

# Lending and taking security in South Africa: overview

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## OVERVIEW OF THE LENDING MARKET

### 1. What have been the main trends and important developments in the lending market in your jurisdiction in the last 12 months?

The lending market in South Africa has seen renewed activity with a number of private equity buyouts and other corporate action being funded by bank-lending. The roll-out of a government-backed renewable energy programme saw a significant amount of activity in the project finance area.

Alternative funding mechanisms (such as the issuance of high yield bonds) continue to grow (in particular in light of the implementation of Basel III) and the lending market will continue to feel some pressure from these alternative funding sources in the near future.

## FORMS OF SECURITY OVER ASSETS

### Real estate

### 2. What is considered real estate in your jurisdiction? What are the most common forms of security granted over it? How are they created and perfected (that is, made valid and enforceable)?

#### Real estate

South African law defines real estate as "immovable property". There is no exhaustive list of what constitutes immovable property but the following are always classified as immovable property:

- Land, minerals in the soil, trees (unless in the act of falling) and growing crops of fruit.
- A building annexed to the land, if its attachment to the land is so secure that separation from it would cause substantial injury to either the land or the building. This includes all buildings or structures with foundations in the soil.
- An object which is attached to immovable property (for example, to a building which is itself immovable property), if its attachment to the immovable property is so secure that separation from it would cause substantial injury to either the immovable property or the article.

Whether buildings or objects that have separate identity and can be detached with relative ease, without causing substantial damage to the immovable property on which they are situated are considered to be part of immovable property depends on the intentions of the owner. If the owner's intention was that these objects or buildings should be annexed permanently, they are considered to be immovable property. Otherwise, these objects or buildings (for example, buildings without foundations, such as sheds, railway lines and all fixtures or annexations to buildings) are not immovable property.

An intangible asset is classified as immovable property if the tangible asset to which it relates is itself classified as immovable property (for example, mineral rights).

### Common forms of security

Security over immovable property can only be obtained by a special mortgage of immovable property as set out in the Deeds Registries Act 1937 (DRA) (*see below, Formalities*).

A mortgage bond does not transfer title in the mortgaged immovable property to the lender. It confers a limited real right on the lender to have the immovable property sold in execution, and the proceeds of that sale applied to settle, or reduce, the debt secured by the mortgage bond.

### Formalities

A special mortgage of immovable property is created by a mortgage bond. A mortgage bond is perfected by registering it at the same deeds registry where the immovable property over which the bond is granted is registered. No other method can confer a valid security over immovable property.

### Tangible movable property

### 3. What is considered tangible movable property in your jurisdiction? What are the most common forms of security granted over it? How are they created and perfected?

#### Tangible movable property

Movable property is anything which can be moved from place to place without damage to itself. Generally, all property which is not immovable property is classified as movable property. A further distinction is drawn between:

- Tangible movable property, which can be handled or touched.
- Intangible movable property, which cannot be handled or touched (for example, intellectual property, book debts and shares) (*see Questions 4 to 7*).

Tangible movable property includes aircraft and ships. There are particular formalities applying to aircraft and ships (*see below, Common forms of security*).

### Common forms of security

The most common forms of security that can be granted over tangible movable property are outlined below.

**Pledge.** A pledge is a type of mortgage of movable property given by a borrower (pledgor) in favour of a lender (pledgee) as security for a debt or other obligation. A pledge can be used as security for both tangible and intangible movable property.

**General notarial bond.** A general notarial bond is a mortgage by a borrower of all of its tangible movable property in favour of a lender as security for a debt or other obligation. However, a general notarial bond does not (in the absence of attachment of the



property before insolvency) make the lender a secured creditor of the borrower. Consequently, it is not a true mortgage of movable property, but is a means of obtaining a limited statutory preference above the claims of concurrent creditors in the borrower's insolvent estate (see *Question 24*).

**Special notarial bond.** A special notarial bond is a mortgage which:

- Is created over the tangible movable property (which can be specifically identified) of a borrower as security for a debt or other obligation.
- Meets the requirements outlined in the Security by Means of Movable Property Act 1993 (see below, *Formalities*).
- Is registered under the Deeds Registries Act 1937 (DRA).

A special notarial bond (once registered) constitutes real security in the mortgaged property as effectively as if it had been expressly pledged and actually delivered to the lender. Title to the movable property remains with the borrower, subject to the lender's security interest. Since property subject to a special notarial bond must be specifically identified, it is not appropriate for creating security over changing (fungible) assets (see *Question 8, Fungible assets*).

**Landlord's hypothec.** If rent is due and payable, but has not been paid, the lessor has a hypothec (an encumbrance giving a creditor a security interest in a debtor's movable property for so long as the movable property is on the leased property), unless the contrary is agreed. The hypothec provides the lessor with a real right of security, allowing the lessor to attach and execute the lessee's property to satisfy payment of the arrears.

**Aircraft.** Security over an aircraft (or a share in an aircraft) can only be created by a deed of mortgage in the prescribed form under the Recognition of Rights in Aircraft Act 1993, as set out in the Mortgaging of Aircraft Regulations 1997. The Convention on International Interests in Mobile Equipment 2001 and the Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment 2001 were made law in South Africa by the Convention on International Interests in Mobile Equipment Act 2007. As a result, the relevant interests constitute an international interest, and can be enforced by third-party creditors where the asset is located in South Africa. A general, or special, notarial bond cannot be created or registered over an aircraft.

