What foreign lenders should know about South Africa loan and credit requirements

By Lischa Gerstle

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South Africa has extensive exchange control rules that govern the inflow and outflow of capital, as well as some stringent legal requirements pertaining to credit and financial assistance, which are pivotal to the success of lending transactions involving a non-South African lender and a South African corporate borrower.

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When a foreign lender advances a loan to a South African borrower (or its group members), the country's exchange control regulations, the National Credit Act and the financial assistance section of the Companies Act are of key relevance.

Exchange control regulations

The exchange control regulations apply to any cross-border lending transaction pertaining to a South African borrower, as well as to the taking of security for such a transaction. No South African borrower is permitted to borrow any foreign currency from any person who is not an authorised dealer, unless that borrower has prior approval from the Financial Surveillance Department (FSD) 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, it is prudent for a foreign lender to confirm that the borrower has properly and timeously obtained the requisite approval.

We recommend including appropriate representations and warranties in the transaction documentation. Generally, once the FSD has approved a loan, the interest payable and loan repayments are freely transferable from South Africa. Where a loan was made without exchange control approval, the foreign lender's claim against the South African borrower could be at risk; the FSD has the authority to prevent repayment or enforcement and could declare the loan invalid. The most recent case law on this issue confirms that although a lack of exchange control approval does not render an agreement void, it could be declared invalid for contravening the regulations. While the FSD may retrospectively grant exchange control approval, it can also impose certain penalties on the South African borrower.

National Credit Act

The National Credit Act (NCA) regulates the provision of credit in South Africa and applies to all credit agreements made in or having an effect within the country.

In other words, the NCA applies even if the credit provider has its principal place of business outside South Africa. This means the provisions of the Act have general application to foreign lenders extending loans to South African borrowers. Lenders whose credit agreements fall under the NCA must register as credit providers with the National Credit Regulator (NCR).

The NCR takes various factors into account in determining whether a credit or loan agreement has an effect within South Africa. These include whether or not the proceeds of a loan from an offshore credit provider to an offshore credit receiver will be remitted to South Africa; whether or not the credit facility will be utilised in South Africa, and whether or not any security for the loan or credit is situated or located in South Africa.

There are certain exemptions to the application of the NCA. Unless exempted, a foreign credit provider must have NCR approval as a credit provider to lawfully extend loans or credit (or to market these) in South Africa. When a lender should be, but is not, registered with the NCR, it will not be able to enforce a credit agreement against a South African borrower, as the credit agreement will be void in terms of the NCA. The registration requirements with the NCR 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 R1m.

Companies Act

Section 45 of the Companies Act provides that a company may not provide direct or indirect financial assistance to a related or inter-related company or corporation unless certain conditions are met. One is that the financial assistance must be made pursuant 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.

- Immediately after providing the financial assistance, the company would satisfy the solvency and liquidity test stipulated by the Companies Act.
- The terms proposed or the financial assistance should be fair and reasonable to the company. Any financial assistance provided in contravention of section 45 is void and can attract personal liability for a director votes for or fails to vote against a financial assistance resolution knowing that this is inconsistent with section 45. Financial assistance includes lending money and guaranteeing a loan or other obligation, as well as the security of any debt or obligation.

Under certain circumstances, a South African company providing security may on a practical level not be able to pass the solvency and liquidity test required by section 45.

Specifically, 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.

Notably, 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 the matter given that the Act is still relatively new. It seems, though, that in determining whether the terms are fair and reasonable, 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. 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 should be carefully considered by the board.

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