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CROSS-BORDER FACTORS: DEMYSTIFYING THE CHIMERA OF FREE MOVEMENT OF CAPITAL WITHIN THE EAST AFRICAN COMMUNITY COMMON MARKET

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Abstract

In most of the East African Community (EAC) countries factoring has been subjected to, inter alia, highly restrictive and unclear regulatory infrastructure with inaccurate terminology, capital adequacy, licence and partly-local ownership requirements, making it difficult for factors to offer their services in the other Partner States. This, therefore, impedes the freedom of movement of capital within the Community, rendering Article 76 of the Treaty for the Establishment of the East African Community (hereinafter referred to as the EAC Treaty) and Article 24 of the Protocol on the Establishment of the East African Community Common Market nugatory. Despite the EAC Treaty prohibiting unnecessary restrictions, the Partner States have exuded some exasperating nonchalance towards liberalizing their internal financial markets to allow free movement of capital. Cross-bordering factoring has been regarded as a significant vehicle that can drive the global economy to development. Despite its impressive prospects for future growth, cross-border factoring regulations within EAC Partner States domestic markets remain largely restrictive, hence impeding free movement of capital within the EAC common market. This paper, therefore, sets out to suggest reforms in the Partner States domestic markets and the Common Market that if implemented, will ensure the EAC objective of enhancing free movement of capital within the Common Market is achieved.

Key words: East African Community Common Market, Cross-border Factoring, EAC Partner States, European Union, regulation, Self-regulatory Organization.

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1. Introduction

The Privy Council in *Chow Yoong Hong v Choong Fah Rubber Manufacturer* quipped, evocatively so, that 'there are many ways of raising cash besides borrowing . . . one is by selling book debts.'[1] Factoring is a form of trade finance that involves the sale of accounts receivables to a third party (also known as a factor) in exchange for working capital.[2] It has gained momentum as one of the most used forms of trade finance, especially to the Small and Medium Enterprises (SMEs), in less than a century.[3] Factoring can be done either with recourse or without recourse. Recourse factoring entails the creditor bearing all the risks such as non-payment by the debtor.[4] On the other hand, non-recourse factoring places the risks on the factor. It can be done both at the local and international spheres.[5] Its cross-border practice enhances movement of working capital to both multinational companies and SMEs, thus ensuring that they have a continuous cycle of capital.

In most of the East African Community (EAC) countries factoring has been subjected to, inter alia, highly restrictive and unclear regulatory infrastructure with inaccurate terminology,[6] capital adequacy, licence and partly-local ownership requirements, making it difficult for factors to offer their services in the other Partner States. This, therefore, impedes the freedom of movement of capital within the Community, rendering Article 76 of the Treaty for the Establishment of the East African Community (hereinafter referred to as the EAC Treaty) and Article 24 of the Protocol on the Establishment of the East African Community Common Market nugatory. Movement of capital within the EAC Common Market has for far too long been considered the duckling that hardly grows due to restrictive Partner States regulations.[7] As

1 (1962) AC 209.

2 Factors Chain International Annual Review 2018 available at https://fci.nl/downloads/Annual%20Review%202018.pdf (accessed 10 March 2020) p 13.

3 Ibid.

4 Yvonne Tan, 'International Factoring, Factoring: The Devise' (1984) 5 SING L REV 192 available at https://heinonlineorg.uplib.idm.oclc.org/HOL/Page?public=true&handle=hein.journals/singlrev5&div=18&start_page=192&collection=journals&set_as_cursor=4&men_tab=srchresults (accessed on 13 March 2020).

5 Ibid.

6 Enga Kameni, 'An Insight into Recent Legal and Regulatory Reforms of Factoring in Africa' available at https://afreximbank.com (accessed 10 March 2020).

7 World Bank report on the East Africa Common Market Scorecard 2016 available at https://www.tralac.org/images/docs/10816/east-african-common-market-scorecard-2016.pdf (accessed 10 March 2020).

will be established, despite the EAC Treaty prohibiting unnecessary restrictions, the Partner States have exuded some exasperating nonchalance towards liberalizing their internal financial markets to allow free movement of capital.[8] One of the sectors that the EAC Treaty demands liberalization but has attracted very dismal performance by the Partner States is in direct investments.[9] Direct investment is a vehicle that can drive capital from one country to another, and consequently, one of the lucrative areas for investment within the Common Market is in factoring.[10] Factoring has been regarded as a significant vehicle that can drive the global economy to development.[11] Regionally, factoring volumes are expected to ameliorate to US$ 200 billion.[12]

Despite such impressive current and prospects for future growth, cross-border factoring regulations remain largely restrictive, hence impeding free movement of capital within the EAC common market. This paper, therefore, sets out to suggest reforms that if implemented, will ensure the EAC objective of enhancing free movement of capital within the Common Market is achieved. It will do this first by establishing how cross-border factoring can be a vehicle that drives capital from one country to another. Second, this will be followed by an exposure of its current status in EAC in comparison to other regions. Third, the paper will then evaluate the extant legal framework governing factors in EAC. Fourth, a comparative analysis of factoring in EAC to that in the European Union (EU) will then follow. The paper will conclude by proposing reforms that can make factoring helpful in advancing free movement of capital within EAC.

2. Exegesis of Factoring

As stated, factoring is a form of trade finance and an alternative to secured lending. It could involve prepayment between the factor and the creditor amounting to a funding arrangement, normally between 70% and 90% of the total face value of the outstanding receivables.[13] The remainder may be settled

8 World Bank report (n 7)..
9 Ibid.
10 Enga Kameni (n 6) p 27.
11 Enga Kameni (n 6) p 27.
12 Enga Kameni (n 6) p 27.
13 Dalhuisen J. 'Dalhuisen on international commercial, financial and trade law' Hart Publishing (2nd ed) (2004) p 886.

upon collection or partly serve as factor's reward.[14] The UNIDROIT Convention defines factoring as a contract between a creditor and a factor whereby the creditor transfers his commercial receivables as the factor performs at least two of the following: (a) provision of finance to the creditor, (b) maintenance of accounts relating to the trade receivables, (c) collection of the trade receivables, and (d) protection against payment risks by the debtor.[15]

Other attempts have been made to define factoring. For example, the Factors Chain International Secretary-General, Peter Mulroy in the FCI Annual Review 2016 described the concept of factoring in these terms:

> Factoring is an alternative and flexible means of finance which is widely used especially amongst SMEs. This is achieved by the supplier assigning and selling its accounts receivables to a bank or non-bank financial institution. The factor will provide a range of services to its clients, including providing capital against the assignment of their receivables, accepting the risk of bad debts and collecting on past due accounts. Factoring has been considered a stable financing alternative by many companies, particularly since the start of the financial crisis [in 2008]. As many SMEs were unable to obtain traditional bank funding during the crisis, due to the fact that SMEs are perceived to have a higher probability of default compared to larger firms, factoring filled the void. Central banks around the world have come to appreciate the product as a safe and secure method of financing trade.[16]

Such funding and collection involve risk. The type of factoring settled upon by the parties depends on who bears the risk of non-payment by the debtor. If the risk of non-payment and expense of collection is transferred to the factor, there is usually a discount deducted to cater for such risk. This is referred to as non-recourse factoring. However, if the creditor retains such risk, the factor can still claim from the creditor the non-collected or non-paid receivables. This is known as recourse factoring.

Factoring has two facets namely: The contractual and proprietary facets. The two facets are briefly discussed below.

[14] Ibid p 886.
[15] UNIDROIT Convention on International Factoring *1988 art 1.*
[16] P Mulroy 'Introduction by the Secretary-General' FCI Annual Review 2016 available at < https://www.fci.nl > (accessed on 10 July 2019).

2.1 Contractual Aspects

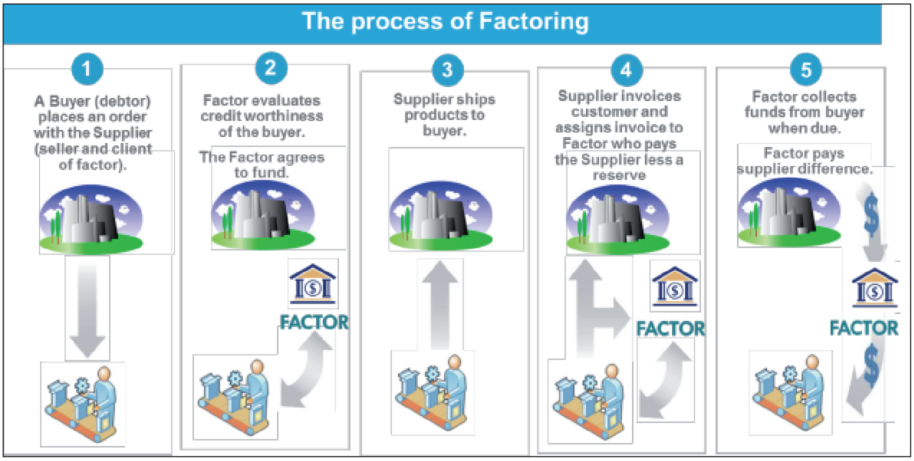
There may exist different forms of factoring agreements, however, there are some constant denominators that lead to their general identification. Firstly, there may be a mere collection agreement which involves administration and collection.[17] Secondly, the agreement could be in the nature of a credit risk transfer involving the grant of a guarantee of payment by the factor who bears the risk of non-payment. Thirdly, the agreement could be of a funding type, whereby the factor advances some percentage of the capital.[18] A concoction of the three is also permissible.

