SOUTH AFRICA

Investment rules of the world

DLA PIPER

About

At DLA Piper, we have one of the largest finance and projects teams in the world with more than 600 dedicated lawyers and an established local law firm network. We share knowledge and skills in debt instruments, debt securities, funds, derivatives and portfolios, as well as energy, infrastructure and other projects, across Europe, the Middle East, Africa, Asia Pacific and the Americas.

When and wherever we work for you on finance and investment deals and projects, you can rely on our international platform; we are backed by the network and resources of one the largest and most-connected business law firms in the world.

We enjoy being part of your team, bringing experience across sectors, borders and financial products, supporting you on first-of-a-kind deals, in new markets and to grow.

With global perspective, we can help you to realize your financial strategy in whichever markets you do business.

Investment Rules of the World

With input from across our global network, this guide covers key legal topics for different financial activities and projects and gives you an overview of the points you may consider when initially looking at financing or investing in particular jurisdictions. Please contact us if you would like to discuss any legal issues or solutions for your business. We also welcome your feedback about this guide via investmentrules@dlapiper.com.

South Africa

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Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

The South African debt capital market is regulated mainly by the Financial Markets Act (FMA), the Companies Act and the Banks Act. The Collective Investment Scheme Control Act and the Exchange Control Regulations may also be applicable to some debt instrument structures.

To offer and issue debt securities, an issuer must be registered as a bank, or authorized as a branch of a foreign bank under the Banks Act or must offer and issue debt securities in compliance with one of the available exemptions. The most prominent exemption for non-bank issuers is the exemption set out in the Commercial Paper Regulations which applies to prospective issuers that are listed companies or issuers that have a net asset value of at least ZAR100 million for at least 18 months prior to any issue of commercial paper.

The offer and sale of debt securities by a non-resident in South Africa is subject to the prior approval of the Financial Surveillance Department and SARB.

The Financial Advisory and Intermediaries Services Act (FAIS) prohibits any person other than a person licensed under the FAIS from marketing debt securities, acting as an intermediary in offers and sales of debt securities and recommending or providing guidance on the purchase of securities.

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What are common issuing methods and types of debt securities?

A corporate special purpose vehicle (SPV) is commonly used for issues of asset-backed securities, high yield debt securities and other types of secured debt securities. This SPV structure is not generally used for issues of unsecured debt securities. The trust structure is not commonly used for issues of debt securities, as a trust is not the most tax-efficient way of structuring these types of transactions. However, there are circumstances where the trust structure has been used.

Types of debt instruments include:

- securities characterized by the type of interest or payment;
- debentures;
- bonds;
- notes;
- derivative instruments;

- convertible debt securities;
- exchange-traded funds or notes;
- asset-backed debt securities;
- depository receipts; and
- warrants.

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What are the differences between offering debt securities to institutional / professional or other investors?

The disclosure requirements

Section 96 of the Companies Act sets out types of offers that are not offers to the public.

They are:

- an offer to persons that deal with securities in the ordinary course of business, banks, mutual funds, financial institutions and financial services providers and wholly owned subsidiaries of banks, mutual funds, financial institutions and financial services providers; and
- an offer where the total acquisition cost of the securities for any single offeree is equal to or greater than a certain threshold, which is currently ZAR1 million.

Where the offer is not to the public, the offer does not require a prospectus.

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When is it necessary to prepare a prospectus?

If the offer is an 'offer to the public' as defined in the Companies Act, the issuer must prepare and register a prospectus satisfying the requirements of the Companies Act. There are certain exemptions as to what constitutes an 'offer to the public' (see section 96 of the Companies Act as discussed above).

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What are the main exchanges available?

JSE Limited (JSE)

Subject to compliance with both the Debt Listings Requirements and the listings requirements relating to the main market of the JSE, an issuer can list its debt securities on the main market of the JSE. An issuer may also list its debt securities on an alternative exchange of the JSE called the Interest Rate Market.

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Is there a private placement market?

Yes.

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Are there any other notable risks or issues around issuing or investing in debt securities?

Issuing debt securities and investing in debt securities

The JSE can suspend the listing of debt securities on failure by an issuer to comply with the Debt Listings Requirements of the JSE – which include ongoing disclosure obligations. The JSE can also censure the issuer (publicly or privately) or impose a fine or any other penalty that is appropriate in the circumstances.

Macro-economic risks

South Africa has recently received a credit-rating downgrade, which has prompted issuers to sidestep the bond market and opt for less public forms of fundraising. A number of South Africa's state-owned entities are in precarious financial positions with their respective corporate governance structures coming under increasingly intense public scrutiny.

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Establishing and investing in debt / hedge funds

Are there any restrictions on establishing a fund?

Generally, funds in South Africa are classified as collective investment schemes and are regulated by the Collective Investment Schemes Control Act (CISCA).

A Collective Investment Scheme is defined in CISCA as 'a scheme, in whatever form, including an open-ended investment company, in pursuance of which members of the public are invited or permitted to invest money or other assets in a portfolio, and in terms of which:

- two or more investors contribute money or other assets to and hold a participatory interest in a portfolio of the scheme through shares, units or any other form of participatory interest; and
- the investors share the risk and the benefit of investment in proportion to their participatory interest in a portfolio of a scheme or on any other basis determined in the deed'.

The primary forms of collective investment schemes are detailed in Establishing and investing in debt and hedge funds – common structures.

South Africa has recently received a credit-rating downgrade, which has prompted issuers to sidestep the bond market and opt for less public forms of fundraising. A number of South Africa's state-owned entities are in precarious financial positions with their respective corporate governance structures coming under increasingly intense public scrutiny.

The definition of 'Hedge Fund' for the purpose of applying CISCA is 'an arrangement in pursuance of which members of the public are invited or permitted to invest money or other assets and which uses any strategy or takes any position which could result in the arrangement incurring losses greater than its aggregate market value at any point in time, and which strategies or positions include but are not limited to (a) leverage; or (b) net short positions.'

Although Collective Investment Schemes do not need to be registered, all companies which wish to manage collective investment schemes (Management Companies) must register with the Registrar of the Collective Investment Schemes in terms of section 42 of CISCA. Also see Managing and marketing debt and hedge funds – investment management restrictions.

Provided that private equity funds are not made available to members of the public, the structures under which they operate are not directly regulated by the FSCA.

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What are common fund structures?

Asset managers and hedge funds

COLLECTIVE INVESTMENT SCHEMES (CIS) (BOTH HEDGE FUNDS AND UNIT TRUSTS ARE CLASSIFIED AS CISS)

CIS in securities

The portfolio consists mainly of securities and includes local funds registered with the FSCA (most collective investment schemes fall in this category).

CIS in properties

The portfolio consists mostly of shares in property investment companies or directly held property.

CIS in participatory bonds

The scheme consists mostly of participatory bonds.

Declared CIS

This is a scheme declared by the Minister of Finance as a CIS (eg hedge funds, as above).

Foreign CIS

These are foreign schemes which solicit investments from South Africans. In terms of Collective Investment Schemes Control Act (CISCA), a foreign CIS must apply to the Registrar of Collective Investment Schemes to be approved and registered.

EN COMMANDITE PARTNERSHIPS

En commandite partnerships are regulated by the common law. The main advantage of this type of partnership is that a *commanditarian*, or limited partner, is not liable for the debts of the partnership in an amount greater than its investment commitment to the partnership (provided applicable common law requirements are met). The managing partner (also known as the general partner) has unlimited liability for the debts of the partnership.

Also see Entity establishment.

DEBENTURE FUNDS

Investors in debenture structures subscribe for debentures issued by a company. The company lends or contributes the proceeds of such subscription to a trust. The trust appoints a hedge fund manager to manage its portfolio of assets, and vests income and gains resulting from the portfolio in the holders of the debentures (in their capacities as beneficiaries of the trust).

Private equity funds

EN COMMANDITE PARTNERSHIPS

See above and also see Entity establishment.

BEWIND TRUSTS

A *bewind* trust is a type of trust vehicle registered under the Trust Property Control Act, in terms which the applicable assets that are subject to the trust arrangements are owned by the beneficiaries of the trust, but the trustees of the trust hold and manage such assets. When a *bewind* trust is used for purposes of a private equity vehicle, the cash contributions of the investors to the trust form the initial assets of the trust. Each investor is a beneficiary of the trust, and the investors own the assets of the trust jointly in undivided shares in proportion to their respective contributions.

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What are the differences between offering fund securities to professional / institutional or other investors?

In terms of board notice 52 of 2015 (Financial Sector Conduct Authority (previously known as the Financial Services Board): Determination on the Requirements for Hedge Funds) (Board Notice 52) there are two categories of hedge funds, namely Qualified Investor Hedge Funds (QIHFs) and Retail Investor Hedge Funds (RIHFs).

RIHFs are aimed at the general public whilst QIHFs are aimed at more advanced investors.