**Ships.** Security over a South African ship (or a share in a South African ship) can only be created by a mortgage in the prescribed form under the Ship Registration Act 1998. The prescribed form is set out in the Ship Registration Regulations 2002. A general, or special, notarial bond cannot be created or registered over a ship.

#### Formalities

**Pledge.** An agreement must be created between the lender and the borrower together with delivery of the pledged movable property to the lender (or its agent). Title to the movable property remains with the borrower, subject to the lender's security interest. There are no registration or notification requirements for a pledge.

**General notarial bond.** The DRA does not prescribe a form for a general notarial bond. The bond must be prepared by a notary public, and is executed either:

- By the owner of the movable property subject to the bond.
- By a notary public under a formal power of attorney granted to him by the mortgagor.

Typically, a bond contains both:

- An acknowledgement of debt by the borrower for the amount of the bond.
- A declaration binding the borrower's movable property in favour of the lender as security for the debt acknowledged.

A general notarial bond must be registered at the deeds registry within three months after the date of its execution.

**Special notarial bond.** A special notarial bond for tangible movable property must identify and describe the property secured in a manner which makes the property readily recognisable. The DRA does not prescribe a particular form for this bond. It must be registered in the manner prescribed in the DRA and must be registered at the deeds registry within three months after the date of its execution.

**Landlord's hypothec.** There are no formalities.

**Aircraft.** The Commissioner for Civil Aviation will record a mortgage over an aircraft on the production of a deed of mortgage and payment of the prescribed fee. The mortgage is recorded in the register kept by the Commissioner for Civil Aviation.

**Ships.** A deed of mortgage over a ship must be presented to the Registrar of Ships and registered in the South African Ships Register.

#### Financial instruments

#### 4. What are the most common types of financial instrument over which security is granted in your jurisdiction? What are the most common forms of security granted over those instruments? How are they created and perfected?

##### Financial instruments

The most common types of financial instruments over which security can be granted are shares and debt securities.

##### Common forms of security

Security over financial instruments is usually created by either a pledge (see *Question 3, Common forms of security*) or a cession in security (or a combination of these).

A cession in security is a way of granting security over intangible movable property. It is created by the debtor (cedant) granting security by way of cession over intangible movable property in the creditor's (cessionary's) favour. It can be structured as either:

- A cession *in securitatem debiti* where title to the property remains with the cedant (as with a pledge).
- An out-and-out cession, where title to the property is transferred to the cessionary, subject to the cedant's right to have the property transferred back to it by the cessionary once the debt, or other obligation secured, is discharged.

##### Formalities

Where financial instruments are evidenced by certificates, those certificates are usually delivered with a transfer form to evidence the security and facilitate its easy enforcement, where necessary. Where financial instruments are uncertificated, the security is perfected by recording its existence on the securities account of the borrower where the financial instrument is registered. In relation to securities which are listed on a stock exchange, the securities account of the borrower is flagged in accordance with the Securities Services Act 2004.

There are no formalities for a cession in security, which is validly created once the agreement to grant security has been reached.

#### Claims and receivables

#### 5. What are the most common types of claims and receivables over which security is granted in your jurisdiction? What are the most common forms of security granted over claims and receivables? How are they created and perfected?

##### Claims and receivables

Claims and receivables include book debts and other rights under contracts such as insurance contracts and are commonly granted in South Africa.

## Common forms of security

Security over claims and receivables is usually created by a cession in security (*see Question 4, Common forms of security*).

### Formalities

There are no specific perfection requirements for a cession in security, as the act of cession itself is sufficient to perfect the security.

### Cash deposits

#### 6. What are the most common forms of security over cash deposits? How are they created and perfected?

Security over cash deposits is usually created by a cession in security of the borrower's bank account (*see Question 4, Common forms of security*).

### Intellectual property

#### 7. What are the most common types of intellectual property over which security is granted in your jurisdiction? What are the most common forms of security granted over intellectual property? How are they created and perfected?

### Intellectual property

Intellectual property includes:

- Patents.
- Trade marks.
- Copyright.
- Designs.

### Common forms of security

The form of security will depend on the type of intellectual property right over which security is being taken.

**Patents.** Security over patents can be taken either by:

- A hypothecation under section 60(5) of the Patents Act 1978. A hypothecation is the practice where a borrower pledges collateral to secure a debt.
- A cession in security (*see Question 4, Common forms of security*).

**Trade marks.** Security over registered trade marks can be taken either by:

- A hypothecation of trade marks under a deed of security under the Trade Marks Act 1993.
- A cession in security.

**Copyright.** Security over a copyright can only be taken by a cession in security.

**Designs.** Security over registered designs can be taken either by:

- A hypothecation under section 30(5) of the Designs Act 1993.
- A cession in security.

In the absence of a registered hypothecation, a transfer of intellectual property to a third party can be validly effected despite a lender's security interest. If the hypothecation has been registered against the intellectual property right, then the proprietor cannot voluntarily license the right to third parties.