2.2 Proprietary Aspects

The proprietary aspects of factoring involve the actual transfer, normally an assignment of bulk or future claims.[19] This bulk assignment or future claims may not be possible in legal systems where, for example, debtor notification of such assignment is a pre-condition of the validity of the assignment.[20] Further, in collection agreements, there is usually an outright assignment where future receivables are transferred to the factor, often done to facilitate his collection, and in return, the factor transfers his collection to the assignor whenever collection or payment is received. However, in guaranteed collection agreements, such transfer of receivables is often conditional. It may be deemed completed only upon approval of each receivable, or when not exceeding in total a certain amount per debtor.[21]

[17] Dalhuisen J. (n 13) p 889.
[18] Dalhuisen J. (n 13) p 889.
[19] Dalhuisen J. (n 13) p 890.
[20] Dalhuisen J. (n 13) p 890.
[21] Dalhuisen J. (n 13) p 890.

A summary of the above exegesis is seen in figure 1 below:



Source: Dalhuisen J in 'Dalhuisen on international commercial, financial and trade law'[22]

2.3 *Benefits of Factoring to SMEs*

The benefits of factoring as a form of trade finance include:

a) Creates a continuous cycle of liquid capital to SMEs;

b) Creates and supports employment opportunities;

c) Promotes productivity since the creditor is relieved of the duties of debt collection and can instead use that time for production;[23]

d) Steers economic growth; and

e) Guarantees against payment default by foreign buyers.[24]

2.4 *Relationship between Cross-border Factoring and Movement of Capital*

Modern SMEs face challenges like significant amplification of capital mobility, especially at the international spheres. Given the recent economic

22 Dalhuisen J. (n 13) p 889.

23 Hamanyati M. 'Factoring as an international trade finance product: making a case for the enactment of a factoring act in Zambia' (unpublished dissertation).

24 G Shams 'Egypt' World Factoring Yearbook 2017 Edition (2017) 161 available at <www.ebglaw.com/content/uploads/2017/06/Tatge-World-Factoring-Yearbook-2017-eBook.pdf > accessed on 10 July 2019.

crises that resulted in growing credits and their subsequent default and liquidity risks thereof, there has been need to come up with pathways that ensure companies increase their competitiveness in the field of growth finance. This can be done through access to finance that ensures that companies remain competitive due to continuous cycle of liquid capital. Faster access to finance also encourages such companies to expand their businesses beyond their country's borders by ensuring they undertake productive investments. The sources of such capital can be credit or equity. A company that opts for credit can access such finance by way of inter alia, bank loans. On the other hand, a company that opts for equity can gain such access through inter alia, issuance of shares, initial coin offering, factoring, and forfaiting.[25]

Understanding the technicalities of credit, for example bureaucracy and the need for sufficient collateral (which a number of SMEs may lack) is helpful in appreciating the need for more accommodative alternative sources of finance. As mentioned earlier, these alternative sources of finance include factoring and forfaiting. Factoring is a far reaching alternative source of finance used in most industries that conduct business-to-business or business-to-government types of sales.[26] Through globalization that is as a result of increased need for a wider market base, companies have become more desirous of expanding their business beyond their national borders. However, during such expansion, such companies are faced with the various impediments that make it almost impossible to establish their companies in another country. This means that companies, like those of factors, can hardly conduct cross-border transactions.

Due to this, countries have come together to form common markets and free trade areas under the ambit of the General Agreement on Trade and Tariffs Article XXIV. The EAC common market is an example of a common market that allows free movement of factors of production. Given that factoring is a form of trade finance that provides capital to companies, it is therefore one of the vehicles that drives movement of capital within the Community.

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25 Surbhi S. 'Difference between factoring and forfaiting' dated 24 May 2017 available at <https://keydifferences.com> accessed 14 March 2020.

26 Tamara M., Ksenija D., 'Factoring in the changing environment: legal and financial aspects' Procedia - Social and Behavioral Sciences (2012) 428 – 435 p 44 available at https://www.sciencedirect.com accessed 13 March 2020.

3. Factoring within the East African Community Common Market in Context

According to the Trade Finance Global 2018 survey on the factoring industry, in 2018 the global factoring industry recorded an increase in volume amounting to 2,767 billion euros, a 6% increase from the 2017 figure.[27] Regionally, despite Israel's negative figure of -19%, the Middle East still recorded an increase of 10% thanks to the United Arab Emirates' volume that saw its factoring industry grow by 38%. In South America factoring volume increased by 4%, recording a volume of over 100 billion euros, although Brazil's figure dropped by 6%. The Asia Pacific region showed an upward trajectory of 6%, recording a combined volume of over 600 billion euros, with China leading with over 400 billion euros record.

Europe remains the largest factoring market, accounting for almost 65% of the world factoring transactions. In 2018, it recorded a 7% increase from its 2017 figure in its factoring industry. Table 1 below shows the EU's factoring industry from 2010 to 2017.

Table 1: Factoring Statistics in the EU between 2010 and 2017

	2010	2011	2012	2013	2014	2015	2016	2017	Change y/y
Total Turnover (M €)	992.746	1.142.718	1.209.587	1.259.343	1.373.774	1.470.821	1.503.170	1.605.697	
of which:									
Domestic	847.022	902.283	1.034.361	1.063.752	1.121.238	1.188.768	1.174.747	1.259.652	7%
International	145.724	240.435	175.226	195.591	252.536	282.053	328.424	346.044	5%
Recourse	710.056	767.592	666.318	757.301	808.048	797.997	777.135	830.013	7%
Non Recourse	282.690	375.126	543.269	502.042	565.725	672.824	726.035	775.683	7%
Owned by banks and banking groups			1.131.994	1.156.876	1.269.056	1.337.292	1.439.932	1.528.357	6%
Owned by non banking companies			77.593	102.467	104.718	133.529	63.238	77.340	22%
Total Advances (M €)	71.856	72.053	169.358	162.415	172.963	168.154	201.596	217.725	8%
Total Security Values (M €)	116.966	105.828	222.376	224.433	237.151	251.070	261.480	277.027	6%
Number of Active Client Relationships	126.269	119.739	160.066	166.502	164.069	171.426	179.675	201.520	12%
Average yearly turnover per client (M €)	7,9	9,5	7,6	7,6	8,4	8,6	8,4	8,0	-5%
Average yearly advances per client (M €)	0,6	0,6	1,1	1,0	1,1	1,0	1,1	1,1	-4%
Average outstanding per client (M €)	0,9	0,9	1,4	1,3	1,4	1,5	1,5	1,4	-6%
Advances/ total receivables	61%	68%	76%	72%	73%	67%	77%	79%	2%
Average no of days outstanding	43	34	67	65	63	62	63	63	-1%

Figures in this table are estimated on the basis of the data provided by the EUF Members and the significance of the sample on total turnover

Source: EU Federation for Factoring and Commercial Finance[28]

[27] James Sinclair, 'Global factoring and receivables finance industry increased by 6% in 2018', Trade Finance Global available at https://www.tradefinanceglobal.com/posts/new-global-factoring-and-receivables-finance-industry-increased-by-6-in-2018/ accessed on 10 March 2020.

[28] Available at https://euf.eu.com/facts-and-figures/facts-and-figures/euf-estimates-on-eu-market.html accessed on 13 March 2020.

Closer home, the Trade Finance Global 2018 survey revealed that Africa's wider regional factoring industry, despite the low volumes, recorded an increase of 2%, with South Africa accounting for 9%, Egypt 24%, and Mauritius accounting for 9%. Morocco's industry dropped by 25%. Domestic factoring in the West African region accounted for approximately 50 million euros in 2017, with Nigeria's record being the highest. In the Northern region, domestic factoring in Tunisia accounted for 95% of the transactions, financing the telecom, white goods, and agriculture industries. In the East African region, Kenya, despite being the region's economic powerhouse, had very dismal results in its international factoring industry, with its domestic factory accounting for 97%. This is despite an existing common market in the region that should enhance cross-border movement of capital. According to Enga Kameni, factoring in Africa records low volumes because of, inter alia, the poor legal framework governing the industry.[29]

The East African Community is a regional economic integration project that was notified to the WTO under the auspices of the Enabling Clause. It draws its mandate from Article 2(1) of the Treaty for the Establishment of the East African Community (the Treaty). It comprises Uganda, Kenya, Tanzania, Rwanda, Burundi, and South Sudan. Its fundamental principles include, inter alia, 'equitable distribution of resources, and co-operation for mutual benefit.'[30] As parts of its integral pillars, EAC has in place a Customs Union that establishes the Community's common external tariff;[31] a Common Market that facilitates the free movement of factors of production;[32] a Monetary Union[33] and an ultimate objective of forming a Political Federation.[34] The political federation objective is a very deep level of integration that is yet to be seen in any other African regional economic agreements.[35]

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29 Enga Kameni (n 6) p 30.

30 Treaty for the Establishment of the East African Community (Treaty for the Establishment of the EAC) art 6(e) & (f).

31 The Protocol for Establishment of the East African Community Customs Union was signed on 2 March 2004, paving way for the customs union to become fully operational on 1 January 2005, See https://www.eac.int (accessed on 8 May 2019); See also Treaty (n 10) art 75.

32 The Protocol for the Establishment of the Common Market was signed on 20 November 2009, entered into force on 1 July 2010, See https://www.eac.int (accessed 8 May 2019); See also Treaty art 76.

33 The Protocol for the Establishment of the East African Community Monetary Union was signed on 30 November 2013 and is yet to come into force.

34 Treaty for the Establishment of the EAC art 5(2).

35 W Masinde and OO Christopher, 'The Road to East African integration', in Emmanuel Ugirashebuja et al *(eds) in East African Community Law: Institutional, Substantive and Comparative EU Aspects Brill (2017) p 17-18 available at* https://brill.com/view/book/edcoll (accessed 10 May 2019).

