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THE CREDIT GUARANTEE IN TERMS OF THE NATIONAL CREDIT ACT 34 OF 2005: AN INSTRUMENT PROMOTING SMALL AND MEDIUM ENTERPRISES' ACCESS TO CREDIT

by

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SUMMARY

The National Credit Act 34 of 2005 (“NCA”) is applicable to three main categories of credit agreements — the credit facility, credit transaction, and the credit guarantee. The credit guarantee, in terms of section 8(5), is an undertaking or a promise by a person to satisfy the obligation of another consumer in terms of a credit facility or a credit transaction to which the NCA applies.

The purpose of the dissertation is to investigate the NCA credit guarantee as an instrument to promote access to credit by small and medium enterprises (“SMEs”) in South Africa. A discussion of the guarantee as an instrument used worldwide to advance SMEs’ access to credit, and of the characteristics of the independent guarantee versus the suretyship agreement, is preceded by a brief discussion of the NCA’s field of application. This is merited by the interrelatedness of the section 8(5) credit guarantee with the other main types of agreements subject to the NCA. The nature of the section 8(5) credit guarantee is discussed next, which, in my opinion, is an independent guarantee. The question is also addressed whether the credit guarantee in terms of the NCA, similarly to the other credit agreements subject to the Act, is classified into sizes.

The dissertation concludes with remarks on the use of the credit guarantee in terms of the NCA as an instrument to address SMEs’ access to credit. It is recommended that the definition and size classification of the credit guarantee in the NCA be clarified, which will enhance the use of this powerful instrument to achieve the Act’s purposes.

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CHAPTER 1: GENERAL INTRODUCTION

1.1 Introduction and background

It is trite that the National Credit Act[1] is the legislative enactment regulating the consumer credit industry in South Africa.[2] The legislature enacted the NCA to address shortcomings that existed in terms of the credit laws and the credit industry they regulated preceding the NCA, with the aim of ensuring a credit market regulated by a single Act.[3] The shortcomings included fragmented[4] and outdated legislation[5] that did not cater for the needs of the larger portion of the population and discriminated against black consumers and businesspersons. Two credit markets existed: one for the whites, who had access to the major financial institutions and were offered credit at cheaper interest rates and costs. The other was the informal credit market, which catered to the black majority and black-owned businesses, and offered credit at a higher interest rate and cost[6] This had to be addressed by the new credit dispensation through, *inter alia*, the promotion of access to cheaper, mainstream credit extended to small or start-up businesses or enterprises. The NCA refers to "small business", and

[1] Act 34 of 2005 ("NCA").
[2] The NCA became effective in stages, on 1 June 2006, 1 September 2006, and 1 June 2007. S 172(4), which was put into operation on 1 June 2006, repealed and replaced the NCA's predecessors, the Usury Act 73 of 1968 ("Usury Act") and the Credit Agreements Act 75 of 1980 ("Credit Agreements Act").
[3] The NCA regulates the financial and contractual aspects of the credit agreements subject to the Act. See ch 2.
[4] The Usury Act regulated the financial aspects, such as interest rates, of credit agreements subject to the Act, and the Credit Agreements Act regulated the contractual aspects, e.g., formalities and the content, of credit agreements. The two Acts therefore had to be read together, but did not always necessarily apply to a contract. The Usury Act and the Credit Agreements Act both applied to a specified ceiling, a principal debt or cash price of R500 000. See Otto and Renke "Introduction and historical background to the National Credit Act" in Scholtz ed *Guide to the National Credit Act* (2008), "Otto and Renke Introduction", pars 1.3.1 and 1.3.3. See Grové and Otto *Basic principles of consumer credit law* 2002 12 ff for the application and scope of these Acts. See in general Otto "The history of consumer credit legislation in South Africa" 2010 *Fundamina*: *A Journal of Legal History* 16(1).
[5] The Usury Act became effective on 1 April 1969 and the Credit Agreements Act on 2 March 1981. See Renke "An evaluation of debt prevention measures in terms of the National Credit Act" 2012 LLD thesis, UP ("Renke LLD thesis") 327.
[6] The Department of Trade and Industry South Africa "Making credit markets work. A policy framework for consumer credit", 2004 ("Policy Framework"), pars 2.1 and 2.2; Goodwin-Groen and Kelly-Louw "The National Credit Act and its regulations in the context of access to finance in South Africa" in *Report prepared for FinMark Trust, South Africa* 2006 13. The Policy Framework was the policy document published by government that gave rise to the promulgation of the NCA, and was preceded by a number of investigations, which commenced in 2002. See Kelly-Louw and Stoop *Consumer Credit Regulation in South Africa* (2012) par 1.3 for the history of the NCA.

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states that the term has the same meaning than that provided in the National Small Business Act.[7] However, the Policy Framework refers to "SME"or "SMEs".[8]

Government set pertinent aims for the NCA in order to address the legacy of South Africa's past. These objectives are entrenched in the preamble to the Act and section 3, which set out the NCA's objectives. Amongst other aims, the purpose of the Act is to regulate the credit market by making it more functional, cost-effective, and competitive, while ensuring that it is fair, competitive, and sustainable.[9] Tied into this purpose is the creation of a non-discriminatory marketplace that promotes reasonable credit granting and use, and allows consumers, in particular historically disadvantaged consumers and businesses, to access credit under the aforementioned conditions.[10] The NCA was introduced to create a single credit legal framework to regulate the post-1994 credit market[11] and to harmonise it with international best practices.[12]

The NCA determines its scope of application, which is important in determining the ambit of the Act's consumer protection. Simply put, if the NCA does not apply in a particular circumstance, the consumer forfeits the Act's protection and must rely on common law and other legislation for protection. In terms of section 4(1), the Act applies to credit agreements, concluded at arm's length, in South Africa, or having an effect in the Republic, unless an exclusion applies. These four criteria for the NCA's application are discussed in more detail in the following chapter. For the moment, a few remarks regarding the NCA's scope of application will suffice to set the background for my research statement. The NCA applies to three main categories of credit agreement, including the credit guarantee. The credit guarantee is an agreement in terms whereof one person undertakes or promises to perform the

[7]Act 102 of 1996 S 1. The correct name of this Act is: National Small Enterprise Act 102 of 1996 ("Small Enterprise Act"). In s 6 of the National Small Business Amendment Act 29 of 2004, the term "small business" is substituted with "small enterprise".
[8] Small- and medium enterprises. Policy Framework pars 1.19 and 2.1. In my dissertation, reference will be made to SME or SMEs.
[9] Policy Framework ch 3, which must be read with ch 2, providing why there was a need for reform of the previous credit legislative framework.
[10] Discrimination in the credit industry and how it should be addressed is a central theme in the credit policy that preceded the NCA. See Policy Framework 2004 pars 1.5, 1.19, and 3.15.
[11] National Credit Regulator ("NCR") *"The National Credit Act, 2005: All you need to know about the National Credit Act as a consumer"* 2007. Available at https://www.ncr.org.za/documents/pages/ENGLISH.pdf.
[12] Policy Framework par 2.10.

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obligations of another consumer in terms of either a credit facility or a credit transaction, on demand.[13]

Two of the main exclusions to the NCA's field of application are credit agreements entered into by large juristic persons as consumers and large credit agreements concluded by smaller juristic persons as consumers.[14] "Juristic person" is defined in section 1 of the NCA, and includes, *inter alia*, a partnership.[15] For a number of reasons, and importantly also for purposes of the aforementioned exclusion of large credit agreements concluded by smaller juristic person consumers, all credit agreements in terms of the NCA are classified into one of three sizes: small, intermediate, and large.[16] However, unclear drafting of the provisions of section 9(2) (4)[17] causes uncertainty whether the credit guarantee forms part of the classification of credit agreements into these sizes.[18] The implications are that SMEs, as juristic persons, or the credit guarantee, as a potential instrument to promote access to credit to SMEs (see below), could be excluded from the NCA's ambit and, thus, its protection.

The question is whether the definition of a credit guarantee in terms of the NCA provides for an independent credit guarantee, a suretyship agreement, or both. There are divergent opinions in this regard, which are addressed in Chapter 4. The differences between and the characteristics of the independent credit guarantee and the suretyship agreement are discussed in Chapter 3.

The credit guarantee as a type of credit agreement was introduced into South Africa's credit laws by the NCA. However, the concept is not unfamiliar in foreign jurisdictions. Various countries around the world, including the United States of America and countries in Europe and Asia have proposed, planned, and implemented credit guarantees and credit guarantee systems[19] as an instrument to address difficulties faced by consumers, mainly SMEs, in accessing credit, and to provide them with

[13] S 8(5).
[14] S 4(1)(a)(i) and 4(1)(b) of the Act, read with the determination of thresholds regulations, promulgated in terms of s 7 of the Act. See GN 713, *GG* 28893, 1 June 2006, "Threshold regulations".
[15] See par 2.4.
[16] S 9 read with the threshold regulations.
[17] S 9(2) – (4) provides for small, intermediate, and large credit agreements respectively.
[18] See par 4.3.
[19] Gudger "Credit guarantees: An assessment of the state of knowledge as new avenues of research" 1998 *Food and Agriculture Organization of the United Nations Agricultural Service Bulletin* 129.

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support and collateral,[20] as well as to provide banks with a mechanism to absorb the risk of non-performance by these entities. Credit guarantee schemes are financial institutions, both private and public, that provide guarantees on loans for the lender to recover the guarantee, should the borrower default,[21] and regulatory and supervisory regimes that monitor credit guarantees are found worldwide. The use of the independent guarantee or credit guarantee schemes to address SMEs' access to credit is discussed in Chapter 3.

The credit guarantee in terms of section 8(5) of the NCA, depending on its true nature, could, accordingly, also be a powerful instrument in promoting South African SMEs' access to credit. This necessitates a discussion and proper interpretation of the definition in section 8(5).[22] The divergent opinions of writers on the true nature of this guarantee and the interpretation and application of the definition by the courts play an important role in this regard.

1.2 Research statement

The purpose of this dissertation is to discuss the credit guarantee in terms of the NCA as an instrument to promote and advance SMEs' access to credit. This research statement is demarcated by the research objectives stated in paragraph1.3 below. The aspects addressed are the use of the credit guarantee in general to promote SMEs' access to credit, the South African government's policy considerations in respect of the promotion of SMEs' access to credit in terms of the NCA, the differences between and characteristics of the independent guarantee versus the suretyship agreement, and the definition of the credit guarantee in terms of section 8(5) of the NCA. If required, changes to the NCA's provisions in respect of credit guarantees will be suggested.

[20] OECD "Evaluating publicly supported credit guarantee programmes for SMEs" 2017. Available at https://www.oecd.org/finance/Evaluating-Publicly-Supported-Credit-Guarantee-Programmes-for-SMEs.pdf.
[21] European Investment Bank "Credit guarantee schemes for SME lending in Central, Eastern and South Eastern Europe" 2014 *A report by the Vienna Initiative working group on credit guarantee schemes*, "European Investment Bank 2014" 9. Available at http://vienna-initiative.com/resources/themes/vienna/wp-content/uploads/2014/11/2014_credit_guarantee_schemes_report_en.pdf
[22] See ch 4.

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1.3 Research objectives and corresponding chapters

The following research objectives are identified and listed in accordance with the chapters in which they are discussed.

(a) Chapter 2 provides a brief exposition of the field of application of the NCA. The reasons for this are mentioned in the delineations that follow and in the discussion in Chapter 2.

(b) Chapter 3 discusses the independent guarantee as an instrument to advance SMEs' access to credit. The chapter also discusses the nature and characteristics of the independent guarantee and the suretyship agreement, as well as the South African government's policy considerations in respect of the use of credit laws to promote SMEs' access to credit.

(c) Chapter 4 discusses the provisions of the NCA in respect of the credit guarantee, including the question whether the credit guarantee is classified as small, intermediate, or large.

(d) Chapter 5 contains final conclusions, recommendations (if required), and final remarks.

1.4 Delineations

It is essential to provide an overview of the field of application of the NCA to sketch the background for the application of the Act to credit guarantees. For instance, in terms of section 8(5), the NCA applies to a credit guarantee only to the extent that the Act applies to a credit facility or a credit transaction. However, a comprehensive discussion of the credit agreements to which the NCA applies, the arm's length principle, the agreement having been concluded in South Africa or having an effect in the Republic, and the exclusions or exemptions to the NCA field of application falls outside the scope of my dissertation. The same holds for a discussion of SMEs, the Small Enterprise Act, and government policies — except as mentioned in paragraph 1.3.(b), above — in respect of the development of SMEs.

