

Research Article: 2019 Vol: 22 Issue: 4

Legal and Organizational Framework for Financial Leasing in Ukraine and Cyprus: A Comparative Analysis

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Abstract

Description: The article is devoted to the study of the organizational and legal foundations of financial leasing in Ukraine and Cyprus. Methodology: During research general scientific and special methods were used. Thus, the analysis and synthesis method as well as the logical method were used to formulate a holistic view on the financial leasing institution in Ukraine and Cyprus in general, as well as the credit aspects of financial leasing. The logical-semantic method was used to establish the meaning of the term "financial leasing". The comparative method was used when analyzing international and national legislation of Ukraine and Cyprus, as well as scientific categories, definitions and approaches. The system-structural method was applied to determine the elements of financial leasing, as well as its functions and tasks. The studied materials are the legislation of Ukraine and Cyprus as well as the scientific works of Ukrainian and foreign scientists on this issue. The results of the study made it possible to study the advantages and disadvantages of financial leasing in general, to examine the pace of growth of financial leasing in Ukraine, to consider the legislation that currently regulates this issue in Ukraine, and to express an opinion on its strength and weaknesses, to analyze the provisions of the Draft [Law](#) of Ukraine on Financial Leasing, to identify its pros and cons, to establish the peculiarities of the regulation of financial leasing in Cyprus, to compare the provisions of the Draft [Law](#) of Ukraine "On Financial Leasing" and provisions of the Cyprus Leasing [Law](#) for emulation positive experience. Practical implications: According to the results of the research, proposals were made to amend and to adjust the Draft [Law](#) of Ukraine "On Financial Leasing" so that it conforms to European requirements and practice. Value/originality: As the legislation of Ukraine regulating financial leasing in Ukraine is currently antiquated and should be updated, the Draft [Law](#) On financial leasing, which should become the normative legal act that will help to create a proper competitive environment in the market of financial services and harmonize the relevant legislation of Ukraine with the legislation of European Union, was analyzed. Based on a comparative analysis of the Ukrainian Draft [Law](#) with Cyprus Leasing Law, recommendations were made to amend the former in order to bring it into line with European standards.

Keywords

Financial Leasing, [Law](#) of Ukraine on Financial Leasing, Cyprus Leasing Law, Draft [Law](#) on Financial Leasing, International Standards, European Experience.

Introduction

During the economic crisis, the provision of leasing services is becoming increasingly relevant. Leasing is an effective means of providing temporary fee-paid using of equipment, machinery, etc. (core funds) required by economic actors that do not have sufficient funds to acquire these capital assets. Besides, the lessee is entitled to purchase such property upon the expiration of the lease agreement.

Financial leasing is considered as a type of financial loan. Leasing in its modern sense emerged in the United States in the 1950s, and is gaining in popularity every year. Thus, the scope of world leasing continues to increase. For example, in America in 2017, leasing operations amounted to \$ 100 billion. In Germany and in the UK, the leasing market stood at € 25.5 billion and € 39.1 billion, respectively. In Ukraine, its scale is far more modest: according to the data of the National Bank of Ukraine and the State Financial Services Commission, the lease portfolio at the beginning of 2018 amounted to UAH 40.4 billion (Financial Pulse, 2018).

Compared to a small number of disadvantages, such as: negative credit rating in case of non-payment of lease payments, limited access to other loans and the need for service the lease assets leasing has several considerable advantages:

1. No need to provide additional security;
2. Absence of any payments for the registration of the case;
3. Financial leasing cannot be subject to seizure by third parties;
4. The possibility of formation of more flexible schedule for lease payments;
5. The possibility of using a wide range of financial instruments to reduce the costs of the lessee;
6. The conclusion of a single financial lease agreement instead of conclusion of a number of agreements related to obtaining a loan (credit agreement, pledge agreement, sale agreement, contract with a transport organization, insurance contract, etc.).