The EAC Partner States signed the Protocol on the Establishment of the East African Community Common Market (the Protocol) in 2009, which came into force in 2010. The Protocol gives effect to Article 76 of the Treaty. It serves to accelerate the economic development of the Partner States by facilitating, inter alia, free movement of capital, labour, goods, and services.[36] The Partner States unanimously agreed to eliminate all forms of technical barriers to trade and any restrictions since that would impede the movement of capital within the Common Market, an act that would see the Community have an integrated financial system.[37] This they would do through 'harmonizing their standards and implementing a common trade policy for the Community.'[38] In fact they are not to introduce new restrictive or apply more restrictive measures to impede free movement of capital,[39] unless such restriction relates to financial sanctions.[40] The EAC Secretariat and the other Partner States should, however, be informed of such restriction, and evidence furnished as to why such restriction is justifiable.[41]

Interestingly, there exist a plethora of laws regulating the financial sector in each of the Partner States domestic realms that undermine the very existence of the Community and its free movement of capital objective.[42] In fact, an objective scrutiny of Annex VI of the Common Market Protocol exposes the exasperating nonchalance by the Partner States to liberalize their capital markets, thus impeding the free movement of capital. The Partner States have instead imposed more restrictive measures and regulations.[43] The areas where such restrictions should be abolished include, inter alia, money markets,[44]

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36 Treaty for the Establishment of the EAC Preamble para 5 & art 2.

37 Treaty for the Establishment of the EAC art 5(2)(f).

38 Treaty for the Establishment of the EAC art 5(2)(a).

39 Treaty for the Establishment of the EAC art 24(1).

40 Treaty for the Establishment of the EAC art 25(1).

41 Treaty for the Establishment of the EAC art 25(2).

42 World Bank report on the *East Africa Common Market Scorecard 2016; A more detailed report on the restrictive measures and regulations that impede the freedom of movement of capital will be discussed in the subsequent sections.*

43 See for example Rwanda's Capital Market Licensing Securities Requirement *of 2012 on approval of foreign securities exchange; See also Uganda's Income Tax Act on withholding tax rate on dividends of listed securities for non-residents which is 15% compared to the one for residents which is 10%.*

44 EAC Common Market Schedule on the Removal of Restrictions on the Free Movement of Capital Annex VI (EAC Common Market Schedule) operation 3.

collective investment schemes,[45] direct investments[46] and repatriation of profits.[47] Such liberalization is aimed at achieving regional financial integration, making the freedom of movement of capital a reality.[48] Neither the Treaty nor the Protocol defines what 'movement of capital is'. The Protocol instead enumerates a non-exhaustive list that could be construed as capital. These include, inter alia, direct investment; equity and portfolio investments; bank and credit transactions.[49]

Direct investment refers to cross-border 'investments of all kinds, by natural or legal persons, that serve to establish or maintain lasting and direct links between the person providing the capital and the entrepreneur or undertaking to which the capital is made available in order to carry on an economic activity.'[50] It can be inward, outward or through repatriation of profits.[51] Cross-border factoring is a form of direct investment.[52] In a Community where its biggest percentage of investors are SMEs, it is imperative that these SMEs get more access to more alternative sources of funding like factoring. However, a common trend among the EAC Partner States has been to regulate non-bank factors under the same umbrella as banks[53] or the tendency to restrict the right of establishment of companies from other EAC Partner States, without recognizing that they should be treated differently from other non-EAC nationals. An example is Uganda's Financial Institution Act of 2014 which defines factoring to be a financial activity conducted by banks thus to be regulated by the Central Bank of Uganda. This means that factors, which are not necessarily banks, are subjected to the same requirements as their banking counterparts e.g. capital adequacy.

Moreover, a foreign investor in Tanzania is defined in the Capital Markets and Securities (Foreign Investors) Regulations as an individual or a corporate

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45 EAC Common Market Schedule operation 4.
46 EAC Common Market Schedule operations 17-19.
47 EAC Common Market Schedule operation 20.
48 Treaty for the Establishment of the EAC *art 5(2)(f)*.
49 Treaty for the Establishment of the EAC art 28.
50 J Nakagawa 'Multilateralism and regionalism in global economic governance: trade, investment and finance' Routledge Studies in the Modern World Economy (2012) 127.
51 EAC Common Market Schedule operation 18.
52 J Dalhuisen 'Dalhuisen on international commercial, financial and trade law' Hart Publishing (2nd ed) (2004) 897.
53 Uganda's Financial Institution Act of 2014 s. 2.

body that is a non-Tanzanian.[54] The regulations also restrict both inward and outward investment, which includes factoring. A similar distinction between foreign and domestic investors is seen in its Investment Act of 1997. For instance, the Act defines a foreign investor as a person who is not a citizen of Tanzania (or incorporated in Tanzania in the case of a company), a citizen of any EAC Partner State regardless.[55] Similarly, as a business, like a factor, in order to enjoy the benefits and protection that accrue from the Act, a foreign investor or a joint venture must have a capital investment of at least $300,000, a figure way exorbitant compared to their domestic counterparts whose capital investment should be at least $100,000. Further, a foreign investor in Tanzania, e.g. a factor, can obtain credit from Tanzanian financial institutions only to the extent that such credit is used for its intended purpose, whose use can be monitored by the bank issuing the loan, and up to the limit established by the Bank of Tanzania in consultation with the Tanzania Investment Centre.

Prior to its amendment, Uganda's Investment Code Act Cap 92 defined a foreign investor as an individual who is not a Ugandan, or a company whose majority of shares (more than 50%) are held by non-citizens.[56] In order to engage in trade in Uganda, a foreign investor, like factors, had to first deposit $100,000 at the Bank of Uganda to be used for their purchase of imports or other goods to be traded within the Ugandan jurisdiction. Also, just like Tanzania, a foreign investor in Uganda must make a capital investment of $500,000 in order to be eligible for the incentives under the Act. Their domestic counterparts should make a paltry $50,000 capital investment. However, the Act was amended by the Investment Code Act of 2019 to accommodate the provisions of the EAC Treaty. The Investment Code Act of 2019 amends the previous Act by defining a foreign investor as a natural or artificial person who is not a citizen of (or incorporated, in the case of companies, in) any EAC Partner State.[57] Commendably, its definition of a domestic investor acknowledges the locality of other nationals of other EAC Partner States.

In addition, the Kenya Insurance Act of 2015 mandates insurance companies (including those that provide factoring services) registered in Kenya to ensure that they are body corporates registered under the Companies Act 2015

[54] Capital Markets and Securities (Foreign Investors) Regulations, 2014 r. 2.
[55] Tanzanian Investment Act 1997 s. 3.
[56] Investment Code Act s. 9.
[57] Uganda Investment Code Act 2019 s. 1.

and at least a third of their controlling interests in the body are held by citizens, a corporate body whose shares are wholly owned by citizens of an EAC Partner State; a partnership whose partners are all citizens of a Partner State of the EAC; or by a body corporate whose shares are wholly owned by citizens of a Partner State of the EAC or the government, or a combination of both.[58] The same ownership rule applies to at least 60% of the paid-up capital of insurance brokerages. As far as minimum capital requirements is concerned, out of the amount of the paid-out capital, not less than one-third shall be owned by citizens of the EAC Partner States, by a partnership whose partners are all citizens of such states, wholly owned by citizens of such states or by the Government.[59] However, such a body corporate incorporated in Kenya with or without a share capital shall not be registered and if registered shall have such registration cancelled if at least one-third of the members of its board of directors or managing board are not citizens of Kenya.[60]

Just like Kenya, in Rwanda, according to its Law on Investment and Export Promotion and Facilitation of 2015, a foreign investor is a natural person who is not a citizen of Rwanda or of a member state of the EAC or COMESA; a business company or partnership not registered in Rwanda, a member state of the EAC or COMESA; or a business company or a partnership registered in Rwanda whose foreign capital from countries other than EAC or COMESA member states is at least fifty-one per cent (51%) of the invested capital.[61] According to the Act, an investor may invest and purchase shares in an investment enterprise in Rwanda and shall be given equal treatment with Rwandan investors with regard to incentives and investment facilitation.[62] However, a more minimum capital is required from investors from Tanzania as compared to other investors from the other EAC Partner States.

In Burundi, section 15 of the Land Act of 2014 implicitly defines a foreign investor as legal entities not instituted in accordance with the laws of Burundi. Foreign investors can experience procedural and substantive barriers as they enter, operate in and exit the economy. Besides, these barriers, which are intentional, require foreign investors and traders (including those from

58 Kenya Insurance Act CAP 487 s. 22.
59 Kenya Insurance Act CAP 487 s. 23(4).
60 Kenya Insurance Act CAP 487 s. 27A.
61 Rwanda Law on Investment and Export Promotion and Facilitation of 2015 Chapter I art. 24.
62 Rwanda Law on Investment and Export Promotion and Facilitation of 2015 Chapter II art. 5.

other EAC partner states) to designate at least $50,000 to their business.[63] This poses a cumbersome approval requirement to invest in Burundi, which consequently hampers foreign investment. Besides, Law 1/23 of 24 September 2009 article 3 in determining tax advantages provides that eligible investments are those which contribute to the achievement of the use of locally produced raw materials, in particular by stimulating the production of goods services intended for the internal market. In addition, a percentage of ownership should be reserved for Burundians upon privatization of state enterprises.

