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Must companies offering financial assistance register as credit provider?

Is a company that provides a loan to a person to buy shares in that company required to registe as a credit provider in terms of the National Credit Act 34 of 2005 (NCA)?

By Darryl Furman 5 Jul 2021

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In considering the answer one must have reference to both the NCA and the Companies Act 71 of 2008.

In terms of the NCA a loan by its very nature is a credit agreement, however its provisions do not apply to every credit agreement. One of the consequences should the NCA apply is that the company lending the funds must be registered as a credit provider at the time the credit agreement is entered into or must have applied for registration within 30 days after the credit agreement is entered into. If the lender was not registered at this time or failed to apply to be registered, the credit agreement is unlawful and may be declared void by a court.

Generally, the provisions of the NCA apply to all credit agreements between parties dealing at arm's lengt which are made within or have an effect within South Africa. There are, however, exceptions when the NC will not be applicable to such arm's length credit agreements, such as:

- where the consumer (borrower) is a juristic person whose asset value or turnover alone (or together w the combined asset value or annual turnover of all related juristic persons), at the time the credit agreement is made, equals or exceeds the prescribed threshold. The current threshold is R1m. A juristic person is defined as a partnership, association or other body of persons, corporate or unincorporated or a trust if there are three or more trustees or the trustee is itself a juristic person, bu does not include a stokvel. A juristic person is related to another juristic person if (i) one of them has direct or indirect control over the whole or part of the business of the other; or (ii) a person has direct indirect control over both of them;
- where the consumer is a juristic person whose asset value or turnover (or together with the combined asset value or annual turnover of all related juristic persons) is less than the threshold of R1m, but the credit agreement constitutes a large agreement. A credit agreement is a large agreement if it is a

"mortgage agreement" (being a credit agreement that is secured by the registration of a mortgage bo over immovable property) or any other credit transaction (except for a pawn transaction or a credit guarantee) and the principal debt under that transaction is R250,000 or above.

Should any of the above exceptions apply, the company which grants the loan does not have to register as credit provider in terms of the NCA before making the loan.

Arms length

In addition to the above exceptions, the NCA will not be applicable to credit agreements in instances wher the parties to the credit agreement are not dealing at arm's length. Although the NCA does not define the term arm's length" it does provide a non-exhaustive list of arrangements in which parties will be deemed to be not dealing at arm's length. For the purposes of this article and the question posed at the outset the following arrangements are deemed to be not at arm's length:

- a loan to a shareholder;
- any other arrangement in which each party is not independent of the other and consequently does not necessarily strive to obtain the utmost possible advantage out of the transaction.

In applying the above, it is simple to deduce that parties are not acting at arm's length in instances where a the time the loan agreement is concluded, the borrower is a shareholder of the lending company. In these instances the company will not have to register as a credit provider as a prerequisite to granting such a loa Accordingly, a loan by a company to an existing shareholder for the purpose of acquiring additional shares the company is not regulated by the NCA and accordingly, the company does not have to register as a cre provider by virtue of granting such loan.

Strict interpretation

As the NCA specifically refers to a loan to a shareholder being excluded from the application of the NCA, does this then imply that loans to non-shareholders, wanting to acquire shares in the lending company, fall within the ambit of the NCA and in all such instances a company which lends money to any non-shareholde for the purpose of acquiring shares in the lending company, and provided none of the other aforementione exceptions are applicable, must register as a credit provider before such loan is entered into? A strict interpretation of the NCA suggests that this may be the case.

Should such a strict interpretation always apply? Can a loan by a company to a non-shareholder for the purposes of acquiring shares in such company in certain circumstances be considered to be an arrangement "in which each party is not independent of the other and consequently does not necessarily strive to obtain the utmost possible advantage out of the transaction" in which case the company would no have to be registered as a credit provider?

One would think this should be the case in instances where, for example, the borrower is a director (but no shareholder) of the lending company and the loan is subject to favourable repayment terms, such as a nominal interest rate (or minimum interest rate so as not to be classified as a dividend by the South Africa Revenue Service) and repayable over an extended period of time or only from the proceeds of dividends attributable to the subject shares which are acquired.

Companies must, however, be cautious in making loans where such company is not registered as a credit

provider as one of the consequences of a company advancing a loan which falls within the ambit of the NC without being registered as a credit provider, is that a court may declare the loan to be unlawful and unenforceable. Given such a consequence companies are vulnerable to abuse by persons who may seek avoid their repayment obligations by raising the company's non-registration as a valid, albeit a technical, defence. With such a harsh consequence it may be advisable that companies register as creditor provider prior to granting loans to persons (other than shareholders) for the purpose of acquiring shares in the company.

Section 44

Companies must also take into consideration the provisions of section 44 of the Companies Act when determining the terms and conditions which will apply to loans to persons to enable them to acquire shares in such company. Section 44(3)(b) of the Companies Act provides that a board of a company may not authorise any financial assistance in terms of section 44 unless the board is satisfied that (i) immediately after providing the financial assistance, the company would satisfy the solvency and liquidity test; and (ii) the terms under which the financial assistance is proposed to be given are fair and reasonable to the company

What constitutes terms which are "fair and reasonable to the company" is not so simple to determine, for example, is the board only required to consider the commercial terms of the loan and/or whether any security provided for the repayment of the loan is adequate or is this requirement inserted to protect the interests of only the shareholders and/or creditors of the company?

If this is the case, would a loan granted at a nominal interest rate and/or contain other favourable repayment terms to a borrower, be deemed to be a loan which contains terms which are not fair and reasonable to the lending company? Therefore, while a company may offer favourable repayment terms to a non-existing shareholder in order to avoid having to register as a credit provider in terms of the NCA, they must ensure that in so doing they do not fall foul of Section 44(3)(b) of the Companies Act.

ABOUT THE AUTHOR

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