There are no requirements in order to invest in an RIHF and RIHFs are able to set their own minimum investment levels.

Only '*Qualified Investors*' may invest in QIHFS. A Qualified Investor is an investor which invests a minimum investment of ZAR1 million per hedge fund and has:

- demonstrable knowledge and experience in financial and business matter which would enable the investor to assess the merits and risks of a hedge fund investment; or
- appointed a Financial Services Provider (authorized in terms of Financial Advisory and Intermediaries Services Act (FAIS)) who has demonstrable knowledge and experience to advise the investor regarding the merits of a hedge fund investment.

The regulations relating to QIHFs are not as stringent as those attached to RIHFs, with QIHFs having more autonomy over their risk profiles and not being subject to the same liquidity and exposure requirements as RIHFs. For more information, see Managing and marketing debt and hedge funds – investment management restrictions.

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Are there any other notable risks or issues around establishing and investing in funds?

For more information, see Managing and marketing debt and hedge funds – investment management restrictions.

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Managing and marketing debt / hedge funds

Are there any restrictions on marketing a fund?

In terms of the Collective Investment Schemes Control Act (CISCA), no Management Company (see Establishing and investing in debt and hedge funds – establishment) may publish any advertisement, brochure or pamphlet referred to in before the management company has been informed by the Registrar of Collective Investment Schemes that he has no objection to the terms thereof.

Qualified Investor Hedge Funds (QIHFs) may only be marketed to Qualified Investors (see Establishing and investing in debt and hedge funds – investor considerations), whilst any investor may invest in a Retail Investor Hedge Funds (RIHFs). As a result, RIHFs are more highly regulated than QIHFs in terms of the risk profile of the assets under investment.

For more information, see Managing and marketing debt and hedge funds – investment management restrictions.

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Are there any restrictions on managing a fund?

No person may manage a fund which is open to the public for investment without being registered in terms of the Collective Investment Schemes Control Act (CISCA) or licensed in terms of the Financial Advisory and Intermediaries Services Act (FAIS).

For registration of Management Companies, see Establishing and investing in debt and hedge funds – establishment.

Under FAIS, four types of licenses are issued to asset managers:

- category I (issued to financial services providers providing non-discretionary intermediary services or advice);
- category II (issued to financial services providers who provide discretionary fund management);
- category IIA (issued to financial services providers who manage hedge funds on a discretionary basis); and
- category III (issued to administrative financial services providers who aggregate client funds or securities, often through providing one-stop investment platform services).

Such license holders (Authorized Financial Services Providers) are bound by principles and rules set out in the relevant codes of conduct created by the Financial Sector Conduct Authority (previously known as the Financial Services Board) (FSCA).

Individuals exercising oversight over the rendering of financial services by a license holder under the FAIS (Key Individuals) or who represent the license holder in rendering financial services to clients (Representatives) must successfully complete certain regulatory examinations prescribed by the FSB.

Hedge fund managers must comply with the Category IIA (Hedge Fund Financial Services Provider) license requirements under FAIS in order to manage investor funds. Hedge fund managers must also register as such with the Registrar of Collective Investment Schemes in terms of section 42 of Collective Investment Schemes Control Act (CISCA).

In addition to the above, hedge funds are regulated in terms of board notice 52 of 2015 (Financial Sector Conduct Authority (previously known as the Financial Services Board)): Determination on the Requirements for Hedge Funds) (Board Notice 52), in terms of which, *inter alia*:

- Both Qualified Investor Hedge Funds (QIHFs) and Retail Investor Hedge Funds (RIHFs) must appoint a separate depository for the safekeeping of assets.
- Managers of QIHFs and RIHFs must comply with leverage, liquidity and asset exposure restrictions imposed by the FSCA. Restrictions are also placed on a fund's ability to invest in derivatives. RIHFs are placed under more stringent restrictions in terms of exposure limits and permitted securities for investment.
- All fund managers must report to the Registrar of Collective Investment Schemes on a quarterly basis, which report must contain information on, *inter alia*:
  - the value assets in long/short positions as a percentage of total assets invested;
  - the exposure permitted under the fund mandate and the actual exposure applied at quarter end;
  - the method used to calculate exposure; and
  - a list of all portfolios administered by that manager.
- Hedge fund managers must provide the Registrar of Collective Investment Schemes with their audited annual financial statement and annual report within 90 days of their year end.

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Entering into derivatives contracts

Are there any restrictions on entering into derivatives contracts?

'Derivative Instruments' are included in the definition of 'securities' under the Financial Markets Act (FMA). Any person wishing to carry on the business of buying or selling listed securities must either be an authorized user or effect such transactions through an authorized user. As such anyone wishing to enter into listed derivatives contracts in South Africa must be authorized by a licensed exchange or enlist the services of such a person.

Unlisted derivatives (OTCs), have historically been largely unregulated. The large majority of OTCs in South Africa are traded and cleared bilaterally and there have been no central risk management regimes imposed outside of the limits which the counterparties impose upon themselves.

Following the 2007-2008 financial crisis, in line with its G20 obligations, South Africa begun the process regulating OTCs and is moving towards a system of central clearing by enacting the FMA, which requires (once fully implemented) that all future derivatives trading will need to be performed through central counterparties (CCPs). The counterparties will each contract with the CCP, which will result in the CCP taking settlement risk and thus being more circumspect in the types of transactions they allow.

No CCP's have, as yet, been licensed in South Africa and the regulation of the OTC market is currently managed through increased reporting requirements on entities which bilaterally clear derivative contracts. The latest draft amendments to the FMA include provisions to allow for the JSE Limited to act as clearing agent for OTCs until 2022, at which point all CCPs will need to be independently owned and managed.

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What are common types of derivatives?

South Africa has a robust derivative market, which makes up approximately 7.5% of GDP, and as such uses all the main types of derivatives contracts, including:

- forwards;
- futures;
- swaps (such as interest rate or currency swaps); and
- options (call options and put options).

Banks are the primary traders of derivatives in South Africa and as a result the most commonly traded derivatives are:

- interest rate derivatives (swaps), which make up 85% of the derivative transactions traded in the South African domestic market; and
- foreign exchange derivatives (currency swaps), which make up approximately 12% of South Africa's derivative trading.

Commodity and Agricultural derivative contracts (futures and options) are also traded extensively in the South Africa.

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Are there any other notable risks or issues around entering into derivatives contracts?

As discussed above, South Africa has not been exempt from the regulatory attention afforded to OTC derivative trading, particularly in the last seven to ten years. As such the reporting requirements in respect of derivative transactions have become increasingly onerous and as South Africa begins licensing CCPs there will be additional compliance and regulatory costs imposed on people transacting in derivatives.

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Debt finance

Lending and borrowing

Are there any restrictions on lending and borrowing?

Lending

Unless exempted, lenders are required to be registered as credit providers and financial service providers with the applicable regulatory bodies.

Lending to individuals and/or juristic entities which fall within the scope of the National Credit Act (due to their lower level of annual turnover and asset value) is subject to greater regulatory scrutiny as the information that is required to be provided to those borrowers prior to entering into a credit is more extensive. The agreements also need to follow a prescribed format and must include certain prescribed information. There is a heavy onus on lenders in these circumstances to ensure that a borrower will not be over-indebted as a result of the credit made available by the lender to that borrower. A court may declare a contract which does not comply with the prescribed format unlawful and a lender will therefore not be able to enforce its rights thereunder.

All financial institutions are required to complete the necessary 'know-your-client' procedures in terms of the Financial Intelligence Centre Act before providing finance to a borrower. In relation to companies, these procedures involve the collection of information regarding the directors and shareholders of that company, ensuring that the company is duly registered in its jurisdiction of incorporation and that the company has filed the necessary tax returns for the preceding tax years.

Lending to state-owned enterprises and other government agencies is subject to a separate legislative regime. State-owned enterprises are created by statute and the provision of finance to those state-owned entities will need to comply with the provisions of the legislation which governs that entity as read together with the Public Finance Management Act.

Borrowing

Borrowers are generally not restricted by legislation from borrowing. There may, however, be restrictions contained in the particular borrower's constitutional documents with regards to the incurral of financial indebtedness. A detailed review of the borrower's constitutional documents should always be a prerequisite to providing financing.

Also, in relation to the provision of financial assistance, see Giving and taking guarantees and security.

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What are common lending structures?

Loans

Other than pursuant to the provisions of the National Credit Act, as contemplated above, there is no prescribed structure for lending transactions and such transactions may be tailored to suit the commercial requirements of the parties.

A loan may be provided on a bilateral basis (a single lender providing the entire facility) or on a syndicated basis (multiple lenders providing portions of the overall facility) to one or multiple borrowers.