With the potential proliferation of factoring entities in Africa,[64] these regulations have made it almost impossible for factors to establish their businesses within the Community, consequently making it difficult for the EAC entrepreneurs to access alternative sources of finance, especially the SMEs that have inadequate (or lack) collateral assets. The resultant effect is that intra-EAC trade will continue to diminish.

3.1 Intra-EAC Trade: The Need for Factoring

Intra-EAC trade has recently significantly depreciated, thanks to the frustrating complacency of the EAC countries to liberalize their financial sectors in order to achieve the Community's financial integration agendum. Intra-EAC trade has recorded low volumes because of, among other reasons, lack of (or inadequate) working capital.[65] According to the International Monetary Fund Report of 2016, intra-EAC trade transactions were as low as 18.1% in 2015, depreciating from the 2012 figure of 19.7%. Similarly, according to the 2017 EAC trade report[66], Uganda's intra-EAC trade imports amounted to $565.5 million, recording a 6.2% increase from the previous year. In the same year, Tanzania's intra-EAC imports were valued at $243.2 million, a figure 18.6% lesser than 2016.

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63 Burundi Ministerial Order 550/29 of December 1980.

64 Enga Kameni (n. 6) p 30.

65 CNBC Africa '*How factoring can improve access to finance in Africa' available at* https://www.cnbcafrica.com/videos/2019/04/26/how-factoring-can-improve-access-to-finance-in-africa/ (accessed on 13 March 2020).

66 Draft EAC trade report 2017 available at http://eabc-online.com/resources/business-guides/105-the-east-african-community-eac-trade-and-investment-report-2017/file (accessed on 13 March 2020).

The Report exposes Burundi's 2017 value which depreciated by 3.1% amounting to $151.0 million. Rwanda has had consistent import figures of slightly above $400 million since 2013, with its 2017 volume amounting to $476.6 million, an unimpressive increase of 2.2% from its 2016 import values. As for South Sudan, despite joining the Community late in 2015, recorded very high volumes of imports amounting to $563.2 million in 2015, which, unfortunately, consistently regressed to $462.5 million in 2017, a figure 17.8% lower than its 2015 counterpart but 15% higher than its 2016. Kenya, the region's economic powerhouse, has also had its fair share of both progress and regress in the intra-EAC trade imports, accounting for $589.5 million, a progress of 81.7% from the 2016 value.

On the flipside, the Report[67] states that intra-EAC trade exports amounted to an aggregate of $2898.2 million in 2017, with Uganda accounting for $1126.3 million, recording an increase of 18.4% from its 2016 intra-EAC export values. Tanzania accounted for $464.5 million, a 33.7% increase from its 2016 value. Burundi recorded an extremely low figure of $11.5 million, a 6% decrease from its 2016 value of $12.3 million. Rwanda had a 6.4% increase from 2016 to 2017, with its 2017 intra-EAC export value amounting to $167.4 million from the 2016 value of $157.4 million. Just like Burundi, South Sudan's intra-EAC export value has been consistently low since it joined the Community, recording a $13.0 million in 2015, $23.6 million in 2016, and $17.9 million in 2017. Finally, Kenya has been recording fairly high intra-EAC export volumes, albeit its consistent regression. It recorded a value of $1,110.5 million in 2017, a figure that is 7.4% lesser than the 2016 value and 23.5% lesser than the 2013 figure.

[67] Ibid.

The table below summarises the above findings.

Table 2: Total intra-EAC Trade between 2013-2017 (US$ million and percentage change)

		2013	2014	2015	2016	2017	Percentage Change			
							2014	2015	2016	2017
Imports	Uganda	616.9	686.1	631.0	532.6	565.5	11.2	-8.0	-15.6	6.2
	Tanzania	397.0	709.9	278.6	298.8	243.2	78.8	-60.8	7.3	-18.6
	Kenya	334.5	416.9	407.8	324.4	589.5	24.6	-2.2	-20.5	81.7
	Burundi	171.4	168.1	151.1	157.2	151.0	-1.9	-10.1	4.0	-3.9
	Rwanda	485.0	554.2	492.7	466.2	476.6	14.3	-11.1	-5.4	2.2
	South Sudan	_	_	563.2	402.0	462.5	_	_	-28.6	15.0
	Total	**2,004.8**	**2,535.3**	**2,524.4**	**2,181.1**	**2,488.3**	**26.5**	**- 0.4**	**-13.6**	**14.1**
Exports	Uganda	802.8	922.5	1,036.7	950.9	1,126.3	14.9	12.4	- 8.3	18.4
	Tanzania	1,118.0	779.5	337.4	338.3	464.5	-30.3	-56.7	0.3	37.3
	Kenya	1,451.0	1,430.8	1,285.9	1,199.0	1,110.5	-1.4	-10.1	- 6.8	-7.4
	Burundi	20.1	15.7	14.8	12.3	11.5	-21.9	-5.3	-17.1	-6.0
	Rwanda	125.8	141.6	135.2	157.4	167.4	12.6	-4.5	16.4	6.4
	South Sudan	13.0		13.0	23.6	17.9			81.4	-24.2
	Total	**3,517.6**	**3,290.1**	**2,823.0**	**2,681.4**	**2,898.2**	**-6.5**	**-14.2**	**-5.0**	**8.1**
Total Intra-EAC Trade value	Uganda	1,244.0	1,608.6	1,667.7	1,483.5	1,691.8	29.3	3.7	-11.0	14.0
	Tanzania	1,515.0	1,489.4	616.0	637.1	707.7	-1.7	-58.6	3.4	11.1
	Kenya	1,785.5	1,847.7	1,693.7	1,523.4	1,700.1	3.5	-8.3	-10.1	11.6
	Burundi	191.4	183.8	165.9	169.5	162.6	-4.0	-9.7	2.2	-4.1
	Rwanda	610.8	695.8	628.0	623.5	644.1	13.9	-9.7	-0.7	3.3
	South Sudan	-	-	576.2	425.6	480.4	-	-	-26.1	12.9
	Total	**5,346.7**	**5,825.3**	**5,347.4**	**4,862.6**	**5,386.6**	**9.0**	**-8.2**	**-9.1**	**10.8**

Source: Annex VII Draft EAC trade report 2017[68]

68 Available at http://eabc-online.com/resources/business-guides/105-the-east-african-community-eac-trade-and-investment-report-2017/file p 26 accessed on 13 March 2020.

Commendably, in 2018, the total intra-EAC trade value appreciated by 9.4% to a cumulative total of USD 5.981 billion from 2017 figure of USD 5.467 billion.[69] Likewise, intra-EAC exports grew by 5.6% to USD 3.2 billion from the previous year's USD 2.898 billion. Save for South Sudan that had a depreciation of -88%, exports in all the Partner States improved in 2018, with Burundi experiencing the highest growth. Ironically, Burundi had a negative growth in its intra-EAC imports by recording 11.1% decrease to USD 134.3 million. However, in small amounts, intra-EAC trade growth is attributable to the favourable weather conditions that were experienced in most parts of the Community, which consequently led to an increase in the production of agricultural products.

These figures prove that indeed intra-EAC trade occurs. However, the trade decline is due to, inter alia, declining competitive advantage among the region's manufacturers due to inadequate working capital, and the restrictive (protectionist) regulatory framework surrounding free movement of factors of production like capital exposing a dearth of political will among the countries.[70] The liquidity challenge has seen most multinational companies and SMEs go under due to unreliable flow of working capital, thus breaking the chain of production and supply. A liberalised regional factoring industry, if achieved, will increase intra-EAC trade, thus being one of the ways to ensure that intra-EAC free movement of capital is enhanced.

The following section will analyse the three basic approaches to regulation of the factoring industry as laid out by Hulki Kara in the 2017 World Factoring Yearbook.[71] Against this backdrop, an evaluation of the EAC Partner States regulatory framework on factoring will ensue.

[69] EAC Trade and Investment Report 2018: Accelerating Market-Driven Integration available at https://www.eac.int/documents/category/trade-investment-reports accessed on 14 March 2020.

[70] Ivan Mugisha 'Why intra-EAC trade is dwindling' *The East African dated 23 March 2019 available at* https://www.theeastafrican.co.ke/business/Why-intra-EAC-trade-is-dwindling/2560-5038534-uobi5r/index.html accessed on 14 March 2020.

[71] Hulki K. 'To regulate or not to regulate factoring?' *World Factoring Yearbook 2017 available at* https://bcrpub.com/system/files/World-Factoring-Yearbook-2017_0.pdf (accessed 14 March 2029) p 4.

4. Competing Approaches to Regulation of Factoring

Should factors be regulated or not? The degree and mode of regulation of factors in a country largely depend on the nature of the regulation of all the country's financial institutions. To some extent, others also depend on whether the country is part of the wider international financial community like a regional economic community. This section does not necessarily limit itself to regulation of the factoring industry by countries in a common market, but rather, how countries (their membership to a regional economic community regardless) generally regulate (or not) their factoring industries. This is in a bid to establish the basic ways in which the industry can be regulated.

4.1 Laissez Faire

In this approach, Kara quips that there is no specific regulatory authority governing the industry. Instead, factoring is governed within the extant fiscal framework. Most factors and other non-bank financial institutions operate based on their corporate governance principles and other contractual obligations. An example of this form of laissez faire form of regulation is seen in Cyprus.

4.1.1 Public Regulatory Authority

According to Kara, the government, through the Central Bank, takes a central role in regulating its factoring industry and other non-bank financial institutions. In most countries, the Central Bank uses regulations that are quite distinct from the other commercial banks to regulate the non-banking financial institutions.[72] This approach to regulation can take place in three different models that are highlighted below.

