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Taking Security in South Africa

A Comparative Guide for Investors

ABOUT THIS GUIDE

In light of Africa's sustained economic growth over the last decade, the continent has become an increasingly attractive destination for investment.

However, to a foreign investor, assessing legal risk requires an understanding of the laws and the legal system particular to the jurisdictions in which the investment is being made.

Taking Security in South Africa - A Comparative Guide for Investors provides an overview of the types of assets over which security can be taken in South Africa, the different types of security, as well as the related procedures for the perfection and enforcement of such security.

This South Africa guide forms part of wider series focusing on the most active jurisdictions in Africa, and was prepared with the help of South African firm Edward Nathan Sonnenbergs.

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SOUTH AFRICA

TYPES OF SECURITY INTERESTS

What categories of assets are typically provided as security to lenders in South African financings?

Shares

In South Africa, shares in companies are issued in certificated form (evidenced by a physical share certificate) or uncertificated form (transfer thereof takes place by way of electronic entry in a central securities depository). Security over certificated shares can be created by way of a pledge agreement. Security over uncertificated shares is created by way of a security cession agreement and notation in the pledgor's securities account. Note that the doctrinal nature of cession in *securitatem debiti* is akin to that of a pledge.

Bank Accounts

A security interest over a bank account can be created by way of a security cession over the account holder's rights in the bank account, and rights against the bank in respect of that account.

Land

Security over land and other immovable property can be created by a mortgage (commonly referred to as a mortgage bond) under the Deeds Registries Act 1937.

Contractual Rights

Security over rights arising under a contract or an agreement can be created by a security cession agreement.

Insurance Proceeds

A security interest over insurance proceeds can be created by a security cession agreement.

Authorisations and Licences

The specific legislation and terms by which an authorisation or license is granted, regulates whether creating a security interest over that authorisation or licence is possible. Consent from the issuing authority will likely be required.

Intellectual Property

Security over intellectual property rights (including trademarks, copyright and designs) can be created by way of a security cession agreement, a general notarial bond or a special notarial bond. Note that security over a copyright can only be taken by a security cession agreement.

Personal Property and Tangible Assets

There are two categories of movable property: (i) corporeal movable property (such as machinery or equipment); and (ii) incorporeal movable property (such as choses in action). Security over either category of movable property can be taken by a pledge, a general notarial bond (over all the debtor's moveable assets), or a special notarial bond (over specific movable assets of the debtor). In addition, a lien may arise over corporeal movable property as a right to retain physical control of the asset to secure payment of a claim. Notarial bonds are most commonly used in South Africa.

Can security be taken over future assets?

The right to future intangible assets can be granted as security by way of a security cession agreement. The courts have adopted the notion of a cession *in anticipando*, whereby the security cession will effect a transfer of the future right when that right comes into existence, without the need for any further act of transfer, and neither party can unilaterally renege on the security cession in the interim period.

Are there any restrictions on who can legally grant and/or hold a security interest?

A grantor of security must have the requisite legal capacity to bind itself and/or its assets. This determination is made on a case by case basis. Some entities have limited capacity to grant security and these include: public entities regulated by the Public Finance Management Act, 29 of 1999; long-term insurers regulated by the Long-Term Insurance Act, 52 of 1998; and short-term insurers regulated by the Short-Term Insurance Act, 53 of 1998.

Further, the principle of *actor sequitur forum rei* applies in South African law such that the party giving security over assets cannot give more rights to the security than he holds himself.

Are security trustees or security agencies recognised under South African law? If so, do any steps need to be taken to ensure the enforceability of a security trustee's or a security agent's right in the secured property?

While security trustees or security agencies are generally not established under South African law, an agency or trustee arrangement is recognised under South African law. The South African law of agency would govern such an arrangement. Consideration must be given to whether the agent or trustee has been given the proper authority to enforce security on behalf of its principal, and the extent of that authority.

What about third-party security?

A person or entity may grant security over its own assets to secure its own obligations or the obligations of a third-party. This is often done by providing a suretyship and/or a guarantee for the obligations of the third-party.

PERFECTING SECURITY INTERESTS AND PRIORITY

Are there any asset-specific perfection requirements?