1.5 Terminology

The "consumer" and the "credit provider", as the parties to a credit agreement that is subject to the NCA, are defined in section 1 of the Act. For purposes of the credit

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guarantee, a consumer is defined as “the guarantor under a credit guarantee”, and the credit provider as “the party to whom an assurance or promise is made under a credit guarantee”.

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CHAPTER 2: AN OVERVIEW OF THE NCA's FIELD OF APPLICATION

2.1 Introduction

Section 4(1) of the NCA provides that the Act applies to credit agreements, concluded at arm's length in South Africa,[23] unless an exception applies. Section 4(1) therefore provides an overview of the steps that are required to ascertain whether the NCA is applicable to a particular agreement. These steps have to be followed in sequence to determine the NCA's applicability, unless, of course, one of the exceptions is patently obvious.

This chapter provides an overview of the NCA's field of application,[24] with the exception of the definition of the credit guarantee in section 8(5) and the provisions of section 9, which provides for the categorisation of "every credit agreement" in terms of the Act into different sizes, which is discussed in Chapter 4. The interrelatedness of the credit guarantee in terms of section 8(5) with the other types of credit agreement under the NCA and the application of the other section 4(1) steps also to credit guarantees, for instance, the at arm's length principle and the exclusions to the Act's scope of application, justify this overview.

2.2 The credit facility and the credit transaction

A credit facility and a credit transaction are listed in section 8(1) as the main species of credit agreements, together with a credit guarantee.[25] A combination of, for instance, a credit facility and a credit transaction is also possible.[26] In terms of section 8(2)(a) to (c), a policy of insurance, a lease agreement in respect of immovable goods,

[23] If the credit agreement is not concluded in South Africa, but has an influence in SA, the Act applies, if the other application criteria in terms of s 4(1) are met. See Van Zyl "The scope of application of the National Credit Act" in Scholtz ed *Guide to the National Credit Act* 2008 ("Van Zyl Scope of application") par 4.2. Van Zyl remarks that the parties to a credit agreement cannot "circumvent the provisions of the Act" merely by concluding the agreement outside the borders of the Republic.
[24] For a complete discussion of the NCA's application and scope, see Van Zyl Scope of Application ch 4, Otto and Renke Credit agreements ch 8; and Kelly-Louw and Stoop ch 2. See also the case law referred to in Van Zyl and Otto and Renke.
[25] S 8(1)(a) – (c).
[26] S 8(1)(d). See Otto and Renke Credit agreements par 8.2.5 for an example.

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and a transaction between a stokvel[27] and its members are not credit agreements, and are therefore not subject to the NCA.[28]

The credit facility is defined in section 8(3) as an agreement in terms of which the credit provider undertakes to supply goods or services, or to pay an amount or amounts of money, to the consumer. However, the provider does this undertaking "as determined by the consumer from time to time", and to the consumer, or on the latter's behalf or direction.[29] The credit provider also undertakes to defer the payment of the cost of the goods or services, or the repayment amount, or to bill the consumer periodically in respect of such cost.[30] The definition of the credit facility further requires that the credit provider charge interest, fees, or charges in respect of the deferred amount.[31] According to Otto and Renke,[32] if the aforementioned definition is considered, the credit facility is either a contract of sale of movable goods, or a contract to render services, or a moneylending contract, but as determined by the consumer from time to time, which indicates that a credit facility and revolving credit are involved. 'Revolving credit' means the payment of instalments by the consumer, which creates more credit to be used by the consumer. Examples of credit facilities are store cards and credit cards.

The eight credit transactions subject to the NCA are listed in section 8(4)(a) to (f), namely pawn transactions, discount transactions, incidental credit agreements, instalment agreements, mortgage agreements, secured loans, leases, and "other agreements". All these credit transactions, except for "other agreements", are defined in section 1, and require the deferral of payment.[33] Their definitions also require the levying of charges, fees, or interest by the credit provider in respect of the deferred amount.[34]

[27] A 'stokvel' is defined in s 1 as an informal savings scheme.
[28] See Van Zyl Scope of application par 4.3.
[29] S 8(3)(a)(i).
[30] S 8(3)(a)(ii)(aa) or (bb).
[31] S 8(3)(b)(i) or (ii).
[32] Otto and Renke Credit agreements par 8.2.2.
[33] However, the discount transaction entails the prepayment of a debt.
[34] However, the definitions of the mortgage agreement and the secured loan do not require interest, fees or charges, and the discount transaction makes provision for a discount if the debt is repaid early.

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The pawn transaction[35] is an agreement in terms whereof money is advanced or credit is granted to the consumer. At the time of the transaction, an item of value is taken into possession by the pawnbroker. If the debt is not settled by the consumer on expiry of a specified date, the pawnbroker is entitled to sell the item and retain the proceeds of the sale to cover the outstanding debt.

The discount transaction[36] involves an agreement for the provision of goods or services to the consumer over a period of time. A discount is provided to the consumer upon early settlement of the debt.[37]

The incidental credit agreement[38] is an agreement in respect of an account sent to the consumer for goods or services that have already been provided to the consumer, or that will be provided over a period of time. In order for the incidental agreement to come into existence, either fees, charges, or interest must have become payable upon the non-settlement of the account on a date specified in the account, or two prices must have been quoted by the credit provider, a lower and a higher price, and the higher price must have become payable when the account was not paid. With regard to the definition in section 1, it therefore seems that the incidental credit agreement comes into existence like any other credit agreement — when payment is deferred (by billing the consumer), and interest, fees, or charges are levied by the credit provider. However, in terms of section 5(2) of the NCA, an incidental agreement only comes into existence 20 business days[39] after the date upon which interest, fees, or charges are levied by the credit provider for the first time, or the date when the pre-determined higher price for full settlement of the account for the goods or services first became payable. The reason for the 20 business days is not clear.[40]

Section 5(3)(b) provides that a credit provider will only be entitled to levy charges, interest, or fees if the payment thereof was disclosed to the consumer on the day the

[35] S 8(4)(a). Otto and Renke Credit agreements par 8.2.3.1.
[36] S 8(4)(a). Otto and Renke Credit Agreements par 8.2.3.2.
[37] The consumer is quoted a lower and higher price. The higher price is payable if the account is paid on or before a determined date, or if the payment of the account takes place periodically.
[38] S 8(4)(b), subject to s 5(2).
[39] "Business days" exclude Saturdays, Sundays, and public holidays. If a number of business days have to be calculated between the occurrence of two events in terms of the NCA, the first day, in contrast to the last day, is not considered. S 2(5).
[40] Otto and Renke Credit agreements par 8.2.3.3.

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goods or services were provided to the consumer. The basis for the fees, interest, or charges must also have been disclosed to the consumer, and the consumer must have accepted it. In terms of section 5, the NCA enjoys only limited application to incidental credit agreements. The providers of this type of credit, for instance, professionals[41] rendering services to and billing clients, do not have to register as credit providers in terms of the Act.[42] It is also significant that the reckless credit prevention provisions in the NCA (sections 80 to 84) do not apply in the case of the incidental credit agreement.[43]

The instalment agreement[44] is a contract of purchase and sale of movable goods; that is, the passing of ownership to the consumer in terms of the agreement. The contract either contains a clause in terms whereof the ownership of the goods only transfers to the consumer upon fulfilment of a condition or a clause that stipulates that the consumer becomes the owner of the goods immediately upon delivery of the goods to the consumer, subject to the right of the credit provider to re-possess the goods in the event of failure by the consumer to satisfy all the consumer's obligations in terms of the instalment agreement. In contrast to the instalment agreement containing an ownership reservation clause that serves as security for the payment of the credit cost, and is thus typically used when more expensive consumer goods are involved, the option of ownership transferring to the consumer immediately is seldomly used in practice.[45]

The next credit transaction is the mortgage agreement,[46] which is any credit agreement that is secured by the registration of a mortgage bond over immovable property by the registrar of deeds, for example, a money loan.[47] The mortgage agreement thus, for example, provides security for the payment of a house loan, and is always a large agreement, irrespective of the amount involved.[48]

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[41] Doctors, attorneys, etc.
[42] S 40(1).
[43] S 78(2)(e).
[44] S 8(4)(c).
[45] Otto and Renke Credit agreements par 8.2.3.4.
[46] S 8(4)(d).
[47] See Otto and Renke Credit agreements par 8.2.3.5.
[48] S 9(4) read with the threshold regulations.

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The secured loan[49] also provides security to the credit provider for the payment of the debt, and is an agreement in terms whereof money is advanced or credit is granted to the consumer. In this case, the credit provider "retains, or receives a pledge to any movable property or other thing of value as security for all amounts due under [the] agreement". The definition specifically excludes the instalment agreement. An example of a secured loan is a cession of rights to secure the payment of a debt.[50]

The lease agreement[51] of movable goods,[52] in terms of the NCA, is not the typical common law lease in terms whereof the leased goods have to be returned to the lessor when the lease expires. The NCA specifically provides that, in order for an agreement to constitute a lease for purposes of the NCA, the consumer must become the owner of the leased goods when the term of the lease comes to an end, either "absolutely", or when specific conditions agreed on in the lease agreement are fulfilled. The rental agreement where for example office furniture is leased and must be returned to the lessor on expiration of the agreement, is neither a lease agreement nor any other credit agreement subject to the NCA.[53]

Section 8(4)(f) excludes the credit facility or credit guarantee, and provides for "any other agreement" than the credit transactions mentioned above[54]. Such an agreement is a credit agreement for purposes of the NCA if, in terms thereof, the payment of an amount owed by one person is deferred and the credit provider is entitled to a charge, interest, or fees in respect of the deferred amount. The agreement referred to in Section 8(4)(f) is a catch-all credit transaction that has as aim to subject any deferred amount, and the cost payable in respect of that amount, to the protective provisions of the NCA under circumstances where one of the other credit transactions is not pertinent per its definition. An example of a section 8(4)(f) agreement is a moneylending agreement that does not involve revolving credit.[55]

[49] S 8(4)(d).
[50] Otto and Renke Credit agreements par 8.2.3.6.
[51] S 8(4)(e).
[52] Leases of immovable goods are not subject to the NCA. S 8(2)(b).
[53] Otto and Renke Credit agreements par 8.2.3.7.
[54] S 8(4)(a) – (e).
[55] Such an agreement is therefore not a credit facility. See Otto and Renke Credit agreements par 8.2.3.8 for other examples.

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2.3 At arm's length

Section 4(1) of the NCA requires that the parties to a credit agreement conclude the agreement "at arm's length"[56] in order for the Act to be applicable. In summary, this means that the credit provider and the consumer must be independent of each other. Section (4)(2)(b)(i) to (iv) provides for arrangements where the parties to a credit agreement are not concluding the agreement at arm's length, with the implication that the NCA is not applicable in these instances. A credit agreement entered into between family members who are in a familial relationship and are co-dependent on each other, or the one is dependent on the other, is an example of an agreement not concluded at arm's length.

If a credit agreement was concluded at arm's length and in South Africa,[57] that agreement is subject to the NCA, unless an exemption to the Act's field of application applies.[58] The exclusion of certain groups of juristic persons as consumers is significant for purposes of this dissertation. "Juristic person", whenever used in the NCA, includes[59] partnerships, associations or other bodies of persons[60], or trusts, provided that the particular trust has three or more natural persons as trustees, or that the trust has a juristic person as a trustee.[61] In what follows, reference is made to a juristic person acting in the capacity of a consumer.

The NCA, first of all, excludes larger juristic persons from its application. A juristic person with an asset value or annual turnover of R1 million, on its own or in conjunction with related juristic persons,[62] is not subject to the NCA.[63] Secondly, smaller juristic persons, those with an asset value or annual turnover of less than R1 million, and that conclude large credit agreements in terms of section 9(4) (such as mortgages), are

[56] See Van Zyl Scope of application par 4.2 and the case law mentioned.
[57] Or it has an effect in the Republic if it was concluded abroad — see par 2.1.
[58] See ss 4(1)(a) – (d), 4(5) and (6), and 8(2)(a) – (c) for the exceptions. See also Van Zyl Scope of application par 4.3 and the case law mentioned.
[59] In addition to companies and close corporations.
[60] Corporate or unincorporated.
[61] S 1.
[62] If the one juristic person has direct or indirect control over the business of the other (wholly or partially), or if a person has direct or indirect control over both juristic persons, they are related. S 4(2)(d)(i) and (ii).
[63] S 4(1)(a)(i) read with the threshold regulations.

