in conformity with these regulations, including but not limited to when the lessor has not filed the affidavit of default, then a lessee shall be entitled to damages.

(6) The court shall ponder the amount of damages in equity.

(7) In the event that the lessee has contested an affidavit of default, a lessor shall seek the intervention of a court of law to take possession of the asset.

(8) The court shall decide whether to authorise the lessor to take possession of the asset in a term not exceeding of thirty days following the date of the lessor filing the claim.

**PART III - FINANCIAL LEASING COMPANY****Restriction on scope of business of financial leasing company**

27. (1) The scope of the business of a leasing company shall be restricted to financial lease, both in the modalities of capital and operating leasing.

(2) A leasing company shall not be entitled to accept demand or fixed period deposits from the general public.

**Supervision of leasing company**

28. The objectives of the supervision to leasing companies by the Commissioner shall be to -

- (a) expand financial leasing, ensuring the performance of solid and sustainable professional providers;
- (b) promote International Best Business and Corporate Governance Practices appropriate to the financial leasing business and taking into account the degree of development of the financial leasing environment conditions in Lesotho;
- (c) evaluate risks assumed by such financial leasing companies and their risk management capabilities;
- (d) provide transparency serving as conduit for information to the capital markets;
- (e) suggest prudential metrics to make sure that a financial leasing company follows parameters aimed for the soundness of their practices and indicators;
- (f) provide for equitable treatment for all stakeholders involved in the financial leasing business, namely customers, vendors, lenders or depositors and shareholders;
- (g) ensure ethical and legal management of funds, preventing money laundering and financing of terrorism, and related corrupt activities;
- (h) ensure prompt and orderly exit of failed lessors; and
- (i) continuously require financial leasing companies to maintain sustainable best practices so that the supervision of the Commissioner may be lifted as it becomes appropriate.

**Licensing of financial leasing company**

29. (1) In this regulation, “permanent licence” means the permanent

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authorisation to conduct a financial leasing business on a regular basis issued under this regulation.

(2) A leasing company shall be licenced as a non-deposit taking institution under the Act.

(3) Pursuant to section 6 of the Act, no person may engage in a financial leasing business unless the person has a licence issued by the Commissioner, in accordance with the Act and the guidelines set out in subregulation (4).

(4) Notwithstanding subregulation(2), the Commissioner may grant a provisional licence to a company already engaged in a financial leasing business, if the company assumes the commitment to comply with the provisions of subregulations (5) to (10) within a term not exceeding 24 months from the date of the issuance of the provisional licence.

(5) The provisional licence shall become a permanent licence once the provisional licence holder complies with the requirements set out by the Commissioner for a permanent licence under subregulation (6).

(6) The Commissioner shall, before granting the provisional licence, verify -

- (a) the solvency and trustworthiness of subscribers and shareholders;
- (b) that a director or an officer of a financial leasing company, in exercising the powers and discharging the duties of his office shall be a fit and a proper person as specified in section 44 of the Act.
- (c) the adequacy of its capital structure;
- (d) the convenience and needs of the community it intends to serve;
- (e) the prospects for profitable operation;
- (f) the compliance of the licensee in providing continuous

financial leasing education to all its personnel in at least two annual training courses conducted by certified consultants and trainers in Lesotho, participation in international seminars, or certified e-learning courses;

- (g) the ability of the applicant to comply with the requirements of these regulations and the Act, and to conduct business in a sound manner.