4.1.1.1 Silo Model

As seen in both Kenya and Tanzania, this model regulates and supervises financial institutions in accordance with their functions e.g. banking, insurance and the securities sectors. Every sector is supervised by a different regulatory authority. Therefore, if factoring services are offered by insurance

[72] Hulki K. 'To regulate or not to regulate factoring?' *World Factoring Yearbook 2017 available at* https://bcrpub.com/system/files/World-Factoring-Yearbook-2017_0.pdf (accessed 14 March 2029) p 4.

companies then the relevant regulatory body in charge of insurance companies will regulate those factoring services. The same applies to banks.

However, this model has been criticized for not taking into account the existence of conglomerates where deposit-taking commercial banks also offer insurance services and can also provide factoring services. Such a financial institution will have to be regulated by the three different regulatory bodies. The shortcoming of this is that it may lead to regulatory arbitrage.

4.1.1.2 Unified Model

As in Malawi, this approach entails a single universal public regulatory authority, normally the Central (Reserve) Bank, regulating and supervising all the financial institutions in a country.[73] The single universal regulator ensures both safety and proper conduct of business requirements are adhered to. With the rapid proliferation of conglomerate institutions like Equity Bank of Kenya, this type of regulation is beneficial in that it creates certainty in the law since it regulates and supervises these conglomerates without creating unnecessary confusion, thus no conflict over jurisdictional lines.[74]

Besides, unlike in 'twin peak' that could lead to duplicity of roles, unification minimizes duplicity and reregulation since a single body regulates and supervises all the institutions.[75] In addition, it prevents regulatory arbitrage by the investors and a race to the bottom by the regulator since there will be no regulatory lax and competition for a better regulated sector.[76]

However, its shortcoming is that it may create the risk of unchecked powers of the regulator.[77] Besides, unlike in a 'twin peak' and silo system that

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73 Llewellyn DT, 'Institutional Structure of Financial Regulation and Supervision: The Basic Issues' (2006); Countries like Malawi have embraced this type of regulation, where the Reserve Bank of Malawi takes charge of the Malawian financial institutions.

74 Group of Thirty report 'Structure of financial supervision: approaches and challenges in a global marketplace' (2008) available at https://group30.org/images/uploads/publications/G30_StructureFinancialSupervision2008.pdf (accessed 14 March 2020) p 14.

75 Quinn J 'Rainmaker: Twin Peaks regulation gets a poor review' *The Telegraph dated 31 March 2012 available at* http://www.telegraph.co.uk/finance/comment/james-quinn/9178018/Rainmaker-Twinpeaks-regulation-gets-a-poor-review.html accessed on 14 March 2020.

76 Financial Services Authority Occasional Paper 2 'The Rationale for Single National Financial Services Regulator' (May 1999) 11.

77 International Monetary Fund Working Paper, *Issues in the Unification of Financial Sector Supervision* (December 2000); International Monetary Fund Working Paper, *Regulatory and Supervisory Independence and Financial Stability* (March 2002) 10; See also Madise S *Developing an Independent Regulatory Framework for the Financial Sector in Malawi* (unpublished LLM thesis, University of the Western Cape 2010-2011).

has flexible regulators and supervisors, the unified model lacks an attractive regulatory framework since it fails to appreciate the dynamic nature of the financial sector.[78] In addition, a unified system fails to steer competition and innovation among the institutions, a fact that can be cured by a silo model since a silo focuses on a particular sector only, thus promoting specialization.[79]

4.1.1.3 Twin Peak Model

As seen in the South African regulatory system, this model of regulation driven by objective, whereby prudential supervision is a function of one regulator whereas the conduct of business is a preserve of another regulator.[80] Expressed differently, the former regulator is concerned with the protection of the customers' assets whereas the latter concerns itself with consumer protection.[81] The benefit of this model is that each regulator has clearly defined objectives with proper checks and balances.[82] Besides, it has been lauded for having a balanced regulatory and supervisory framework thus preventing regulatory arbitrage.[83] Just like the unified approach, this model is also in a better position to regulate conglomerates.[84]

The demerit of this model is that the financial institutions are susceptible to overregulation.[85] Also, if the objectives are not clearly defined, it may lead to an overlap of regulatory obligations.[86]

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[78] Di Giorgio G & Di Noia C 'Financial Market Regulation and Supervision: How Many Peaks for the Euro Area?' *(2003) Brooklyn Journal of International Law 4.*

[79] PEW Economic Policy Department Financial Reform Project 'The International Experience with Regulatory Consolidation' Briefing Paper p 6 (2009).

[80] Strickett C 'What do the changes in regulation mean for the SA insurance industry?' *Cape Times Business Report* 30 April 2015.

[81] Ibid.

[82] Lwellyn DT, 'Institutional Structure of Financial Regulation and Supervision: The Basic Issues (2006) 28.

[83] Group of Thirty 'The Structure of Financial Supervision: Approaches and Challenges in a Global Marketplace (2008) 40 available at http://www.group30.org/images/PDF/The%20Structure%20of%20Financial%20Supervision.pdf accessed on 14 March 2020.

[84] Taylor M 'The Road from "Twin Peaks" and the Way Back' (2009) 16(1) Connecticut Insurance Law Journal 61 80.

[85] Quinn J 'Rainmaker: Twin Peaks regulation gets a poor review' *The Telegraph* 31 March 2012 accessed 20 February 2015 at https://www.telegraph.co.uk/finance/comment/james-quinn/9178018/Rainmaker-Twinpeaks-regulation-gets-a-poor-review.html accessed on 14 March 2020.

[86] Financial Services Authority Occasional Paper 2 *'The Rationale for Single National Financial Services Regulator'* (May 1999) 25.

4.1.2 Autonomous Self-Regulatory Organization (SRO)

Most people view government regulations as the bane of commercial financing.[87] This has largely contributed to the recent shift of SMEs from the highly regulated industries to the less regulated ones in order to get financing. One of the areas with less government regulation is the self-regulated industries. A self-regulatory organization is a non-governmental organization with the mandate of creating and enforcing regulations and standards. The SRO often guards the industry against professional misconducts and other malpractices. In most cases, its ability to act as a watchdog does not flow from governmental power donation. Instead, its ability to do so stems from its internal mechanisms or external agreements among participants of the industry.[88] This is in a bid to exclude government intervention.

The regulations set by the SRO are often binding, such that a participant's failure to adhere to them attracts some sanctions. These regulations set the standards and conditions to be met before becoming a member. The SRO can also undertake to educate its members on the most appropriate business practices. Besides, the SRO can also have the power to resolve disputes among its participants.

The merits of a self-regulation include minimising information asymmetry, boosting consumer confidence, being flexible enough to accommodate new entrants, internalizing ethical behaviours since the rules are based on a peer approach and not the top-down government model. Its limitations can be either economic or legal. The economic implications include the free rider challenge where non-participants that conduct the same business but are not members of the SRO can still enjoy the benefits of the SRO. Besides, SROs may hardly regulate the intricacies of the industry, especially where government regulation comes in to protect issues to do with fundamental rights. This model has been adopted in the USA.[89]

87 *Business factors and finance available at* https://businessfactors.com accessed on 14 March 2020.
88 Ibid.
89 Business Factors and Finance '*How are invoice factoring services regulated?' available at* https://businessfactors.com/invoice-factoring-services-regulated/ accessed on 14 March 2020.

5. Regulation of Factors in a Common Market: The Hybrid Approach

It is noteworthy that the above approaches did not establish how factors can be regulated in an international financial community, given that countries, like those in the EAC common market, are mandated to ensure that movement of capital within the common market is achieved. The approach used by an EAC Partner State to regulate its factoring industry will determine whether or not free movement of capital within the common market is achieved. This section advances a hybrid approach that will ensure that the factor of production freely moves within the common market. This is so because global games require global rules.

5.1 Hybrid Approach to Regulation of Factors within the EAC Common Market

As exposed by the 2007 financial crisis, the absence of government rules does not mean business entities engage in illegal activities, neither does their presence imply they are engaging in legal ones.[90] As earlier on stated, state government regulation can be more restrictive or permissive.[91] It could be a source of conflict in the economy since whereas others may want the intervention to be more restrictive in a particular industry, others favour a more permissive approach. A permissive government regulation favours the autonomy of the participants in the market economy thus self-regulation, whereas a restrictive one circumscribes their autonomy.

Government regulation of business entities uses the 'coercive power' of the state to regulate inter alia, prices, new entrants, investment, foreign invasion, growth of start-ups.[92] The benefits of government regulation include: ease of comprehension; certainty of sanctions; minimises information asymmetry;

[90] Daniel Castro, 'Benefits and limitations of industry self-regulation for online behavioral advertising,' The information technology and innovation foundation dated December 2011.

[91] Porket JL., 'The pros and cons of government regulation', Institute of Economic Affairs, 3rd IEA discussion paper dated 23 January 2003 available at https://www.iea.org.uk accessed on 14 March 2020.

[92] Nancy Rose, 'Regulation, political economy of,' *International Encyclopedia of the Social & Behavioral Sciences (2nd* ed) 2015 available at https://doi.org/10.1016/B978-0-08-097086-8.71033-6 p 178-180.

and predictability.[93] On the flipside, the limitations include: the cost of implementation; prevention of the operation of price mechanism; and may lead to government failure if such regulation leads to misallocation of resources.[94] It is therefore safe to conclude that government regulation cannot be plainly understood as a blanket efficient remedy for market failure.

On the other hand, government regulations enhance accountability, increase internal controls, increases consumer confidence due to cemented and clearly structured consumer protection guidelines. The major demerits are that it increases the workload for people ensuring that such regulations are implemented, increase in costs, and also stifles innovation. It is for these reasons, among others, that there have been numerous calls for deregulation by the government in the financial markets and instead have a self-regulatory organization (SRO).