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also excluded from the NCA.[64] Therefore, the NCA applies to smaller juristic persons that conclude small or intermediate-sized credit agreements.[65]

It is important to note that the NCA's exclusion of larger and smaller juristic persons concluding large credit agreements is not unconstitutional. The court in *Standard Bank of South Africa Ltd v Hunkydory Investments 194 (Pty) Ltd*[66] held that there is "a legitimate governmental purpose" behind the enactment of these exclusions.[67] The court also held that is it not unconstitutional to exclude suretyship agreements entered into by natural persons in respect of a credit agreement concluded with an excluded juristic person. The decision was confirmed in *Standard Bank of South Africa Ltd v Hunkydory Investments 188 (Pty) Ltd and Others (No 2)*.[68]

[64] S 4(1)(b) read with the threshold regulations.
[65] See par 4.3. for the size classification of credit agreements.
[66] 2010 (1) SA 627 (C).
[67] Par 25.
[68] 2010 (1) SA 634 (WCC). Appeal against the "*Hunkydory*" decisions was refused by the SCA and the Constitutional Court ("CC"), due to a lack of prospects of success.

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CHAPTER 3: THE CREDIT GUARANTEE AS AN INSTRUMENT TO PROMOTE ACCESS TO CREDIT

3.1 Introduction

The emergence of credit guarantees dates back to the late 19th century, when groups of entrepreneurs would contribute funds to provide guarantees for each other in the event of a need to access finances.[69] Credit guarantees have since evolved to an instrument offered publicly by the government in some countries, and also privately by institutions such a mutual guarantee schemes,[70] and have been advocated around the world to address the difficulties in obtaining funding from banks. Deelen and Molenaar define the credit guarantee as "a financial product that a small entrepreneur can buy as a partial substitute for collateral.[71] It is a promise by a guarantor to pay all or part of the loan if the borrower defaults".[72] Credit guarantees are a form of credit derivative, which is a financial contract that allows the guarantor to assume the credit risk associated with a particular debt obligation.[73] The credit guarantee was designed to provide relief to SMEs[74] that have difficulty obtaining financing from commercial

[69] Gurmessa and Ndinda "The role of loan guarantees in aleviating credit constraints: lessons for smallholder farmers cooperatives" 2014 *IJBSS* 144.
[70] Vienna Initiative working group on credit guarantee schemes "Credit guarantee schemes for SME lending in Central, Eastern and South-Eastern Europe" 2014 9. Available at https://www.eib.org/attachments/efs/viwg_credit_guarantee_schemes_report_en.pdf., "Vienna Initiative Working Group 2014".
[71] Collateral refers to an asset accepted by the lender as security for a loan, which the lender will retain in the event that the borrower defaults on payment. See investopedia.com and European Central Bank "What is collateral". Available at http://www.ecb.europa.eu/ecb/educational/explainer/tell-me/html/collateral.en.html. It is the tangible assurance that a debt will be satisfied, and ensures that the loan will be offset should the borrower fail to pay the principal amount and the interest in terms of the loan agreement.
[72] Deelen and Molenaar *Guarantee funds for small enterprises: A manual for guarantee fund managers* (2004) 11.
[73] Hirtle "Credit derivatives and bank credit supply" 2009 *J. FINAN* 4.
[74] Most international literature on the topic of credit guarantees, including articles on the World Bank's website, mention guarantees in terms of funding for SMEs. The literature includes: Gudger 1998 *Food and Agriculture Organization of the United Nations Agricultural Service Bulletin*; Aboojafar *et al The role of credit guarantee schemes in the development of small and medium-sized enterprises with an emphasis on knowledge-based enterprises* (2019); Schmukler "Are public credit guarantees worth the hype?" *Development research* 2017, Samujh *et al* "Credit guarantee schemes supporting small enterprise development: A review" 2012 *AJBA*. It can be deduced from this that the establishment of credit guarantees was for the purpose of support of SMEs.

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financial service providers because of their lack of collateral, to increase access loans[75] and limit the bank's risk in the event of a debtor defaulting.

Although hailed as the drivers of economic growth in economies because of their contribution to social cohesion, poverty alleviation, job creation, development,[76] and creating an inclusive economy and a transformed society,[77] SMEs[78] are faced with difficulties in accessing the financial assistance they require to develop. This is due to their lack of collateral, information asymmetries, the high transaction costs of small-scale lending, and perceptions of high risk and lack of experience.[79] These factors lead to financial institutions being reluctant to allocate credit to SMEs, or the offering of credit to SMEs at high interest rates.[80] To address the problem faced by SMEs and the need to provide them with financial assistance, governments of countries around the world have established loan guarantee and credit guarantee schemes to assist SMEs to access funding, develop credit markets that contribute to the expansion of finance, and encourage banks and non-bank financial institutions to contribute towards the SME market.[81]

In South Africa, the credit guarantee was introduced in March 1995, in the White Paper of the Department of Trade and Industry,[82] with the intention to create a system that would strengthen the commercial funding of SMEs.[83] From this, Khula Enterprise

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[75] Cowan, Drexler and Yañez "The effect of credit guarantees on credit availability and delinquency rates" 2015 *JBF* 59.
[76] Katua "The role of SMEs in employment creation and economic growth in selected countries" 2014 *IJERN* 264 .
[77] Business Unity South Africa "Small & medium enterprises thriving". Available at https://www.busa.org.za/2-small-medium-enterprises-thriving/
[78] The terms "small and medium enterprises" ("SMEs") and "small, medium, and micro enterprises" ("SMMEs") are synonymous and used interchangeably in South Africa. See International Leadership Development Programme "Informal small medium and micro enterprises (SMME) retailers in South Africa" 2014 *ILDP* 9.
[79] FinFind "Inaugural South African SMME access to finance report reluctant" 2018. Available at https://www.accesstofinancereport.co.za/pdf/INAUGURAL-REPORT.pdf.
[80] Rahman, Rahman and Belas "Determinants of SME finance: Evidence from three central European countries" 2017 *REP* 264.
[81] The World Bank "Principles for public credit guarantee schemes for SMEs" 2016. Available at https://documents1.worldbank.org/curated/en/576961468197998372/pdf/101769-revised-english-principals-cgs-for-SMEs.pdf.
[82] "DTI".
[83] DTI "White Paper on national strategy for the development and promotion of small business in South Africa" 1995. Available at https://www.gov.za/sites/default/files/gcis_document/201409/163170.pdf ("DTI White Paper").

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Finance Limited was formed, in 1996, under the Companies Act,[84] in order to assist SMEs having difficulty accessing financing from the formal sector.[85]

This chapter discusses the credit guarantee, starting with an introduction to the two concepts that make up the term 'credit guarantee', and explores in more detail what credit guarantees entail, with the focus on the 'guarantee' component of the term. This chapter concludes with a brief discussion of the credit guarantee in the South African context.

3.2 The credit guarantee in general terms

3.2.1 "Credit"

The word 'credit' is derived from the Latin word '*credere*', meaning to trust, entrust, or believe.[86] The creditor extends funds to the borrower in the belief that the borrower can and will repay the loan, together with interest, according to the agreed terms.[87]

Credit has since the early 19th century been an essential and integral part of the modern industrial economy, and, as economies grew, there was an increase in the need for the provision of credit by banks and financial institutions to finance the growth of both consumption and investment.[88] Credit is an important instrument in this regard, one that improves the welfare of communities and enhances productive capacity through financing investment.[89] Access to credit has been extolled worldwide for its ability to generate sustainable economic growth.[90]

A credit agreement is a legal contract that involves the supply of goods or services, or the lending of money by credit providers to consumers, with a fee, charge, or interest levied in respect of the deferred payment.[91] In more basic terms, a credit agreement

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[84] Act 71 of 2008.
[85] Underhill Corporate Solutions "Literature review on small and medium enterprises' access to credit and support in South Africa" 2011 11.
[86] Bullivant ed *Credit management* 2016.
[87] Delhaise ed *The bank credit analysis handbook: A guide for analysts, bankers, and investors* 2013.
[88] Eichengreen and Mitchener "The great depression as a credit boom gone wrong" *Research in Economic History* 2004.
[89] Baiyegunh "Access to credit and the effect of credit constraints on household welfare in the Eastern Cape province, South Africa" 2008 LLD thesis, University of Forte Hare, "Baiyegunh LLD thesis" 7.
[90] Baiyegunh LLD thesis 2.
[91] Nedbank "Understanding your responsibility in terms of credit agreements". Available at https://www.mfc.co.za/insights/understanding-your-responsibility-in-terms-of-credt.

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is an agreement between a lender and a borrower, where the lender agrees to advance to the borrower a requested sum of money based on qualification criteria, or offers goods and services on credit, and the borrower or purchaser agrees to repay the money, or pay for the goods or services, at a future date, with interest on the outstanding balance. In essence, the debtor is afforded the ability to 'buy now, pay later' in a system known as 'deferred payment'.[92] Credit enables consumers to access goods and services they otherwise would not have been able to access. Peebles, quoting Anderlini, describes it as follows: "[i]t is a method derived for a debtor to borrow speculative resources from his/her own future and transform them into concrete resources to be used in the present".[93] Peebles further states that, for the creditor, it is denying one use of concrete resources today, in exchange for speculative gains in the future.[94] "[a]ccess to credit is critical for consumers, small and medium sized enterprises (SMEs) and large companies."[95] In a business sense, it is vital, in that credit enables access to working capital and enhances the ability to cope with risks.[96]

3.2.2 "Guarantee"

Commercial loans and credit agreements are usually entered into with a backing security or collateral to cover the lender in the event that the borrower defaults, which collateral may take the form of fixed assets, company shares, or investments. In the event that the borrower does not have collateral, the borrower may enter into an agreement with a third party who will bind itself as collateral and guarantee that the debt will be repaid.[97] This agreement with the third party is referred to as a 'guarantee agreement' or 'guarantee'.

McGuiness defines a guarantee as "a promise by one person to answer for the due performance of the obligation of another person [in] the event that the person fails to

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[92] Pitfield "Buying on credit" *Mastering Commerce. Macmillan Master Series* 1982.
[93] Peebles "The anthropology of credit and debt" 2010 *Annual Review of Anthropology* 227.
[94] Peebles "The anthropology of credit and debt" 2010 *Annual Review of Anthropology* 227.
[95] Devenney *Consumer credit, debt and investment in Europe* 2012.
[96] Bai, Shi, Liu, and Sarkis "Banking credit worthiness: Evaluating the complex relationships" 2019 *Omega*.
[97] Minnesota Department of Employment and Economic Development and Moxness "Loan documentation: An introduction for small businesses" 2005.

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perform that obligation". Guarantees are typically used as a form of collateral for a debt.[98] Goode provides a more refined description, defining a guarantee as follows:

> "[The guarantee] is [a] money promise which is independent of the transaction that gives it birth and which is considered binding when received by the beneficiary (or sometimes when issued by the promisor) without acceptance, consideration, reliance, or execution in solemn forms."[99]

The guarantee is an irrevocable payment obligation to secure a contractually agreed performance, payable upon the presentation of a written demand that indicates that the performance in the underlying agreement has not been fulfilled. It is used to share the risk of loss between the financial institution and the guarantee institution, according to an agreed risk ratio.[100] Guarantees are a globally accepted instrument for securing and enforcing the claims of parties to a contract in a way that protects the interests of all participants.

The guarantee has three main benefits: it ensures that (a) the beneficiary will be repaid in the event that the principal is not able to fulfil its contractual obligation; (b) the principal will obtain financing; and that (c) lower costs are attached to the financing, because a guarantee earns the borrower higher a credit rating and, therefore, a lower interest rate.[101]

Kelly-Louw states[102] that many terms are used that essentially have the same meaning and, from a legal viewpoint, are merely synonyms of an undertaking to perform an obligation. These include "'performance bonds/guarantees', 'tender bonds/guarantees', 'independent (bank) guarantees', 'independent undertakings', 'demand guarantees', 'bank guarantees', 'first demand guarantees', 'default undertakings' and 'standby letters of credit'".

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[98] LexisNexis "Guarantee overview". Available at https://www.lexisnexis.com/uk/lexispsl/bankingandfinance/document/391289/55kb-65s1-f185-x16g-00000-00/guarantees_overview.

[99] Goode "Abstract payment undertakings" *Essays for Patrick Attiyah* 1991 209.

[100] Nigrini and Schoombee "Credit guarantee schemes as an instrument to promote access to finance for small and medium enterprises: An analysis of Khula Enterprise Finance Ltd's individual credit guarantee scheme." 2002 *DSA* 735.

