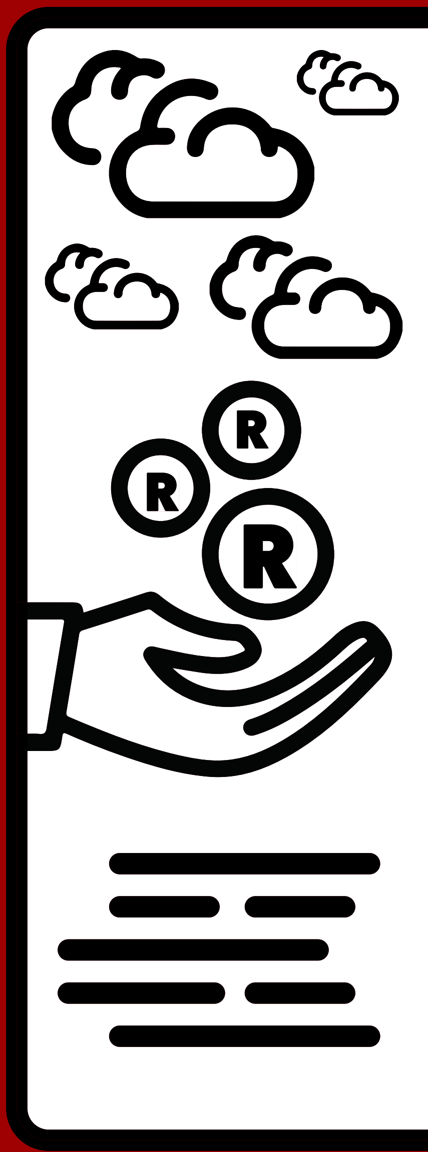
national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

South African Reserve Bank

THE BANKING ASSOCIATION SOUTH AFRICA

Answering your questions about the COVID-19 LOAN GUARANTEE SCHEME



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As a result of the novel coronavirus and the steps taken to curb its spread, many businesses face a significant loss of income. In this context, government is partnering with commercial banks to provide financial support to small and medium-sized firms to enable them to meet their operational needs over the next few months. On 4 May 2020, the National Treasury, South African Reserve Bank and Banking Association South Africa agreed on the detailed design, legal agreements and administrative processes to implement the loan guarantee scheme announced by President Ramaphosa on 20 April 2020. Participating banks started receiving and processing covid-19 loan applications from Tuesday 12 May 2020.

1. WHAT IS THE LOAN GUARANTEE SCHEME?

The Covid-19 loan guarantee scheme is an initiative to provide loans, guaranteed by government, to businesses with an annual turnover of less than R300 million to meet some of their operational expenses. Government and commercial banks are sharing the risks of these loans. Initially, the National Treasury has provided a guarantee of R100 billion to this scheme, with the option to increase the guarantee to R200 billion if necessary and if the scheme is deemed successful.

2. HOW IS IT STRUCTURED?

The National Treasury has provided a guarantee to the Reserve Bank. This guarantee is recorded as a contingent liability on the government's account. The Reserve Bank will lend money to commercial banks at the repo rate (currently 4.25 per cent) plus a 0.5 per cent credit premium. Banks will lend this money to small and medium-sized businesses at the repo rate plus a fixed spread of 3.5 per cent (currently 7.75 per cent, equal to the prime lending rate).

3. WHO MANAGES THE SCHEME?

The National Treasury, South African Reserve Bank and commercial banks, represented by the Banking Association South Africa, have agreed on the relevant legal framework, and financial and operational requirements. The Reserve Bank is the administrator of the scheme. The SARB will provide the finances for these loans to banks and will keep a record of the amounts owing by each bank as well as default rates. The Reserve Bank will publish an annual report setting out how much each bank has used from the scheme and the performance (default rate) of each bank's COVID-19 loan portfolio.