Loan durations

The duration of the loan is subject to negotiation between the parties. Generally, the duration of loans varies between:

- **bridging loans** – short-term loans, normally for up to three to six months (there are generally tighter operational restrictions placed on the borrower and the margin is higher than longer-term loans);
- **term loans** – provided for an agreed period of time and is made available for a specific purpose (the availability period of such loans ends once the borrower has utilized the loan for the applicable purpose);
- **revolving loans** – provided for an agreed period of time and may be redrawn if repaid; and
- **working capital facilities** – made available to the borrower for a period of 365 days and is repayable on demand (these types of loans are ordinarily utilized by the borrower to fund its general working capital requirements and may be redrawn if repaid).

Loan security

Loans may be secured or unsecured. For more information, see Giving and taking guarantees and security.

Loan commitment

Loans may be committed or uncommitted. It is common, in relation to committed facilities, for the lender to charge a commitment fee for the duration of the availability period of the particular commitment. In order for a loan to qualify as being uncommitted, the provision of that loan must be subject to conditions which are in the lender's discretion (eg credit committee approval).

Loan repayment

Loan repayments vary according the commercial capabilities of the borrower and the purpose for which the transaction was implemented. Repayments vary between:

- **capital bullet** – the full amount of capital is repaid on the maturity date with interest being paid in arrears on each interest payment date (normally monthly or quarterly);
- **equal payments** – equal payments comprising capital and interest payable at set intervals during the term of the loan;

- **equal capital payments** – equal payments of capital plus accrued interest payable at set intervals during the term of the loan;
- **sculpted profile** – instalments vary according to the borrower's projected income during the term of the loan; and
- **on demand** – capital is repayable on demand with interest having been paid at set intervals during the term of the loan.

Preference shares

An alternative basis on which to provide financing is by way of subscribing for preference shares in the borrower. The advantage of using this type of funding is that the dividends that a preference shareholder receives (ie akin to the interest it would have received on a loan) is exempt from tax under South African tax legislation. In order to benefit from the exemption on dividends, the provision of finance by way of preference shares does, however, need to comply with the requirements set out in the Income Tax Act as to the purpose of such financing and the security provided for such financing. Failure to comply with the provisions of the Income Tax Act for preference share funding has the consequence that the dividends received on account of the preference shares are deemed to be interest (which is taxable) and, accordingly, the tax benefit of such preference share funding will be lost.

In the event of the insolvency of the borrower, a preference shareholder will rank behind secured creditors of the borrower and ahead of the ordinary shareholders of the borrower.

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What are the differences between lending to institutional / professional or other borrowers?

Lending to large corporations/institutional investors is less burdensome, particularly on enforcement, than lending to individuals or small corporations. Enforcement of a lender's rights under a loan advanced by a lender to an individual or any other entity regulated by the National Credit Act requires the lender to first refer the applicable borrower to a debt counsellor in order to agree a payment plan before the lender is entitled to enforce its rights under the applicable credit agreement.

A lender is also obliged to ensure that, when lending to an individual or small corporation, that individual or small corporation will not become over-indebted as a result of loan advanced by the lender. The lender must take reasonable steps to ascertain a borrower's understanding of the credit agreement it is to enter into, its debt repayment history and its existing financial means, prospects and obligations.

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Do the laws recognize the principles of agency and trusts?

Under South African law, an agent does not have *locus standi* (the right to bring an action) in litigious proceedings before South African courts. South African law therefore does not recognize the provision of security in favor of an agent (on behalf of other parties) or in favor of a trust (other than a trust which has been properly established in accordance with South African law). Further, the Deeds Registries Act does not permit registerable security (mortgage bonds, special notarial bonds and general notarial bonds) to be registered in favor of an agent. Security, under South African law, should be provided to the finance parties directly or to a special purpose vehicle (Security SPV) as described below.

For syndicated lending transactions, the most common security structure in the South African markets, involves the creation of a guarantee and indemnity structure and the interposition of a Security SPV (which is owned by an independent orphan trust). Pursuant to the structure, the special purpose vehicle issues an on demand guarantee in favor of the finance parties, in terms of which the Security SPV undertakes to guarantee the obligations of the borrower in favor of the finance parties. The security providers then enter into an indemnity agreement in terms of which the security providers indemnify the Security SPV against any claims made against it under the guarantee. All security provided by the security providers is provided in favor of the Security SPV as security for the security providers' obligations under the indemnity agreement.

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Are there any other notable risks or issues around lending?

Generally

No contractual arrangement may breach a legal rule or public policy. Legal rules may be derived from statute or from the common law whereas public policy is a subjective determination made by a judge by taking into account various policy issues, including the spirit and purport of the Constitution of South Africa.

There are a number of rules regarding the charging of interest and penalties. For instance, the *in duplum* rule states that the amount of interest charged by a lender may not exceed the capital amount of the loan. Further, under and in terms of the Conventional Penalties Act, a creditor shall not be entitled to recover, in respect of an act or omission which is the subject of a penalty stipulation, both the penalty and damages or, except where the relevant contract explicitly provides, to recover damages in lieu of a penalty. A court may also reduce a penalty where it is of the opinion that the penalty is out of proportion to the prejudice suffered by the creditor.

The rights of a creditor may also be limited by application of insolvency, reorganization, business rescue or other similar laws and a creditor may therefore not be able to enforce its rights under a finance agreement to the full extent contemplated therein.

It is important that all financial assistance resolution have been passed as a failure to do so results in the provision of such financial assistance being void. For more information, see Giving and taking guarantees and security – restrictions.

Specific types of lending

Lending to individuals and small corporations which are subject to the National Credit Act requires the lender to take greater precautions in order to ensure that the borrower will not be over-indebted. For more information, see Lending and borrowing – borrower considerations.

Standard form documentation

Most syndicated and large bilateral financing transactions are governed by loan documentation based on the recommended forms published by the Loan Markets Association and which have been tailored to suit the South African market. Documentation developed in-house by the banks is more commonly used for smaller, bilateral finance arrangements.

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Are there any other notable risks or issues around borrowing?

None.

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Giving and taking guarantees and security

Are there any restrictions on giving and taking guarantees and security?

Some of the key areas affecting the giving of guarantees and security are:

Financial assistance

When providing a guarantee or security for the obligations a related or inter-related company the guarantor or security provider must be able to comply with the financial assistance provisions and solvency and liquidity requirements as contemplated in the Companies Act. The Companies Act considers the entry into of a guarantee and/or the provision of security for the obligations of a related or inter-related company as the provision of financial assistance. Financial assistance may only be provided if the shareholders of the company, as a first step, have passed a resolution authorizing the provision of that financial assistance, in particular, or financial assistance generally. In order for a company to provide financial assistance, the shareholders of that company must have passed such a shareholder resolution within the preceding two years.

As a further step, the directors of the company will need to pass a separate resolution authorizing the provision of the financial assistance and confirming that the company will comply with financial assistance provisions as contemplated in the Companies Act which require the directors to confirm that:

- the guarantor's/security provider's assets (fairly valued) exceed its liabilities (fairly valued);
- the guarantor/security provider will be able to pay its debts as they fall due for the 12 months; and
- the terms under which the financial assistance is proposed to be given are fair and reasonable to the company.

Distributions

The companies act includes, in its definition of a distribution, the incurrence of a debt or other obligation by a company for the benefit of one or more holders of any of the shares of that company or of another company within the same group of companies. The provision of a guarantee or security by a company in respect of the obligations of a company within the same group of companies would therefore be classified as a distribution. Accordingly, the company providing that guarantee and/or security will need to comply with the applicable provisions of the Companies Act and the directors of that company will need to pass a resolution confirming that, at the time if the provision of such guarantee and/or security:

- the guarantor's/security provider's assets (fairly valued) exceed its liabilities (fairly valued); and
- the guarantor /security provider will be able to pay its debts as they fall due for the 12 months.

Capacity

The guarantor's/security provider's constitutional documents must make provision for that guarantor/security provider to enter into a guarantee and/or provide security for the obligations of a related party or a third party;

Agency

For information regarding the provision of security in favor of an agent, see Lending and borrowing – agency and trusts.

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What are common types of guarantees and security?

Common forms of guarantees

The most common type of guarantee in financing transactions is a first demand payment guarantee where the guarantor undertakes to make payment in the event of a default by the borrower.

It is important to ensure that the guarantee creates a principal obligation to pay or perform regardless of the enforceability, validity or legality of the underlying obligation. For more information, see Giving and taking guarantees and security – other issues.

Common forms of security

The most common forms of security are as follows.

PLEDGE OF SHARES

Perfection requirements include the delivery of share certificates evidencing the shares together with signed, undated share transfer forms where the shares are in certificated form or the noting of the pledge on the account held by the security provider with a central securities depository where the shares are dematerialized.

CESSION OF RIGHTS

All incorporeal rights may be cede in security, provided that the subject of that cession does not expressly prevent the cession of such rights. The most common forms of rights ceded are rights in and to insurance policies and amounts payable thereunder; bank accounts and amounts standing to the credit thereof; key customer contracts; and debtors book.