[101] Miruka, Mah, and Nchake "Finacial guarantees and public debt in South Africa" 2015 in *Risk governance & control: Financial markets & institutions* 215.

[102] Kelly-Louw "Selective legal aspects of bank demand guarantees" 2008 LLD thesis, UP, "Kelly-Louw thesis" 5.

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For a guarantee to be provided, it must be at the request of the debtor, and it is usually provided at a fee.[103] The first demand payment guarantee is the most common type of guarantee in financial transactions.[104] It is essentially a promise by one party to pay a sum of money to another upon demand, due to a certain event that disables the debtor to meet an obligation. It allows that payment be made to the party to whom the promise was made simply by presentation of a written demand,[105] and it provides the beneficiary immediate access to funds.[106] The International Chamber of Commerce[107] defines a demand guarantee as follows:

> "[A]ny guarantee, bond or other payment undertaking, however named or described, by a bank, insurance company or other body or person [g]iven in writing for the payment of money on presentation in conformity with the terms of the undertaking of a written demand for payment and such other document(s) (for example, a certificate by an architect or engineer, a judgment or an arbitral award) as may be specified in the guarantee".[108]

3.3 The guarantee in more detail

3.3.1 Forms of guarantees

According to Stoop and Kelly-Louw, there are two forms of guarantees: a primary guarantee, which is independent, and a secondary guarantee, which is an accessory to another agreement.[109] Each form of guarantee creates a different obligation for the liable parties.

3.3.1.1 Primary guarantees

This form of guarantee is often referred to as a 'demand guarantee', a 'first demand guarantee', or an 'independent guarantee'. The main feature of the primary guarantee

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[103] Vienna Initiative Working Group 2014. Most guarantee schemes require the payment of a fee or premium in respect of the guarantee. This fee can be paid once-off when the loan is arranged at a percentage of the loan, or it can be an annual premium of between 1–4% of the total loan. See Levitsky 1987 6.
[104] DLA Piper *Investment rules of the world: South Africa* 2019. Available at https://www.dlapiperintelligence.com/investmentrules/countries/index.html?p=financial-regulation&t=entity-establishment&c=ZA&s=types-of-legal-entity 14. (Hereafter Investment Rules)
[105] Kelly-Louw thesis 3.
[106] Kelly-Louw thesis 20.
[107] "ICC".
[108] ICC *Uniform rules for demand guarantees* 1992.
[109] Stoop and Kelly-Louw "The National Credit Act regarding suretyships and reckless lending" 2011 *PER/PELJ* 69.

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is that it is independent of the underlying agreement, and creates rights and duties that are not subject to the underlying agreement, meaning that the rights of the beneficiary to be paid are reliant on the terms of the guarantee itself, and not on the terms of the underlying agreement.[110]

Kelly-Louw describes a demand guarantee as follows:

> "a short and simple instrument issued by a bank (or other financial institution) under which the obligation to pay a stated or maximum sum of money arises merely upon the making of a demand for payment in the prescribed form and sometimes also the presentation of documents as stipulated in the guarantee within the period of validity of the guarantee".[111]

The purpose and intention of a demand guarantee is to ensure that the beneficiary will be able to recover the agreed amount in accordance with the presented demand letter, irrespective of whether the principal debtor defaulted,[112] and no proof of this default is required.[113]

3.3.1.2 Accessory guarantees

Accessory guarantees are also known as 'surety agreements', 'secondary guarantees', 'ancillary guarantees', 'conditional guarantees', 'dependent guarantees', and 'guarantees with joint and several liability'. In this form of agreement, the obligations created in the guarantee are subject to the underlying agreement.

An accessory guarantee can be defined as:

> "[a] contract in terms of which one person (the surety[114]) binds himself as debtor to the creditor of another person (the principal debtor) to render the whole or part of the performance due to the creditor by the principal debtor if and to the extent that the principal debtor fails, without lawful excuse, to render the performance himself".[115]

Forsyth and Pretorius note the following:

[110] Nordea Trade Finance "Bank guarantees in international trade" 2010. Available at https://www.nordea.no/images/152-67647/bank-guarantees-in-international-trade.pdf ("Nordea").
[111] Kelly-Louw thesis 17.
[112] Stoop and Kelly-Louw 2011 *PER/PELJ* 76.
[113] Horowitz *Letters of credit and demand guarantees defences to payment* 2010 90.
[114] In an agreement of suretyship, the party making the promise is referred to as 'the surety' and not 'the guarantor'. See Kenny "Misconceptions about suretyships" 2014 *Polity*. Available at https://www.polity.org.za/article/misconceptions-about-suretyships-2014-09-10.
[115] Lötz "Suretyship" *LAWSA* 1997 79.

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> "[f]or there to be a valid suretyship there has to be a valid principal obligation, between the debtor and the creditor. The suretyship is said to be accessory to the transaction which creates the obligation of the principal debtor. Put another way, every suretyship is conditional upon the existence of a principal obligation".[116]

In the case of the accessory guarantee, the surety becomes immediately liable upon default by the principal debtor,[117] and the beneficiary can hold the guarantor and the principal debtor jointly and severely liable for payment in terms of the underlying agreement.[118] The guarantor may only raise the same defence against the beneficiary that the principal debtor would have been able to in terms of the underlying contract,[119] and the beneficiary may only hold the guarantor liable to the same degree that they would have the principle debtor. The intention of the parties in this form of agreement is that only if and once the principal debtor defaults will the surety be held liable.[120] In an accessory agreement, the obligation of the surety is discharged once the principal obligation is extinguished.[121]

3.3.1.3 Differences between the demand guarantee and the accessory guarantee

The major difference between the demand guarantee and the accessory guarantee is that the demand guarantee is not dependent on the underlying contract, and the debtor's breach of the primary agreement does not affect the obligation of the guarantor, even if the primary agreement is invalid.[122] In the case of the accessory guarantee, the guarantor is affected by the principal debtor's breach of the underlying agreement. Forsyth and Pretorius confirm this principle as follows:

> "If the creditor suffers grave losses when it turns out that the debtor's contract is invalid, the guarantor's obligation remains in force and he will have to pay those losses, but the surety's obligation falls away and he will not have to pay a penny. A second point of distinction is this: as we have seen, a suretyship is an undertaking, in the first instance, that the debtor himself

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[116] Forsyth and Pretorius *Caney's law of suretyship* (2002) 28.
[117] Henkel "Personal guarantees and sureties between commercial law and consumers in the United States" 2014 *AJCL* 332.
[118] Henkel 2014 *AJCL* 348.
[119] Nordea 10.
[120] Stoop and Kelly-Louw 2011 *PER/PELJ* 74.
[121] Popatlal "The contract of guarantee in South African law" 2006. Available at https://www.bowmanslaw.com/insights/finance/the-contract-of-guarantee-in-south-african-law/ ("Popatlal").
[122] Stoop and Kelly-Louw 2011 *PER/PELJ* 77.

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> will perform, and only secondarily that if he fails to perform that the surety will do so. With a guarantee, on the other hand, the guarantor undertakes to pay on the happening of a certain event but does not promise that event will not happen."[123]

Stoop and Kelly-Louw[124] remark that, in a demand guarantee, the liability is primary, while it is secondary in the accessory guarantee. The term 'guarantee' is used in this chapter in referring to the independent guarantee.

3.3.2 The guarantee agreement

A guarantee agreement is normally a written contract signed by the party to be charged that creates rights and duties between the lender and the guarantor.[125] According to Popatlal "[i]t is a collateral engagement to answer for the debt, default or miscarriage of another person".[126] It is an agreement concluded between the guarantor and the beneficiary at the request of the guarantor's customer.[127]

According to Henkel, the guarantor acts on behalf of the principal by promising that the principal's obligation will be satisfied, but does not become a party to the main contract. Thus, a contract separate from and independent of the underlying obligation is created.[128] Because the liability arises from the guarantee documents, it must explicitly express the terms and conditions of the agreement, including the amount to which the liability extends,[129] the parties to the agreement, and the duration of the guarantee.

According to the United Nations Development Programme,[130] the guarantee contract should also specify the following:[131]

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[123] Forsyth and Pretorius 32.
[124] Stoop and Kelly-Louw 2011 *PER/PELJ* 75.
[125] Ichegbo "The protection of a guarantor's rights in a loan transaction and the extent of his liability". Available at https://www.aaachambers.com/articles/protection-of-guarantor-rights-in-a-loan-transaction/.
[126] Popatlal.
[127] Lukic "The role and importance of bank demand guarantees in international trade" 2014 *Int. J. Eco. Res* 6.
[128] Henkel 2014 *AJCL* 337.
[129] Nordea 23.
[130] "UNDP".
[131] UNDP "Public guarantees" 2016. Available at http://www.undp.org/content/sdfinance/en/home/solutions/publicguarantees.html ("public guarantees").

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(a) The extent of the loss covered, which may be the full amount of the potential loss and interest to creditors for the entire obligation in the event of a default (unlimited), or partial (limited) cover, which specifies a portion of the debt service.

(b) The risk covered. This may cover all risks that may arise from the default, regardless of the cause, or it may be coverage of a risk arising from specified events, such as non-payment. The risks covered may be a commercial or a political risk.

(c) The instrument covered, which can be an individual instrument, such as a bond issue, or a portfolio instrument, for example, a credit facility for an SME.

(d) The fees levied by the guarantor.

Article 7 of the ICC Uniform Rules for Demand Guarantees[132] states that a guarantee agreement should state all conditions of the guarantee, including the date or period that should lapse for the guarantee to be enforced, and the documents that indicate the requirements for compliance with those conditions, and that, should it not specify the required documents, then the guarantor can disregard the agreement.[133]

It must be noted that, in order for the beneficiary to claim from the guarantor in terms of the guarantee, the beneficiary need not prove that it raised a claim against the principal debtor, or that it failed to secure payment from the principal. Only the conditions of the guarantee need to be met.[134] The guarantee must also state the form of obligation created in the agreement, that it is a primary obligation and not a suretyship,[135] and that the guarantor's obligations will not be affected by validity or legality of the underlying obligation.[136]

3.3.3 The parties to a guarantee

The guarantee agreement generally involves three parties: the guarantor, the beneficiary, and the principal debtor/applicant, although, in some agreements, it may

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[132] "URDG".
[133] Čipčič-Bragadin & Associates "ICC uniform rules for demand guarantees" 2015 5. Available at http://www.cipcic-bragadin.com/.
[134] Henkel 2014 *AJCL* 338.
[135] Popatlal.
[136] Investment Rules 14.

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include other parties, such as the issuing bank and the agent. Only the main parties to the guarantee agreement will be discussed.

3.3.3.1 The guarantor

The guarantor is the party who grants the promise in terms of the guarantee and obliges itself to make payment to the beneficiary in the event of a miscarriage by the primary debtor in terms of the underlying contract.[137] The guarantor could be a bank, insurance company, or a parent company. The guarantor's guarantee is to pay an amount of money to the beneficiary in terms of the guarantee agreement, and not to ensure the performance of the principal debtor, nor to pay what is due by the principal in terms of the underlying agreement.[138] The guarantor's liability depends on the specific wording of the contract,[139] irrespective of whether the principal has committed breach of the underlying contract.[140]

Peden quotes Lord Diplock as follows:[141]

> "The guarantor's liability under this contract does not ... depend upon the debtor's failure to perform his primary obligation continuing to exist after the contract had been rescinded".[142]

The guarantor is obligated to pay when a demand is made that complies with the terms of the guarantee.[143]

3.3.3.2 The beneficiary

The beneficiary is the third party to whom the promise is made in terms of the guarantee, who is also the creditor in the underlying contract. The beneficiary is defined as "the party in whose favour a guarantee is issued".[144] The beneficiary can claim according to the guarantee if the principal debtor fails to enter a valid contract or

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[137] Popatlal.
[138] Nordea 30.
[139] Peden "A classification of contracts of guarantee" 1991 *SYDLR* 221.
[140] Kelly-Louw thesis 84.
[141] *Moschi v KP Air Service* [i9cca731 ac 331] at 347-349.
[142] Peden 1991 *SYDLR* 222.
[143] Nordea 30.
[144] ICC "Uniform rules for demand guarantees: Article 2". Available at ICC-URDG-758.pdf (cipcic-bragadin.com).