### Formalities

**Patents.** A hypothecation must:

- Be recorded in writing.

- Be lodged with the Companies and Intellectual Property Commission, together with a Form P16 application to record the hypothecation.
- Have the application served on the registered proprietor of (or applicant for) the patent, as well as any other parties recorded on the register as having an interest in the patent. Proof of service must be provided to the Registrar of Patents.

**Trade marks.** The formalities for hypothecation are the same as those for patents (*see above, Patents*). However, Form TM6 must be used to record the hypothecation.

Security over unregistered trade marks is granted by a cession in security (*section 41(1), Trade Marks Act 1993*).

**Copyright.** There are no formalities for creating and perfecting copyright.

**Designs.** The formalities for hypothecation are the same as those for patents (*see above, Patents*). However, Form D7 must be used to record the hypothecation.

### Problem assets

#### 8. Are there types of assets over which security cannot be granted or can only be granted with difficulty? Which assets are difficult or problematic when security is granted over them?

### Future assets

To create genuine security in an asset, the asset must be delivered, or deemed to be delivered, to the creditor. For intangible assets, it is now generally accepted that rights to future intangible assets can be granted as security. However, when dealing with immovable assets, or intangible movable assets, at best there can only really be an undertaking by the debtor to deliver the asset (or procure the registration of a bond over the asset) once that asset is in its possession. This undertaking is nothing more than a contractual undertaking, which affords no real security. A general notarial bond can be passed over all present and future movable property, but until the property is attached and taken into the possession of the creditor, no real security is created (*see Question 3, Common forms of security*).

Intangible assets present difficulties regarding the granting of security. A person's right to grant security over an intangible asset can be restricted by common law, by agreement and by statute. Under common law the principal restrictions on a person's right to cede an intangible asset are that:

- A third-party debtor's position cannot be burdened by the cession. Therefore, a cession of a portion of a debt is not valid without the third-party debtor's consent.
- A cession which deprives a third-party debtor of a right of set-off is invalid if the debtor and the creditor have acted in bad faith to deprive the third-party debtor of the right of set-off.
- Purely personal rights are incapable of cession (for example, the rights of partners against each other), as are rights under employment contracts.

### Fungible assets

Taking security over tangible movable fungible assets presents difficulties, as the asset must be delivered to the holder of the security to create real security. A security interest in a tangible movable fungible asset is usually created using a general notarial bond, but a general notarial bond will only give the security holder a limited security interest (*see Question 3, Common forms of security*).

### Other assets

The law governing taking security over minerals in the soil, and mineral rights, is complex. Restrictions on granting security over these assets are contained in the Mineral and Petroleum Resources Development Act 2002.

## RELEASE OF SECURITY OVER ASSETS

### 9. How are common forms of security released? Are any formalities required?

Generally, once a principal obligation of a borrower is discharged, the security accessory to the principal obligation is automatically released, whether there are further formalities depends on the type of security. Certain forms of security require a further act to release the security, for example, the cancellation of a mortgage bond, special notarial bond or general notarial bond at the deeds registry.

In addition, parties can enter into a release agreement to govern the release of security.

## SPECIAL PURPOSE VEHICLES (SPVS) IN SECURED LENDING

### 10. Is it common in your jurisdiction to take security over the shares of an SPV set up to hold certain of the borrower's assets, rather than to take direct security over those assets?

Security SPVs are commonly used to create security where there are multiple lenders. The security SPV is established, which grants a guarantee to the lenders for the obligations of a borrower under a loan agreement. The borrower in turn provides an indemnity to the security SPV and the borrower secures its obligations under the indemnity by granting security to the security SPV. The shares in the security SPV are usually held by an owner trust or other administrative party. The owner trust or administrative party can be required to grant a pledge to the lenders over the shares it holds in the security SPV, although this is not a common feature of these structures.

## QUASI-SECURITY

### 11. What types of quasi-security structures are common in your jurisdiction? Is there a risk of such structures being recharacterised as a security interest?

#### Sale and leaseback

In a sale and leaseback, the owner of an asset sells it to a buyer, who then leases it back to the owner (in its capacity as lessee). The lease period is equivalent to the useful life of the asset and the rental payments are equal to the purchase price plus financing costs. The commercial effect of a sale and leaseback is similar to a secured loan to the owner in respect of the asset.

#### Factoring

In a factoring transaction (also known as a discounting transaction), the owner (seller) of receivables sells its receivables to a buyer (factor) for a discounted amount. Ownership of the receivables passes to the buyer. The benefit of this to the buyer is that, in the event of the insolvency of the seller (assuming proper title transfer), the receivables do not fall into the estate of the seller. Transfer of the receivables is effected by an out-and-out cession of the rights in the receivables being sold. Factoring is completed either on a:

- Without recourse basis. Here, the buyer (factor) assumes the risk of non-payment by the debtors.
- With recourse basis. Here, the seller of the receivables assumes the risk (wholly or partly) of non-payment by the debtors.