MORTGAGE BONDS

These provide real security over immovable property and are required to be registered in the South African Deeds Office nearest to where the property is located. This form of security must be prepared and filed by a conveyancing lawyer.

SPECIAL NOTARIAL BOND

A special notarial bond is provided over specified movable assets and is required to be registered in the South African Deeds Office where the security provider's principal place of business is located. This form of security must be prepared and filed by a conveyancing lawyer.

GENERAL NOTARIAL BOND

A general notarial bond is provided over the security provider's movable assets in general and is required to be registered in the South African Deeds Office where the security provider's principal place of business is located. This form of security must be prepared and filed by a conveyancing lawyer.

In relation to the Security SPV structure, also see Lending and borrowing – common structures.

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Are there any other notable risks or issues around giving and taking guarantees and security?

Giving or taking guarantees

Guarantees must explicitly state that the guarantee creates a primary obligation and not a suretyship and that the guarantor's obligations thereunder will not be affected by the enforceability, legality of validity of the underlying obligations. A suretyship under South African law creates an ancillary obligation and a defect in the underlying obligation will similarly impact the suretyship. By way of example, if a company is placed under business rescue, the business rescue practitioner is entitled to cancel certain contracts in order to improve the financial position of the company. If the main contract is cancelled, then the suretyship will too be cancelled as it is merely ancillary to the principal obligations.

If the financial assistance provisions of the Companies Act have not been complied with the provision by a company of that financial assistance will be void. Directors may, however, face personal liability, in certain instances, for failing to comply with the financial assistance provisions of the Companies Act.

Giving or taking security

Under, and in terms of, the Insolvency Act, a mortgage bond passed for the purposes of securing a debt that was not previously secured must be registered in the applicable South African Deeds Office within two months from the date on which the debt it is securing is incurred. If registration has not occurred within the aforementioned time period and the security provider is liquidated within six months from the date on which the mortgage bond was registered, the mortgage bond will not secure that debt.

It is also important for the board of directors to have confirmed that the security provider is able to comply with the provisions of the Companies Act relating to financial assistance and distributions (see above) as, upon the occurrence of the liquidation in insolvency of the security provider, a liquidator may consider the provision of the security to have been a voidable disposition and require the creditor to return the assets acquired pursuant to the enforcement of such security.

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Financial regulation

Law and regulation

What are the main laws and regulations that apply to entities that are involved in finance and investments generally?

Generally

Banks Act No. 94 of 1990
Co-Operative Banks Act No. 40 of 2007
Financial Advisory and Intermediaries Services Act No. 37 of 2002
Financial Intelligence Centre Act No. 38 of 2001
Financial Markets Act No. 19 of 2012
Income Tax Act No. 58 of 1962
Mutual Banks Act No. 124 of 1993

Consumer credit

Consumer Protection Act No. 68 of 2008
Insolvency Act No. 24 of 1936
National Credit Act No. 34 of 2005

Mortgages

Home Loan and Mortgage Disclosure Act No. 63 of 2000

Corporations

Companies Act No. 71 of 2008
Trust Property Control Act No. 57 of 1988

Funds and platforms

Collective Investment Schemes Control Act No. 45 of 2002

Energy and infrastructure

Civil Aviation Act No. 13 of 2009
Electricity Regulation Act No. 4 of 2006
Gas Act No. 48 of 2001
Independent Communications Authority of South Africa Act No. 13 of 2000
Petroleum Pipelines Act No. 60 of 2003
Preferential Procurement Framework Act No.5 of 2000

Other key market legislation

Broad-Based Black Economic Empowerment Act No.53 of 2003
Commercial Paper Regulations
Competition Act No. 89 of 1998
Conventional Penalties Act No. 15 of 1962
Currency and Exchanges Act, No. 9 of 1933 (including the Exchange Control Regulations)
Inspection of Financial Institutions Act No. 80 of 1998
Securitization Regulations

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Regulatory authorization

Who are the regulators?

The Bank Supervision Department of the South African Reserve Bank (the central bank of South Africa) (SARB), headed up by the Registrar of Banks, is responsible for regulating and supervising all banks and banking groups registered in South Africa.

The SARB and the Financial Surveillance Department of South Africa are responsible for implementing and administering South African exchange control policy and as such oversee the inflow and outflow of local currency and other local assets.

The Financial Sector Conduct Authority (previously known as the Financial Services Board) oversees the non-banking financial services industry, which includes retirement funds, short-term and long-term insurance, companies, funeral insurance schemes, collective investment schemes (unit trusts, funds and listed derivatives) and financial advisors and brokers. The Financial Sector Conduct Authority (previously known as the Financial Services Board) also supervises JSE Limited (the Johannesburg Stock Exchange).

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What are the authorization requirements and process?

Depending on the type of services a prospective applicant wishes to render in South Africa, an applicant must submit an application:

- to the Registrar of Banks, in accordance with the Banks Act in order to register as a bank in South Africa;
- in accordance with the Collective Investment Schemes Control Act (CISCA), to register as a manager of a collective investment scheme, (see Establishing and investing in debt and hedge funds); or
- to the Financial Sector Conduct Authority (previously known as the Financial Services Board) or a recognized representative body, in accordance with Financial Advisory and Intermediaries Services Act (FAIS) to become a financial services provider. FAIS regulates the activities of all non-banking financial services providers.

International banks can operate in South Africa as either a representative office or a branch with the approval of the Registrar of Banks. Each of these models is subject to the requirements of the Banks Act, and the overall regulatory oversight of the South African Reserve Bank. The authorization requirements and process (the process can take up to six months) in respect of branches are more onerous than those of representative offices, as representative offices are not authorized to accept deposits from the public.

Foreign investment funds may register as 'foreign collective investment schemes' under CISCA. In order to qualify for South African registration, a foreign fund must have an investment policy which is consistent with the requirements set out under CISCA.

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What are the main ongoing compliance requirements?

The main ongoing compliance requirements include:

- the payment of annual fees, such as licensing fees;
- if required, maintaining required levels of capital; and
- adhering to any conditions of authorization imposed by regulators, such as continuous disclosure.

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What are the penalties for failure to be authorized?

A person undertaking regulated activity without being duly authorized or exempt commits a criminal offence and is liable to imprisonment and, if applicable, fines.

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Regulated activities

What finance and investment activities require authorization?

Generally

PROVISION OF CREDIT AND OTHER REGULATED ACTIVITIES

A person who is required to register as a credit provider but who has not done so must not offer, make available or extend credit, enter into a credit agreement or agree to do any of those things without first having registered as a credit provider with the National Credit Regulator. A credit provider includes:

- any person who extends credit under a credit facility;
- a mortgagee under a mortgage agreement; and
- a lender under a secured loan agreement.

A person must apply to be registered as a credit provider if the total principal debt owed to that credit provider under all credit agreements (as defined in the National Credit Act) exceeds the prescribed threshold. With effect from 1 November 2016, the current threshold has been set at ZAR nil. This has far-reaching consequences as companies providing employee loans will be required to register as credit providers in terms of the National Credit Act. A credit arrangement will only fall within the definition of 'credit agreement' in terms of the National Credit Act if the person providing the credit will earn some form of fee (such as interest).

Banks, pension funds and other collective investment schemes are also required to obtain licenses from the relevant regulators in order to carry on their businesses. In relation to legislation applicable to these entities, see Law and regulation.

PROVISION OF ADVICE

A person may not act or offer to act as a financial services provider, unless such person has been issued with a license by the registrar of financial services. A financial services provider is any person who as a regular feature of such person's business provides any recommendation, guidance or proposal of a financial nature in respect of the purchase of, or investment in, any financial product, the conclusion of any transaction aimed at the incurring of any liability or the variation of any term relating to a financial product.

Persons not domiciled in South Africa must also obtain a license in order to provide financial advice in South Africa.

Consumer credit

See above in relation to entities which are required to be registered as credit providers and financial services providers.

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Are there any possible exemptions?

Certain persons may carry on business as a credit provider without having to register with the National Credit Regulator, for example, where that person carries on business in only one province in South Africa and it has complied with the provincial regulations applicable to it.

Financial services may also be provided without having to obtain a license if that person has been exempted from having to obtain a license under the Financial Advisory and Intermediaries Services Act.

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Do any exchange controls or other restrictions on payments apply?

Payments out of South Africa are regulated by the Exchange Control Regulations published under and in terms of the Currency and Exchanges Act. Approval must be sought for the making of such payments from the Financial Surveillance Department of the South African Reserve Bank. Applications are required to be made through specified authorized dealers (including commercial banks).

There are also tax considerations which should be taken into account particularly when financing assets which are to be imported into South Africa.

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What are the rules around financial promotions?

