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FOREIGN LENDERS; SOUTH AFRICAN BORROWERS

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Given South Africa's strict foreign exchange controls, it is not surprising that foreign lenders often ask if one or other regulation could prevent them from taking their money "out of South Africa". The answer is: all should be well if the i's are dotted and the t's crossed at the outset.

When a foreign lender advances a loan to a South African borrower, three key sets of laws or regulations must be considered: the South African Exchange Control Regulations, the National Credit Act and the financial assistance sections of the Companies Act, 2008. All three are pivotal to the success of lending transactions that involve a South African corporate borrower.

Borrowers must have prior approval

The Exchange Control Regulations apply to any cross-border lending transaction involving a South African borrower, and to the taking security for such a transaction. No South African corporate may borrow any foreign currency from any person who is not an authorised dealer. The only exception is if the borrower has prior approval from the Financial Surveillance Department of the South African Reserve Bank.

The onus of obtaining exchange control approval rests on the South African borrower, not the foreign lender. Even so, a foreign lender would be wise to confirm that the borrower has obtained approval properly and in good time to avoid the transaction being tainted. For this reason, the appropriate representations and warranties should be included in the transaction documentation.

Generally, once the Financial Surveillance Department has approved a loan, the interest payable and loan repayments are freely transferable from South Africa – unless the loan was made without exchange control approval. The foreign lender's claim against the South African borrower may then be at risk as the Financial Surveillance Department has the authority to prevent repayment or enforcement and could declare the loan invalid.

The most recent case law confirms that although a lack of exchange control approval does not render an agreement void, it could be declared invalid for contravening the Regulations. Also, while the Financial Surveillance Department may grant exchange control approval retrospectively, it can impose certain penalties on the South African borrower.

Another critical factor for loans from a foreign lender to a South African borrower is adherence to South African's credit law and regulations.

Foreign lenders bound by local credit law

The National Credit Act regulates the provision of credit in South Africa and Africa. Where the borrower is South African, it applies even if the credit provider is foreign and has its principal place of business outside South Africa. Lenders whose credit agreements fall under the NCA must register as "credit providers" with the National Credit Regulator.

Note that these registration requirements are triggered where credit is made available to a corporate borrower in South Africa with a net asset value or annual turnover of less than ZAR 1 million.

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Gerstle

The National Credit Regulator takes various factors into account in deciding whether a credit or loan agreement has an effect within South Africa. These include whether or not the proceeds of a loan will be remitted to South Africa; whether or not the credit facility will be used in South Africa, and whether or not any security for the loan or credit is situated in South Africa.

There are certain exemptions to the application of the NCA. If not exempted, a foreign credit provider must have the approval of the National Credit Regulator as a credit provider to lawfully extend or market loans or credit in South Africa. When a lender should be, but is not, registered with the National Credit Regulator, it will not be able to enforce a credit agreement against a South African borrower as the agreement will be void in terms of the NCA.

In addition to exchange control and credit regulations, loan transactions must also meet the financial assistance requirements of the Companies Act.

Lending equates to financial assistance

Financial assistance includes lending money and guaranteeing a loan or other obligation, as well as the security of any debt or obligation.

or indirect financial assistance to a related or inter-related company or corporation unless certain conditions are met.

One condition is that the financial assistance must relate to an employee share scheme or a special shareholders' resolution adopted within the previous two years. The other is that the board of the company providing the financial assistance (typically in the form of security in favour of the lender) should be satisfied on two counts. First, immediately after providing the financial assistance, the company must be able to satisfy the solvency and liquidity test stipulated by the Companies Act. Second, the terms proposed or the financial assistance should be fair and reasonable to the company.

Under certain circumstances, a South African company providing security may not be able to pass the solvency and liquidity test. This could happen when the financial assistance sought from the South African security provider is intended to support the entire indebtedness arising under a (multi-jurisdictional) loan, but the balance sheet of the South African security provider is less than the aggregate indebtedness.

For the success of the funding transaction, it is vital that the auditors of the company providing the financial assistance adequately advise its directors, who must satisfy themselves that the financial assistance sought is adequate to cover the indebtedness arising under the loan.

Any financial assistance provided in contravention of s45 is void and can attract personal liability for a director who votes for or fails to vote against a financial assistance resolution, knowing that this is inconsistent with this section.

Fair and reasonable financial assistance

The Companies Act provides no guidance on what constitutes fair and reasonable terms to the company granting the financial assistance. Similarly, South African case law is silent on this as the Act is still relatively new. It seems, though, that the financial wellbeing of the South African company providing the financial assistance should be the most important factor for the directors. Conversely, they should not place paramount importance on the financial health of the group to which the company belongs, to the detriment of the company itself.

Also not to be overlooked is whether the company satisfies the solvency and liquidity test immediately after providing the financial assistance, to the board's satisfaction. This introduces subjectivity in the directors' analysis and is something the board should carefully consider.

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RELIEF TO COMPANIES BY WAY OF DEBT STANDSTILL AGREEMENTS

PRESHAN SINGH-DHULAM

Given South Africa's current economic situation, it is very likely that a number of companies that are on the verge of becoming financially distressed will have to undergo a corporate restructure, failing which they will go into business rescue or liquidation. There are various red flags, such as a missed repayment on a loan facility or a ratio breach, which can signal that a company is on the verge of financial distress. One of the reasons to assist a company to remain in business, and to remain profitable, is to prevent job losses, particularly as our unemployment rates are already high.

An option available to such a company is to request its lender to standstill in enforcing a scheduled repayment to give it time to develop and finalise its financial restructuring plan. If the lender agrees, a formal debt standstill agreement will be concluded between the lender and the company.

A debt standstill can be implemented for various reasons, including to prevent the company from becoming insolvent in a situation where the company cannot meet its repayment obligations under a loan facility, thereby improving the lender's chances of getting the loan repaid. This is as opposed to a liquidation process where a lender may receive no repayment and might have to write-off the loan if no security exists or if the security is unenforceable.

A debt standstill agreement will usually regulate the following aspects:

1. A standstill period will be agreed to. The standstill period is dependent on the circumstances and can range anywhere between two to six months;
2. The lender will agree, for the duration of the standstill period, not to, *inter alia*:
   - 2.1 take any enforcement action;
   - 2.2 accelerate or demand repayment;