Factoring is commercially equivalent to a loan secured by a security interest over receivables. The risks associated with factoring are as follows:

- Care must be taken to ensure that the consent of the debtor is not required to transfer ownership of the relevant receivables, otherwise a transfer made without consent will not be effective against the debtor.
- While notification of the transfer of the receivables is not required for a valid transfer of ownership to the buyer, failure to notify the debtors continues to entitle them to make payment of the receivables to the seller in discharge of their obligations. In such circumstances the buyer (factor) will have no recourse to the debtor.
- Care must be taken to ensure that a valid transfer of ownership in the receivables occurs by way of a valid out-and-out cession of the rights to the receivables.

#### Hire purchase

A hire purchase transaction is a lease transaction which usually includes an option for the lessee to purchase the asset for an agreed (and sometimes nominal) amount at the end of the period of the lease. However, it can also provide that on payment of the last rental, ownership passes to the lessee without the need to exercise an option. This is a common method of financing movable assets, where a bank or financial institution acquires the asset of its customer, and then enters into a hire purchase transaction with the customer in respect of the asset.

All the risks and rewards of ownership of the asset are generally passed to the lessee, and so hire purchase contracts are also known as finance leases. If the lessee becomes insolvent before exercising the option, the lessor remains the owner of the asset. This is commercially equivalent to a secured loan in respect of the asset. The major risk associated with a hire purchase arrangement is ensuring that the lessor takes title to, and becomes the owner of, the asset.

#### Retention of title

This involves the sale of an asset where the buyer takes possession of the asset, but title to the asset remains with the seller until the purchase price (including a finance charge element) has been paid in full. The seller of an asset (typically a bank or financial institution) will acquire the asset from a supplier at the purchaser's request, and then sell it to the purchaser for a price (including a finance charge element). This type of transaction is also known as an instalment sale, where the purchaser pays the purchase price in instalments over an agreed period. This is commercially equivalent to a transfer of title to the buyer, who grants a security interest over the asset as security for payment of the purchase price. The major risk associated with a retention of title arrangement is ensuring that the seller takes title to, and becomes the owner of, the asset from the supplier. If the purchaser of the asset then becomes bankrupt, or is liquidated, for the purposes of winding up the estate of the purchaser, the asset is treated as forming part of the estate of the purchaser, subject to a security interest. The amount still due under the transaction is secured (the seller of the asset does not have an absolute right of retention on the insolvency of the purchaser).

#### Other structures

The other structures are:

- **Sale and repurchase agreement (repo transaction).** Under this arrangement an entity transfers absolute title in a fungible asset (typically a security) to another entity. In return, the transferee undertakes to transfer another security, equivalent to the original security, back to the transferor at the end of the transaction. On default, the parties' respective obligations terminate and are offset.

- **Rights of set-off.** This contractual arrangement allows a lender to consolidate a loan, or set-off the loan balance, against money in the borrower's bank account. Set-off also occurs by operation of law where debts in liquid form are mutually owed and simultaneously due and payable between two parties.

#### Risk of recharacterisation as a security interest

These structures are permitted under South African law and are unlikely to be recharacterised as security interests if the parties genuinely intend the contracts to have the effects stated. Sale and leaseback transactions have a higher risk of recharacterisation (as a loan secured by a security interest over the relevant asset), although the South African Supreme Court of Appeal has held that the risk of recharacterisation is low if the parties both:

- Genuinely intend ownership to pass to the purchaser (lessor) of the asset.
- Give effect to that intention by transferring ownership by a legally recognised method.

#### Application of the National Credit Act 2005

The National Credit Act 2005 governs the extension of credit by credit providers. It applies to the lease element of a sale and leaseback transaction, and to hire purchase and retention of title structures (unless they fall into one of the exemptions provided for in the Act). The exemptions include where:

- The consumer is a legal person whose asset value or annual turnover, together with the combined asset value or annual turnover of all related legal persons, at the time the agreement is made, equals or exceeds ZAR1 million.
- There is an agreement for a principal sum in excess of ZAR250,000, and the consumer is a legal person whose asset value or annual turnover is, at the time the agreement is made, below ZAR1 million.

## GUARANTEES

### 12. Are guarantees commonly used in your jurisdiction? How are they created?

Guarantees are commonly used in South Africa, to create an obligation on the guarantor (who is not the borrower) in relation to a lending transaction. The obligations of the guarantor are often secured by the guarantor granting a security interest in favour of the lender. Guarantees are also used as part of a security SPV structure (see *Question 8*).

## RISK AREAS FOR LENDERS

### 13. Do any laws affect the validity of a loan, security or guarantee (or the terms on which they are made or agreed)?

#### Financial assistance

Unless the company's constitutive documents provide otherwise, the board can authorise the company to provide financial assistance to any person for the purpose of, or in connection with, the subscription or purchase of options or securities issued or to be issued by the company or a related or inter-related company, subject to certain requirements (*section 44, Companies Act 2008*). The board cannot authorise financial assistance unless both:

- It is pursuant to either:
  - an employee share scheme that satisfies the requirements of section 97 of the Companies Act 2008;
  - a special resolution of the shareholders, adopted within the previous two years, which approved the assistance either for:
    - the specific recipient; or

- a category of potential recipients into which the specific recipient falls.

- The board of the company granting financial assistance is satisfied that:
  - immediately after providing the financial assistance the company will satisfy the solvency and liquidity test; and
  - the terms relating to the financial assistance are fair and reasonable to the company.