A credit provider must not harass a person in an attempt to persuade that person to apply for credit or to enter into a credit agreement or related transaction. Credit providers are restricted from entering into credit agreements at various times and at specific places unless they comply with a number of legislative requirements. Only persons that are registered as credit providers may advertise the availability of credit, or of goods or services to be purchased on credit.

Any advertisement concerning the granting of credit must clearly state the interest rate and other credit-related costs in the format prescribed by the applicable legislation.

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Entity establishment

What types of legal entity are generally used to undertake financial or investment activity?

Generally

PRIVATE COMPANIES

The choice for most setting up a business in South Africa. Private companies (denoted by the suffix Proprietary Limited (Pty Ltd)) are seen as separate legal, limited liability, entities and as such are taxed in their own right and offer the shareholders protection against liabilities (commonly known as the corporate veil). Private companies are not prohibited from having foreign shareholding and only require one shareholder and one director. The Companies Act, however, prohibits a private company from offering its equity to the public.

PUBLIC COMPANIES

A public company is a limited liability company incorporated to offer shares to the general public for purposes of capital raising. Public companies are identified by the suffix Limited/Ltd and have their own legal identity. Public companies must have at least three directors.

PARTNERSHIPS

A partnership is akin to a coming together of between two and 20 people who contractually agree to operate a profit-generating business together. They further agree to split any profits as per their agreement (usually in proportion to their interests). In establishing a partnership each partner needs to make a contribution, which contribution may be in cash, expertise or otherwise. A partnership is not a separate legal entity, leaving partners liable for the liabilities of the partnership and exposed to creditors of the partnership.

FOREIGN COMPANIES

Section 23(2) of the Companies Act requires a foreign company that has established a permanent 'place of business' in South Africa for more than 21 days to register as an 'external company', unless a separate legal entity (ie a private company) is established. The registered external company is colloquially referred to as a 'branch' in South Africa. The effect of registration is not to create a new legal entity, but merely results in the foreign company becoming subject to the Companies Act. Under the Companies Act, a branch does not enjoy an identity separate from that of the foreign company. Consequently, the foreign company will remain liable in respect of all acts carried on

by the branch in South Africa through its employees/agents/directors. The foreign company must operate in South Africa in its own name and the foreign country in which the foreign company is incorporated must be disclosed. This therefore creates unlimited liability in South Africa for the foreign company.

Funds

FOREIGN COLLECTIVE INVESTMENT SCHEMES

Foreign investment funds may register as 'foreign collective investment schemes' under the Collective Investment Schemes Control Act (CISCA). In order to qualify for South African registration, a foreign fund must have an investment policy which is consistent with the requirements set out under CISCA.

EN COMMANDITE PARTNERSHIPS

The principal vehicle housing South African private equity funds investing in South Africa is the limited liability partnership (called *en commandite* partnerships). A trust structure (called a *bewind* trust, and is governed by the Trust Property Control Act No. 57 of 1988) is also sometimes used. Unless the trust structure is used, there are no registration requirements for establishing, and no legislation regulating, *en commandite* partnerships.

An *en commandite* partnership is carried on by one or some of the partners, called the general or managing partner, to which every partner whose name is not disclosed (called a *commanditarian* partner or partner *en commandite*) contributes a fixed sum of money on condition that he or she receives a certain share of the profit, if there is any, but that in the event of loss he or she is liable to his or her co-partners to the extent of the fixed amount of his or her agreed capital contribution only. Because *commanditarian* partners are undisclosed, this means that they are not presented as partners, are not liable for partnership debts (enjoy limited liability), may not actively participate in the business of the partnership and cannot reclaim payment of their partnership contribution or payment of their share of the partnership profits in competition with the creditors of the partnership. The general partner of the *en commandite* partnership has unlimited liability toward creditors of the partnership in circumstances where the partnership's assets are insufficient to settle relevant debts.

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Is it possible to conduct lending or investment business through a branch or establishment?

Yes. International banks can operate in South Africa as either a representative office or a branch with the approval of the Registrar of Banks. Non-banking foreign companies may also establish branches in South Africa in accordance with the Companies Act. As set out above, registration may be required as an 'external company' as contemplated in section 23(2) of the Companies Act.

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FinTech

FinTech products and uses

What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?

South Africa is recognized as one of the main FinTech hubs in Africa. South African FinTech companies are currently focusing on mobile banking, payment services and alternative financing. Major banks and FinTech companies are slowly starting to tap into the large unbanked population and are designing FinTech products aimed at this group.

Mobile banking

South Africa has experienced exponential growth in the uptake of mobile banking, mostly due to the fact that a large percentage of the South African population lives in rural locations with limited access to traditional banking infrastructure. Socially, there is a need for

workers in urban areas to transfer money to dependents living in rural areas and with both parties having access to mobile phones, this creates a platform for the transfer of funds, thus providing banking services to the unbanked. The major South African banks have identified the need and there has been significant growth in the remittance space, through electronic wallet services.

Peer-to-peer funding platforms and marketplace lending

Lending platforms and crowdfunding arrangements are growing steadily in the South African market, in particular gaining popularity with small to medium-sized enterprises who are seeking funding. Retail and institution based interfaces have been developed by non-bank lending enterprises and the major banks and other financial institutions. In addition to corporate lending, these platforms are also being used for philanthropic purposes (an example being a major bank setting up a crowdfunding platform where individuals can contribute to assisting tertiary level students in paying their fees).

Payment services

In the mobile payment space, there are a number of startups which are receiving good traction from customers in South Africa. These startups offer a number of services, including mobile payment solutions for e-commerce and mobile businesses. There are some startups which are tackling the hugely successful funeral parlor industry, by introducing point of sale (PoS) devices which assist insurers and their clients in keeping track of payments using invoices, especially in rural areas where this this type of insurance is prone to fraud.

Blockchain, smart contracts and cryptocurrencies

The oldest and best-known cryptocurrency is bitcoin (itself based on the bitcoin platform) although many other cryptocurrencies now exist. For example, the most widely-known alternatives to bitcoin include ether based on the ethereum platform and litecoin (these cryptocurrencies are now actively traded with a large developing infrastructure for holding, pricing and exchanging currency).

Cryptocurrency attracted a lot of attention in South Africa during 2017, with significant growth in trade volumes and token values. It has also been announced that the South African Reserve Bank is currently testing regulations with regard to bitcoin and other cryptocurrencies and will be introducing new rules regarding the use of cryptocurrencies in the coming months. The South African Reserve Bank also stated that it will be carrying out feasibility studies regarding the associated technology in South Africa and increasing numbers of South African FinTech startups are being established. According to bitcoinzar.co.za there are two fully licensed exchanges, ICE Cubed and Luno, and the first bitcoin ATM in South Africa has been installed in a Johannesburg suburb. There are more than five other unlicensed bitcoin exchanges which are currently operating in South Africa.

Artificial intelligence and robo advisory systems

Automated financial advice tools, also known as 'robo advisors' are software tools driven by artificial intelligence (AI) that provide a variety of investment advice services, from portfolio selection to personal finance planning. The systems are generally operated on a platform /personal dashboard basis; a user can input a set of personalized data to be processed by the AI algorithms which produce optimized outcomes around specified parameters. AI and automated advice tools also impact the banking and private wealth advisor sectors; the implications include decreased human involvement although based on experiences elsewhere, it may be preferable to operate hybrid structures which combine AI and human inputs.

Data analysis and cloud computing

Cloud computing enables delivery of information technology services through internet-based tools and applications, rather than direct connection to a physical server. Cloud-based storage makes it possible to save masses of data to remote servers, accessible through the internet rather than by way of a physical connection. With the vast data processing and storage capabilities offered by cloud computing technology and virtually no infrastructure barriers to entry, there are a number of FinTech business targeting this space in South Africa.

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Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?

General financial regulatory regime

Although banking and financial services are tightly regulated industries in South Africa, there is currently no FinTech specific regulatory regime. FinTech activity is therefore regulated by legislation which governs lending, deposit taking, investments and electronic communications and transactions. Broadly, these laws have onerous requirements and have a focus on protecting consumers.

Electronic payments platforms and regulation of peer-to-peer lenders

ELECTRONIC PAYMENT PLATFORMS

In South Africa, there is no specific legislation that regulates electronic payment platforms and peer-to-peer (P2P) lending. However, some of the provisions contained in the National Payment Systems Act 78 of 1998 relating to payment services can have application in the context of electronic payment platforms.

PEER-TO-PEER LENDERS

P2P or marketplace lenders are largely constrained by the National Credit Act, 34 of 2005 (NCA), which subject to certain exceptions, requires all lenders to register as credit providers. The NCA also regulates fees, interest and other charges that lenders may levy. P2P lending for project development purposes may also fall within financial intermediary services within the Financial Advisory and Intermediary Services Act, 37 of 2002 (FAIS), and as a result, lending through an online platform may trigger the requirement to obtain a license as a financial services provider under sections 7 and 8 of FAIS.

