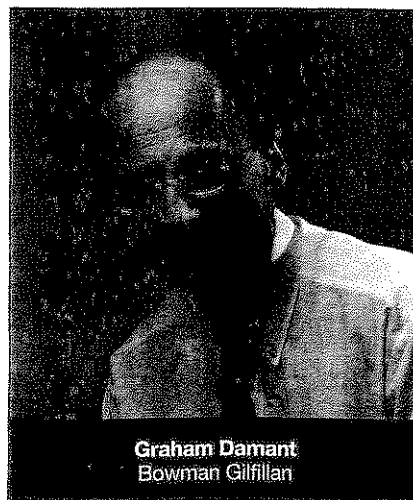




Housing Loans – Problems arising from section 14 transfers and from changes in Financial Service Providers

There is only one circumstance in which pension funds are permitted to provide loans or guarantees to members and that is in respect of housing or immovable property. Presumably this is in support of a socially desirable practice of encouraging home ownership. Most funds that permit this practice do so by way of providing a guarantee to a third party lender who makes the loan to the member concerned. Many funds have exclusive relationships with third party lenders in terms of which they will only furnish a guarantee if a loan is made by a specific lender. The guarantee provided by the fund is usually provided in the form of a suretyship, in terms of which the fund stands surety for the debt, and in some instances by the fund signing as co-principal debtor and surety. Given the passing of the National Credit Act in 2005 it is up to the third party lender to conduct the appropriate due diligence to ensure that the member is credit worthy. The fund is protected in respect of the guarantee given by the member signing a pledge of the member's pension benefits in favour of the fund. Accordingly, if the fund is forced to pay against the guarantee because the member defaults on the loan, the fund will be able to recoup its money from the member's benefit.



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There are two instances where the guarantee relationship can prove problematic – the one is where there is a section 14 transfer from the fund providing the guarantee (the transferor fund) to another fund (the transferee fund) and the other is where one third party lender is substituted for another. The purpose of this article is to highlight the problem areas so that trustees can be aware of them and appropriately manage the transactions.

Business restructurings and transfers are part and parcel of the commercial world. When a company or part of the company is transferred from one employer to another it is usual for members and their benefits to be transferred from the fund in which the company participated (the transferor fund) to another fund (the transferee fund) in terms of section 14 of the Pension Funds Act (Act). The question arises as to whether the guarantee and suretyship provided by the transferor fund would automatically transfer to the transferee fund as part of the liabilities. The question is also whether the pledge transfers from the transferor fund to the transferee fund as part of the assets. It is apparent from a legal analysis of the wording of section 14 and the nature of a pledge and suretyship that they do not constitute either an asset or a liability of the fund and as such do not automatically transfer. Section 14(4) of the Act recognises that a creditor of the fund (which could include the third party lender) is not deprived of rights against the transferor fund as a consequence of a section 14 transfer. Effectively this means that the third party lenders' rights against the transferor fund are protected notwithstanding the section 14 transfer.

That the suretyship and pledge do not automatically transfer is also recognised by section 37D of the Act which provides that the fund is permitted to deduct from the member's benefit, "*in the case of a transfer of the member to another fund, the amount of the benefit which the fund is so entitled to transfer, if the board of the transferor fund is satisfied that it is not otherwise reasonably possible to negotiate the repayment or to transfer the loan or the guarantee*".

This section places an onerous obligation on the trustees of the transferor fund to negotiate with the third party lender, the member and the trustees of the transferee fund to allow the loan to continue and for the transferee fund to sign a suretyship in favour of the lender, for the member to sign a new pledge in favour of the transferee fund and the third party lender to release the transferor fund from the suretyship. If the transferor fund is not able to do so then it would have the consequence that either the loan will be called up and the transferor fund will have to pay the third party lender in terms of the guarantee or alternatively that the transferor fund will have to hold sufficient monies to cover the guarantee to meet any potential liability. Neither of these results is socially desirable in the context of trying to ensure long term saving. The trustees can go a long way to making this task easier for themselves by including appropriate clauses in the suretyship agreement in terms of which the lender will agree to release the fund from suretyship in the

context of a section 14 transfer provided that the transferee fund provides suretyship in identical terms. The member would similarly provide an undertaking in the pledge to sign a new pledge in favour of the transferee fund in the context of a section 14 transfer.

The second problem arises where the fund or a third party lender makes a decision to change from one third party lender to another. This is usually done by way of a third party lender transferring or ceding its loan book to another third party lender. Section 95 of the National Credit Act which deals with changes, deferrals and waivers to credit agreements provides "*the provision of credit as a result of a change to an existing credit agreement, ... is not to be treated as creating a new credit agreement for the purposes of this Act if the change, ... is made in accordance with this Act or the Agreement*". This means that a cession or transfer in terms of which one third party lender is replaced by another would not constitute a change warranting a conclusion of a new credit agreement and with it all of the obligations placed on the third party lender to ensure that the member is credit worthy. However section 4(5) of Schedule 3 to the Act provides "*Despite Section 95, for the purposes of this item, a change after the effective date to any credit agreement that was made before (June 2006) constitutes the making of a new credit agreement, unless it is a change to –*

- (a) *the interest rate ...; or*
- (b) *... the credit limit ...*".

This appears to create a distinction for credit agreements concluded prior to 1 June 2006. Effectively in the context of a cession of the loan from one third party lender to another, for all agreements concluded before June 2006, a new credit agreement would arguably need to be concluded. All of the aspects of the Act would apply, including an appropriate due diligence by the third party lender which would have to be conducted. This may have the unfortunate consequence that the member may be found to be not credit worthy in the context of a due diligence done at the current date which in turn would have the consequence that the loan will be recalled and the fund would have to pay out in terms of the guarantee. Again this is not socially desirable in the context of encouraging long term savings.

Accordingly trustees need to be aware that in the context of both a section 14 transfer and in the context of changing from one third party lender to another that there are onerous obligations on them to ensure that members are not prejudiced. In the context of a section 14 transfer they can make the task easier by incorporating appropriate clauses into the guarantees and the pledges to be signed. In the context of a decision to transfer from one third party lender to another careful consideration needs to be given in respect of guarantees provided for loans prior to June 2006. In the longer term it may be appropriate for the legislation to be amended to specifically protect members in the context of these kinds of transaction. □