(7) An application for a permanent licence shall be made in writing and shall include -

- (a) an applicant's proposed business classification code articles of incorporation;
- (b) a statement of the address of the head office, location of the principal and other places where it proposes to do business and, in the case of a mobile agency, the area to be served;
- (c) the name and address of every subscriber, shareholder, board directors, Chief Executive Officer and any officer directly reporting to the Chief Executive Officer;
- (d) information for purposes of assessing solvency and trustworthiness of each shareholder with a significant interest;
- (e) a sworn affidavit of each shareholder indicating that the shareholder has the solvency required to support the commitments assumed under the corporation by-laws, articles of incorporation and all other corporate governance documents;
- (f) a sworn commitment for undertaking continuous education in the leasing and financial business, participating in seminars, events, or e-learning courses about leasing and financing;
- (g) such financial data, business plans and other documents

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and information as the Commissioner may require in order to conduct the investigation during review of the application; and

- (h) a business plan, indicating the selected business model, resources required, corporate governance, business management and employees continuous education plans, internal controls and risk management processes.

(8) An applicant shall make a presentation in person about their business plan to the Commissioner and be prepared to answer all questions put forward by the Commissioner.

(9) The Commissioner shall undertake the investigation and verification provided in the Act, as follows:

- (a) the completeness and validity of the documents submitted;
- (b) the solvency and trustworthiness of subscribers and shareholders;
- (c) that a director or an officer of a leasing company, in exercising the powers and discharging the duties of his office is a fit and a proper person as specified in section 44 of the Act.
- (d) the adequacy of its capital structure;
- (e) the convenience and needs of the community it intends to serve;
- (f) the prospects for profitable operation; and
- (g) the ability of the applicant to comply with the requirements of these regulations and the Act and to conduct business in a sound manner.

(10) In ensuring and maintaining compliance with these regulations and the Act, the Commissioner shall focus on the following:

- (a) the extent to which the intended credit policies, procedures and internal controls of the applicant are designed to promote sound financing of economic activities in underserved communities;
- (b) the extent to which the intended training and employment programmes of the applicant are aimed at promoting professionalism in the financial sector; and
- (c) such other matters as the Commissioner may think necessary and appropriate for carrying out the objectives of these Guidelines and the Act.

(11) The Commissioner may, within ninety days from the date of submission of the application, grant or refuse the licence.

(12) In case of a refusal, the Commissioner shall provide the applicant with a written explanation of the grounds upon which the refusal is based.

### **Special licencing requirements for banks to engage in financial leasing**

30. (1) The Commissioner shall keep track of all capital and operating leasing portfolios, benchmark them and continuously evaluate their performance.

(2) A bank which intends to open a financial leasing division shall apply, in writing, to the Commissioner for a financial lease licence.

(3) The application for approval shall be accompanied by a business plan, indicating the selected business model, resources required, corporate governance, business management and employees continuous education plans, internal controls and risk management processes.

(4) The bank seeking approval shall be required to make a presentation to the Commissioner on its business plan.

(5) Where the Commissioner approves of an application made under subregulation (4), the Commissioner shall grant the bank with a financial lease licence within thirty days after the date of submission of the application.



(6) In the case of a refusal, the Commissioner shall issue the bank with a written explanation of the grounds upon which the refusal is based, in which case the bank may re-apply for an authorisation to amend the terms of the business plan as required.

### **Capital requirements**

31. (1) Pursuant to section 23 of the Act, the Commissioner hereby determines that a financial leasing company is subject to different capital requirements from that of a bank, and therefore, a financial leasing company shall -

- (a) commence operations with and maintain at all times a minimum of core capital of not less than 5 million Maloti or such other amount as the Commissioner may prescribe by order published in the Gazette;
- (b) at all times maintain core capital of not less than 10% of its total risk-weighted assets and off balance sheet exposure; and
- (c) at all times maintain total capital of not less than 12% of its total risk weighted assets and off balance sheet exposure.

(2) In determining risk weighted assets, financial lease receivables shall be allocated a weight factor of 50%.

### **Risks management**

32. (1) A financial leasing company shall design, adopt and put in place systems and processes addressed to identify, manage and mitigate risks.

(2) A financial leasing company shall identify, measure, control and monitor all risks involved in a financial lease service.

(3) The following categories of risk shall follow the best practices of risk management -

- (a) credit risks;

- (b) residual risks;
- (c) liquidity risks;
- (d) market risks;
- (e) operational risks;
- (f) legal risks;
- (g) reputational risks;
- (h) strategic risks; and
- (i) any other risk that the Commissioner may determine.

