

Ecuador

MARKET REVIEW

The year 2003 went within the limits established by the Stand-by Agreement entered into with the IMF (February 2003). The principal political actions of the Ecuadorian Government were aimed to reach equilibrium for the finances of the public sector and to promote structural changes in the oil, telecommunications and energy sectors.

According to the International Monetary Fund: "Ecuador experienced severe economic stress in 1999, involving accelerating inflation, public debt default, and a currency and banking crisis. Following the adoption of the US dollar as legal tender in January 2000, expectations stabilised, confidence returned to the banking system, and economic activity began to turn around. Demand was given further impetus by the start of the construction of a new oil pipeline, and escalating public sector spending.

"However, economic growth slowed again in 2002 due to policy slippages and faltering confidence. Fiscal discipline weakened with large increases in the

public wage bill, new revenue earmarking, and discretionary tax cuts. Moreover, oil output dropped because of inefficiencies in PetroEcuador; the structural reform agenda was suspended; and there was a high level corruption scandal in June. By the end of the year, the treasury was very short of cash and facing payment arrears. Nevertheless, in September, the Ecuadorian congress approved the *Fiscal Responsibility and Transparency Law*, which sets medium-term fiscal rules. This law could substantially lower the public debt and the country risk spreads, thereby crowding in investment and employment in the non-oil economy."

During 2003, GDP grew only 2.7% and such growth occurred basically because of oil activities (oil price increase).

The development of the non-oil sectors had low dynamism. These sectors did not have good expectations because of high interest rates, lack of finance facilities to small and medium businesses, and due to the high cost of basic services (electricity, telecommunications, legal stability).

Regarding international trade, the balance has been improving during the

last year, especially due to the favourable evolution of oil prices, private-sector exportation and non-traditional exportation levels increases and the slowdown of importations.

The evolution of public-sector salaries is becoming an issue that shall be carefully watched, especially because the income generated is not enough to cover any increase in salaries. The Ecuadorian Government shall implement measures aimed to control public expenditures.

The leasing industry. The leasing industry in Ecuador started in 1969 and it was one of the first countries to enact a Leasing Law.¹ However, the leasing industry in Ecuador has been declining since 1994, due to several factors of a diverse nature, with the most important being the enactment of the financial reforms of 1994 and 1996.²

These two reforms were inspired in the universal banking model and led to the consolidation and absorption of leasing companies by the banks.³

According to an interesting study performed by Lafuente and Valle, Ecuador had 16 independent leasing companies in 1993, falling to only three independent leasing companies in 1996.⁴

In the 1980s and early 1990s, Ecuador had a very strong leasing industry. However, some regulatory changes that allowed banks to provide such leasing services led to a concentration process. Leasing del Pacífico, the largest lessor, was absorbed by Banco del Pacífico, Contileasing, the second largest, was absorbed by Banco Continental and Arlesa was absorbed by Banco Popular.

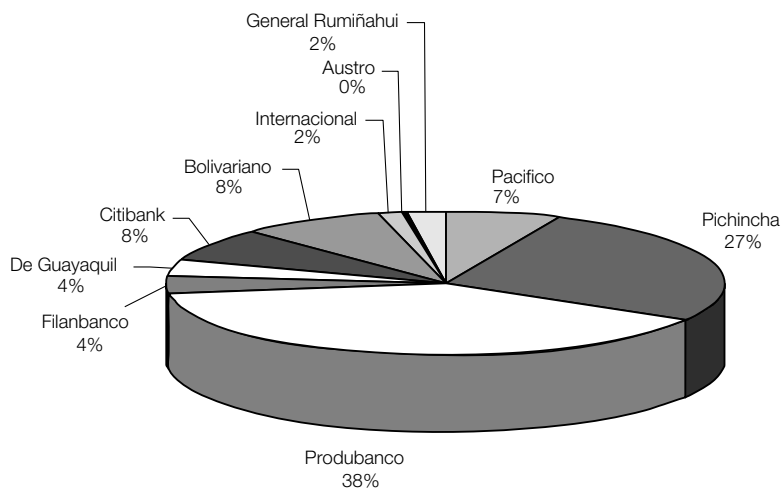
Independent leasing companies like Leasingcorp do not play a major role since they have diversified their portfolio, reducing the relative importance of leasing transactions for their business.

The total of the leasing industry in Ecuador can be estimated at around US\$87.8m.

Law and regulation. The organisation of new leasing companies in Ecuador is subject to the provisions of the "Superintendencia de Bancos".⁵

Ecuadorian Law reserves the privilege

Table 1: Leasing market share in Ecuador



Source: Superintendencia de Bancos del Ecuador and calculations of Alta Group LAR.

to act as lessors in financial leasing agreements, to the banks, financial companies, the Mutual Associations of Savings and Housing, leasing companies and the Corporación Financiera Nacional.⁶

Therefore, all these financial entities have access to the licence to operate as financial lessors, in addition to their licence for their core purpose (e.g. banking or trade financing or mortgage or investment banking).