There are certain exemptions in sections 44(1) and (2) of FAIS, where the registrar of financial services providers may, based on a list of factors set out in section 44(1), exempt persons or categories of persons from the section 7 authorization requirements. It may be argued that a P2P platform could be exempted under one of these headings; however, there is no regulator approved route for these businesses and currently no specific regulations addressing the P2P space.

Regulation of payment services

The National Payment Systems Act 78 of 1998 (the NPS Act) identifies and regulates two kinds of persons in the market who are non-banks.

- A 'systems operator' is non-bank authorized to provide services in respect of payment instructions. In essence, a systems operator provides the electronic means to two or more persons to make payments and/or to receive the proceeds of payment instructions. A systems operator is required to be authorized by the Payments Association of South Africa, on behalf of the South African Reserve Bank. Any entity which effectively facilitates the transfer of information between a payment portal and a payment provider or acquiring bank will be authorized as a systems operator in terms of the NPS Act.
- A 'third-party payment provider' accepts money or payment instructions from other persons for the purpose of making payments on behalf of those other persons to third parties to whom those payments are due. A third-party payment provider may hold funds in its own bank account for a short period of time prior to paying those funds over to the third party concerned. This differs from systems operators, which provide the technology for the payments but typically do not receive money or the proceeds of payment instructions.

Application of data protection and consumer laws

In South Africa, the Protection Personal Information Act 4 of 2013 (POPI), is the proposed legislative framework for the protection of personal information. POPI will only come into effect in its entirety, by presidential proclamation, on a date which is still to be determined. In the interim, the laws relating to data protection and consumer protection can be found in several pieces of legislation, with the most pertinent being the Electronic Communications and Transactions Act 25 of 2002 (ECTA) and the Consumer Protections Act 68 of 2008 (CPA). Briefly, the CPA aims to create certain protections for consumers in the marketplace and to protect consumers' rights to privacy, particularly in the context of direct marketing. ECTA also aims to provide consumer protection in the context of unsolicited goods, services and communications. In relation to the protection of personal information, ECTA merely sets out the principles to be used, when a data controller collects personal information electronically.

Money laundering regulations

In South Africa, the primary statute governing anti-money laundering is the Financial Intelligence Centre Act, 39 of 2001, as amended (FICA). FICA established a Financial Intelligence Centre and a Counter-Money Laundering Advisory Council in order to combat money laundering activities and the financing of terrorist and related activities; and it imposes certain duties on institutions and other persons who might be used for money laundering purposes and the financing of terrorist and related activities. FICA imposes obligations on

accountable institutions to conduct customer due diligence and where the institution is unable to satisfactorily verify the identity of the customer, it is precluded from entering into a business relationship with the customer, may not conclude a transaction with the customer or must terminate the relationship in line with its risk and compliance procedures. However these provisions are only applicable to accountable institutions which include financial instrument traders, persons carrying on the 'business of a bank', or persons carrying on the business of lending money against the security of securities. A number of FinTech companies may not fall within the definition of an accountable institution but may elect to comply with these provisions to manage their risk.

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What type of funding arrangements and incentives are available to FinTech businesses?

Early stage

With the current drive to grow the South African economy, attract foreign investment and ultimately increase employment in South Africa, small and medium-sized businesses in the FinTech sector are seeing an increase in funding and support opportunities from both the private and public sector.

Private loans

Given the inherent risk, unstructured loans from family or friends of founders are arguably the most viable funding option for startup and early stage FinTech businesses. FinTech businesses can also privately place shares in their enterprises in order to raise funds. In South Africa, because the angel investor community is still relatively small, the terms of this type of financing can range from relatively generous to extremely onerous. Angel investment sizes will typically range from as little as ZAR 100,000 to ZAR 4 million, with almost all such investments originating from personal relationships. Aspiring FinTech entrepreneurs with limited angel investor personal relationships can connect with the South African Business Angels Network in order to get in touch with parties interested in making angel investments.

Venture capital and debt

The South African Revenue Service and National Treasury, with effect from 1 July 2009, introduced section 12J to the Income Tax Act, 58 of 1962 (the Act) to cater for investments in venture capital (VC) companies. Section 12J of the Act allows a person who invests in VC shares through a VC company to claim an upfront tax deduction of a 100% of the amount invested. However, as an anti-avoidance measure, section 12J is subject to strict requirements that must be adhered to by both VC companies and investors. This is one of the ways in which South Africa has created an enabling environment for VC funding. VC companies in South Africa will only invest in a company that has a scalable business model and strong intellectual property with the ability to scale five to twenty times the value at which they buy in at within a limited time frame. A list of the main VC companies can be accessed through the Southern African Venture Capital and Private Equity Association website.

Crowdfunding

Given that the Financial Sector Conduct Authority (previously known as the Financial Services Board), which oversees the non-banking financial services industry in the public's interest, has not crafted any regulations around crowdfunding there is a lack of certainty and as such no encouragement or protection for investors, making crowdfunding a less attractive investment option at present. As a result, both entrepreneurs and the economy miss out on the benefits that this funding model offers. There are however a number of platforms actively setting the South African crowdfunding space, namely, RainFin (which is an online lending marketplace that connects borrowers and lenders) and Uprise.Africa (which is looking to be South Africa's first equity crowdfunding platform).

Senior bank debt and capital markets funding

SENIOR BANK DEBT

The amount of bank debt available to FinTech entrepreneurs is often limited by the security that can be offered against the loan. Senior debt requires security in the form of mortgage bonds, with security being registered over fixed assets, or in the case of term-financing of moveable assets. When making use of these forms of financing, financial institutions have no vested interest in the business' ultimate success or failure and, as such, provide no on-going business support. The collateral requirements often make this an option that is out

of reach of many aspiring FinTech entrepreneurs. However, this funding option is particularly attractive for FinTech enterprises with an existing track record and positive cash flows and those entrepreneurs wishing to retain control over the strategic direction of the enterprise.

CAPITAL MARKETS FUNDING

South Africa has both debt and equity capital markets which are accessible, subject to certain requirements, to enterprises.

EQUITY CAPITAL MARKETS

In South Africa, over the last couple of years, the sectors most actively raising finance by way of Initial Public Offering are healthcare, financial services and real estate, among others. Technology is a sector that is rapidly increasing its activity in the equity capital markets. Although, no FinTech focused business has listed on the Johannesburg Stock Exchange (JSE) to date, we have seen FinTech founders in South Africa raise funds by way of sale of business. For example, Tyme, a mobile money business, was acquired by the Commonwealth Bank of Australia, and Fundamo, a mobile based financial services enterprise, was acquired by Visa.

DEBT CAPITAL MARKETS

Subject to compliance with both the Debt Listings Requirements and the listings requirements specifically relating to the main board of the JSE, established FinTech enterprises, acting as issuers, can list debt securities on the JSE. To offer and issue debt on a public exchange securities, an issuer must be registered as a bank, or authorized as a branch of a foreign bank under the Banks Act or must offer and issue debt securities in compliance with one of the available exemptions. The most prominent exemption for non-bank issuers is the exemption set out in the Commercial Paper Regulations which applies to prospective issuers that are listed companies or issuers with a net asset value of at least ZAR 100 million for at least 18 months prior to any issue of debt securities. The offer and sale of debt securities by a non-resident in South Africa is also subject to the prior approval of the South African Reserve Bank.

PREFERENCE SHARES

Although typically reserved for larger businesses, an alternative basis on which to raise finance is by way of issuing preference shares. The advantage of using this type of funding is that the dividends that a preference shareholder receives are exempt from tax under South African tax legislation. In order to benefit from the exemption on dividends, the provision of finance by way of preference shares does, however, need to comply with the requirements set out in the Income Tax Act as to the purpose of such financing and the security provided for such financing. Failure to comply with the provisions of the Income Tax Act for preference share funding has the consequence that the dividends received on account of the preference shares are deemed to be interest (which is taxable) and, accordingly, the tax benefit of such preference share funding will be lost.

Incentives and reliefs

There are also some options for obtaining government grants which, unlike loans, are awards of money that do not need to be repaid. Grants from the South African government are typically tied in with key deliverables such as; black economic empowerment, job creation and developing the economy. The selection criteria is strict, the paperwork extensive and there are often on-going reporting obligations on the business receiving a grant. The government also offers low cost finance to entrepreneurs through state owned entities such as: the Industrial Development Corporation, the National Empowerment Fund, the Technology Innovation Agency and the Development Bank of Southern Africa. The application process for government grants and financing is highly competitive.

There are a range of FinTech accelerator programs in South Africa, which are looking to rapidly grow FinTech startups not just in South Africa but in emerging markets generally. In addition, the vast majority of large corporates in South Africa have government mandated enterprise development initiatives, which provide supplier opportunities, business support and in some instances, funding opportunities. Barclays Africa, for instance, has an established global innovation program called RISE which supports FinTech innovation, provides FinTech business development support and offers opportunities for global collaboration.