Shares

There are no formal requirements regarding certificated shares. As a practical step to enable the enforcement of security, the share certificates together with a share transfer form signed by the pledgor (and left blank as to transferee) are delivered to the pledgee. In accordance with the Financial Markets Act, 2012, a security interest over uncertificated shares is established by way of electronic entry in the securities account where the shares are held.

Bank Accounts

There are no specific requirements or formalities prescribed for establishing a security cession over a bank account. The conclusion of a valid security cession agreement is sufficient to establish the security. Best practice is for the bank to sign an acknowledgement of the pledge.

Land

The owner of the immovable property over which security is to be created, or a duly authorised conveyancer acting on the owner's behalf, must execute a mortgage bond in the presence of the Registrar of Deeds. Registration is deemed upon the Registrar's signature being affixed to the bond. The Registrar thereafter enters the mortgage in the appropriate register and endorses the registration of the bond against the title deed of the property burdened by the bond.

Contractual Rights and Insurance Proceeds

There are no specific requirements or formalities prescribed for establishing a security cession over contractual rights. The conclusion of a valid security cession agreement is sufficient to establish the security.

There are no specific requirements or formalities prescribed for establishing a South African law security interest in insurance proceeds. The conclusion of a valid security cession agreement is sufficient to establish the security. The pledgee should take possession of the policy documents.

Authorisations and Licences

Requirements in respect of security over authorisations and licences vary depending on the specific legislation under which the authorisation or licence is granted.

Intellectual Property

The security interest over trademarks, patents and registered designs must be recorded against the trademark, patent or design in the official registers maintained for that intellectual property right. In addition, the security interest must be recorded in writing and lodged with the Companies and Intellectual Property Commission (CIPC) with proof that the application has been served on the registered proprietor of the intellectual property right, together with any other parties recorded as having an interest in the intellectual property right.

As described above, there are no specific requirements or formalities prescribed for establishing a security cession over copyrights.

Personal Property and Tangible Assets

The steps required to create and perfect security interest over movable property depends on the type of security that is created, as described below.

Pledge: A pledge is established by entering into a valid security cession agreement and, in the case of corporeal property, delivery of the pledged property to the pledgee. Except as set out below, no specific formalities are required to deliver incorporeal property, but to deliver, for example, certificates evidencing the incorporeal property, is customary in order to grant the pledgee a measure of control over the pledged property. There are no registration or notification requirements for a pledge.

General Notarial Bond: A general notarial bond must be attested by a public notary and is established by registration at the deeds office in accordance with the Deeds Registries Act 1937 within three months after the date of the bond's execution, in order for the notarial bond to be enforceable against third parties. However, the creditor only acquires a right over the bonded property under a general notarial bond upon taking possession of the property.

Special Notarial Bond: A special notarial bond must be attested by a public notary and registered at the deeds office that covers the area where the property is situated, within three months after the date of the bond's execution. A special notarial bond is perfected by possession of the assets over which security is held.

Lien: There are no specific perfection requirements for a lien. A lien is established by the existence of an obligation owing to the lien-holder and the lien-holder's possession of the asset over which the lien is held.

What are the fees, costs and expenses associated with creating and perfecting security in South Africa?

Conveyancers (in relation to mortgage bonds) and public notaries (in relation to notarial bonds) are entitled to charge fees for preparing bonds according to a prescribed tariff, which calculates a fee based on the sum secured by the bond on a sliding scale, and range from 0.8% to 1.9% of the sum secured as the starting amount charged.

Nominal registration fees are payable for the registration of mortgage bonds, general notarial bonds, special notarial bonds and security interests relating to intellectual property.

On enforcement of security, nominal fees are payable to the Sheriff of the court to the extent that the Sheriff will be required to attach property.

There are no exceptions or exemptions to making such payments; however, the level of fees payable to conveyancers and public notaries can be negotiated.

Can security over the same asset be granted to two creditors? If so, how will priority be determined?

Creating a security interest over immovable property in favour of two or more creditors is possible. The ranking of the various creditors' security would have to be expressly stated in the mortgage bonds. In the absence of an express statement on the ranking of creditors' rights to the secured assets, the secured creditor whose security is registered first will presumably take priority. Regarding immovable property, a creditor can verify the priority of its security interest by inspecting the deeds register.