### **Credit risks management**

33. (1) In this regulation, “probability of default” means the likelihood that a financial lease will not be repaid and will fall into default.

(2) A financial leasing company shall have in place -

- (a) a methodology to assess, evaluate and measure their credit risk exposures;
- (b) a billing and collection processes; and
- (c) credit surveillance and delinquency management systems.

(3) The methodology in place shall apply the three basic universal components of indication for credit risk -

- (a) probability of default;
- (b) loss given default; and
- (c) exposure at default;

(4) A financial leasing company shall calculate a probability of default probability of default for each lessee, pursuant to internal processes and metrics adopted by the financial leasing company that shall be consistent with the guidelines issued by the Commissioner.

(5) The information about credit history of the prospective lessee and nature of the investment shall all be taken into account to calculate the PD figures.

(6) A leasing company shall put in place processes to gather such information and convert them into a probability of default.

(7) The methodology for gathering credit history that shall be in place, before the establishment of credit information infrastructure, should at least assume the best available information about.

### **Systems and processes to evaluate probability of default**

34. (1) A financial leasing company shall design and apply systems and processes to evaluate the probability of default, which shall, at least, address the following data -

- (a) cash flow generation by the applicant in the business concerned where the leased asset should be incorporated;
- (b) expected cash flow generation of the new leased asset;
- (c) vulnerabilities of the cash flow to certain specific risks factors among others, dramatic fluctuations in commodities prices, government price controls or devaluation; and
- (d) collaterals valuation, including fixed, free of liens assets, and the new leased asset.

(2) The Commissioner may require a supplier to provide such applicable information as may be subject to the Data Protection Act of 2012<sup>3</sup>.

(3) A financial leasing company shall include a written statement

made by a credit bureau concerning the assessment on the character of the applicant, and the grounds for such judgment, which should be based on personal interviews, third party references and visits to the applicant's premises.

## **Defaults**

35. (1) In this regulation,

“loss given default” means the magnitude of likely loss on or a percentage of the exposure; and

“exposure at default” means the amount actually at risk in the event of a default.

(2) In a lease, exposure at default shall be the difference between the total balance due by a lessee, less the net value of realisation of the underlying equipment or collateral, less net worth of the credit applicant or obligor.

(3) An effective maturity of probability of default, loss given default and exposure at default shall be estimated during a timeframe equal to the total maturity of the financial lease term.

(4) A financial leasing company shall, during the term of a financial lease, track payments and defaults records within its portfolio, and shall have in place processes and systems to -

- (a) identify delinquent accounts;
- (b) adopt a credit surveillance process, assessing the causal factors of each delinquency and determining actions to collect, restructure or normalise each account;
- (c) undertake a delinquency management strategy and execution consistent with the best practices.

## **Residual risks management**

36. (1) In this regulation,

“residual risk” means the risk that contractual payments under a financial lease are insufficient to cover the amount of investment at risk by a lessor;

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“evergreen clauses” means the contractual practice of deemed renewals of the term of the lease, unless otherwise indicated by a lessee;

“third party arrangements” means essentially conditional obligations assumed by third parties to either purchase or repurchase the asset or buy-back arrangements, sale and lease back transactions entered into by asset vendors or distributors or to cover any deficiency in the net proceeds of the asset if such proceeds are not large enough to cover the amount of the residual risk exposure and includes but not limited to guarantees, repurchase agreements, put options, insurance.

(2) A residual risk shall be covered by -

- (a) net proceeds of asset in secondary markets;
- (b) contractual or predictable renewals generating new contractual payments.

(3) A financial lease company which assumes a residual risk in Lesotho shall have, in place, consistent information systems and processes that shall convince about their ability to conduct a short time repossession to sale to cash receipts out of the resale of a leased asset.