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Portfolio sales

Loan transfers and portfolio sales

What are common ways of buying and selling loans?

There is no formal market for the buying and selling of loans. Rather, these transactions are negotiated between the lender looking to sell all or part of its participation in a loan and a financial institution interested in buying that particular interest. This process may need to be performed in consultation with the borrower, unless the facility agreement provides otherwise.

The most common ways of selling loans are:

- **Assignment** – Both the rights and obligations of a lender are transferred; assignment generally requires the consent of the borrower.
- **Cession** – All or a portion of the rights of the existing lender are transferred to the new lender; this may be done without the consent of the borrower, but notice should be provided.

Most finance documents cater for an ability of the finance parties to transfer with or without consent or to any persons listed on agreed list of transferees. The general market position is that no consent is required to transfer all or a portion of a loan following the occurrence of a default.

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What are the main considerations when transferring a loan and related security?

The mains considerations for transferring a loan and related security are whether:

- the underlying contract allows for such transfer;
- there are limitations on the financial institutions to whom the loan and related security may be transferred;
- the consent of the borrower or any other party is required for such transfer;
- there are any other formalities that need to be adhered to for the transfer of a loan and related security;
- the transfer will prejudice the borrower; and
- costs.

Using a Security SPV structure for syndicated transactions (see above) obviates the need for security to be re-registered in the event of a transfer of the loan. The timing and costs associated with transferring a loan are reduced considerably as a result of using this structure.

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Projects

Financing / investing in energy / infrastructure

To what extent are energy and infrastructure assets publicly or privately owned?

Generally

The ownership of infrastructure in South Africa is a combination of private, public (directly by government or through state-owned enterprises) and public-private partnerships. This applies to a large extent in respect of both economic infrastructure (energy, aviation, telecommunications and roads) and social infrastructure (education, health and housing).

The state has, however, maintained a near monopoly when it comes to rail infrastructure and to a large extent the corrections/prisons infrastructure (there are only two 'privately owned' prisons in South Africa and the South African government has stopped granting concessions to private corporations for the construction of private prisons).

Energy

Eskom Holdings SOC Limited, a state-owned enterprise (SOE) owns the bulk of the energy generation and transmission infrastructure in South Africa. The infrastructure ranges from a nuclear power plant (Koeberg Power Station in Cape Town), a hydro-electric power plant (Gariep Power Station), an open cycle gas turbine plant (Ankerlig Power Station), various coal fired power plants (such as Lethabo Power Station), a pumped storage scheme (Palmiet Power Plant) and various wind farm projects (such as Sere Power Station). Eskom is in the process of constructing a number of new coal fired power plants, the most prominent of which are Medupi Power Station and Kusile Power Station which are expected to be completed by 2021 and 2023 respectively.

In and around 2010 the government of South Africa launched a renewable energy program which saw a number of Independent Power Producers entering the energy sector and by the end of October 2016 Eskom had procured approximately 6400 MW from 102 Independent Power Producers. There have been five bid windows during which independent power producers bid for the right to set up renewable energy projects. The renewable energy projects are a mixture of wind, solar photovoltaic, biomass, biogas, and concentrated solar thermal plants.

The National Energy Regulator (NERSA) is the regulatory body tasked with the regulation of the electricity, piped-gas and petroleum pipelines industries in terms of the Electricity Regulation Act, the Gas Act and the Petroleum Pipelines Act.

The Independent Power Producer Procurement Programme is administered by the IPPPP Unit which was established by the Department of Energy (DoE), National Treasury and the Development Bank of Southern Africa (DBSA) for the purposes of delivering on the Independent Power Producer procurement objectives.

Telecoms infrastructure

Ownership of infrastructure in telecoms is also a combination of private and public (through an SOE) ownership. Telkom SA SOC Limited owns the bulk of the wireline telecommunications infrastructure and also owns a sizeable portion of the wireless telecommunications infrastructure. Wireless telecommunications infrastructure is mostly privately owned, with Vodacom and MTN being the largest players in this space.

The Independent Communications Authority of South Africa (ICASA) is the regulator for the South African communications, broadcasting and postal services sector. It was established in terms of the Independent Communications Authority of South Africa Act.

Transport infrastructure

RAIL INFRASTRUCTURE

Transnet SOC Limited, through its Transnet Freight Rail division (Transnet Freight Rail), controls the heavy rail infrastructure sector and owns the majority of South Africa's extensive national rail network, representing approximately 80% of Africa's total rail network as well as rolling stock.

The Passenger Rail Agency of South Africa SOC Limited (PRASA), an SOE, controls the passenger rail sector and owns a portion of South Africa's national rail network through its Metrorail and Mainline Passenger Service divisions.

The Bombela Concession Company (RF) Proprietary Limited owns and operates the Gautrain rapid train service which services commuters from Sandton to O.R Tambo Airport and Pretoria to Park Station (Johannesburg CBD). The Bombela consortium is owned by private shareholders.

ROAD TRANSPORT INFRASTRUCTURE

Ownership of the road network is held by the state (through the South African National Roads Agency SOC Limited (SANRAL)), with concessionaires (the Bakwena Concession (Bakwena), the N3TC Concession (N3TC) and the TRAC Concession (TRAC)) performing infrastructural development and management on three major national routes.

AVIATION

Cargo and passenger aviation is a combination of state and private ownership. South African Airways SOC Limited and its divisions dominate the local passenger routes, however, there are a number of private passenger airlines which operate within South Africa. ComAir (through the British Airways franchise and Kulula) is the longest surviving private commercial passenger aviation company. A number of private airlines have taken to the skies since 1994, however, most of them have since been liquidated amid a harsh operating environment due to their failure to compete with the state-owned airlines and their access to public funds.

The major airports are owned and managed by the Airports Company South Africa (majority owned by the South African Government) most notably O.R Tambo International Airport and Cape Town International Airport. The only other international accredited airport in Johannesburg, Lanseria International Airport is privately owned and is host to a number of commercial and charter airlines.

The South African Civil Aviation Authority (established in terms of the Civil Aviation Act) is responsible for the regulation of the aviation industry in South Africa.

PORTS AND PORT TERMINALS

Transnet, through its various divisions dominates infrastructure ownership in this sector.

Transnet, through its National Ports Authority division (National Ports Authority) owns and provides port infrastructure at the eight commercial seaports in South Africa. The National Ports Authority owns 19 container berths, 36 dry-bulk berths, 29 break-bulk berths, 13 liquid-bulk berths and eight entrance channels with supporting breakwaters, turning basins, networks and utilities.

Transnet, through its Transnet Port Terminals division (Transnet Port Terminals) owns infrastructure or packing and unpacking of containers, agricultural, breakbulk and mineral bulk.

Transnet, through its Transnet Pipelines division (Transnet Pipelines) transports 100% of South Africa's bulk petroleum products and owns a petroleum and gas transportation pipelines. It also owns a tank farm capable of carrying 30 million litres of petroleum products.

Other infrastructure

DEFENSE INFRASTRUCTURE

Defense infrastructure is owned by the state.

EDUCATION INFRASTRUCTURE

Ownership of education infrastructure is a combination of public and private ownership with public schools being in the majority. There are a number of prominent private schools which service the middle to high income market with two of the big private school players ie Curro and Advtech being listed on the JSE.

HOSPITAL INFRASTRUCTURE

Ownership of health facilities is a combination of public and private ownership. There a number of private entities operating health centers most notably Netcare and Mediclinic hospitals.

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Are there special rules for investing in energy and infrastructure?

Generally

The overarching consideration for any investment in infrastructure in South Africa, especially where government or regulatory consent is required, is the impact on the country's transformation agenda ie the impact of black economic empowerment (BEE). For example, in the renewable energy sector, each project has been required to have a certain level of black (as defined in the Broad-based Black Economic Empowerment Act) ownership. The Development Bank of Southern Africa provided the primary project finance funding for many of the BEE investors wishing to invest in these projects, allowing for greater participation by historically disadvantaged South Africans in the projects, as investors and developers.

Energy

This is a very regulated sector regardless of the type of energy infrastructure involved and there is a complex licensing regime which usually has the attainment of certain ownership thresholds for example, black ownership and procurement as prerequisites. Accordingly, potential investors must consider the impact of their investment on any licenses held by the investee entity as well as any potential local partners. Any investment that potentially dilutes black ownership in a project is unlikely to receive regulatory approval.

Telecoms infrastructure

South Africa's telecommunications sector is regulated by a number of statutes that enforce certain requirements for applications for different licenses and approvals to establish and operate telecommunications infrastructure.

