

## DRAFTING SECURITY CESSION AGREEMENTS

### IMPORTANT CONSIDERATIONS

A cession *in securitatem debiti* (also sometimes referred to as a security cession), is where a Debtor cedes (transfers) to a Creditor certain incorporeal personal rights to secure the repayment of a debt (the "Principal Debt").

Examples of these ceded personal rights are - book debts, insurance policies, shares and the like.

The agreement creating the obligation to cede (the "obligatory agreement") and the execution or fulfilment of the obligation to cede can be contained in one document (the obligation to cede and the execution or fulfilment thereof, however, remain separate juristic acts).

No formalities are required for the obligatory agreement or the act of cession itself, although the parties may agree on formalities with which the cession must comply. The cession may be express or tacit or may be inferred from the parties conduct. Whilst the cession need not be reduced to writing, the parties may agree that it should be in writing, in which event it will only be valid if reduced to writing.

### THE WORKINGS OF A SECURITY CESSION

The mechanisms surrounding the working of security cessions have been a controversial topic.

There are two main views:

1. the first view is that a security cession is an outright cession of rights with an undertaking that the Cessionary will restore rights to the Cedent on the satisfaction of the secured debt (the practical implications of this construction appears to benefit the Cessionary and hold more risk for the Cedent);
2. the other view is that under a security cession the rights of the Cedent are "pledged" to the Cessionary, and the Cedent retains "ownership" despite cession thereof (the "pledge construction").

Save to say that at this stage, it appears that parties can structure security cessions either way and if the intention is not clearly expressed, the pledge construction will prevail (see [Grobler v Oosthuizen SCA](#) case)

The purpose of this article is not to discuss different theories.

This article will focus on the important considerations when drafting a security cession based on the pledge construction.

## SECTION 43 OF THE SHORT-TERM INSURANCE ACT, 1998 AND SECTION 44 OF THE LONG-TERM INSURANCE ACT, 1998

Something often missed by Parties that do not regularly participate in the credit industry are the provisions of section 43 of the Short Term Insurance Act, 1998, and section 44 of the Long Term Insurance Act, 1998 (the "Free Choice provisions").

It often happens that you need to structure a transaction to fall outside the ambit of the NCA (see – [Drafting Loan Agreements and the NCA: Important considerations](#)).

If the transaction falls outside the ambit of the NCA and the Lender requires the Borrower to cede as security an insurance policy, then you need to take the Free Choice provisions into consideration.

These Free Choice provisions provide that –

- The Cedent must be provided with a "free choice" in certain circumstances about:
  - whether the Cedent wants to cede as security **a new policy** or an **existing policy** (or a combination of these options)
  - the insurer that the Cedent wants to use (only applicable to new policies) as well as the intermediary (if applicable)
  - whether the benefits under the policy must be provided in an event other than the death or disability of the Cedent (breach of a contract must accordingly be expressly stated in writing)
  - whether the value of the cession will exceed the value of the debt it secures
- The Cedent must **confirm in writing that before the security cession takes effect:**
  - the Cedent was notified of the choices he or she is entitled to make as contemplated above
  - the Cedent exercised freedom of choice
  - the choices made was not subject to any coercion or inducement as to the manner in which the Cedent exercised his or her freedom of choice.

If the above Free Choice provisions have not been complied with the security cession will be void.

## THE MATRIMONIAL PROPERTY ACT

Section 15 (2) (c) of the Matrimonial Property Act, 1984, provides that a spouse married in community of property may not alienate, cede or pledge any shares, stock, debentures, debenture bonds, insurance policies, mortgage bonds, fixed deposits or any similar assets, or any investment by or on behalf of the other spouse in a financial institution, forming part of the joint estate; without the written consent of their spouse attested by two competent witnesses in respect of each such transaction.

The exception to this rule is where someone who is married in community of property signs a security cession in the ordinary course of their profession, trade or business.

## FINANCIAL ASSISTANCE IN TERMS OF SECTION 45

Something that is also often overlooked is section 45 of the Companies Act, 2008.

For example, a Creditor may require a holding company (the "Cedent") to sign a security cession in respect of a security interest held by the Cedent (for example a loan account (the "secured debt") for principal debt to be incurred by a subsidiary (the "Debtor").