If more than one interest or limited interest is entered against the same uncertificated securities, priority must be granted to the interest or limited interest in the order entered in the securities account or central securities account. The order of priority in any interest or limited interest may be varied by agreement between the parties, but this variation is not effective against third parties.

The principle of *prior in tempore, potior in iure*, which means 'first in time, first in law' is applicable to security cessions. If there is a conflict between two or more security cessions, the *prior in tempore* principle implies that the security cession first in time will be preferred first in law. As such, the security interest of the first cessionary will not rank *pari passu* with the security interests of subsequent cessionaries. Subsequent cessionaries are only entitled to the balance of the proceeds once the first security interest is satisfied. The *prior in tempore* principle applies by operation of law, and this principle can only be varied if the party who was first in time agrees to have their rights subordinated.

ENFORCEMENT OF SECURITY

Outside the context of bankruptcy or insolvency proceedings, what steps should a secured party take in order to enforce its security interest?

In a default or breach of the secured obligation, generally, a secured creditor is entitled to enforce its security against the asset over which the creditor holds a security interest.

For a mortgage bond over immovable property, or a general notarial bond over all the assets of a person or entity, the secured creditor is first required to take possession of the secured assets, usually by way of attachment by the Sheriff of the High Court of South Africa, under a court order to that effect. After this, the secured creditor can sell the assets and apply the proceeds to discharge the outstanding obligation.

Except for mortgage bonds, general notarial bonds and special notarial bonds, a secured creditor can, without having to obtain a court order and without notifying the security provider, enforce security by procuring the sale of the secured assets and applying the proceeds to satisfy the principal obligation — provided this is in a contractual agreement between the parties.

A court order would always be required to enforce mortgage bonds, general notarial bonds and special notarial bonds.

Are any governmental or other consents required in connection with the enforcement of any category of security interest or against any type of asset?

There are no governmental or other consents required in connection with the enforcement of any category of security interest or against any type of asset. However, a party wishing to enforce security should consider exchange control implications and the legislation governing the asset that is the subject of a security interest.

INSOLVENCY/BANKRUPTCY PROCEEDINGS

Overview

In South Africa insolvency is regulated primarily by the Insolvency Act 24 of 1936 (the Insolvency Act). Regarding companies, the Companies Act, 71 of 2008 (the Companies Act 2008) and the Companies Act, 61 of 1973 (the Companies Act 1973 and together with the Companies Act 2008, the Companies Acts) would also apply.

Regarding banks, the Banks Act, No. 94 of 1990 would apply together with the Insolvency Act and the Companies Acts.

Regarding long-term and short-term insurers, the Long-Term Insurance Act, No. 52 of 1998 or the Short-Term Insurance Act, No. 53 of 1998 would apply together with the Insolvency Act and the Companies Acts.

Winding up or insolvency registers

No such registers exist in South Africa. A search can be conducted with the CIPC to determine whether a company is in the process of being wound up. However, this search is not always accurate because the search provides no information on whether a company is solvent, nor does it contain any information on whether an insolvency application has been launched.

Are “company rescue” or reorganisation procedures available?

Prior to commencing insolvency proceedings, there are various reorganisation procedures available under South African law:

Regarding companies, the Companies Act 2008 provides for (i) business rescue proceedings or (ii) compromises with creditors. The Financial Institutions (Protection of Funds) Act, 28 of 2001 (the Financial Institutions (POF) Act) provides for the curatorship of certain “financial institutions” (as defined in section 1 of the Financial Institutions (POF) Act). The Banks Act, 94 of 1990 (the “Banks Act”) provides for the curatorship of banks.

Business Rescue

“Business rescue” is defined in section 128(1)(b) of the Companies Act 2008 and relates to proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for temporary supervision of the company; a temporary moratorium on the rights of claimants against the company; and the development and implementation of a plan to either rescue the company by restructuring its affairs to maximise the likelihood the company can continue existing and be solvent; or, if the company cannot so continue, that results in a better return for the company’s creditors or shareholders than would result from the company’s immediate liquidation.