4. WHICH BANKS ARE PARTICIPATING?

All commercial banks can access the guarantee scheme, though the Reserve Bank reserves the right to limit the amount that can be accessed by an individual bank. Participating banks at the moment include Absa, Mercantile Bank, First National Bank (FirstRand), Investec, Nedbank and Standard Bank. Discussions are under way to enable more banks to participate. Start dates for the programme may differ by bank, though the larger banks launched the scheme from 12 May 2020. Participating banks have signed bilateral agreements with the SARB setting out the terms of the scheme and the legal and operational obligations of banks and the SARB.

5. WHICH BUSINESSES QUALIFY?

To qualify for the loan, a business must have an annual turnover of less than R300 million (measured at a group level) and be in good standing with its bank. This means that the business must be up to date with its other loan payments or be an account holder without any loans as at end-February 2020. The business must have an existing relationship with the bank granting the loan, be registered with SARS and be financially distressed as a result of the Covid-19 outbreak and subsequent lockdowns.

6. WHAT CONDITIONS ARE ATTACHED TO THE COVID-19 LOAN?

The loan can only be used for operational expenditure such as salaries, rent, utilities and ordinary-course supplier payments. Businesses may not use these loans to pay dividends, make investments, pay bonuses or pay off other loans that the business may have. The loan amount will be disbursed to the customer in up to three monthly instalments. After that, no payment is expected from the customer for a further three months. The customer then has five years to pay off the loan and associated interest. The interest rate is fixed at the repo rate plus 3.5 per cent. Banks cannot vary this condition. This implies that the interest rate will change when the repo rate changes. Each applying business is entitled to only one loan under this guarantee scheme. In addition, banks may ask customers to provide security or suretyships for this loan and may impose additional conditions as each bank deems fit. Banks are not obliged to extend Covid-19 loans. They will use their risk evaluation and credit application processes to approve or decline applications.

7. HOW WILL LOSSES WORK?

Commercial banks and the National Treasury share the risks of the scheme. The South African Reserve Bank takes no financial risk in the scheme as its loans to banks are guaranteed by the National Treasury.

Losses will be allocated as follows:

a. The net margin on the loan portfolio (approximately 2 percentage points) is pooled as the first loss buffer.
b. The 0.5 percentage point credit premium charged by the National Treasury is the second loss buffer.
c. Banks will take the third loss, up to 6 percentage points of the amount loaned by that particular bank in terms of the scheme.
d. After that, losses will be borne by the National Treasury.

If a customer defaults on the loan, banks can claim on the guarantee from the Reserve Bank, which will in turn claim the funds from the National Treasury, but only after banks have followed the allocations outlined above and their standard recovery processes. If a bank initiates such a claim, the Reserve Bank will require an independent audit to ensure that sound lending practices were applied. The difference between the 3.5 percentage points above the repo rate and the 2 percent net margin is attributed to the 50 basis point (or half a percent) credit premium and costs incurred by banks in terms of capital, statutory costs and administration costs.

8. WHO PROFITS FROM THE LOAN GUARANTEE SCHEME?

The loan guarantee scheme is intended to help small and medium-sized businesses. While these arrangements are designed to encourage banks to lend more than they would otherwise lend, banks are expected to make sound lending decisions and avoid reckless lending. The intention is not for banks to make a profit from these loans. Any net profits will be pooled to offset losses in the scheme, so as to minimise total losses to South African taxpayers.

9. WHAT CONDITIONS DO BANKS HAVE TO MEET?

Banks are required to check the qualifying criteria of applicants. They will use their existing processes and infrastructure to process loan applications. Banks have discretion on whether they wish to extend a loan to an applicant.

Banks will cede any loans under this scheme to the Reserve Bank as security, and will report regularly to the Reserve Bank on the performance of the loan portfolios.

10. WHAT HAPPENS IF A BUSINESS THAT HAS TAKEN A COVID-19 LOAN CLOSES DOWN?

If a business that has taken a loan goes into liquidation, the Covid-19 loan is treated as equity and therefore ranks behind other creditors.

11. WHO CAN I CONTACT FOR MORE INFORMATION?

To access the loan guarantee scheme, contact your primary or main banker.