(4) A financial lease company shall make provision for risk assessment and coverage.

(5) A financial lease company shall assess a third party credit risk in its metrics probability of default, loss given default and exposure at default.

(6) A financial lease company shall have, in place, processes and systems to assess, evaluate and mitigate their residual risk exposure such as -

- (a) asset management internal department or an asset management outsourced solution;
- (b) information about residual risk exposures; and
- (c) contractual arrangements for tracking a leased asset, including but not limited to periodical inspections, maintenance agreements.

**Liquidity risks management**

37. (1) In this regulation,

“amortisation” means writing off an intangible asset or investment over the projected life of the asset; and

“liquidity risk” means a risk that a lessor may not be able to perform its current obligations due to insufficiency of its cash flow to pay liabilities unbalanced with its cash flow forecast;

(2) A financial lease company shall mitigate a liquid risk, but if the debt markets do not offer alternatives to meet the needs of a leasing company in mitigating liquidity risks, then they shall be mitigated by the shareholders equity.

(3) In order to mitigate the liquidity risk, a financial leasing company shall -

- (a) forecast all the cash flows arising from its portfolio, as well as the cash flows associated to the service of their debts and other liabilities;
- (b) calculate the average life of the portfolio and the average life of the liabilities by dividing the sum of all resulting outstanding balances by the original principal; or
- (c) determine net cash flows for future dates and needs arising to cover funding and liquidity in such dates just to keep the portfolio;
- (d) determine the tenures, interest rates and amortization schedules to negotiate a financial leasing company indebtedness, either with private funding sources or via issuance of notes, commercial papers, bonds or any other debt instrument feasible to be placed in the capital markets;
- (e) evaluate the gaps between the cash flows generated by the portfolio and the actual funding arrangements of such a leasing company and detect contingencies; and

- (f) allocating enough liquid capital to cover detected contingencies.

(4) In the event that Commissioner detects imminence of uncovered liquidity risk in a financial leasing company, it may impose one of the following orders -

- (a) partial sale or syndication of existing portfolio in order to generate enough cash to match maturities; or
- (b) capital calls to company's shareholders.

(5) If the Commissioner does not apply any of the measures set out in subregulation (4), the Commissioner shall downgrade the risk rating of the corresponding leasing company.

### **Market risks management**

38. (1) In this regulation,

“market risks” means the risks of losses in the value of certain financial assets or financial portfolios, due to -

- (a) interest rate fluctuations;
- (b) exchange rate fluctuations;
- (c) stock prices; or
- (d) commodities prices.

(2) A financial leasing company shall be vulnerable to market risks only as far as interest rate fluctuations and exchange rate fluctuations are concerned.

(3) A financial leasing company shall manage markets risks by keeping them matched to its portfolio and its liabilities in terms of interest rates and exchange rates.

(4) If some of the debt resources of a finance leasing company are

contracted with floating interest rates, the portfolio of the leasing company shall have the same amounts subject to floating rates.

(5) If some of the debt resources of a financial leasing company are not contracted with floating interest rates as stated in subregulation (2), the financial leasing company shall prove that they have hedged their exposure to interest rates fluctuations, so that in such events, they can be covered against potential losses.

(6) In similar terms, if the debt is contracted in foreign currencies, the corresponding exposure must be covered in the portfolio by exchange rate adjustment clauses, or in absence of such adjustments, the financial leasing company must have hedged its exposure to such fluctuations.

(7) If any of the above mitigation processes is absent, the corresponding financial leasing company shall build enough reserves, and adjust its second tier capital to cover market risks exposure or, the Commissioner shall downgrade the company in its risk ratings with an explanatory note to be published on the website of the Central Bank of Lesotho.

### **Operational risks management**

39. (1) In this regulation, “operational risks” means the risks of losses due to -

- (a) internal errors by a lessor;
- (b) fraud;
- (c) inadequacy of processes;
- (d) inadequacy of systems;
- (e) inadequacy of employees, officers or people;
- (f) external events.