The board must ensure that any conditions or restrictions concerning the provision of financial assistance contained in the company's constitutive documents are satisfied.

Section 45 of the Companies Act 2008 which regulates the granting of financial assistance to a related or inter-related company imposes substantially the same requirements as section 44 of the Companies Act 2008 set out above.

#### Corporate benefit

Directors breach their fiduciary duties if they allow the company to enter into a transaction (such as a grant of guarantee or security) which is not in the company's best interests. This is not usually problematic in downstream guarantees (guarantees made by a parent company to its subsidiary), as the parent company can usually show that it derives some benefit from its subsidiary's increased financial strength.

#### Loans to directors

The provisions in relation to loans to directors are contained in section 45 of the Companies Act 2008 and are similar to those regarding the granting of financial assistance (see *above, Financial assistance*).

#### Usury

The rate of interest which can be charged by a lender under a credit agreement can be subject to limitations imposed by the National Credit Act 2005.

### 14. Can a lender be liable under environmental laws for the actions of a borrower, security provider or guarantor?

The National Environmental Management Act 1998 and the National Water Act 1998 extend the net of liability to include, among others, persons:

- Responsible for or who have directly or indirectly contributed to pollution or degradation.
- Who negligently failed to prevent the activity being performed that resulted in the pollution or degradation. Whilst the ambit of this terminology has not been tested in South African courts, it is possible that in certain circumstances, liability may extend to include a lender for the actions of a borrower, security provider or guarantor.

## STRUCTURING THE PRIORITY OF DEBTS

### 15. What methods of subordination are there?

#### Contractual subordination

It is possible to contractually subordinate a debt, and contractual subordination is common in South Africa. Subordination is achieved by agreement either between the debtor and the creditors concerned, or between the creditors concerned. Subordination of a debt can also be created for the benefit of third-party creditors who are not a party to the agreement. There is no need to comply with any specific formalities to conclude a subordination agreement, other than compliance with the normal principles required to create a valid contract.

## Structural subordination

It is possible to structurally subordinate a debt. Structural subordination is common in South Africa and can be achieved by lending at different levels of a group structure.

## Inter-creditor arrangements

Inter-creditor arrangements are common in South Africa. Parties to inter-creditor agreements typically include the relevant lenders and a security SPV. Inter-creditor agreements usually provide for the manner in which parties are to exercise their rights under loan and/or security documentation.

## DEBT TRADING AND TRANSFER MECHANISMS

### 16. Is debt traded in your jurisdiction and what transfer mechanisms are used? How do buyers ensure that they obtain the benefit of the security and guarantees associated with the transferred debt?

Secured debt is regularly traded in South Africa. Rights to security associated with transferred debt are usually transferred by the cession of the transferring creditor's rights in the security. If the rights granted include rights under mortgage bonds or notarial bonds, the cession must be registered at a deeds registry.

If only part of a debt is transferred, the debtor's consent to the transfer must be obtained (unless the document giving rise to the debt expressly permits the transfer of part of the debt without the debtor's consent).

If a security SPV structure has been used (*see Question 10*), the guarantee granted by the security SPV usually stipulates that it is granted for the benefit of all holders of the debt for which the guarantee was granted, including transferees. If the guarantee does not contain this statement, the transferring lender usually transfers the rights under the guarantee to the extent of the debt transferred.

## AGENT AND TRUST CONCEPTS

### 17. Is the agent concept (such as a facility agent under a syndicated loan) recognised in your jurisdiction?

An agency arrangement created under the law of another country is generally recognised in South Africa.

Lenders in syndicated loan or funding structures can appoint one of the finance parties to perform the role of facility agent. The facility agent role is purely administrative.

The facility agent can enforce rights on behalf of the other syndicate lenders in South African courts on the instructions of the relevant finance parties, if the relevant security documents authorise it to do so.

### 18. Is the trust concept recognised in your jurisdiction?

The trust concept is recognised in South Africa. A trust created under the law of another jurisdiction is recognised, and a security trustee can enforce its contractual rights in South African courts.

However, it is uncertain whether security can validly be created in favour of a security trustee acting as trustee for a group of lenders. This is because for a security to be lawful, a valid principal obligation (in other words, not an accessory obligation) must be owed to the grantor of that security, and the security trustee arrangement lacks this requirement. This problem cannot be overcome by having the security documents governed by a foreign law, since the proper law for a security document granting security

over property situated in South Africa is South African law. In addition, the registration of mortgage bonds and notarial bonds where security is granted in favour of an agent for a principal is prohibited (*DRA*). There is a risk under South African law that a security trustee can be seen as an agent for the lenders in relation to the security, with the result that the security was therefore not validly created.

There are three main ways to grant security which help to overcome the problem of the security trustee:

- Joint and several security. The security is granted in favour of the lenders jointly and severally. This is not commonly used as it is complex to apply and there are a number of risks associated with it (for an example, an invalid splitting of claims). The structure has also not been tested by the South African courts.
- Parallel debt obligation. A parallel debt obligation can be created where an obligation is created in the documentation owed by the borrower to the security trustee, which is equivalent to the obligation owed to the lenders. This security is then passed in the security trustee's favour as security for the parallel debt obligation.
- Security SPV structure (*see Question 10*).