The organisation of a financial lessor in Ecuador is subject to the following conditions:

1. Every leasing company must have the form of a corporation ("*Sociedad Anónima*"), which may be incorporated by two means, namely: private procedure or public promotion.⁷ The public promotion system is based upon an invitation made by the sponsors to an open group of investors for their participation as shareholders of the company. The Law requires that the minimum number of sponsors must be five,⁸ and it is subject to the prior approval of the "*Superintendencia de Bancos*" before executing the public deed of incorporation. By means of the private procedure the founder shareholders must execute a public deed without prior procedures, but may not operate without the licence granted by the "*Superintendencia de Bancos*".
2. The minimum paid capital was recently reformed by the Banking Board, by means of JB-2002-452, May 14, 2002. Formerly, minimum capital was set forth at the equivalent to 500,000 constant value units,⁹ but must be raised to 1,500,000 constant value units as soon as the leasing company starts operating. Each constant value unit was equal to US\$2.6289.¹⁰ Therefore the minimum paid capital for a leasing company was US\$1,314,470, and the minimum equity to operate US\$3,943,350. New figures were determined by the Banking Board in US dollars. The authorised capital shall not exceed the double amount of the paid capital when the company is incorporated.
3. An application must be filed at the "*Superintendencia de Banco y Seguros*" by either the sponsors (in a public promotion procedure) or the founding shareholders (in a private procedure) whereby they must provide all information and an affidavit about their clean background, reliability

and responsibility to undertake financial activities, a feasibility study for the company and the bylaws of the company.

4. The application must be published in a widely circulated newspaper for three times with intervals of no less than one day, to give the chance to third parties to file an opposition, within the next 20 days. If an opposition were filed, the Superintendency should have a term of up to 60 days to resolve after giving the sponsors or founders the chance to reply to the opposition.
5. In any event, the Superintendencia requires the names and information of the shareholders, in order to control their morality and reliability.
6. Once the incorporation of the company is authorised, the corresponding public deed must be executed and recorded in the public registry as well as in the Government official journal. Copies of all these documents must be submitted again to the Superintendencia de Bancos with the deposit receipt of the paid capital issued by the bank that received the deposit.

Ecuador still has inadequate regulations regarding leasing transactions. In order to provide some development of the industry, the adoption of the Unidroit Convention provisions are highly recommended.

Accounting. Lessors are subject to accounting rules set forth by the Superintendencia de Bancos. The latest regulation is contained in Resolución No. SBS-2002-0297 29 de abril del 2002, which basically adopted the same principles of IAS No. 17. The inconvenience of this accounting system is that it conceals the disclosure of leasing transactions.

Taxation. Leasing contracts are subject to value-added tax (VAT) of 12% over the amount of the corresponding lease payments, and such VAT paid can be used by the lessee as fiscal credit in its monthly VAT report.

Income taxes are applied at a uniform tariff of 25%. For lessees only the financial component of the lease rentals is deductible from taxable income. The lessee is the only taxpayer allowed to claim depreciation of leased assets, but it must subject the depreciation to the general rules as if the asset was purchased.

For cross-border leases, the corresponding withholding tax only will be applied if the rate of the corresponding

agreement is greater than the maximum rate published by the Ecuadorian Central Bank. The tax will be levied over the excess (art. 13 of Ley de Regimen Tributario Interno).

The lease contract. The lease contract is subject to the general rules for contracts and obligations as provided by the Banking and Financial Entities Law, the Commercial Code and the Civil Code. The legal definition for the leasing contract contained in the new Compilation of Banking Law and Regulations differs from the definition contained by the Ottawa Convention.

Therefore, among other things, lessors are not legally protected against defences to the hell-or-high-water provision and the tripartite nature of the leasing transaction is not recognised.

The landscape for equipment leasing in Ecuador is not very promising. This will certainly affect the ability of the country to generate capital investment.

Notes:

- 1 Decreto Supremo No. 3121 de 22 de diciembre de 1978.
- 2 Ley Reformatoria de la Ley General de Instituciones del Sistema Financiero *et al.*, 1996.
- 3 Until 1994, the largest leasing company operating in Ecuador was Leasing del Pacifico. The company was absorbed by the Banco del Pacifico, which in 1999 would be nationalised and intervened by the Ecuadorian Government.
- 4 LAFUENTE, Danilo and VALLE, Angelica. "Heterogeneidad Eficiencia en el Sistema Bancario Privado Ecuatoriano. Banco Central del Ecuador, 1997.
- 5 In particular Resolution SB-JB-96-0084, August 19, 1996.
- 6 Article 2, Chapter IV Compilation of Resolutions of the Banking Board, and article 51, Financial System Law ("Ley No. 52. RO/Sup 439 de 12 de Mayo de 1994").
- 7 Financial Institutions Law and Companies Law (Compiled in "*RO/312 de 5 de Noviembre de 1999*").
- 8 Article 9, Financial Institutions Law.
- 9 Article 2, Section II, Chapter IV Compilation of Resolutions of the Banking Board.
- 10 Article 12 of the Dollarisation Statute (Ley para la Transformación Económica del Ecuador, publicada en el Suplemento del Registro Oficial No. 34 de 13 de marzo de 2000), better known as the Trolebus Law.

Sources:

- Banco Central de Ecuador: www.bce.fin.ec
- Superintendencia de Banca y Seguros: www.superban.gov.ec
- Proyecto SICA – Banco Mundial: www.sica.gov.ec
- Servicio de Rentas Internas – Ecuador: www.sri.gov.ec

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