Self-regulation may be defined as a 'regulatory process whereby an industry-level organization (such as trade association), as opposed to governmental- or firm-level organization sets and enforces rules and standards relating to the conduct of firms in the industry.'[95] Businesses have often opted for self-regulation to enhance consumer confidence and combat the adverse effects of government regulation. In most instances, self-regulation comes in as a response to excessive government intrusion or in cases where the government has not regulated.[96]

Most financial SROs involve many stakeholders, including those that represent consumers and the public at large. Such stakeholders engage in crafting rules and monitoring for compliance, thus addressing concerns beyond the narrow purview of government regulation e.g. protection of other stakeholders. The benefits of a self-regulatory organization include: faster rulemaking, monitoring, enforcement and remediation process as compared to government regulation, thus enabling sooner protection of consumers.[97]

93 Smith T., 'Government regulation,' dated 5 January 2013 available at https://getrevising.co.uk accessed on 28 August 2019.
94 Smith T. (n 95).
95 Anil G. & Lawrence J., 'Industry self-regulation: an economic, organizational and political analysis,' The Academy of Management Review 8, no 3 (1983) p 417.
96 Boddewyn JJ, 'Advertising self-regulation: private government and agent of public policy' Journal of Public Policy and Marketing 4 (1985) p 131.
97 Daniel Castro, 'Benefits and limitations of industry self-regulation for online behavioral advertising' The information technology and innovation foundation dated December 2011 p 5.

Besides, self-regulation encourages entities to internalize ethical behaviour and principles since they are based on social norms and conduct of peers rather than top-down approach taken by government regulation.[98] In addition, self-regulation minimises information asymmetry in the market.[99] For example, most SROs have in place independent third party organizations that are responsible for monitoring compliance.[100] Further, where government regulation protects established interests, self-regulation is more flexible enough to accommodate new entrants and other market participants.[101] Such flexible regulations provide firms with a conducive environment to operate efficiently, besides minimising compliance costs. The end result of such efficient operation is more innovation.[102]

SROs in the financial sector have received their fair share of criticisms. For example, if not properly supervised, they may encourage money laundering and protect the interests of a few individuals.[103] Besides, SROs are not effective in instances where solutions are known and the circumstances unlikely to change, neither in high-risk situations.[104] Finally, without express or implied endorsement by the government the SRO may suffer from adverse impacts of regulatory uncertainties and lack of public confidence.[105]

Given that most jurisdictions have opted for either active government regulation of the domestic financial markets as others opt for self-regulation, settling on one approach to regulation of factors is catastrophic. This is so because the demerits of government regulation, in most instances, far outweigh the advantages thereof. On the flipside, if SROs are left to operate on their own there may be instances of money laundering, protecting their own interests etc. amounting to putting a fox in charge of the hen house.

This paper, therefore, proposes that at the regional level, it is impertinent that EAC Partner States come up with a regional self-regulatory organization

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98 Ibid p 5.
99 Daniel Castro (n 99) p 5.
100 Ibid p 5.
101 Ibid p 6.
102 Lisa S., Stephen T., & Kelly D., 'The food industry and self-regulation: standards to promote success and to avoid public health failures' American Journal of Public Health 100, no 2 (2010) p 242.
103 Daniel Castro (n 99) p 6.
104 Neil G. & Joseph R., 'Industry self-regulation: an institutional perspective,' *Law & Policy Vol. 19 No. 4 (1997).*
105 Christopher Marsden, Internet co-regulation: European law, regulatory governance and legitimacy in cyberspace Cambridge University Press (2011).

empowered with legislative powers to set standards for factors, dispute resolution and enforcement powers, regularly updates its members of factoring statistics in the region, periodically offers training services to factors providing them with updated information on how best to improve their services, etc. The regional SRO will be comprised of national associations of factors with similar powers in their respective national jurisdictions. Similarly, the level of government involvement in those national associations of factors is limited to supervision. Notably, the regional SRO will be limited to factoring activities. However, it will be subject to the regional rules of the EAC Monetary Union. This is in a bid to avoid an overlap of roles of institutions created by the Protocol establishing the Monetary Union such as the East African Monetary Institute, the East African Central Bank and the East African Statistics Bureau.

In order to counter the adverse impacts of self-regulation like money laundering, this paper proposes that the regional SRO will periodically report to the Partner States the progress of the regional factoring industry. This, therefore, means that there will be co-regulation of the factoring industry, comprised of the regional SRO that is in charge of the prudential actions of the factors, whereas the EAC Partner States will be in charge of supervision to ensure compliance and consistency with their domestic and international financial obligations. The end result is a 'best of breed' combination that conflates narrowly-tailored government regulations and supervisory guidelines and a Self-Regulatory Organization (SRO) empowered with legislative, dispute resolution and enforcement powers over the activities of factors.

6. Hybrid Approach to Regulation of Factors in the European Union: A Practical Template

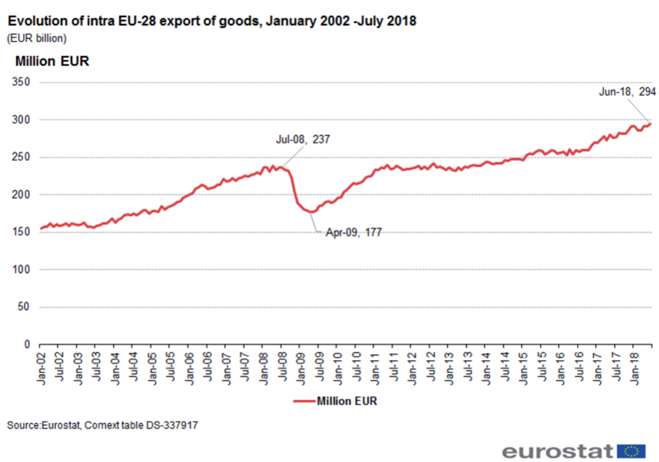
The politics of Brexit aside, the European Union (EU) is one of the most advanced models of regional integration in the world.[106] The EU success can be attributed to visionary politicians like France's Robert Schuman; the Franco-German leadership axis; consensus approach coupled with tolerance;

[106] Fraser Cameron, 'The European Union as a model for regional integration*' Council on foreign relations, International Institutions and global governance and program, available at* https://cfrd8-files.cfr.org/sites/default/files/pdf/2010/09/IIGG_Eurozone_WorkingPaper_Cameron.pdf accessed 14 December 2019 p 1.

and the strong political will to ensure the region's agenda are achieved.[107] These, among other fundamental tenets, have been the driving force behind the region's steady rise after stumbling during the 2008 global financial crisis. Just like the EAC, the fundamental objective of the EU is to ensure they share strong common institutions for the benefit of their citizens. It is for this reason that the EU was the best option to analyse in order for EAC to draw lessons that will help its partner states achieve its objective in its common market.

Just like the EAC Treaty and its Protocol Establishing the Common Market, none of the EU Treaties defines what capital is. Instead, Annex I of the Council Directive for the implementation of Article 67 of the Treaty (Directive 88/361/EEC) provides a list what could be referred to as capital. They include, inter alia, direct investments, transfers in performance of insurance contracts, physical import and export of financial assets, etc.[108] Given the EU internal market provides a platform for economic growth due to free movement of capital, in the past two decades, intra-EU trade has since continued to grow as seen from table 3 below, save for the 2008 depression due to the global crisis.

Table 3[109]



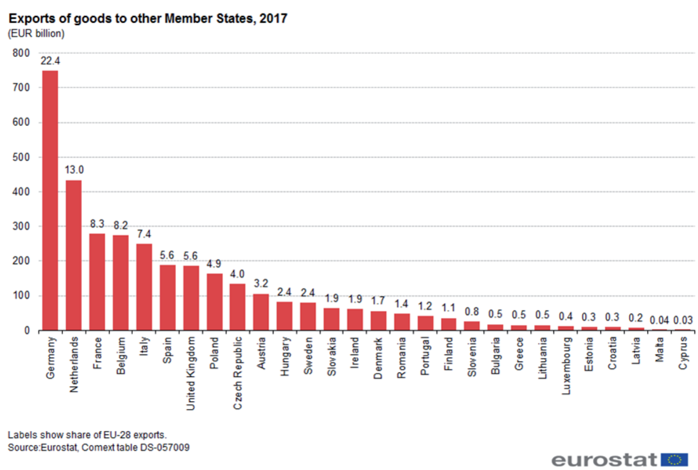
[107] Fraser Cameron (n 106) p 1.

[108] Republic of Turkey, Ministry of Foreign Affairs, Directorate for EU Affairs, *Chapter 4: Free movement of capital dated 04 June 2018 available at* https://www.ab.gov.tr/chapter-4-free-movement-of-capital_69_en.html accessed on 14 December 2019.

[109] Available at https://ec.europa.eu/eurostat/statistics-explained/index.php/Intra-EU_trade_in_goods_-_recent_trends#Intra-EU_trade_in_goods_balance accessed on 14 December 2019.

An analysis of the domestic markets regarding intra-EU exports reveals that the 2017 values ranged between EUR 750 billion (Germany) and slightly above EUR 1 billion (Cyprus). As seen from the table below, Germany's figure accounted for 22.4% of the total intra-EU export while Cyprus' figure accounted for approximately 0.3% of the same. Table 4 below shows the value of the total intra-EU exports in 2017.