Financial leasing in international practice is characterized by such terms as "capital leasing" or "leasing with full cost-recoveries of a lease assets", and can be described by a complex system of economic relations-lease, trade, credit, etc. Credit relations of financial leasing are multidimensional by their nature, which is manifested in a rather wide range. These credit aspects of financial leasing are reflected in the following: the need for long-term credit; ensuring that the borrowing needs of the enterprise for a specific target are fully met; providing cover with the "tax shield" for the entire amount of the loan; providing a wider range of debt service payment forms. Unlike a bank loan, where debt service and repayment of its principal amount are made in the form of cash payments, financial leasing provides for the possibility of making such payments in other forms, for example, in the form of deliveries of products made with involving of leasing assets; implementation of a more simplified procedure for issuing a loan compared to a bank one; reducing the cost of credit due to the liquidation value of the leasing asset (Prokushev, 2016).

The considered credit aspects of financial leasing define it as a sufficiently attractive credit instrument in the process of attracting borrowed capital to ensure its economic development.

Materials and Methods

During research general scientific and special methods were used. Thus, the analysis and synthesis method as well as the logical method were used to formulate a holistic view on the *financial leasing* institution in Ukraine and Cyprus in general, as well as the credit aspects of financial leasing. The logical-semantic method was used to establish the meaning of the term "*financial leasing*". The comparative method was used when analyzing international and national legislation of Ukraine and Cyprus, as well as scientific categories, definitions and approaches. The system-structural method was applied to determine the elements of financial leasing, as well as its functions and tasks.

The studied materials are the legislation of Ukraine and Cyprus on the subject under investigation, namely: the [Law](#) of Ukraine "*On Financial Leasing*", the Draft [Law](#) of Ukraine "*On Financial Leasing*", Cyprus Leasing Law, scientific works of Ukrainian and foreign scientists who considered the legal and organizational problems of financial leasing in Ukraine and Cyprus.

Results and Discussion

The financial lease market in Ukraine is currently developing very fast, as it has been in the shadow of the processes, which took place in the country for a long time. The increase in the pace of financial leasing in recent years is 80-90% in comparison with the previous reporting periods. Deregulation in this area has led to a certain increase in the demand for investment, which has contributed to the expansion of the financial leasing palette not only towards transportation, which has been quite familiar in the last five years, but also towards agriculture, which is an important sector of the Ukrainian economy. Today, if we consider the portfolio of the results of the first quarter of 2019, we will see that financial leasing in the area of transportation has increased by almost 4.5%. Structurally, transportation is followed by agriculture-it is the second one, followed by construction, mining sector, metallurgy, and services. These are the main areas of financial leasing (Financial club, 2019).

Lease services in Ukraine are provided by: lease companies (legal entities that are not financial companies but are licensed to provide financial lease services); banks; non-banking financial organizations. In 2018, in the Register of the State Financial Services there have been registered 188 lease companies and 315 financial companies licensed to conduct leasing operations (Financial Pulse, 2018)

In Ukraine, the legal and economic principles of financial leasing are determined by the [Law](#) of Ukraine "*On Financial Leasing*". According to this [Law](#) financial leasing shall mean a type of civil and legal relations arising from a financial leasing contract. Under a financial leasing contract the lessor shall be obliged to acquire an object into ownership from a seller (supplier) pursuant to specifications and conditions established by the lessee, and transfer it into use to the lessee for a specified term of not less than one year for an established fee (lease payments). A leasing object can be an inconsumable thing defined by individual features and classified by valid legislation as fixed assets. Land plots and other natural objects, integral property complexes of enterprises and their separated entities (subdivisions, affiliates, shops and branches) cannot be leasing objects. The leasing subjects are: a lessor-a legal entity that transfers to the lessee the right to possess and use the leasing object; a lessee-a legal entity or an individual that accepts from the lessor the right to possess and use the leasing object; a seller (supplier)-a legal entity or an individual from whom a lessor acquires a thing that in future shall be transferred to a lessee as a leasing object; other legal entities or individuals which are parties to a multilateral leasing agreement.

At present, however, the legislation governing financial lease relations in Ukraine is outdated and therefore requires a comprehensive updating and adjustment to the European standards. In this regard, the Bill no. 6395 (On Financial Leasing, 2017) was registered in the Verkhovna Rada of Ukraine (hereinafter referred as to the Draft Law), which defines the general legal and organizational principles of financial leasing in Ukraine in accordance with international legal standards in this area. With this Draft [Law](#) lease services will be more available; it will help to upgrade fixed assets and raise production.