## ENFORCEMENT OF SECURITY INTERESTS AND BORROWER INSOLVENCY

### 19. What are the circumstances in which a lender can enforce its loan, guarantee or security interest? What requirements must the lender comply with?

Since security is an accessory obligation (that is, an obligation that is dependent on the existence, or coming into existence, of a valid and effective principal obligation), the secured creditor can enforce its security on the default of the principal obligation.

#### Methods of enforcement

### 20. How are the main types of security interest usually enforced? What requirements must a lender comply with?

With certain types of security (such as security conferred by way of a cession in security, a pledge and a special notarial bond), the secured creditor can, without prior judgment against, or pursuit of, the security provider, procure the sale of the secured assets and apply the proceeds to satisfy the principal obligation.

For mortgage bonds or general notarial bonds, the secured creditor must first perfect the security by taking possession of the secured assets. The secured creditor must obtain a court order directing the sheriff of the High Court to attach the relevant asset. The secured creditor can then procure a sale of the assets, and apply the proceeds of the sale to discharge the principal obligation.

In some cases the secured creditor can simply agree with the borrower that the secured assets are sold without the need for judicial execution. This is known as *parate executie* (the right of a creditor to realise a borrower's property without first obtaining a court order). An agreement of *parate executie* concerning movables pledged and delivered to the secured creditor is valid provided there is no prejudice to the security provider. However, an agreement of this nature is invalid in relation to security over:

- Immovable property.
- Secured assets not in the possession of the secured creditor at the time it wishes to enforce its rights.

## Rescue, reorganisation and insolvency

### 21. Are company rescue or reorganisation procedures (outside of insolvency proceedings) available in your jurisdiction? How do they affect a lender's rights to enforce its loan, guarantee or security?

Under the Companies Act 2008, two new company rescue procedures are available.

**Compromise (section 155)** This is an arrangement between the company and its creditors, or certain classes of creditors. The board of a company or a liquidator can propose an arrangement or a compromise of the financial obligations of the company to all of its creditors or to all of the members of a class of its creditors. The proposal will be adopted if it is supported by a majority in number representing at least 75% in value of the creditors or class who are present and voting at a meeting called for that purpose.

**Business rescue proceedings (sections 128 to 154)** Business rescue can be used where a company is financially distressed, including where a company anticipates being unable to pay its debts in six months' time. It includes the sale of the whole business to generate a better return than a liquidation dividend would achieve. A company can invoke business rescue by filing a resolution at the Companies Office. To dispute this, a creditor must then make a court application and prove that the proposed business rescue would fail.

Once business rescue proceedings are commenced, a moratorium is imposed on all claims (secured and unsecured). The moratorium runs from the date the board resolution is filed (and, consequently, before notice is given to creditors and other affected persons). If a shareholder or creditor applies to the court to have the company placed into business rescue, the moratorium applies as soon as the application is issued. Following the board resolution, or court application, for business rescue, the board of directors stay in office throughout the business rescue period. The company must appoint a business rescue practitioner. The practitioner can both:

- Suspend (entirely, partially or conditionally), for the duration of business rescue, any obligation of the company arising from any pre-commencement contracts (even if that obligation arises post-commencement).
- Apply urgently to a court to cancel (entirely, partially or conditionally), on any terms that are just and reasonable in the circumstances, any agreement to which the company is a party.

A business plan must be prepared and voted on by the company's creditors. The plan must be approved by creditors whose aggregate claims against the company comprise at least 75% of the total value of all amounts owed by the company to all its creditors. At least 50% of this 75% above must be amounts owed to independent creditors (that is, creditors who are neither related to the company, nor to any of its directors (this excludes shareholders' loans)). Voting is weighted depending on the size of the claim, and employees are considered to be independent creditors. If the business plan is not formulated within a specified time, or approved by the creditors, the company must go out of business rescue, or be put into liquidation.

### 22. How does the start of insolvency procedures affect a lender's rights to enforce its loan, guarantee or security?

Under common law, once insolvency procedures are commenced, a creditor holding movable or immovable property as security cannot realise that security itself, but must deliver it to the liquidator for realisation. The secured creditor must give notice to the Master of the High Court and (if one has been appointed) the liquidator, that it holds the security before the second meeting of creditors.

However, a secured creditor can realise movable property itself provided the following procedures are followed (*Insolvency Act 1936*):

- If the property is a class of property usually sold through a stockbroker, the creditor can, before the second meeting of creditors, sell the property through a stockbroker (or if the creditor is a stockbroker, through another stockbroker).
- If the property is a financial instrument, the creditor can, before the second meeting of creditors, sell the property either:
  - through a financial instrument trader; or
  - to another financial instrument trader or financial instrument principal if the creditor is a financial instrument trader or a financial instrument principal.
- If the property is a bill of exchange the creditor can, before the second meeting of creditors, realise it in any manner approved by the liquidator or the Master of the High Court.
- If the property is a right of action, the creditor cannot realise it without the approval of the liquidator or the Master of the High Court.
- If the property is any other property the creditor can, before the second meeting of creditors, sell the property by public auction after giving:
  - the liquidator a reasonable opportunity to inspect it;
  - notice of the time and place of the sale as directed by the liquidator.