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fails to perform in terms of the underlying contract, irrespective of the actual loss suffered.[145]

3.3.3.3 The principal debtor or the applicant

The applicant is the principal debtor or customer in the underlying contract, on behalf of whom the guarantee is made. The principal debtor is defined in Article 2 of the Uniform Rules for Demand Guarantees 758 as “the party indicated in the guarantee as having its obligation under the underlying relationship supported by the guarantee”.[146] This party may also be referred to as the ‘instructing party’. Another term for principal debtor is ‘obligor’, due to direct liability for the obligation in the underlying contract.[147]

3.3.4 The characteristics of a guarantee

3.3.4.1 The principle of independence

Article 4 of the URDG 758 goes on to explain that a demand guarantee is

> “[b]y its nature independent of the underlying relationship … and the guarantor is in no way concerned with or bound by such relationship. A reference in the guarantee to the underlying relationship for the purpose of identifying it does not change the independent nature of the guarantee. The undertaking of a guarantor to pay under the guarantee is not subject to claims or defences arising from any relationship other than a relationship between the guarantor and the beneficiary”.[148]

Horowitz explains that the guarantee is not a primary obligation, but rather an intention, should the primary obligation, being the contract or agreement of credit between the creditor and the debtor, not be met. This separation of the agreement from the underlying transaction is referred to as the ‘independence principle’, meaning that it does not have reliance on the underlying agreement based on which it exists.[149]

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[145] Kelly-Louw thesis 108.
[146] Nordea 25.
[147] Henkel 2014 *AJCL* 336.
[148] Hugo “Demand guarantees in the People’s Republic of China and the Republic of South Africa” 2019 *BRICS Law Journal* 9.
[149] Horowitz 227.

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The guarantee being independent by nature means that the guarantor has no interest in or concern with the underlying relationship entered into between the borrower and the lender, and this agreement serves only for reference purposes to the guarantee.[150] The obligation of the guarantor is therefore not subject to the underlying agreement, and arises only from the terms of the guarantee signed between all the parties. Although the guarantee is independent of the underlying transaction between the parties, it is there to support that transaction.

3.3.4.2 Demand

The second characteristic of the guarantee is that it is payable upon first written demand, without the need to produce any other documents or conditions.[151]

Karl states that the demand is a document informing of the facts that confirm that the guarantor must honour its guarantee in accordance with the agreement.[152] The demand should stipulate the guaranteed amount and the terms and conditions to be followed. The doctrine of strict compliance is applicable to the demand, and the guarantor is obligated to pay the beneficiary, provided that the document presented provides, on the face of it, the terms and conditions of the guarantee agreement.

3.3.4.3 Irrevocable contract

Once a guarantee has been issued, it cannot, for the period that it is valid, be amended or cancelled without the consent of the parties.

3.3.5 Final remarks: Credit guarantees

Ferreti defines a credit guarantee as "a tool intended to attenuate the loss arising from a debtor's default and facilitate a bank's recovery of the sums loaned".[153] It is a tool intended to reduce the loss arising from a debtor defaulting and to facilitate recovery

[150] Čipčič-Bragadin & Associates 2015 4.
[151] Horowitz 87.
[152] Marxen *Demand guarantees in the construction industry: A comparative legal study of their use and abuse from a South African, English and German perspective* 2018 69.
[153] Ferretti *New perspectives on the bank–firm relationship* 2016 79-125.

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on behalf of the bank or other guarantor,[154] even if there is the probability of a default.[155]

The credit guarantee provides a benefit for lenders in that guaranteed credit provides them with lower risk, which allows lenders to offer better lending conditions.[156] The guarantee therefore gives lenders the opportunity to enhance their client base and, potentially, their reputation.[157] In essence, the guarantee is a form of insurance for the lender against loss due to default.[158] The guarantee also serves as an incentive to help financial institutions overcome the lack of information asymmetry.[159] Samujh quotes Freedman as follows: "[c]redit guarantees are tools for building robust credit markets, and they prove more effective when implemented together with policy reform that alleviates barriers to credit".[160]

3.4 The credit guarantee in South Africa

In South Africa, as in many countries around the world, SMEs play an important role in the economy. However, according to the Organisation for Co-operation and Development[161] report, despite SMEs' contribution to economic growth and employment, they have a low success rate,[162] and lack of access to finance remains a challenge for these enterprises. In terms of the OECD report, factors influencing SMEs' access to finance include a lack of financial products available to them, their lack of available credit information, and the perceived financial risk.

[154] Credit guarantees are not only provided by banks, but also by governments, financial institutions, insurance companies, private institutions, and organisations operating as credit guarantee schemes. See Bastiaenen and Rooij "Guarantee funds and NGOs: Promise and pitfalls: A review of the key issues" 1997 *ILO working papers*.
[155] Gozzi and Schmukler "Public credit guarantees and access to finance" 2016 *Warwick Journal of education* 2.
[156] Abraham and Schmukler "Addressing the SME finance problem" 2017 *Research & Policy Brief*. Available at https://documents1.worldbank.org/curated/en/809191507620842321/pdf/addressing-the-SME-finance-problem.pdf.
[157] Samujh, Twiname, and Reutemann "Credit guarantee schemes supporting small enterprise development: A review." 2012 *AJBA* 34.
[158] Gozzi and Schmukler 2016 *Warwick Journal of education* 2.
[159] Abu-Baker and Adeinat "The economic impact of credit guarantees in Jordan" 2020 *IJBER* 289.
[160] Samujh, Twiname, and Reutemann 2012 *AJBA* 34.
[161] "OECD".
[162] OECD "Financing SMEs and entrepreneurs 2020: An OECD scoreboard" 2020. Available at http://doi.org/10.1787/061fe03d-en.

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Reference has already been made[163] to the 1995 South African government White Paper on the National Strategy for the Development and Promotion of Small Business, aimed at accelerating the growth of the small-business sector.[164] The Small Enterprise Act was subsequently passed, in 1996, followed by initiatives to assist and support small enterprises. Amongst these initiatives was Khula Enterprise Finance Limited, which later became the Small Enterprise Finance Agency[165] the Industrial Development Corporation, which focuses on black empowerment, supporting economic growth, and wealth distribution,[166] and the National Empowerment Fund, which focuses on supporting transformation enterprises and encouraging savings and investments.[167]

Khula Enterprise Finance Limited offered two products for SME financing: the Khula Credit Guarantee Scheme and the Non-bank Retail Financial Indemnity. According to the Small Enterprise Financing Agency, the purpose of the Khula Credit Guarantee Scheme is to issue a range of credit guarantees to lenders for SME borrowers who experience difficulty accessing financing, and to facilitate access to credit for these enterprises.[168] Similar to other guarantee schemes, it was introduced with the aim of encouraging banks to assist SMEs' access to credit,[169] and to share the risk of loans to SMEs with the commercial banks through partial credit guarantees.[170]

One of the aims of the South African treasury is to improve the effectiveness of support provided to SMEs by the SEFA scheme.[171] It has been found that regulatory constraints limit banks' risk-taking abilities[172]. Banks have to comply with the NCA with

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[163] Par 3.1.
[164] DTI White Paper.
[165] SEFA. See Mthimkhulu and Aziakpono "Do credit guarantee schemes address credit market failures for small business? in Preliminary evidence from South Africa Paper for presentation at the African Development Finance Workshop 2012.
[166] Fuchs *et al* "Financing small and medium enterprises in the Republic of South Africa" 2011 *Open Knowledge Repository*, "Fuchs *et al*" 90.
[167] Fuchs *et al* 93.
[168] SEFA "Credit guarantee scheme". Available at sefa.org.za/services/products/9.
[169] Sophocleous "Access to credit for small business in South Africa towards a value-based decision framework." 2019 PhD, NWU, "Sophocleous PhD" 116.
[170] Fuchs *et a*l 116.
[171] The South African National Treasury "Financial inclusion treasury" 2020. Available at http://www.treasury.gov.za/comm_media/press/2020/Financial%20Inclusion%20Policy%20-%20An%20Inclusive%20Financial%20Sector%20For%20All.pdf.
[172] Sophocleous PhD 52.

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regard to all credit agreements that fall within the ambit of the Act, which agreements include the credit guarantee.

The NCA is a burdensome Act, but it also constitutes a single credit legislative framework that currently regulates the credit industry and -market in South Africa.[173] The Policy Framework that preceded the NCA and gave rise to its promulgation does not focus on the credit guarantee; it does not even mention it. However, SMEs are mentioned a number of times. Broad remarks are made and goals are envisioned in this regard, *inter alia*: (a) the new credit framework will make credit markets work by "the increased availability of alternative finance at reasonable cost for SMEs";[174] (b) as far as credit and SME finance are concerned, research shows the existence of two markets, one for low-income consumers (of which the majority is historically disadvantaged)[175] and a market for "primarily middle and high-income consumers (who are predominantly white) and large enterprises, with easy access to credit at preferential cost";[176] (c) denied access to credit and savings is "a major inhibitor of SME start-up and growth";[177] and (d) the SME market is perceived to be "high risk with high levels of uncertainty" by "investors and financial service providers".[178] A number of reasons are cited for (d) above, *inter alia*, weaknesses in consumer protection,[179] which the new credit Act must address.

The legislature embodied the objectives of the Policy Framework in the NCA. The preamble of the NCA provides for the promotion of "a fair and non-discriminatory marketplace for access to consumer credit" and the "promotion of black economic empowerment and ownership within the consumer credit industry", but does not refer to SMEs. Section 3, "Purpose of the Act", provides that the purposes are:

> "to promote and advance the social and economic welfare of South Africans, promote a fair, transparent, competitive, sustainable, responsible, efficient, effective and accessible credit market and industry, and to protect consumers".

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[173] Policy Framework par 4.7.
[174] Policy Framework par 1.19(1).
[175] The concept "historically disadvantaged" is defined in s 2(6) of the NCA.
[176] Policy Framework par 2.1.
[177] Policy Framework par 3.20.
[178] Policy Framework par 4.13.
[179] Policy Framework par 4.13.3.

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Section 3 further provides that these objectives must be realised by, *inter alia*, "promoting the development of a credit market that is accessible to all South Africans, and in particular to those who have historically been unable to access credit under sustainable market conditions".[180]

All the aforementioned objectives are relevant to the promotion and advancement of credit to SMEs, and are indeed pursued in the provisions of the NCA. One example will suffice: the NCR is responsible for the development of an accessible credit market, in compliance with the objectives in section 3 to, *inter alia*, "serve the needs of historically disadvantaged persons".[181]

[180] S 3(a).
[181] S 13(a).

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CHAPTER 4: THE CREDIT GUARANTEE IN TERMS OF THE NCA

4.1 Introduction

As mentioned above,[182] the credit guarantee is one of the main types of credit agreement governed by the NCA. This chapter examines the credit guarantee in terms of the NCA in accordance with its definition in section 8(5), related provisions, and the application of these provisions by the courts. The chapter also discusses whether the credit guarantee in terms of the NCA is an independent guarantee or an accessory. With reference to the discussion in the previous chapter of the worldwide use of the independent credit guarantee as an instrument to promote access to credit by SMEs, regarding the credit guarantee in the NCA as the one or the other has important consequences for access
s to credit by SMEs in South Africa. The categorisation of credit guarantees into different sizes in terms of the NCA will also be addressed briefly. The credit guarantee is defined as "an agreement that meets all the criteria set out in section 8(5)" of the NCA.[183]

4.2 Section 8(5) of the NCA

The credit guarantee is defined as follows in section 8(5) of the NCA:

> "An agreement, irrespective of its form but not including an agreement contemplated in subsection (2), constitutes a credit guarantee if, in terms of that agreement, a person undertakes or promises to satisfy upon demand any obligation of another consumer in terms of a credit facility or a credit transaction to which this Act applies."

The credit facility and the credit transaction were discussed in Chapter 2.[184] Section 8(2)(a) to (c) was also mentioned,[185] and refers to agreements that are not credit agreements for the purposes of the NCA, and are thus not subject to the Act. In what follows, the definition in section 8(5) is dissected.

[182] Pars 1.1. and 2.1.
[183] S 8(5).
[184] See par 2.2.
[185] Par 2.2.

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4.2.1 An agreement

An agreement is defined as "the meeting of minds or a mutual understanding and acceptance of reciprocal legal rights and duties as to a particular action or obligation which parties intend to exchange".[186]

In terms of the Law of Contract of South Africa a contract is an agreement entered into by two or more persons with the intention of creating a legally enforcable obligation.[187]

In terms of Section 3(c)(ii) of the Act one of the purposes is to promote responsibility in the credit by discouraging reckless credit granting by credit providers and contractual default by consumers. This therefore them implies that the credit agreement is a contract, and therefore all requirements of a valid contract apply.