The purpose of this Draft [Law](#) is to protect the rights and legitimate interests of lessees, lessors and lease agents, to create an adequate competitive environment in the financial services market and to increase confidence in it, to ensure favorable conditions for the development of the Ukrainian economy, to harmonize the legislation of Ukraine with the legislation of the European Union and international standards.

The Draft Law, in particular, proposes:

1. To establish a uniform procedure for regulating relations related to financial leasing and its individual types and forms;
2. To introduce the mechanism for attracting lease mediators, whose activities are not financial services but may include consulting, provision of information and other mediation services in the area of financial leasing;
3. To establish the protection of the rights of lessees along with the protection established by the legislation on protection of the owner's rights in respect of possession and use of property;
4. Provide for the procedure and conditions for the transfer of the leased asset to the lessee's property, the conditions for the lessee to acquire the ownership of the leased asset;
5. To establish the right of the lessor to rescind the financial lease contract and to request the return of the leasing object if the lessee violates the requirements of the [law](#) or submits unreliable information, documents or information, documents regarding the financial status of the lessee to mislead the lessor;
6. To protect the interests of the lessor if the lessee's debt is significant and the lessor has warned the lessee in writing of the need to remedy the breach of the terms of the lease payment obligation within a specified period, which is in line with international practices and in particular with the UNIDROW Convention on International Financial Leasing and the Draft Model [Law](#) on Leasing;
7. To provide that the misappropriation, alienation, concealment, replacement, damage, destruction of property or other unlawful acts with property that is transferred to financial leasing is a criminal offense (Rybnitska, 2017).

Besides, the Draft Law, in comparison with the current [Law](#) of Ukraine "On Financial Leasing" details the procedure for concluding a financial lease agreement, specifies the peculiarities of concluding a financial lease agreement with natural persons (except for an individual entrepreneurs), expands the list of essential terms of this agreement, defines the legal consequences for termination of the financial lease agreement and early termination of the financial lease agreement. Since the conclusion of a financial lease agreement may be related to the need for the lessee to obtain additional or related services on the part of the lessor or third parties through the conclusion of the relevant contracts for the provision of additional or related services, it is stipulated which contracts belong to the contracts for the provision of additional or related services.

The Draft [Law](#) also provides for amendments to the Criminal Code of Ukraine, the Civil Code of Ukraine, and the Commercial Code of Ukraine and to some other Laws in order to bring them into line with the norms of the Draft law.

However, despite some of the certain advantages of the Draft Law, some lawyers believe that in its current version, some provisions are ill-considered and too petty. For example, according to Oleg Danylchenko, instead of the imperfect but laconic (in a good sense) definition of financial leasing contained in the current Law, the drafters propose an extremely complicated and casuistic one.

Besides, the role of the State in regulating the financial services market is increasing: the Draft [Law](#) limits the range of persons who may be lessors, requiring their acquisition of special status (in doing so who, in what order and on what basis will grant this status is not provided by the Draft Law).

Furthermore, the author considers the efforts of the State to protect the rights of lessees-individuals who are not subjects of business activity somewhat exaggerated. Thus, Article 10 of the Draft [Law](#) determines not only the list and form of information, which the lessor is obliged to provide to the lessee, and the obligation to receive written confirmation of acquaintance with it, but also the requirements for the font and format of such information and the order of delivery of the copy of the contract. According to the lawyer, such detailing is somewhat excessive and too formal for the procedure of conclusion of the contract (Danylchenko, 2017).

Therefore, it can be concluded that the Draft [Law](#) on Financial Leasing requires serious refinement and error recovery. In order to adopt a truly effective normative act in Ukraine on this issue, which meets international requirements and practices, it is necessary to turn to foreign experience. In this article, we look at the specifics of financial leasing regulation in Cyprus, which after joining the EU in 2004 immediately became one of the most popular countries for doing business thanks to its favorable tax climate and holding regime (On Financial Leasing, 2004).

Financial Leasing in Cyprus is an alternative way of financing whereby a licensed leasing company (the "Lessor") purchases an asset on behalf of its customer (the "Lessee") in return for a contractually agreed series of payments which usually include an element of interest. The lessor maintains ownership of the asset while the lessee enjoys the use of the asset for the duration of the lease agreement, usually accompanied by an option to buy the asset at the end of the contract. The lessee bears all costs and risks associated with the use of the leased asset (Markou, 2017).