The test for whether a company is “financially distressed” is set out in section 128(1)(f) of the Companies Act 2008, and is satisfied if it appears reasonably unlikely that the company will be able to pay all of its debts as they become due and payable within the immediately ensuing six months; or, it appears reasonably likely that the company will become insolvent within the immediately ensuing six months.

The Companies Act 2008 provides for the appointment of a business rescue practitioner to oversee the company during business rescue proceedings.

Compromise

Section 155 of the Companies Act 2008 provides for a compromise between a company and its creditors, regardless of whether the company is financially distressed.

A company’s board of directors or liquidator (if the company is being wound up) can propose an arrangement or a compromise of the company’s financial obligations to all of its creditors, or to all of the members of a class of the company’s creditors.

The company's board of directors or liquidator, as applicable, is required to deliver the proposal to every company creditor or to every member of the relevant class of creditors, and to the CIPC. The proposal will be adopted if supported by a majority in number representing at least 75% of all the creditors or class of creditors who are present and voting at a meeting called for that purpose.

Curatorship of Financial Institutions

Under section 5 of the Financial Institutions (POF) Act, the registrar can apply to the High Court "on good cause shown" to have a curator appointed to take control of and manage the business of a "financial institution." The definition of "financial institution" in section 1 of the Financial Institutions (POF) Act includes collective investment schemes, hedge funds, long-term insurers and short-term insurers. The registrar is determined according to the financial institution in question. For example, if the financial institution is a pension fund, then the registrar would be the Registrar of Pension Funds. Or, if the financial institution was a collective investment scheme, then the registrar would be the Registrar of Collective Investment Schemes.

No meeting of creditors results from curatorship, and therefore, the secured party's contractual rights will not automatically be stayed by reason of a curatorship of a financial institution (as defined). However, while a financial institution is under curatorship, the High Court can stay all legal actions against the financial institution or issue any other order regarding the curator's powers and duties.

Bank Curatorship

Under section 69 of the Banks Act, the Minister of Finance can put a bank under curatorship if, in the opinion of the Registrar of Banks, the bank is experiencing financial difficulties and curatorship is in the public's best interest.

No meeting of creditors results from curatorship, but while the bank is under curatorship all legal actions (except as described below) against the bank are stayed, and a curator can, in terms of section 69(3) of the Banks Act, "suspend or reduce ... the right of creditors of the bank concerned to claim or receive interest on any money owing to them." A secured creditor's contractual rights would not be stayed by reason of a bank curatorship (as no concurrence of creditors results from curatorship).

Will the commencement of insolvency proceedings against a grantor of security affect the ability of a secured party/creditor to enforce the security interests granted to it by that company?

At the commencement of insolvency proceedings, a moratorium is placed on the enforcement of security against the insolvent company.

Once insolvency procedures commence, a secured creditor holding movable or immovable property as security may not as a general rule realise that security itself, but must deliver it to the liquidator of the insolvent debtor for realisation. The secured creditor must give notice to the Master of the High Court and the liquidator, that the creditor holds the security before the second meeting of creditors. Once the liquidator realises the secured property, the liquidator must pay the proceeds (less the liquidator's fees) to the secured creditor, in preference to other creditors.

Section 83 of the Insolvency Act provides for alternative procedures regarding the realisation of certain types of property held as security. For example, if the property consists of a marketable security (*i.e.*, property that is ordinarily sold through a stockbroker), a bill of exchange, or a financial instrument, the secured creditor can, before the second meeting of creditors, sell the property through a stockbroker (or if the creditor is a stockbroker, through another stockbroker).

After realising the property, the secured creditor must forthwith pay the net proceeds to the liquidator. Provided that the secured creditor can prove a valid claim against the insolvent's estate, the secured creditor will be entitled to a payment out of the proceeds of such realisation.

Section 35B of the Insolvency Act imposes a statutory netting of all obligations arising under certain master agreements. Obligations incorporated in the netting would include those of a transferee of security to return the security to the transferor. We note that security that is pledged, mortgaged or bonded to a secured party cannot be included in netting.

Are there any preference periods, claw-back rights or preferential creditors' rights that creditors should be aware of?