The requirements for a valid contract are that there must be consensus between parties who agree on the rights and obligations and the terms of the agreement, must have the capacity to understand the effect of the contract, the agreements must be legally compliant, the parties must be able to perform the terms of the agreement, the agreement must not be ambiguous, and it must meet the formalities of that said agreement.[188]

A credit guarantee as an agreement, must therefore meet all the requirements of a valid contract, and must meet the formalities of a credit guarantee in terms of the Act.

A credit guarantee, as an agreement, is therefore a mutual written or verbal agreement that is legally binding upon two competent parties (who are of sound mind, and not influenced to conclude the agreement).

For the credit guarantee agreement to be valid and binding on the parties, all the elements of a contract must be present. These are: consensus, contractual capacity, legality, certainty, and possibility of performance. Further, if formalities are required for the validity of the agreement, these formalities must be observed.[189]

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[186] "Agreement". Available at thefreeditionary.com.
[187] Hutchison and Pretorius *The Law of contract in South Africa* Oxford University press.
[188] See "Formalities of valid contracts in South Africa" found at www.golegal.co.za/valid-contract -law/
[189] For a discussion of these requirements, see Nagel *et al Commercial Law* (2019) 77ff.

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Consensus entails that the parties to an agreement have the "serious and true intention" "to create certain consequences", and they must be unanimous with regard to creating such consequences.[190] There must also be unanimity that the consequences are legal consequences, and they must know that they are unanimous in their intentions.[191] As mentioned earlier, consensus is reached by the acceptance of an offer made by the offeror to the offeree. The acceptance of the offer by the offeree must be unqualified.[192] In the case of a credit guarantee in terms of the NCA, the guarantor as the consumer makes the offer to the credit provider, "the party to whom an assurance or promise is made under a credit guarantee".[193] The latter party is the beneficiary.

The undertaking between the guarantor and the beneficiary only becomes binding once received by the beneficiary,[194] and sometimes when issued by the credit provider-promisor.[195] The guarantor and the beneficiary must reach consensus on the terms of the guarantee.

Contractual capacity to conclude a contract refers to the competency to enter into a valid, legally binding contract, and consists of two elements, namely the ability (a) to form a will; and (b) to act "with sound judgement in accordance with such will".[196] However, these elements hold for natural persons. As a 'non-human entity', a juristic person acts through representatives, and can only perform the juristic acts it is authorised to perform in its registration documents.[197] Contractual capacity and legal capacity must be distinguished. Legal capacity is the ability to be the bearer of rights and duties, and also applies to juristic persons.

The South African Law Reform Commission notes:

> "A juristic person has the same capacity to contract and to acquire, hold and dispose of rights as an individual, so far as is compatible with its nature, within any general or special rules defining its powers, and within the objects and terms of its particular constitution."[198]

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[190] Nagel *et al* 50.
[191] Nagel *et al* 50.
[192] Nagel *et al* 52ff.
[193] S1(g). See also s 8(5).
[194] Kelly-Louw thesis 41.
[195] See par 3.2.1.
[196] Nagel *et al* 79.
[197] Nagel *et al* 92.
[198] South African Law Reform Commission "Project 122: Assisted decision making report" 2015.

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Therefore, if the guarantor to a credit guarantee is a juristic person, be it, for instance, a bank or a credit guarantee scheme, it has legal capacity, but must act inside the borders of its registration documents to conclude a binding credit guarantee.

A contract, including a credit guarantee, complies with the requirement of legality if the agreement is not contrary to the common law, public policy or in contravention of a statute.[199] However, in determining the consequences when a contract contravenes a statute, whether it is illegal and what the consequences of the contravention are, the provisions of the statute are the determining factor.[200] The NCA provides, in section 89(2), for a number of unlawful credit agreements in terms of the Act, and if a credit agreement is unlawful, it will be declared void under section 89(5). Although the non-registration of a credit provider is listed in section 89(2), credit guarantees are disregarded in terms of section 40(6)(b) when determining whether a credit provider must register as such.

The performance in terms of a contract must be physically possible and certain, meaning that the performance "must be capable of delivery" and "should be determined or at least determinable".[201] No obligation to perform comes into existence if performance cannot be determined.[202] In respect of a credit guarantee, the guarantor must have the ability and capacity to pay the beneficiary in accordance with the terms of the guarantee agreement.

The NCA does not provide specific formalities, such as writing and signature, that need to be met in order for a credit guarantee agreement to be valid.[203] However, section 93(1) of the NCA requires of the credit provider to provide the consumer with a written copy of the credit agreement, which means the agreement, if concluded orally, must be put in writing to enable the credit provider to comply with section 93(1).

The phrase "irrespective of its form" in section 8(5) and in the definitions of the other credit agreements in the Act refers to the prescribed minimum contents of a credit agreement. Section 93 is titled "[f]orm of credit agreements", and the form of the credit

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[199] Nagel *et al* 94ff.
[200] Nagel *et al* 95.
[201] Nagel *et al* 102 and 103.
[202] Nagel *et al* 102-103.
[203] Stoop and Kelly-Louw 2011 *PER/PELJ* 83.

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agreement depends on the size of the agreement. In terms of section 93(2), the "document that records a small credit agreement must be in the prescribed form". In the case of the small agreement, this is done in regulation 30, read with Form 20.2.[204] Section 93(3) provides that an intermediate or large credit agreement must be as prescribed, which, in this instance, means regulation 31 of the Credit Regulations. Regulation 31 refers to "the guarantor's right" to settle the credit agreement,[205] and thus seems to apply to the credit guarantee. However, it is unsure whether the credit guarantee is classified as small, intermediate, or large.[206]

The general content of a credit guarantee agreement may include the names of all parties, the loan amount, the specific amount being guaranteed, and the requirements for a valid claim. The URDG suggests that the guarantee itself, upon issuing, contain clear and precise instructions, avoiding excessive detail, and specify the following:

> "the applicant, the beneficiary, the guarantor, a reference number or other information identifying the underlying relationship, reference number or other information identifying the issued guarantee and in the case of a counter-guarantee, the issued counter-guarantee, the amount or maximum amount payable and the currency in which it is payable, the expiry of the guarantee, any terms for demanding payment, whether a demand or other document shall be presented in paper and/or electronic form, the language of any document specified in the guarantee; and the party liable for the payment of any charges".[207]

Section 90(1) of the NCA prohibits a credit agreement containing any unlawful provisions. Examples of unlawful provisions are provisions[208] that have the general purpose or effect to "defeat the purposes or policies of [the] Act; deceive the consumer; …waive or deprive a consumer of a right set out in [the] Act". An unlawful provision in a credit agreement is void from the date it takes effect,[209] and may be severed from the credit agreement, or be altered by the court to make it lawful,[210] or the court may declare that the whole credit agreement is unlawful and void in terms of section 89(5).[211]

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[204] Of the Regulations in terms of the NCA, GN R 489, *GG* 28864, 31 May 2006 ("Credit Regulations").
[205] Reg 31(2)(u).
[206] See par 4.3.
[207] Čipčič-Bragadin & Associates 2015 5.
[208] The unlawful provisions are listed in s 90(2).
[209] S 90(3).
[210] If it is reasonable to do so having regard to the context of the whole agreement.
[211] S 90(4)(a) and (b).

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It must be noted that, even if an agreement meets the definition of a credit guarantee as contained in the Act but is not protected by the Act for any reason, that agreement is still legally binding and can be enforced by the law.

4.2.2 Undertaking by a person to satisfy any obligation of another consumer

The credit guarantee in terms of the NCA is an undertaking or promise by the guarantor to satisfy the obligations of the consumer specified in the credit guarantee agreement. In the context of section 8(5), "consumer" is qualified as such in terms of either a credit facility or a credit transaction to which the NCA applies. This qualification is discussed below.[212]

The concept 'obligation' is defined by Nagel[213] as follows:

> "a legal connection (tie or bond) between two or more persons in terms of which the one can claim performance from the other (for example, to do or to give something, or to refrain from doing something) and the latter can be compelled by law to perform his duty".

The main sources of obligations are statutes, contract, delict, and unjustified enrichment.[214]

4.2.3 Upon demand

In terms of the definition in section 8(5) of the credit guarantee, the guarantor must perform the obligation of the other consumer "upon demand". This is one of the operative terms in the definition. A demand guarantee is defined in the URDG as "any signed undertaking, however named or described, providing for payment on presentation of a complying demand".[215] By this definition, the credit guarantee qualifies as a demand guarantee. Karl[216] states that the demand is a document informing of the facts that confirm that the guarantor must honour its guarantee in accordance with the agreement.

[212] This requirement is discussed in par 4.2.4.
[213] Nagel *et al* 7.
[214] Nagel *et al* 7.
[215] Čipčič-Bragadin & Associates 2015 2.
[216] Marxen *Demand guarantees in the construction industry* 2018 69.

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The guarantee can only be performed upon the presentation of a written document that provides and proves the terms of the guarantee,[217] and, according to Article 15 of the URDG, where the guarantee requires that supporting documents be provided by the beneficiary, these should accompany the demand, together with a statement indicating in what respect the applicant/principal debtor is in breach of its obligations under the underlying relationship.[218]

In *Minister of Transport and Public Works and others v Zanbuild Construction (Pty) Ltd and Another*,[219] where the question was whether the guarantee was a conditional or on demand bond, it was held that an on-demand bond is one that requires merely that the claimant demand payment. In *State Bank of India and another v Denel Soc Limited*, the court held as follows:

> "[a] bank issuing an on-demand guarantee is only obliged to pay where a demand meets the terms of the guarantee. It is therefore imperative that the demand meets the requirements as worded in the guarantee itself. Such a demand, which complies with the terms of the guarantee, provides conclusive evidence that payment is due.[220]

4.2.4 Obligation in terms of a credit facility or a credit transaction subject to the NCA

The term "upon demand" in section 8(5), discussed above, is an indication that the legislature could have had an independent guarantee in mind when drafting the definition of a credit guarantee. However, section 8(5) provides for a promise or undertaking by the guarantor to satisfy the obligations of another "consumer in terms of a credit facility or a credit transaction to which [the] Act applies". The words in quotation marks complicate matters by creating the impression that the credit guarantee is dependent on another credit agreement, which must either be a credit facility or a credit transaction, the other main types of credit agreement subject to the NCA.[221] This impression is reiterated by the court in *Firstrand Bank (Pty) Ltd v Carl Beck Estates (Pty) Ltd and Another*,[222] in which the second respondent, Carl Beck,

[217] Kelly-Louw thesis 3.
[218] Čipčič-Bragadin & Associates 2015 9.
[219] 2011 (5) SA 528 (SCA).
[220] 2015 2 All SA 152.
[221] See par 2.2.
[222] 2009 (3) SA 384 (T) ("*Carl Beck*").

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entered into a suretyship agreement as surety and co-principal debtor on behalf of Carl Beck Estates (Pty) Ltd, the first respondent. The court remarked as follows:

> "There is no doubt that the surety obligations of the second respondent theoretically fall within the definition of a credit agreement which encompasses a credit guarantee in terms whereof 'a person undertakes or promises to satisfy upon demand any obligations of another consumer in terms of a credit facility or a credit transaction…"[223]

Furthermore, Satchwell J, in *Carl Beck*, remarked that the second respondent is a "guarantor of a consumer's obligations to a credit giver", and, importantly, the "second respondent's relationship with the applicant [Firstrand] remains ancillary to the main agreement between the applicant and the first respondent".[224]

Section 4(2)(c) reiterates section 8(5)'s last part, and provides that the NCA applies to a credit guarantee only to the extent that the Act applies to the credit facility or the credit transaction in respect of which the guarantee is concluded.

4.2.5 Compliance with the section 8(5) requirements and the parties to the NCA's credit guarantee

Compliance with the definition of the credit guarantee in terms of section 8(5) of the NCA is required to constitute this type of credit agreement in terms of the Act. It is significant that the right in section 8(5) to rely on performance in terms of the credit guarantee merely requires a demand, and not that default should be committed by the consumer in terms of the credit facility or the credit transaction. If any of the individual elements of the credit guarantee discussed above is not complied with, the guarantee does not come into existence.

The section 8(5) definition, read with the definition of "consumer" and "credit provider" in section 1 (in respect of the guarantee),[225] determines the parties to the credit guarantee. The consumer is the guarantor of the promise or undertaking under the credit guarantee agreement, and the credit provider of the credit facility or the credit transaction is the party to whom an assurance or promise is made under the guarantee, who then becomes the beneficiary of the guarantee.

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[223] *Carl Beck* par 18.
[224] *Carl Beck* par 18.
[225] See par 1.5.