The Finance Leasing [law](#) (72(I)/2016 (the Leasing Law) entered into force, in Cyprus, on April 28, 2016 with a further Financial Leasing Directive (2017) issued by the Central Bank of Cyprus on 17 February 2017.

The purpose of the Leasing [Law](#) is to regulate the provision of financial lease services to the public and ensure the regulation and supervision of financial lease services providers' activities, with the objective of providing consumers and businesses with alternative ways of financing, thus contributing to the growth of the leasing services sector and generally the financial sector and the economy as a whole (Deloitte, 2017).

The purpose of the Leasing Directive is:

1. To establish the procedure for granting authorisation to a financial leasing company;
2. To regulate the activities of financial leasing companies including the methodology for determining additional capital, internal governance, central registry for lessees and the creditworthiness assessment of lessees;
3. To set the procedures for the conclusion of a finance lease contract, namely the provision of pre-contractual information and reflection period and the determination of the methodology of the calculation of the outstanding amount in case of advance repayment, annulment or termination of the lease agreement (Article 3 of the Directive) (Financial Leasing Directive, 2017).

According to Section 3(2), the Leasing [Law](#) does not apply to the provision of financial leasing services:

1. Within a group of companies to which the legal entity belongs;
2. By physical or legal persons whose primary business activity is the sales of movable property and which provide leasing services for the sale of movable property up to the amount of €5.000 per object, and exclusively to the extent required for the exercise of their main business purposes;
3. For which the agreement provides a credit for a total period of less than three months.

The following lease types may be provided: Simple financial leasing. A lease arrangement under which the lessee chooses the asset leased and the lessor buys and leases it to the lessee for an agreed series of payments; Hire-purchase. A type of lease which gives the lessee (hirer) the option to purchase the asset. Ownership of the asset is transferred immediately after the last payment is made; Leveraged (Participatory) leasing. A lease that is partially financed by the lessor through a third-party financial institution. The lending institution holds the title of the asset and the loan is serviced through the lease payments. The lessor collects the payments from the lessee.

Leaseback (Reverse Leasing)

A lease arrangement under which the lessee transfers the full ownership of the asset to the lessor and at the same time the lessor leases it back to the lessee

Joint (Syndicated) Leasing

A lease agreement between one lessee and multiple lessors, usually in cases where the cost of the asset is too high for a single lessor. This type of lease shares the same characteristics of a syndicated loan;

Leasing with a Sub-Lease

A lease agreement which between the original lessee and a new lessee. The new lessee enjoys the use of the asset for the duration of the sublease while the original lessee maintains the obligation to make the agreed payments and the right to buy the asset at the end of the contract (Deloitte, 2017).

The Leasing [Law](#) enshrines that financial leasing services may be provided to the public by:

1. Authorized credit institutions in Cyprus;
2. Authorized credit institutions in other Member States of the European Economic Area (EEA) which are licensed to provide financial leasing services, and which provide such services through a branch or on a cross-border basis;
3. Financial leasing companies which are subsidiaries of credit institutions established in EEA Member States, and which provide such services in Cyprus through a branch or on a cross-border basis;
4. A new category of regulated entity-financial leasing companies registered in Cyprus, which shall be licensed by the CBC to provide such services under the Law.

A company wishing to obtain authorization to provide financial leasing submits to the Central Bank, duly completed and signed by two members of the management body, the application for authorization to provide financial leasing based on the relevant template posted on the Central Bank website. The application shall include information, specified by the article 5 of the Leasing Directive.

The Leasing Directive also determines the minimum initial capital of €200,000, which the financial leasing companies are required to maintain as well as other prudential requirements, imposed on them. Thus, subject to the provisions of section 6 of the Law, the financial leasing companies are required to maintain at all times in addition to the minimum initial capital, additional capital based on the size of their operations. For the calculation of the additional capital, the financial leasing company must maintain at all times a minimum total capital (basic and additional), depending on the amount of its assets in accordance with the scale, presented in the Directive (Article 7 of the Directive).

Besides, the Leasing [Law](#) defines the supervisory and regulatory framework of the Central Bank of Cyprus, including the power to take enforcement measures and impose sanctions.