Where a secured creditor realises the security of an insolvent borrower, the creditor must pay the net proceeds to the liquidator. The secured creditor is only entitled to a payment out of such proceeds if its claim is proved and admitted under the Insolvency Act.

Where a secured creditor values its security when proving its claim the liquidator can, unless the security has already been realised, take over the relevant movable or immovable property at the value placed on it by the creditor. Take over means the liquidator buying the property from the creditor for an amount equal to the value placed on it, effectively settling the claim and freeing the property from the creditor's rights.

### 23. What transactions involving loans, guarantees, or security interests can be made void if the borrower, guarantor or security provider becomes insolvent?

The Insolvency Act allows the court to set aside dispositions made by an insolvent debtor in the following cases.

#### Disposition without value

A court will set aside an insolvent debtor's disposition where the liquidator can prove that it falls within one of the following categories:

- Dispositions of property made more than two years before the liquidation of the insolvent debtor's estate, where:
  - immediately after making the disposition, the liabilities of the insolvent debtor exceeded its assets; and
  - the disposition was not made for value.
- Dispositions of property made within two years of the liquidation of the insolvent debtor's estate which were not for value. The disposition will not be set aside if the person who benefitted from the disposition can prove that, immediately after making the disposition, the insolvent's assets exceeded its liabilities.

In either case, where it is proved that at any time after making the disposition the insolvent debtor's liabilities exceeded its assets by an amount less than the value of the property disposed of, the disposition will only be set aside to the extent of that excess.

#### Voidable preferences

The court can set aside a disposition where all the following apply:

- It is made by an insolvent debtor within six months before the date of liquidation.
- It has the effect of preferring one creditor over another.
- Immediately after the disposition, the liabilities of the insolvent debtor exceeded the value of its assets.

The setting aside of a disposition can be avoided where the person who benefitted from the disposition can prove that it was both:

- Made in the ordinary course of the debtor's business.
- Not intended to prefer one creditor over another.

#### Undue preference to creditors

The court can set aside a disposition of property made by a debtor as an undue preference where all the following apply:

- The debtor's liabilities exceed its assets.
- It was made with the intention of preferring one creditor over another.
- The debtor's estate is subsequently liquidated.
- No time limit applies.

## 24. In what order are creditors paid on the borrower's insolvency?

#### Secured assets

A secured creditor is a creditor who holds security for its claim in the form of a (*Insolvency Act*):

- Special mortgage (including a mortgage bond, special notarial bond and general notarial bond).
- Landlord's hypothec.
- Pledge.
- Right of retention.

Each secured creditor whose security is properly perfected has a secured claim over the property constituting its security. The *Insolvency Act* provides the methods by which a secured creditor's security can be realised. A proven secured claim must be paid in priority to any other claim from the realisation of that property, after the deduction of liquidation costs. The creditor is responsible for those costs, which represent the costs of maintaining, conserving and realising the property. Where secured creditors have security over the same asset, the creditor granted security earlier in time has a higher-ranking claim in respect of that asset.

A lender under a general notarial bond that takes possession of any of the property subject to the bond before the borrower's liquidation also becomes a secured creditor in respect of the property taken into its possession. Where a lender under a general notarial bond has not taken possession of the property subject to the bond, it remains an unsecured creditor.

#### Free residue

Whatever remains of the estate once the secured creditors' claims have been settled is called the free residue and is applied in the following order:

- The costs of liquidation and the costs of execution.

- Proved preferential claims to which the *Insolvency Act* (or any other statute) has assigned a preference, including:
  - the salary and wages of employees (and certain other amounts payable to, or on behalf of, employees);
  - certain statutory obligations (for example, amounts owing to the workmen's compensation fund, unemployment insurance fund, value added or other sales taxes and amounts owing to other statutory bodies);
  - taxes.
- Proved preferential claims arising from bonds giving preferences (such as general notarial bonds). The bondholder is entitled to payment out of the borrower's movable property before any concurrent (that is, unsecured) creditor. The preference is only given in respect of the movable property subject to the general notarial bond. Once the holder of a general notarial bond goes into possession of the property secured, it becomes a secured creditor (*see above, Secured assets*).
- Proved concurrent claims (that is, claims which are neither secured nor preferential). Concurrent claims include any claim for the unpaid amount of any proved secured claim (unless the secured creditor concerned has waived its right to have the balance of the claim paid out of the free residue). A secured creditor will usually waive this right when the free residue is insufficient to cover the liquidation costs (in which case, creditors with proved claims are liable for a proportionate share of such costs) (*see above, Secured assets*). Concurrent claims are paid in proportion to the amount of each concurrent claim in the insolvent estate.
- Subordinated creditors, if they have subordinated their claims to the claims of concurrent creditors.
- Shareholders (holders of preference shares generally take priority to holders of ordinary shares).

Where multiple creditors are granted the same security interest over the same asset at different times, the creditor granted security first takes priority. Creditor(s) granted security after the first-in-time creditor will generally only have security over the debtor's reversionary interest in the asset.

It is possible for creditors to agree to rank equally (*pari passu*) when creating a security interest over immovable property. It is also possible to grant security over the same asset to multiple creditors jointly and severally, although this form of joint and several security is complicated.