If an exception stipulated in section 45 of the Companies Act, 2008, does not apply, the security cession may constitute "financial assistance" and trigger various actions required by the board and the shareholders of the holding company.

Section 45 may require a special resolution of the shareholders of the holding company to provide the security cession, and the board of the holding company will need to be sure that:

- immediately after providing the financial assistance, the company would satisfy the solvency and liquidity test; and
- the terms under which the financial assistance is proposed to be given are fair and reasonable to the company; and
- any conditions or restrictions respecting the granting of financial assistance set out in the company's Memorandum of Incorporation have been satisfied.

If the board of the holding company does not act within section 45 of the Companies Act, 2008, then the security cession may be void and the directors may be held personally liable.

## LOCUS STANDI

Once the security cession is in place, the Cedent will not be in the position to enforce the usual rights under the security interest.

The problem surrounding locus standi can best be illustrated by way of example. Where the Cedent, for example, cedes in securitatem debiti book debts and the debtor or debtors of those book debts default, the Cedent will not be able to enforce the debt.

When drafting the security cession agreement, it is important to ensure that the relevant clauses are included in the agreement addressing the aspects surrounding locus standi.

A clause that can be considered to address this situation is one in terms of which the Cessionary re-cedes the required rights to institute action against the defaulting debtor. When acting for the Cessionary, the drafting of these clauses becomes very important and specific obligations will need to be placed on the Cedent to institute action and once the action has been finally prosecuted or settled the Cedent must again cede in securitatem debiti the security interests back to the Cessionary.

## PARATE EXECUTIE CLAUSE

When acting for the Cessionary, one would want to ensure maximum protection for your client. If the security cession does not contain an express parate executie clause it is doubtful whether the Cessionary may alienate the ceded security interest in the absence of an appropriate court order, even after the debt may have become due.

It is therefore advisable to include a comprehensive parate executie clause (when sanctioned by the obligatory agreement this is a form of parate executie which is valid for movables and invalid for immovables ([Contract Forwarding \(Pty\) Ltd v Chesterfin \(Pty\) Ltd 2003 1 All SA 267 \(SCA\)](#); [Bock v Duburoro Investments \(Pty\) Ltd supra](#); [SA Bank of Athens Ltd v Van Zyl 2006 1 All SA 118 \(SCA\)](#); [2005 5 SA 93 \(SCA\)](#))).

## THE CESSIONARY'S OBLIGATIONS

In [Retmil Financial Services \(Pty\) Ltd v Sanlam Life Insurance Company Ltd and others \[2013\] 3 All SA 337 \(WCC\)](#), the Court held that a cessionary must act as a bonus paterfamilias in relation to the ceded right, and the Cessionary has a duty to exercise due diligence in respect of the ceded right and must protect the Cedent's interests in the right. When acting for the Cessionary this situation can be problematic and can result in a claim against the Cessionary if the Cessionary has not executed its duties as contemplated in the aforementioned case.

If we again look at the earlier example where the Cedent cedes in securitatem debiti book debts, and we consider the above obligations applicable to the Cessionary, it appears that a situation may arise where the Cessionary fails to act pursuant to the said obligations and in turn opens itself up to a damages claim.

Inserting an exemption of liability clause can be considered, stipulating that the Cessionary shall not be obliged to take any steps to collect or enforce any rights associated with the ceded rights.

## ACCESSORIAL NATURE OF A CESSION

Something also often overlooked is the principle that a cession is accessorial in nature. The [Brayton Carlswald \(Pty\) Ltd and Another v Brews SCA](#) case illustrates the key principals surrounding this issue.

Key takeaway being that in law, transfer by cession of a non-existent right is a nullity (i.e. a claim that is going to be ceded, must be an extant claim).

The debt which gives rise to the claim is settled on payment. So, if a claim is to be ceded, it is important to ensure that the debt is not settled before the claim is ceded.

The distinction between non-existent rights and future rights must be kept in mind. A future right is a right which does not exist on the cession date, but which may come into existence. Our law permits the cession in security of future rights.

## IN CONCLUSION

Security cessions can get complicated and should be drafted with care. Working through the [contracts.tech](#) automated security cession agreement will ensure that you address various important consideration that may relate to a security cession.



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