The Independent Communications Authority of South Africa (ICASA) is the regulator for both the telecommunications and broadcasting sectors. A company wishing to deploy and operate a physical network will require an Electronic Communications Network Service license. An Electronic Communications Service license is required for a company to provide electronic communications services to customers on its own network or through another company's network. Some resources in the telecommunications sector are considered a scarce resource, and as a result there is certain criteria which applicants must meet to obtain the various licenses, with particular emphasis on meeting the South African black economic empowerment requirements and limiting the amount of foreign investment in telecommunications infrastructure to 30%.

Transport infrastructure

RAIL, PORT AND PIPELINE INFRASTRUCTURE

Any form of infrastructure development in relation to railways, ports and pipeline infrastructure will need to be done in conjunction with procurement processes run by Transnet Freight Rail, PRASA, National Ports Authority and Transnet Port Terminals and Transnet Pipelines respectively.

ROAD TRANSPORT INFRASTRUCTURE

As stated above, all national roads are controlled by SANRAL. These concessions granted to Bakwena, N3TC and TRAC are for 30 years and will expire around 2030. All road infrastructure development will need to be performed in conjunction with SANRAL and its procurement processes.

AIRPORTS

In order to service the international market an airport will need to be granted 'international status' from the Department of Home Affairs in order to have the ability to clear customs from the airport terminal.

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What is the applicable procurement process?

Investing in energy and infrastructure

The constitution of South Africa imposes certain obligations on government entities (including state-owned enterprises) to ensure proper and responsible expenditure of public funds and allows such government entities to give priority to the government's socio-economic goals particularly transformation. This is given effect to through the Preferential Procurement Framework Act which imposes certain thresholds to be met by an entity seeking to do business with an SOE for example with regard to the local goods and services to be procured as part of the contract or project. The Preferential Procurement Framework Act also requires bidders to submit a certificate issued under the Codes of Good Practice prescribed by the Broad-Based Black Economic Empowerment Act. This certificate indicates what level of black economic empowerment contributor the bidder is and depending on the level, a certain score is allocated to the bid and counts towards the overall evaluation of the bid.

Financing energy and infrastructure

There are no specific procurement processes which attach to the financing of energy and infrastructure but due to the fact that a funder may end up acquiring an interest in a project or investment pursuant to the occurrence of an event of default, funders may need to consider some of the aspects raised above which affect investors. Examples of such considerations may include the conditions under which certain licenses were awarded to certain project companies or restrictions on the transferability of shares in black-owned project companies, such that the project companies remain predominantly black-owned in terms of the black economic empowerment requirements of the tender prerequisites.

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What are the most common forms of funding / investing in energy and infrastructure?

Funding

Common forms of funding in energy and infrastructure are:

- **debt funding (senior, junior and mezzanine)** – both on a balance sheet basis and project finance basis; and
- **preference share funding** – this has been prominent in the renewable energy sector where the initial participants, particularly the black economic empowerment partners, were initially funded through development funding institutions (such as the Development Bank of Southern Africa and the Industrial Development Corporation) and, now that the projects are operational, are refinancing the development funding through the issue of preference shares (which entitle the holder to set dividends ahead of ordinary shareholders and to take over the issuer in the event of a default) to some of the investment banks, which results in a lower cost of funding for those investors.

Investing

The most common form of investing is through the acquisition of equity shares or concessions.

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Restructuring

Enforcement and sanctions

When can there be regulatory investigations?

Companies Act

The Companies Act makes provision for any person to initiate a complaint in terms of which it is alleged that a person has acted in contravention of the provisions of the Companies Act. Upon receipt of a complaint the Companies and Intellectual Property Commission (CIPC) may elect:

- not to investigate the complaint if it appears vexatious or frivolous;
- refer the complaint to the Companies Tribunal for resolution; or
- appoint an investigator to investigate the complaint.

Competition Act

The Competition Commission is a statutory body constituted in terms of the Competition Act. The Competition Commission is empowered by the Competition Act to investigate, control and evaluate restrictive business practices, abuse of dominant positions and mergers in order to achieve equity and efficiency in the South African economy. One of the Competition Commission's stated objectives is to investigate and evaluate alleged anti-competitive conduct. As such the Competition Commission has wide-ranging powers to investigate any alleged or suspected anti-competitive conduct.

FICA

In terms of the Financial Intelligence Centre Act (FICA), an inspector may at any reasonable time and on reasonable notice enter and inspect any premises at which an 'accountable institution' (eg banks, lawyers, estate agents, insurers, casinos and forex traders) conducts its business, in order to investigate any possible non-compliance.

Inspection of Financial Institutions Act

Inspectors, appointed in terms of the Inspection of Financial Institutions Act (including the Registrar of Banks) have the power to investigate the affairs, or part of the affairs, of any financial institution (including registered medical schemes). Inspectors have the power to (i) summon any person and any document relating to the affairs of the financial institution and (ii) administer an oath or affirmation in order to examine any person referred to in (i). On the authority of a warrant issued by a judge or magistrate with jurisdiction, the inspector has wide ranging powers to search premises and seize documents and other evidence.

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What regulatory penalties may apply?

Companies Act

In terms of the Companies Act, if the Companies and Intellectual Property Commission believes a person has contravened the Companies Act, it may issue a compliance notice to that person directing that any steps reasonably designed to rectify the contravention be taken. In the event that a company fails to comply with a compliance notice, CIPC may apply to a court for an administrative fine to be imposed. Such administrative fine may not exceed the greater of:

- 10% of that company's turnover for the period during which the person failed to comply with the compliance notice; or
- ZAR1 million.

Competition Act

Section 59(2) of the Competition Act limits the maximum administrative penalty which may be imposed by the Competition Commission to 10% of that company's annual turnover (in South Africa and from its exports from South Africa) for the preceding financial year.

Financial Intelligence Centre Act (FICA)

The Financial Intelligence Centre has wide discretion when imposing 'administrative sanctions' within the following categories:

- a caution not to repeat the conduct which led to the non-compliance;
- a reprimand;
- a directive to take remedial action or make specific arrangements;
- the restriction or suspension of certain specified business activities; or
- a financial penalty not exceeding ZAR10 million in respect of natural persons and ZAR50 million in respect of any juristic person.

Inspection of Financial Institutions Act

Administrative penalties will be derived from the relevant legislation which the financial institution is found to have contravened.

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What criminal penalties may apply?

POCA

The primary piece of legislation to combat organized crime, racketeering and money laundering is the Prevention of Organized Crime Act (POCA). In terms of POCA the courts may impose severe punishments in the form of fines or, in certain instances, imprisonment.

Convictions for racketeering activities can result in a fine of up to ZAR1 billion or life imprisonment being imposed.

Money laundering convictions may result in a fine of up to ZAR100 million being imposed or possible imprisonment for up to 30 years.

Competition Act

Any person convicted of an offence in terms of the Competition Act is liable to a fine not exceeding ZAR500,000 or to imprisonment for a period not exceeding 10 years, or to both a fine and such imprisonment.

Companies Act

Any person convicted of an offence in terms of the Companies Act, is liable:

- in the case of a contravention of section 213 (1) (disclosure of confidential information) or 214 (1) (false statement, reckless conduct and fraudulent conduct) to a fine or to imprisonment for a period not exceeding ten years, or to both a fine and imprisonment; or
- in any other case, to a fine or to imprisonment for a period not exceeding 12 months, or to both a fine and imprisonment.

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Tax

Tax issues

Are stamp, registration, transfer or other similar taxes applicable?

No stamp duty is imposed in South Africa.

Securities Transfer Tax is imposed on the transfer of securities, except as part of an intra-group asset-for-share transaction.

Intra-group transactions between related companies may result in tax roll-over provisions being applied, which allow for any tax consequences to be rolled over until the relevant assets are transferred outside of that particular group of companies.

Transfer Duty is imposed on the transfer of immoveable property, unless the transaction is subject to Value Added Tax (VAT). If the transfer of immoveable property is part of the sale of a business as a going concern between two VAT-registered persons, the transaction will be zero-rated and no VAT (or Transfer Duty) will be payable.

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Do tax authorities take priority on enforcement?

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (eg secured bond holders)?

The South African Revenue Service (SARS) is a preferred creditor under the Insolvency Act, 1936. However, SARS still ranks behind any secured creditors on the liquidation of a company, but ranks (with other preferred creditors) ahead of concurrent creditors.

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Is withholding tax on interest payments applicable?

Is there withholding tax on interest payments under a loan?

There is no withholding tax levied on interest payments made to South African residents.

Interest payments made to, or for the benefit of, persons not resident in South Africa (which includes individuals and natural persons) are subject to withholding tax.

If so:
What is the rate of withholding?

The withholding tax rate is 15%.

What are the key exemptions?

An exemption may be available (in whole or in part) under a double tax treaty where applicable.

Would the same analysis apply to interest payments under a debt security (eg a bond)?

Yes.

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Are foreign lenders and debt security holders subject to tax on interest payments?

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding tax (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (eg by virtue of incorporation, residence or local branch)?

No.

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