Table 4



6.1 *The Nature and Trends of the Factoring Industry in the European Union*

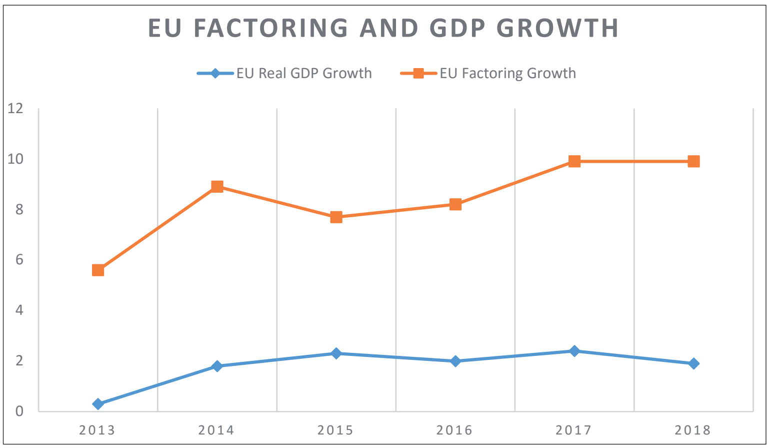
The higher volume of trade transactions, as compared to the EAC lower figures, has been attributed to the existence of working capital that freely moves within the Union,[110] with asset-based finance taking the lead as a form of trade and commercial finance to the Union's enterprises.[111] Factoring in Europe, as a form of asset-based finance, has been hailed as one of the forms of trade finance that provide easy and faster access to capital compared to the secured lending form, no wonder the EU factoring industry accounted

[110] European Commission Single Market Scoreboard available at https://ec.europa.eu/internal_market/scoreboard/integration_market_openness/fdi/index_en.htm accessed on 14 December 2019.

[111] Kevin Day, 'European ABF Factoring: why Germany and France are the markets to watch' *dated 20 May 2019 available at* https://www.finextra.com/blogposting/17262/european-abf-and-factoring-why-france-and-germany-are-the-markets-to-watch accessed on 14 December 2019.

for close to 15% of the total EU Gross Domestic Product (GDP) in 2017, a percentage that rose by 0.5% in 2018 to record a value of over EUR 1.7 trillion.[112]

Table 5: EU Factoring Industry versus GDP Growth from 2013-2018



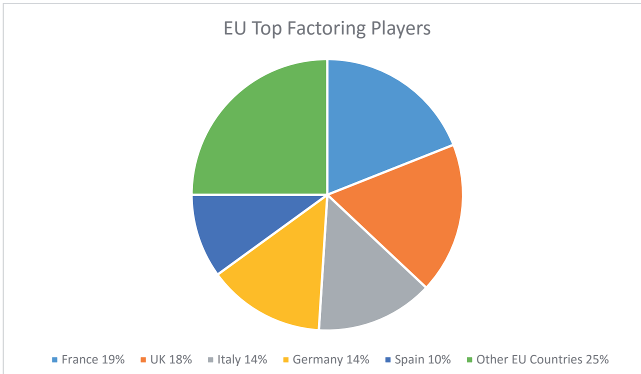
Source: EUF Factoring and Commercial Finance Newsletter 2019

As seen from table 5 above, the growth of the EU factoring industry has been fairly consistent, its consistency proving it to be one of the significant financial resource options for the Union's companies. To be country-specific, the chart below shows the top five dominant players in the EU factoring industry. They are France (19%), United Kingdom (18%), Germany (14%), Italy (14%), and Spain (10%), with the other EU countries accounting for the remaining 25%.[113]

112 European Union Federation of Factoring and Commercial Finance May 2019 Newsletter available at file:///C:/Users/User/Downloads/EUF%20Newsletter_2019_spring.pdf accessed on 14 December 2019

113 European Union Federation of Factoring and Commercial Finance (n 114) p 5

Table 6: EU Top Factoring Players in 2018



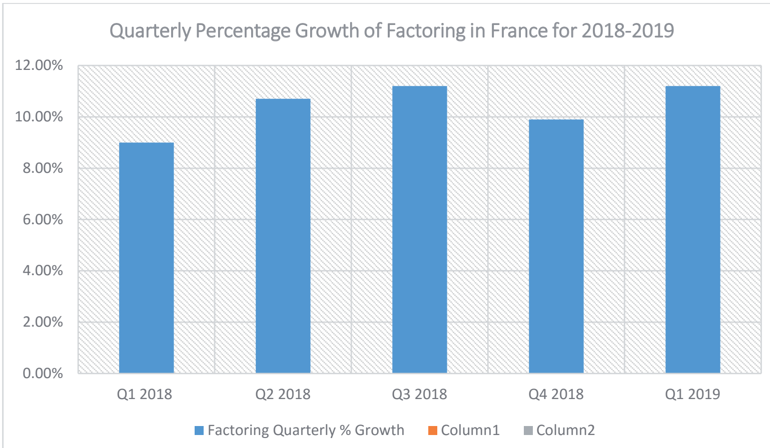
Source: EUF Factoring and Commercial Finance Newsletter 2019

In France, with a view of promoting specialization in the financial market by credit institutions, investment firms, and other financial services, the French Banking Act of 1984 established the French Association of Financial Companies (ASF) whose members are permitted to offer financial services like factoring.[114] As shown in the table below, the Association provides statistics relating to the French factoring industry. The most recent statistics show that the country's factoring industry grew in the first quarter of 2019 by 1.3% from the figure recorded in the last quarter of 2018.[115]

114 French Association of Credit and Investment Institutions available at http://www.afecei.asso.fr/Web/Afecei/content.nsf/DocumentsByIDWeb/7S6RZ2?OpenDocument&loglvl=7SGDWG accessed on 6 December 2019

115 Available at https://www.asf-france.com/wp-content/uploads/Statistiques/Affacturage/201903-Activite-Affacturage.pdf accessed on 6 December 2019

Table 7: Factoring quarterly statistics in the French financial market in 2018-2019



Source: Association française des Sociétés Financières (ASF)

Regionally, the ASF chairs the European Union Federation for the factoring and commercial finance (EUF), the Union's representative body for the factoring and commercial industry.[116] Its membership comprises the EU Member States national factoring associations and international factoring bodies e.g. Factors Chain International active in the Union. The aim of EUF is to engage the Member States governments on how their countries' enterprises can have enhanced access to finance through inter alia, factoring. The EUF is the central platform that, besides offering expert advice and opinions regarding the Union's factoring industry, brings together the Union's legislators to discuss the cross-cutting issues in the factoring industry, and offers expert advice and opinions regarding the Union's factoring industry. In addition, the function of the EUF is to ensure that Europe's factoring industry is well-structured with properly priced financial prices.[117]

Internationally, EUF has been a subdivision of Factors Chain International since its merger with International Factors Group in 2016.[118] Factors Chain

[116] EU Federation for the factoring and commercial finance industry available at https://euf.eu.com/what-is-euf/objectives/an-active-platform-in-the-eu.html accessed on 14 December 2019.

[117] Ibid.

[118] EU Federation for the factoring and commercial finance industry (n 114).

International is the global association for open account trade finance. In 2017 the EUF conducted a legal study of the EU Member States legal framework governing the factoring industry in a bid to compile the relevant information regarding national factoring industries into a single document.[119] The legal study revealed some disparities in the practice of factoring in the Member States, where some countries e.g. France, do not have a specific legislation governing its factoring industry, but rather the services are governed by the extant French fiscal framework and the EU Directives and Regulations.

Commendably, the EUF collates data as frequently as possible in a bid to inform its members of up-to-date statistics on the industry.[120] As seen in the graph below, some of the information contains a comparative analysis of the Member States practice their domestic and intra-EU factoring tendencies in order to ensure that the internal market's agendum of financial integration and free movement of capital that will enhance access to capital is achieved. In order to enhance its intra EU factoring, EUF conducts training on the best current practices in the industry, and also offers advice on how legislators can restructure their domestic legal instruments in order to ensure that a wider access to those domestic financial markets by other citizens of the Union is achieved.[121] This ensures that factors of production, such as capital, moves freely within the EU internal market.

6.1.1 Cross-border Factoring in the EU and EAC: A Comparative Analysis

The European Union draws its mandate from two treaties: the Treaty on the European Union and the Treaty on the Function of the European Union (TFEU).[122] The TFEU provides for both exclusive and shared competences of the Member States and the Union.[123] The exclusive competence of the EU include the customs union, establishing competition rules necessary for the function of the internal market, and common commercial policy.[124] Shared

[119] EUF Legal Study available at https://euf.eu.com/what-is-euf/objectives/euf-legal-study.html accessed on 14 December 2019.

[120] EUF Legal Study available at https://euf.eu.com/what-is-euf/objectives/what-is-factoring.html accessed on 14 December 2019.

[121] EUF Legal Study available at https://euf.eu.com/what-is-euf/objectives/euf-legal-study.html.

[122] Treaty on the Function of the European Union art. 1(2).

[123] Treaty on the Function of the European Union art. 2(1) & (2).

[124] Treaty on the Function of the European Union art. 3.

competence between the Member States and the Union include consumer protection, internal market, and economic, social and territorial cohesion.[125] On the other hand, the competence of the EAC is not expressly stated thus blurry. Instead, what can be interpreted as its competence is inferred from its broad objectives as proffered in the EAC Treaty Article 5. In tandem with Article 8 of the Treaty, the EAC partner states have the obligation to collaborate with the EAC regional bodies in order to ensure that the Community's objectives are achieved.