If a security interest has not been validly perfected, the security holder is not considered a secured creditor in respect of that asset, and ranks as a concurrent creditor.

However, the holder of a security interest under a general notarial bond will rank as a preferential creditor in respect of the borrower's movable assets, even where the general notarial bond is not perfected by the security holder by attaching the relevant assets before the borrower's insolvency.

## CROSS-BORDER ISSUES ON LOANS

### 25. Are there restrictions on the making of loans by foreign lenders or granting security (over all forms of property) or guarantees to foreign lenders?

Security over movable or immovable property can be granted in favour of foreign lenders. However, the borrower must obtain the prior approval of the South African Reserve Bank (SARB) to allow a South African resident to validly grant the security.

The prior approval of the Financial Surveillance Department of the SARB is also required before:

- Creating a loan from a foreign lender to a South African resident.
- Creating a loan from a South African resident to a foreign borrower.
- Granting a guarantee from a South African resident in favour of a non-resident, or granting a guarantee from a non-resident in favour of a South African resident.

- Aircraft mortgages.
- Ship mortgages.
- Hypothecations relating to trade marks, designs and patents.

#### Notaries' fees

Conveyancers (in relation to mortgage bonds) and notaries public (in relation to notarial bonds) are entitled to charge fees for preparing bonds. Fees are charged according to a prescribed tariff, which calculates fees on a sliding scale, based on the sum secured by the bond.

#### Court fees

Nominal court fees are payable on the enforcement of security where it is necessary to apply to court for an order entitling the lender to enforce its security. If property is attached and/or sold in execution, nominal fees are payable to the sheriff of the court in connection with any attachment and sale in execution.

### 26. Are there exchange controls that restrict payments to a foreign lender under a security document, guarantee or loan agreement?

Payments to foreign creditors arising from loan agreements or security documents require exchange control approval at the time the loan is granted, or the security is given. Where exchange control approval has been granted, an authorised dealer in foreign exchange will permit the repatriation of the proceeds of any appropriate realisation.

## TAXES AND FEES ON LOANS, GUARANTEES AND SECURITY INTERESTS

### 27. Are taxes or fees paid on the granting and enforcement of a loan, guarantee or security interest?

#### Documentary taxes

No documentary taxes are payable in connection with the granting, or taking, of security.

#### Registration fees

Nominal registration fees are payable for the registration of:

- Mortgage bonds.
- General notarial bonds.
- Special notarial bonds.

### 28. Are there strategies to minimise the costs of taxes and fees on the granting and enforcement of a loan, guarantee or security interest?

The registration fees, court fees and sheriff's fees (*see Question 27*) that are charged for the granting or taking of security are not prohibitively expensive.

Where there is a bond with a large secured sum, the fee charged by the conveyancer or notary public (once calculated at the prescribed tariff) can be prohibitively expensive. In these instances, it is usual for the lender to request a discount on the fee. Discounts of 50% are commonly negotiated.

## REFORM

### 29. Are there any proposals for reform?

The Government is looking to revise the Insolvency Act 1936 and the insolvency provisions relating to companies. There is no time line for these amendments currently in place.

## ONLINE RESOURCES

W [www.gov.za](http://www.gov.za)

**Description.** This website is the official entry point to South African government and related information. The Government documents section includes documents and publications such as the Constitution, Acts (from 1991 including Repealed Acts), Bills, Regulations, notices, policy documents, reports, and so on. Access is also provided to documents that are available on provincial government websites, and to international reports referring to South Africa. The website is developed and maintained by the Department of Communication and Information Systems.

W [www.acts.co.za/home.htm](http://www.acts.co.za/home.htm)

**Description.** Acts Online provides legislation, including amendments and regulations for free. The site aims to provide frequently referenced legislation in as complete and up-to-date a manner as is practically possible for free. However, budget and resource restrictions may prevent an Act being timeously updated. The site is developed and maintained by Guarantee Trust Hypertext Systems (Pty) Limited.

## Practical Law Contributor profile



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**Non-professional qualifications.** Bachelor of Commerce, University of Stellenbosch

#### Recent transactions

- Advised Rand Merchant Bank and Nedbank Limited in connection with a ZAR4.5 billion leveraged term and working capital facility provided to Foodcorp Proprietary Limited, a subsidiary of Remgro, to refinance certain notes issued in the international markets.
- Advising Rand Merchant Bank and Investec Bank Limited in relation to various term facilities amounting to about ZAR2.4 billion made available to Accelerate Property Fund Limited for purposes of funding various property acquisitions made by Accelerate Property Fund Limited on the date of listing of the fund.
- Advising Rand Merchant Bank, The Standard Bank of South Africa Limited, Nedbank Limited, Absa Bank Limited and The Bank of China in the negotiation and conclusion of a ZAR4.5 billion secured term and revolving facility comprised of a ZAR2.5 billion revolving credit facility and a ZAR2 billion term loan facility.
- Advising Alexander Forbes Equity Holdings Proprietary Limited and its subsidiaries, a large insurance company, on the reorganisation of its capital structure, including various debt to equity conversions, share buy backs and acquisitions of loans outstanding.

**Languages.** English, Afrikaans, German

**Professional associations/memberships.** Law Society of the Northern Provinces; International Bar Association; Banking Law Committee member.