(2) A leasing company shall have, in place, and continuously monitor the execution of -



- (a) internal audits (accounting and to all processes and systems);
- (b) continuous education for their employees.

(3) If a financial leasing company does not have, in place, processes and systems that prevent operational risks, the Commissioner shall downgrade the company in the risk rating, and cause an explanatory note of the downgrade, to be published on the website of the Central Bank of Lesotho.

### **Legal risks management**

40. (1) In this regulation, “legal risks” means risks of losses arising from internal and external legal factors which may be materialised as follows -

- (a) a risk that a financial leasing contract and any other financial contract may not be consummated by legal reasons, due to interference or objections of counsel that prevent the completion of agreement;
- (b) a risk that a financial leasing contract and any other financial contract and all other financial contracts become non-enforceable due to deficiencies in the content of the contract;
- (c) a risk of lawsuits against the institution for lack of compliance with laws and regulations;
- (d) changes in the law.

(2) A lessor shall have, in place, the following processes to prevent legal risks -

- (a) a strong counsel with authority to oversee all documents and situations affecting the lessor; and
- (b) a continuous legal education.

**Reputational risks management**

41. (1) In this regulation,

“reputational risks” means the risks of losses resulting out of a negative perception of the public about the operations or activities of the lessor.

(2) Reputational risks may lead to -

- (a) loss of customers or business; and
- (b) loss of funding sources.

(3) A lessor shall have, in place, processes to manage and control the public relations of their business, and such processes shall entail having an internal department of public relations or an outsourced contractor providing such services.

(4) Where a lessor fails to have the processes set out in subregulation (3) in place, the Commissioner shall, in writing, order the lessor to comply.

**Strategic risks management**

42. (1) In this regulation, unless the context otherwise requires, “strategic risks” means the risks of losses associated with the loss of revenue opportunities and or a deterioration of a lessor’s equity, due to -

- (a) adverse management decision or strategy;
- (b) inadequate or lack of execution of decision or strategy;
- (c) lack of reaction to changes in the business environment.

(2) In the event that the Commissioner detects that such losses are resulting in a downward trend for a financial leasing company, the Commissioner may require explanations from Chief Executive of the lessor, and accordingly rate the risk exposure of the leasing company.

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## PART IV - MEASURES FOR LEASING COMPANIES RISK MANAGEMENT

### **Risks rating**

43. (1) The Commissioner shall undertake a risk rating role in order to inform the market, the quality of risk management that a financial leasing company will be applying, in comparison to best practices of risk management.

(2) A risk rating set out by the Commissioner under subregulation (1) may be challenged by a financial leasing company or third party through a short procedure as may be determined by the Commissioner.

(3) A challenge to the risk ratings under subregulation (2) shall be well founded and it shall be supported by an international expert assessment that should convincingly override any risk ratings made by the Commissioner.

(4) The financial leasing company aggrieved by the decision of the Commissioner under this regulation shall appeal against such a decision to the Tribunal in accordance with the section 76 of the Act.

(5) The Commissioner shall design a rating scale to be compatible with other risk rating scales at international level.

### **Preventive supervision**

44. In addition to the risk ratings applicable under regulation 41, the following measures shall be applied by the Commissioner -

- (a) supervision focused on risk management;
- (b) review of financial information and other reports;
- (c) occasional random specific visits to lessors;
- (d) review of processes focusing on;
- (e) risk awareness;
- (f) risk mitigation strategies;

- (g) processes;
- (h) implementation;
- (i) continuous supervision based upon information received.

### **Transparency**

45. (1) A financial leasing company shall report to the Commissioner on a monthly basis, the following financial information -

- (a) balance sheet;
- (b) profit and loss statements;
- (c) portfolio composition classified by PD range;
- (d) past due accounts and delinquency;
- (e) inventory of assets repossessed or returned;
- (f) funding information: terms and conditions of borrowing facilities.