Under section 32 of the Insolvency Act, a court can, at the liquidator's insistence, set aside certain transactions entered into by an insolvent person/entity prior to its liquidation. These are referred to as impeachable dispositions. A disposition is any transfer or abandonment of rights to property, and can include a mortgage over immovable property, a cession, a pledge or a special notarial bond, among others.

The Insolvency Act provides for the following impeachable dispositions:

Disposition without Value

In terms of section 26 of the Insolvency Act, a court may set aside an insolvent company's disposition of property provided such disposition is not made for value. A court will set aside such a disposition if the liquidator proves that either at any time:

- More than two years before the liquidation of the insolvent's estate, the insolvent made a disposition of property and that, immediately after the disposition was made, the insolvent's liabilities exceeded its assets and the disposition was not made for value
- Within two years of the liquidation of the insolvent's estate the insolvent made a disposition of property not for value, unless the person claiming under or who benefited by the disposition proves that, immediately after the disposition was made, the insolvent's assets exceeded its liabilities

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

Voidable Preferences

Section 29 of the Insolvency Act provides for the setting aside of a disposition of an insolvent person or entity's property made within six months before the date of liquidation and has the effect of preferring one creditor above another, if, immediately after the disposition, the liabilities of the insolvent person or entity exceed the value of its assets. In these circumstances, a court can set aside the disposition.

The setting aside of such a disposition may be avoided if the person or entity in whose favour the disposition was made can prove that the disposition was made in the ordinary course of the insolvent person or entity's business, and that the disposition was not intended to prefer one creditor above another.

Undue Preference to Creditors

Section 30 of the Insolvency Act provides that if an insolvent person/entity, prior to its liquidation, made a disposition of its property at a time when the insolvent's liabilities exceeded its assets, with the intention of preferring one of its creditors above another, that disposition can be set aside.

Collusive Dealings

Section 31 of the Insolvency Act provides for the setting aside of dispositions under which the insolvent person/entity, prior to its liquidation, and in collusion with another person, disposed of its assets in a manner prejudicing the insolvent's creditors or preferring one creditor over another.

Fraudulent Dispositions

In addition to the Insolvency Act, dispositions of property prior to liquidation or sequestration can be set aside at common law, if the insolvent and the recipient of the alienation had the common intention of prejudicing other creditors. For an action to be successful, the third-party that acquired the asset must (i) have had actual knowledge of the fraud, or (ii) have not given value for the asset.

Preferential Creditors

The Insolvency Act creates preferences regarding the following claims over an insolvent estate (amongst others):

- Costs of liquidation (section 97)
- Costs of execution (section 98)
- Salary or remuneration of employees (section 98A)
- Statutory obligations (section 99)
- Income tax (section 101)
- Claims of holders of general notarial bonds and certain special notarial bonds (section 102)

Can debt a company owes a creditor be contractually subordinated to debt a company owes another creditor? Are contractual subordination provisions that are agreed among creditors legally recognised on the company's insolvency or bankruptcy?

Contractual subordination provisions agreed between creditors of a company are legally recognised if the company should become insolvent. This is subject to the qualification that they are not dispositions that can be set aside, and subject to an exception for uncertificated securities.

The Insolvency Act provides for mandatory netting of master agreements, which cannot be contracted out of as an intercreditor matter. As of the date of liquidation of the company's estate, all unperformed obligations arising out of "master agreements" are automatically terminated. These unperformed obligations include obligations regarding assets in which ownership has been transferred as security. The values of the unperformed obligations are calculated at market value as at the date of liquidation or sequestration, and the market values so calculated are netted against one another so that a net amount payable is determined.

How is priority among secured parties determined on the insolvency of the debtor?

The Insolvency Act and the Companies Act regulate the ranking of security in circumstances of insolvency. The order of priority for the ranking of creditors on the insolvency of a company is typically as follows:

- Secured creditors
- Preferential creditors
- Unsecured creditors

The Insolvency Act does not prescribe any special priority between secured creditors, since each creditor has a secured claim on a particular asset. If different creditors hold security over the same asset, the secured creditor that took security earlier in time than the other will have a higher ranking claim regarding that asset.

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