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The 'consumer' under the credit guarantee would thus be the credit guarantee scheme, bank, or institution granting the guarantee, and is not the consumer under the credit facility or the credit transaction in respect of which the credit guarantee is concluded. However, the 'credit provider' under the credit guarantee is also the credit provider under the credit facility or the credit transaction. In this sense, unlike the other types of credit agreements under the NCA, the consumer under the credit guarantee is not the party to whom credit is advanced.

The guarantor under a credit guarantee is, however, only compelled to perform in terms of the credit guarantee upon demand by the credit provider in terms of the guarantee. The question therefore still remains whether the credit guarantee referred to in section 8(5) of the NCA is an independent guarantee, a suretyship agreement, or both. This will be discussed further at the end of this chapter.

4.3 Size classification of credit guarantees

4.3.1 Introduction

Section 9 of the NCA distinguishes categories or sizes of credit agreements, and section 9(2), (3), and (4), providing for these sizes, must be read with the threshold regulations.[226] In terms of section 9(1) "every credit agreement" subject to the Act is classified as small, intermediate, or large. The credit guarantee is also a credit agreement under the Act, but its classification into sizes is contentious. The size of a credit guarantee is discussed below.

Section 9(2) provides for small credit agreements, namely pawn transactions, credit facilities with a credit limit of R15 000 or below, or any other credit transaction, except a mortgage agreement, with a principal debt of R15 000 or below. The intermediate credit agreement is a credit facility with a credit limit between R15 000 to R250 000, or any credit transaction, except a pawn transaction or a mortgage agreement, with a principal debt ranging from R15 000 to R250 000.[227] Section 9(4) provides that a large credit agreement is a mortgage agreement or any other credit transaction, except a pawn transaction, with a principal debt of R250 000 or higher. The reason for the

[226] The threshold regulations were promulgated in terms of s 7, which authorises the Minister to promulgate different thresholds for different purposes in terms of the Act.
[227] S 9(3).

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exclusion of the pawn transaction in section 9(3) and (4) is that the pawn transaction is always considered small. The mortgage agreement is excluded in section 9(1) and (2) because it is always considered large, irrespective of the amount involved. A credit facility can be either small or intermediate.[228]

4.3.2 The credit guarantee

The credit guarantee is mentioned in sections 9(2) to (4). For purposes of illustration, section 9(4), providing for the large credit agreement, provides the following:

> "A credit agreement is a large agreement if it is –
> (a) a mortgage agreement; or
> (b) any other credit transaction, except a pawn transaction or a credit guarantee, and the principal debt under that transaction or guarantee falls at or above the higher of the thresholds established in terms of section 7(1)(b) [R250 000]."

Section 9(4) first refers to mortgage agreements as "large". Then it refers to "any other credit transaction except a pawn transaction [which is a credit transaction, but is classified as small] or a credit guarantee". It therefore seems that the pawn transaction and the credit guarantee are excluded from the classification. However, section 9(4)(b) next refers to "the principal debt under that transaction or guarantee", but at this point seems to include the credit guarantee under the classification of a large transaction. Section 9(4)(b) also seems to regard the credit guarantee as a credit transaction, which it is not. Section 8(1) lists these as different credit agreements.[229] Section 9(4)(b) is worded similarly to sections 9(2)(c) and 9(3)(b) in respect to the credit guarantee.

There is uncertainty whether the credit guarantee is classified as small, intermediate, or large. Kelly-Louw[230] is of the opinion that, as, in terms of section 9(1), every credit agreement is classified according to size, the same should hold for the credit guarantee. According to her, the credit guarantee should be classified in accordance with the size of the underlying credit agreement. However, the classification of the credit guarantee into one of the size categories is made difficult by the grammar and

[228] See Otto and Renke "Credit agreements" par 8.7.
[229] See par 2.2.
[230] Kelly-Louw "Categorising credit agreements, particularly credit guarantees, as small, intermediate or large agreements in terms of the National Credit Act 34 of 2005: Analyses" 2012 *SA Merc LJ* 214-215.

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punctuation mistakes in the NCA. Otto and Renke[231] summarise the uncertainty with regard to whether credit guarantees are classified into sizes as follows:

> "Despite the clumsy wording of the Act, … it appears on the wording of section 9(2) to (4) that credit guarantees are not classified as small, intermediate or large. However, it could be argued, for various reasons, that credit guarantees are also classified into different sizes, the latter depending on the size of the credit facility or credit transaction in respect to which the credit guarantee is concluded."

The researcher agrees with the first possibility mentioned by Otto and Renke, namely that it was not the intention of the legislature to classify credit guarantees in terms of section 8(5) of the NCA, which are independent guarantees, into sizes. Although the credit guarantee is classified as a credit agreement in the Act, it, in essence, does not involve the deferral of payment in instalments and the levying of charges, fees, or interest in respect of a deferred payment. However, certainty whether the credit guarantee is subject to the section 9 NCA size classification is essential. If the guarantor under the independent credit guarantee is a juristic person and enters into a large credit guarantee with the credit provider in terms of the guarantee, the credit guarantee falls outside the scope of the NCA.

4.4 Case law

4.4.1 Introduction

Carl Beck, in which Satchwell J remarked that "there is no doubt" that a suretyship agreement could theoretically fit the provisions of section 8(5), was mentioned earlier.[232] In what follows, remarks by Satchwell J later in the case are mentioned, followed by a brief discussion of two Supreme Court of Appeal[233] decisions in respect of section 8(5). It is important to note that I could not find a decision by a court discussing whether the section 8(5) credit guarantee could be an independent guarantee.

[231] Otto and Renke "Credit agreements" par 8.7.
[232] Par 4.2.5.
[233] "SCA".

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4.4.2 *Carl Beck*

The underlying agreement in *Carl Beck* was a mortgage agreement between Firstrand Bank Ltd (applicant) and Carl Beck Estates (Pty) Ltd (first respondent), in respect of which a suretyship agreement was entered into by Carl Beck (second respondent) as "surety and co-principal debtor".[234] Satchwell J held that no credit was granted to Carl Beck, and that he did not become a party to the mortgage agreement concluded between Firstrand Bank Ltd and Carl Beck Estates (Pty) Ltd. The only enforceable right the applicant had against the second respondent arose from the surety agreement Carl Beck had signed. The second respondent was therefore not a consumer, "but a guarantor of a consumer's obligations to a credit giver. Second respondent's contractual relationship with the applicant remains ancillary to the main agreement between the applicant and the first respondent". Thus, also signing the suretyship a co-principal debtor does not change the nature of the suretyship agreement.[235]

4.4.3 *Mostert v Firstrand Bank T/A RMB Private Bank*[236]

This SCA case relates to a loan agreement between Mostert and RMB Private Bank,[237] in terms whereof a trust, *inter alia*, entered into a suretyship agreement with RMB to secure the payment of the loan.[238] The trust entered into the suretyship agreement as surety and co-principal debtor. The SCA in *Mostert* confirmed that section 8(5) of the NCA includes suretyships entered into in respect of a credit facility or a credit transaction. The surety as guarantor is a consumer in terms of the suretyship contract, but not in terms of the agreement in respect whereof the surety agreement is concluded. Due to the fact that the surety is a consumer in terms of the suretyship or the credit guarantee, the surety may rectify a default in respect of the suretyship.[239]

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[234] *Carl Beck* par 17.
[235] *Carl Beck* pars 20 – 22.
[236] 2018 (4) SA 443 (SCA) ("*Mostert*")
[237] "RMB".
[238] *Mostert* paras 2 – 12 set out the background for the SCA's decision.
[239] *Mostert* par 28.

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4.4.4 *Shaw and Another v Mackintosh and Another*[240]

Shaw, in the words of the SCA, concerned "the proper interpretation of s 8(5)".[241] Briefly, the facts were that,[242] in about 2009, Mackintosh lent R2 million to a company, Mabili Search and Selection (Pty) Ltd[243] in terms of an oral agreement. The parties subsequently entered into a written acknowledgement of debt, "the agreement". In terms of the agreement, Mabili acknowledged its debt to Mackintosh. The agreement provided that the debt would be payable in instalments, and that interest would be payable in respect of the deferred amount. The parties were in consensus that the agreement fell outside the ambit of the NCA, as Mabili was a large juristic person. However, in terms of clause 5 of the agreement, titled "The Suretyship", the appellants bound themselves as joint and co-principal debtors with Mabili in its indebtedness. Mabili defaulted on the agreement, and was subsequently liquidated. Mackintosh alleged that the 2009 loan gave rise to the agreement. Relying on clause 5 of the agreement, he sued the appellants as sureties, alleging that they concluded a credit guarantee in terms of section 8(5) of the NCA. Mackintosh also alleged that the credit guarantee, which was concluded in respect of an underlying agreement falling outside the NCA's area of application, was not covered by the Act's provisions. The appellants, however, contended that they were not sureties, and that they had become co-debtors in respect of the acknowledged debt; thus, a section 8(4)(f) "other agreement" had been concluded, and they were therefore entitled to the NCA's protection.[244]

The SCA did not agree with the appellants that the agreement fell inside the scope of the NCA, and dismissed the appeal.[245] The SCA remarked:

> "[a]n essential precondition to the operation of s 8(5) … is that it applies to the obligations of another. The language of the section refers both to an undertaking and a promise to satisfy the obligation of another. It makes no reference to a suretyship or guarantee or any similar word."[246]

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[240] 2019 (1) SA 398 (SCA) ("*Shaw*").
[241] *Shaw* par 1.
[242] *Shaw* pars 1 – 10.
[243] "Mabili".
[244] *Shaw* pars 1 – 10.9
[245] See *Shaw* par 13.
[246] *Shaw* par 10.

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Thus, only Mabili was liable for the debt. The appellants were not parties to the 2009 loan, and no credit was extended to them. They only became involved "when they undertook or promised to pay on demand" the debt owed by Mabili to Mackintosh. This brings the obligations of the appellants "squarely within the language of s 8(5)".[247]

4.5 Section 8(5) of the NCA: An independent guarantee or suretyship agreement?

The independent demand guarantee, the suretyship agreement, and the characteristics of each were discussed in Chapter 3. There are divergent opinions as to whether the credit guarantee in terms of section 8(5) of the NCA caters for an independent demand guarantee, a suretyship agreement, or both. The court cases discussed in the previous section show that the courts, including the SCA, have no problem in bringing the suretyship under the scope of section 8(5) of the NCA and, therefore, under the Act's protection. All that is required by the courts is that the credit facility or the credit transaction in respect of which the suretyship is concluded be subject to the Act. In this regard, the courts also rely on the provisions of section 4(2)(c).[248] In all three cases discussed above, the courts encountered a suretyship agreement that was entered into in respect of an agreement that complied with the definition of one of the credit transactions subject to the NCA. Only Satchwell J in *Carl Beck* mentioned the accessory nature of the suretyship, that it is ancillary to the underlying agreement. Probably due to the fact that the courts were not confronted with the question whether section 8(5) could include an independent guarantee, they did not address the issue.[249] No specific attention was paid in any of the decisions to the meaning of the term "upon demand" in section 8(5).

However, Mostert[250] relies heavily on the term "upon demand" in section 8(5) to opine that the section 8(5) definition caters for independent guarantees, and not for suretyship agreements. In discussing the suretyship agreement,[251] Mostert refers to Innes CJ's remark in *Corrans and Another v Transvaal Government and Coull's Trustee*[252] that "the surety undertakes that the obligation of the principal debtor will be

[247] *Shaw* par 12.
[248] See par 4.2.4.
[249] See also Otto and Renke "Credit agreements" par 8.2.4.
[250] Mostert "Surety agreement must comply with NCA" 2009 *De Rebus* 53 and 55.
[251] Mostert 2009 *De Rebus* 53.
[252] 1909 TS 605.

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discharged, and if not, that the surety will indemnify the creditor under the principal obligation". Mostert remarks that the suretyship has "one conspicuous element" distinguishing it from other agreements, "the element of accessoriness", which means that the surety's liability is completely dependent on that of the principal debtor. The surety can raise any defence that can be raised by the principal debtor in respect of the principal obligation. The surety does not have to satisfy the obligation of a third party upon demand. The principal obligation does not have to be paid or performed upon demand, as the surety can raise any defence available to the principal debtor.[253] It is not the intention of the surety to be liable. The surety only undertakes to stand in for the liability of the principal debtor if the latter does not perform. This is not in accordance with the definition of "credit" in terms of the NCA,[254] which is the deferral of payment or a promise to defer the payment.[255] Mostert is of the opinion that, if the legislature wanted to include the suretyship in the NCA as a credit agreement or a credit guarantee, it would have been done explicitly.[256] However, due to the use of this type of agreement in practice, the legislature must provide clarity as to whether the suretyship must form part of section 8(5).