The Directive, in turn, enshrines that each financial leasing company must establish, implement and maintain accounting policies and procedures which will enable it to promptly submit to the Central Bank valid financial statements which reflect the true and fair view of its financial condition. Every financial leasing company must submit to the Central Bank its annual audited financial statements within six months from the end of each financial year together with the signed copy of the audit report of the statutory auditor. The Central Bank may determine the type, frequency and the reference dates of additional returns that financial leasing companies must submit to the Central Bank for purposes of prudential supervision and for statistical purposes, including statistical reporting requirements in relation to the European Union and the Euro system (Article 16 of the Directive).

So, if we compare the provisions of the Draft [Law](#) of Ukraine “*On Financial Leasing*” and the provisions of the Cyprus Leasing Law, we can see that the latter is much more meaningful and thought-out than the Ukrainian version. Firstly, the Draft [Law](#) restricts the range of persons who may be lessors by requiring special status. Thus, the lessor is a legal entity that transfers the right of ownership and use of the object of financial leasing to the lessee under the financial lease agreement, and has acquired the status of the person entitled to provide financial lease services according to the procedure established by the law. However, who, in what order and on what basis will grant this status is not provided by the Draft Law.

Article 4 (1) of the Leasing [Law](#) explicitly provides for a list of institutions entitled to provide financial lease services; at the same time the Directive prescribes the mechanism for granting authorisation to a financial leasing company as well as the methodology for determining additional capital, internal governance, central registry for lessees and the creditworthiness assessment of lessees.

Secondly, the list of essential terms of the financial lease agreement, enshrined in Article 11, Part 1 of the Draft [Law](#) is too detailed, since it covers practically all the essential conditions which in one way or another are laid down in any civil contract; however, the Draft [Law](#) says nothing has been said about any of the specific conditions, which characterize the financial lease agreement.

The list of essential terms, which is in the Leasing Law, is narrower, but much more thoughtful and, in our opinion, includes one very important point. Thus, according to Article 27 (1) of this [Law](#) in relation to any leasehold described in the contract, the financial leasing must include, inter alia, the nominal and effective interest rate included in the rent, their calculation method and their amendment. Clearly, such a paragraph should be included in the future [Law](#) of Ukraine “*On Financial Leasing*”.

Thirdly, the current [Law](#) of Ukraine “*On Financial Leasing*” says nothing about the controlling bodies, which supervise the provision of financial lease services. The Draft [Law](#) contains only a reference to the [Law](#) of Ukraine (“*On Financial Services and State Regulation of Financial Services Markets*”), which contains the provisions governing this issue.

As opposed, the Leasing [Law](#) designates the Central Bank of Cyprus (CBC) as a supervisory authority for financial leasing companies therefore broadening its current functions and activities. Thus, this [Law](#) expands the CBC’s powers to supervise financial leasing companies, hence complementing the CBC’s current responsibilities for the supervision of the leasing activities of licensed credit institutions and the macro prudential supervision of the financial system for the purpose of safeguarding financial stability (Opinion of the European Central Bank, 2015).

We consider that the paragraph on the controlling bodies should be included in the content of the new [Law](#) on Financial Leasing, as it is in line with the leading European and world practice.

Conclusion

Leasing as a service of financial intermediation is one of the factors for increasing the competitiveness of domestic enterprises, improving the quality of services and production efficiency. Although the role of lease services in Ukraine is objectively increasing as a result of unprecedented decline in bank lending, and today

leasing remains a virtually alternative tool for upgrading fixed assets and technologies, the lease market in Ukraine is in a state of stagnation. On the one hand, this is caused by macroeconomic factors and, on the other, by the imperfection of regulatory and legislative regulation, the absence of any incentives and encouragement that have traditionally taken place in developed economies.

In this regard, it became necessary to draft a new version of the [Law](#) of Ukraine "On Financial Leasing", which is aimed at bringing the legislation governing this issue in line with current practices and best international experience. Although the Draft [Law](#) has been drafted in line with European best practice, it still has a number of shortcomings and gaps that need to be rectified.

The Cyprus Leasing [Law](#) 72 (I) of 2016, which is one of the most thoughtful and progressive regulations governing financial leasing issues, has been analyzed to address this issue.

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