Secondly, the TFEU categorically prohibits any form of discrimination based on nationality.[126] In fact, any national of a Member State automatically and additionally becomes a citizen of the Union.[127] Such a citizen of the Union has the right to, inter alia, move freely within the Union and enjoys the privilege of free movement of other factors of production.[128] Likewise, its EAC counterpart also expressly prohibits discrimination based on nationality. However, the EAC, unlike the EU, which is a supranational organization, is an intergovernmental organization that does not grant the EAC partner states additional citizenship. This means, therefore, that the benefits of extra citizenship as envisaged by the Community are left at the mercy of the partner states.

In addition, the EU performs better than the EAC as far as free movement of capital is concerned because of the strong political will transcending the Members to their citizens. In fact, the EU has an online Single Market Scoreboard that periodically informs the Members and their citizens of the performance of the Members towards implementation of their EU obligations.[129] This is in a bid to identify non-compliance and come up with better strategies to enhance compliance. For example, in the first quarter of 2019, the EU Commission sent formal notices to Spain, Latvia and Cyprus notifying them of their failure to comply with the EU requirements established in EU Directive 2016/97 on cross-border distribution of insurance services

125 Treaty on the Function of the European Union art. 4(2).
126 Treaty on the Function of the European Union article 18.
127 Treaty on the Function of the European Union article 20(1).
128 Treaty on the Function of the European Union article 20(2).
129 European Commission Press Release Database, Member states compliance with EU law: not yet good enough dated 6 July 2017 available at https://europa.eu/rapid/press-release_IP-17-1846_en.htm accessed on 14 December 2019.

like factoring.[130] Depending on the Members compliance to EU law, they are awarded a yellow card for above average performance, green card for average, and a red card for below average performance.[131]

Further, the Scoreboard evaluates how useful the EU is in helping its citizens and their business entities by evaluating how open or closed the individual countries' markets are to intra-EU trade and investment.[132] Failure to comply with the EU law attracts sanctions in the form of financial penalties.[133] Such financial sanctions are calculated taking into account the period of non-compliance, ability of the non-compliant country to pay, and the impact of non-compliance to general and particular interests.[134]

On the flipside, EAC lacks strong political will from its partner states, to the extent that the same trickles down to their denizens' awareness and involvement in the Community's activities. This means that majority of the citizens in the EAC partner states do not fully enjoy the benefits stemming from a common market not because they do not want to, but rather because they have little or zero knowledge of the same. The same deduction cannot be deduced from the analysis of the data presented herein above concerning trade in the EU internal market because the citizens are actively involved, directly or otherwise, in the day-to-day activities of the EU institutions. In the same vein, there is little compliance with the EAC requirements as far as free movement of capital is concerned because the EAC, in its Common Market Protocol failed to provide for sanctions in the event of non-compliance.[135]

In order to expose instances of inconsistencies, this study opted for France domestic and international legal instruments governing cross-border factoring. This study's aim was not to paint France as the 'lamb without blemish' as far as its factoring industry is concerned, but rather to distil some of

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[130] European Commission Press Release Database, 'March infringements package: key decisions,*' dated 7 March 2019 available at* https://europa.eu/rapid/press-release_MEMO-19-1472_en.htm accessed on 14 December 2019.

[131] Ibid.

[132] European Commission Press Release Database, (n 128).

[133] European Commission Database, *Infringement procedure, available at* https://ec.europa.eu/info/law/law-making-process/applying-eu-law/infringement-procedure_en accessed on 13 December 2019.

[134] Ibid.

[135] The East African, *EAC Partner States delaying key regional protocol, dated 9 May 2015 available at* https://www.theeastafrican.co.ke/business/EAC-partner-states-delaying-key-regional-protocol-/2560-2710950-4sqt8t/index.html accessed on 13 December 2019.

its best practices, because despite its flaws the country has still managed to compete fairly well in the factoring market. France still underperforms in international factoring, however, despite such underperformance; it still manages to be among the top five EU countries in international factoring volumes. This chapter settled for France as the most appropriate jurisdiction to analyse because, just like the EAC partner states, it has no specific legislation governing factors alone, but rather, the industry is governed by the extant fiscal regulations and supervised by public bodies. Similarly, France, just like the EAC countries, belongs to a regional economic community whose internal market obligates it to ensure that it liberalizes its financial markets to ensure that capital moves freely in the market.

However, unlike the EAC countries, France regulation of its financial market has seen it record very high volumes in its factoring industry. It had the highest value in 2018, accounting for 19% of the total EU factoring volumes, followed by United Kingdom (18%), Germany (14%), Italy (14%), and Spain (10%), with the other EU countries accounting for the remaining 25%. The reason for such high performance is attributed to its model of financial regulation that gives effect to the requirements of the Union. Besides, unlike any of the EAC partner states, it has in place a functioning factoring national association (ASF) that closely monitors the industry and regularly provides relevant information and statistics on the trends of factoring within the country. In addition, the ASF chairs the EU federation of factoring and commercial finance, a regional representative body of factors and other financial institutions. The EUF, just like the ASF, constantly updates its Members of the trends and best practices in the regional industry. This creates more awareness of the factoring industry thus increasing access to finance to small and medium enterprises both within the Member States and out of the Union.

7. Conclusion

There is no legislative instrument exclusively governing factoring within the EAC. What exists instead are fragmented sections of the various laws, both regionally and domestically. These laws include the various agreements signed by the EAC Partner States, their respective constitutional provisions and common law underpinnings. In addition to these regional and domestic laws are the international instruments like the UNIDROIT Convention on

International Factoring (1988), UNCITRAL Convention on the Assignment of Receivables in International Trade (2001), International Factors Group Model Factoring Law (2014), and the Afreximbank Model Law on Factoring (2016). However, despite the existence of such laws, EAC Partner States still perform dismally in their factoring industries, thanks to their restrictive internal regulations. These restrictions impede free movement of capital amongst them. In order to rectify this, it is imperative that the Partner States adopt a hybrid approach to regulation of factoring since in so doing, capital movement within the common market will be advanced.

8. Recommendations

Going forward, the following, if undertaken, will facilitate the formulation of an informed and sound regulatory mechanism on factoring that will enhance free movement of capital in the EAC Common Market.

8.1 Hybrid Approach to Regulation of Factoring in the Common Market

The extant competing approaches towards regulation of factors do not take into consideration the obligations of countries to ensure they achieve the objectives of a common (or internal) market. This created inconsistencies between the EAC and its partner states regulations on cross-border movement of capital like factoring. Nonetheless, global games require global rules. This, therefore, means that the EAC partner states need to come up a with a regional "best of breed" combination that conflates narrowly-tailored government regulations and a Self-Regulatory Organization (SRO) empowered with legislative, dispute resolution and enforcement powers over the activities of non-banks institutions like factors.

8.2 Accession of UNIDROIT Convention on International Factoring

EAC lacks a subtle regional legal pathway to ensure that free movement of capital like factoring is enhanced. As a solution, this study proposes that the partner states ought to (re)consider acceding to the UNIDROIT Convention. The Convention is effective having attained its minimum ratification threshold.[136] However, none of the EAC Partner States has ratified this Convention, save for Tanzania that signed it on 28 May 1988, but has since joined its EAC sisters in not ratifying the Convention. Its plurilateral nature gives it a non-binding aspect upon the countries that have not ratified it. Given that the aim of the Convention is to provide a uniform global framework governing international factoring, it is imperative that the EAC Partner States accede to the Convention. The benefit of this is that there will be no inconsistencies in how they regulate factoring both domestically and regionally.

8.3 Accession of UNCITRAL Convention on the Assignment of Receivables in International Trade

This Convention provides a more comprehensive effort in dealing with cross-border factoring issues in comparison to the UNIDROIT Convention. Unlike the UNIDROIT Convention, the UNCITRAL Convention is yet to gain entry into force with only Luxembourg, Madagascar, and USA signing but yet to deposit their instruments of ratification, and Liberia that deposited its instrument of accession in 2005.[137] Five more actions are needed for its entry into force. The EAC Partner States, in the spirit of enhancing cross-border factoring, can (re)consider acceding to this Convention.

8.4 Additional EAC Citizenship

The reason why the EU flourishes is accredited to the additional citizenship it grants the citizens of its Members. This enables them to freely access and enjoy the benefits of an internal market. Just like the EU, EAC needs to grant additional citizenship to the partner states citizens. Efforts towards the same have been in place, including granting an EAC passport. However, such efforts are yet to bear fruits since despite the inception of the passport, more restrictive regulations are in place to hamper free movement of other factors of production.

Besides, more awareness about the activities of the EAC institutions ought to be created to educate the citizens about the benefits of belonging to

[136] The signatories include France, Italy, Nigeria, Germany, Belgium, Hungary, Latvia, Russian Federation, and Ukraine. Available at https://www/unidroit.org accessed on 13 December 2019.
[137] Information available at https://www.uncitral.org accessed on 14 December 2019.

the Common Market. Such benefits, which include free movement of factors of production like capital from factors, will enhance intra-EAC trade thus enhancing regional integration.

8.5 Sanctions for Non-compliance

The EU also has a solid foundation in terms of integration and successful implementation of its single market policies and regulations because it has a good back-up strategy in the event of non-compliance with its treaties. Such compliance or otherwise, are evaluated by the Commission, which makes periodic reports on individual countries performance and refers cases of non-compliance to the European Court of Justice which issues financial sanctions upon conviction. Such is yet to be seen in the EAC because the EAC lacks strong enforcement mechanisms to ensure compliance with its laws. As such, in order to demystify the chimera of free movement of capital within the Common Market, it is imperative that the EAC institutions come up with sanctions upon conviction on non-compliance. Perhaps this will encourage the Partner States to liberalise their factoring markets to allow cross-border investments of factors.

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