According to Mostert, the section 8(5) NCA definition of the credit guarantee provides for an independent contract of guarantee, which must be distinguished from suretyship.[257] In the case of the contract of guarantee, the guarantor undertakes an original obligation, and not an accessory one.[258] The guarantor "stands in for a future fact or event of whatever nature".[259] The creditor is indemnified if the future event does not happen.[260] "The event is not necessarily linked to the obligation of a third party, but independent of it. Often, the guarantee is simply an undertaking to pay subject to conditions."[261] Mostert remarks that the language used by the legislature in section 8(5), with specific reference to the liability of the debtor to perform upon demand,

[253] Mostert 2009 *De Rebus* 53.
[254] In s 1. See par 1.5.
[255] Mostert 2009 *De Rebus* 53.
[256] Mostert 2009 *De Rebus* 53.
[257] Mostert 2009 *De Rebus* 55.
[258] Mostert 2009 *De Rebus* 53 and 55.
[259] Mostert 2009 *De Rebus* 55.
[260] Mostert 2009 *De Rebus* 55.
[261] Mostert 2009 *De Rebus* 55.

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"indicates against the liability of a surety". It is a strong indication of a guarantor's "more liquid and certain liability".[262]

Stoop and Kelly-Louw[263] contrast the suretyship and its accessory nature, the demand guarantee, and the letter of credit, noting the independence of the last two guarantees.[264] The characteristics of the independent agreement were discussed earlier, but it is important to note here that the authors are of the opinion that section 8(5) of the NCA includes the suretyship agreement. They go so far as to imply that section 8(5) only applies to accessory agreements.[265] However, they subsequently remark as follows: "[I]f the Act were to apply to a suretyship agreement…" and "[I]f one accepts or assumes that the *National Credit Act* applies to a contract of suretyship and such a contract is a credit guarantee…"[266]

The main reasons for Stoop and Kelly-Louw's argument that the NCA includes the suretyship agreement are that not too much emphasis must be placed on the phrase "upon demand", and that the accessory character of the section 8(5) guarantee is proved by its dependence on a credit facility or a credit transaction that is subject to the NCA. In respect of the latter argument, they refer to, *inter alia*, section 4(2)(c), and remark that there would have been no link to the primary debt in the case of one of the independent guarantees. Section 4(2)(c) makes it clear that the NCA will only apply to the credit guarantee to the extent that it "will apply to the primary debt".[267]

Stoop and Kelly-Louw opine that Mostert over-emphasises the phrase "upon demand" in the NCA.[268] They also contend that, "[u]nfortunately, the use of the phrase … could unnecessarily lead one to the wrong conclusion that the definition of 'credit guarantee' does not cater for the conditional nature of a contract of suretyship".[269] According to Stoop and Kelly-Louw, 'upon demand' could have a wider meaning than in the sense used in independent guarantees.[270] The words may also mean to inform the surety, in

[262] Mostert 2009 *De Rebus* 55.
[263] Stoop and Kelly-Louw 2011 *PER/PELJ* 67ff.
[264] Stoop and Kelly-Louw 2011 *PER/PELJ* par 2.2.
[265] Stoop and Kelly-Louw 2011 *PER/PELJ* pars 2.3 and 4.
[266] Stoop and Kelly-Louw 2011 *PER/PELJ* pars 2.4 and 3.
[267] Stoop and Kelly-Louw 2011 *PER/PELJ* par 2.3.
[268] Stoop and Kelly-Louw 2011 *PER/PELJ* par 2.3.
[269] Stoop and Kelly-Louw 2011 *PER/PELJ* par 2.3.
[270] See Stoop and Kelly-Louw 2011 *PER/PELJ* par 3.

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whichever way, that the principal debtor is in default and that the surety now has an obligation, as promised or undertaken, to satisfy the debtor's remaining obligations in terms of the credit facility or credit transaction.[271] In conclusion, Stoop and Kelly-Louw submit that "it is vital to know if a suretyship agreement is a credit agreement in terms of the *National Credit Act*", due to its importance as a tool used by credit providers to limit their risks in terms of credit agreements.[272] Otto and Renke remark that Mostert's arguments have merit, but if regard is had to the objectives of the NCA, it is unlikely that the legislature intended to protect only consumers in respect of independent guarantees. The following remark summarises the two divergent opinions discussed above. Otto and Renke submit that "it would be in accordance with the purposes of the Act as a whole were both suretyships and guarantees covered by the definition of 'credit guarantee'".[273]

The researcher supports Mostert, and is of the opinion that the credit guarantee in terms of section 8(5) of the NCA is an independent guarantee. This is clearly indicated by the use of the phrase "upon demand" in section 8(5) of the Act. Mostert's argument makes sense, and is in accordance with the discussion of the independent guarantee in Chapter 3.[274] Although Otto and Renke are of the opinion that, due to its practical application and importance in the credit market, the suretyship agreement should not be excluded from the section 8(5) definition, they support the merits of Mostert's opinion and argument.

In spite of the researcher's view that the credit guarantee in terms of the NCA is an independent guarantee, it is conceded that the arguments presented by Stoop and Kelly-Louw cannot be ignored. However, it seems that their explanation of the phrase "upon demand" in section 8(5) to make the suretyship fit into the definition in section 8(5) is forced. As Mostert remarked, if the legislature intended to include the suretyship agreement as a credit agreement under the NCA, it would have done so explicitly. The "dependence" of the credit guarantee in the NCA on a credit facility or a credit transaction that is subject to the NCA does not prove the credit guarantee's accessory character, but the dependence of the credit guarantee on one of the other two credit

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[271] Stoop and Kelly-Louw 2011 *PER/PELJ* par 2.3.
[272] Stoop and Kelly-Louw 2011 *PER/PELJ* par 4.
[273] Otto and Renke "Credit agreements" par 8.2.4.
[274] Pars 3.3.1.1. and 3.3.4, in particular par 3.3.4.2.

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agreements, in order to be protected by the NCA. This fact, however, does not detract from the credit guarantee's independent character per section 8(5).

The definition of the credit guarantee in terms of section 8(5) has not been properly tested by the courts because they have not been called upon to provide a proper interpretation. Otto and Renke, with reference to *Carl Beck*, remark that "[t]he court was not presented, it appears, with arguments along the lines proposed by Mostert".[275]

[275] Otto and Renke "Credit agreements" par 8.2.4.

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CHAPTER 5: CONCLUSIONS, RECOMMENDATIONS, AND FINAL REMARKS

5.1 Introduction

The purpose of this dissertation was to discuss the credit guarantee in terms of section 8(5) of the NCA as an instrument to promote SMEs' access to credit in South Africa. One of the pertinent purposes of the NCA, which gave rise to its promulgation, was the promotion and advancement of access to credit for the broader South African population. If regard is had to the Policy Framework 2004 document that preceded the NCA, the NCA's preamble and objectives, and the provisions in the Act in order to give effect to its goals, it is clear that, *inter alia*, historically disadvantaged persons as owners of businesses were the target of improved access to credit.[276] Except for the reference in passing to SMEs in the Small Enterprise Act and the Policy Framework,[277] It was not the aim of this dissertation to discuss which businesses in South Africa qualify as SMEs for purposes of the NCA's goals.

Credit guarantees are, worldwide, an important instrument in the advancement and promotion of access to credit by SMEs.[278] This much is reiterated by Kraemer-Eis and Van Steensel, who remark that "[c]redit guarantee mechanisms are a commonly used response to market failures and market weaknesses in the area of SMEs' access to finance".[279] Although the Policy Framework does not refer to the credit guarantee, it does recognise the need to promote start-up businesses and SMEs. All the mentioned objectives of the NCA[280] and, in particular, the goals of promoting and advancing the accessibility of credit to historically disadvantaged persons black empowerment and ownership in the credit industry, indirectly pursue the Policy Framework's ideals. The same holds for the provisions of the NCA, of which one example was mentioned.[281]

[276] Par 3.4.
[277] Pars 1.1. and 3.4.
[278] Par 3.1.
[279] Kraemer-Eis and Van Steensel "SME credit guarantees issued by the European Investment Fund (EIF)" 2016 *Dossier* 1.
[280] Par 3.4.
[281] S 13(a). See par 3.4.

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The majority of SMEs in South Africa are black-owned,[282] and, according to a report by the NCR as recently as 2019, research has shown that only formal SMEs have access to formal suppliers of financing. Informal SMEs are totally excluded from these financial sources,[283] and it is therefore imperative that the credit market be opened to SMEs. In a report, the NCR suggests to the Minister that incentives to banks and other private sector credit providers to loan to SMEs should be considered in order to give effect to section 3(a) of the NCA.[284] Fuchs *et al*[285] suggest that "it may be worth government considering financing the establishment of a new 'window' of credit guarantees",[286] and that utilising the credit guarantee is attractive, and not only as collateral for asset-poor borrowers. It can also leverage the risk-assessment expertise of the private sector and increase lending transparency and operational efficiency, which further align with the purpose of the NCA.

This dissertation briefly discussed the field of application of the NCA.[287] The reasons for this, and, in particular, the inter-relatedness of the NCA credit guarantee with the credit facility and the credit transaction were mentioned.[288] It is important that the SME as a big juristic person, or as a smaller juristic person that concludes a large credit agreement, is excluded from the NCA's field of application, and thus from the Act's protection.[289] According to the courts,[290] this exclusion of groups of juristic persons from the NCA's application and protection is not unconstitutional.[291]

[282] Bamu *et al* "The National Credit Act: Will it increase access to credit for small and micro enterprises?" 2007 *Law Democracy and Development* 35.
[283] NCR "Literature review on small and medium enterprises' access to credit and support in South Africa". Available at https://www.smallbusinessinstitute.co.za/wp-content/uploads/2019/12/NCRLiterature-Review-on-SME-Access-to-Credit-in-South-Africa_Final-Report_NCR_Dec-2011.pdf.
[284] See par 3.4.
[285] Fuchs *et al* 60.
[286] Fuchs *et al* 60.
[287] Ch 2.
[288] Pars 1.1. and 2.1.
[289] Par 2.4.
[290] The *Hunkydory* decisions, the SCA and the CC.
[291] Par 2.4.

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5.2 The credit guarantee in terms of the NCA

The NCA, which is not an example of clear legislative drafting,[292] by no means clarifies whether an independent guarantee, suretyship agreement, or both, were intended in section 8(5). Stoop and Kelly-Louw, who remark that they have provided "numerous reasons" that the suretyship agreement is, in fact, covered in section 8(5), do not seem convinced that this is the case.[293] The researcher has already provided an opinion and reasons for preferring the inclusion of the independent guarantee, and not the suretyship agreement, in the credit guarantee's definition.[294] However, Stoop and Kelly-Louw[295] posit that it is vital that clarity be provided regarding what was intended with the inclusion of the credit guarantee in the NCA. The researcher agrees with this view, particularly in light of the role credit guarantees play in SMEs' access to credit and their development as businesses.[296]

The size classification provisions in section 9(2) to (4) of the NCA also cause uncertainty with regard to the credit guarantee.[297] If the credit guarantee as an instrument to improve SMEs' access to credit is classified as large, that credit guarantee causes a smaller juristic person that enters into that credit guarantee to be excluded from the NCA's application and protection.[298]

5.3 Recommendations and final remarks

It is recommended that the definition of section 8(5) of the NCA be amended in order to provide clarity with regard to the credit guarantee's true nature. Section 9(2) to (4) should similarly be amended, to clarify whether credit guarantees are classified into different sizes. It is vital that the drafting of the NCA in respect of these provisions be revisited by the legislature. If this does not occur, it can only be hoped that the courts will provide the much-needed clarity. Such clarity is vital because, in the words of

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[292] This observation has been made in a number of decisions, *inter alia* by the SCA in *Nedbank v The National Credit Regulator* 2011 (3) SA 581 (SCA) par 2 and *Du Bruyn NO v Karsten* 2019 (1) SA 403 (SCA) par 1.
[293] Par 4.5.
[294] Par 4.5.
[295] Par 4.5.
[296] See pars 3.1 and 3.4.
[297] Par 4.3.
[298] See par 2.4. for the exclusion of smaller juristic persons concluding large credit agreements from the NCA's field of application.

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Freedman, as quoted by Samujh, "[C]redit guarantees are tools for building robust credit markets",[299] which is what is needed in South Africa in order to address the legacy of the country's past.

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[299] Par 3.3.5.

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