(2) In the event that a financial leasing company does not have the electronic infrastructure to transmit its financial statements via the internet, it shall apply to the Commissioner for a special procedure for transmittal of information.

(3) The lack of electronic infrastructure shall be taken into account to downgrade the risk rating of such a leasing company on the grounds of greater exposure to operational risks.

(4) A financial leasing company shall prepare and submit a report to Commissioner, quarterly and electronically, their following financial information -

- (a) balance sheet;
- (b) profit and loss statement;

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- (c) cash flow statement;
  - (d) footnotes to all financial statements;
  - (e) portfolio composition by probability of default range;
  - (f) management report; and
  - (g) auditor opinion.

(5) The Commissioner shall validate, in terms of its consistency and accuracy, the information submitted to it in the report, and once validated cause it to be published on the website of the Central Bank of Lesotho.

(6) A financial leasing company shall, in addition to its submittal of its Annual Report to the Central Bank and the corresponding publication on the website of the Central Bank of Lesotho, publish its Annual Report on its website.

### **Fair business practices**

46. (1) A financial leasing company shall comply with the rules of fair competition and be accountable for their fair practices.

(2) Without prejudice of the role of any other competition law authority, the Commissioner shall undertake the following functions in connection with fair competition practices in the leasing market -

- (a) with respect to competition policies the Commissioner shall -
  - (i) detect and prevent -
    - (aa) abuse of dominant positions by any leasing companies;
    - (bb) predatory practices, i.e. practices addressed to expel out a competitor from the marketplace;

- (ii) control and approve consolidations (mergers, acquisitions, portfolio purchases for over 75% of the assets of a single lessor); and
  - (iii) control and prevent other practices contrary to free and fair competition;
- (b) with respect to customers' and other stakeholders' protection, the Commissioner shall -
  - (i) open an electronic and a physical window for complaints against lessor's abusive practices;
  - (ii) give a lessor the opportunity to explain and amend errors or failures; and
  - (iii) publish, on the website of the Central Bank of Lesotho, statistics of the number of complaints against all leasing companies.

### **Liquidation of a failed financial leasing company**

47. (1) When a financial leasing company fails, the following are at stake -
- (a) the repayment rights of its creditors or funding sources;
  - (b) the possibility of lessees to keep undisturbed possession and to exercise purchase options, if the case;
  - (c) payment to employees of their salaries, benefits and indemnities;
  - (d) payment of taxes, duties and other government obligations; and
  - (e) shareholder's equity.
- (2) In the event that the risk ratings of a financial leasing company becomes lower than a threshold set out in the risk rating scale, it shall be an in-

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indicator of an imminent failure of such a leasing company, and in such a case the Commissioner shall liquidate the company by selling its portfolio after undertaking, among others, the following steps -

- (a) update and validation of portfolio information (amounts, probability of default ratings, loss given default and exposure at default metrics);
- (b) Initiate a competitive a bidding process inviting other lessors, banks and domestic and foreign financial institutions to bid;
- (c) dedicate a due diligence window for not more than 1 month;
- (d) evaluate bids;
- (e) adjudicate and transfer portfolio;
- (f) apply sales proceeds to pay indebtedness in legal order:
  - (i) employees;
  - (ii) taxes;
  - (iii) creditors;
  - (iv) liquidation expenses;
  - (v) if anything left, to shareholders, subject to determination of their liability in the demise of the company.

#### PART V - PENALTY

##### **Penalty**

48. Subject to the provisions of Section 32 of the Act, the Commissioner may impose a fine to a lessor who breaches a provision of these regulations of up to two times the damages caused to the lessee, without prejudice of the rights

and remedies available to the lessee before the courts of Lesotho.

**DATED:**

**DR. RETŠELISITSOE MATLANYANE  
COMMISSIONER OF FINANCIAL INSTITUTIONS**

**NOTE**

1. Act No. 3 of 2012
2. Act No. 18 of 1976
3. Act No. 5 of 2012