Slow uptake of Covid-19 Loan Guarantee Scheme

By Chantel van Zyl and Penjani Mseteka

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Following the economic downturn and immense pressure placed on businesses as a result of the worldwide Covid-19 pandemic and ensuing global lockdown, National Treasury, the South African Reserve Bank (SARB) and the Banking Association of South Africa (BASA) announced the launch of the Covid-19 Loan Guarantee Scheme (the Scheme) on 13 May 2020. The aim of the Scheme was to provide financial support to distressed businesses with a turnover below R300 million. The National Treasury initially provided a R100 billion guarantee to the Scheme with an option to increase the guarantee to R200 billion, depending on the success of the Scheme.

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Covid-19 Loan Guarantee Scheme: Phase I

Although the National Treasury has taken a significant portion of the risk, the participating commercial banks do not receive full guarantees for each loan and therefore carry a portion of the risk if the qualifying business is unable to repay its loan under the Scheme. Currently Absa, Bidvest Bank, First National Bank (FirstRand), Grindrod Bank, Investec, Mercantile Bank, Nedbank, SASFIN Bank and Standard Bank are participating in the Scheme. The main purpose of the loans is to enable businesses to withstand the economic pressures of the Covid-19 pandemic by having access to borrower-friendly loans for operational expenses.

In terms of the Scheme, SARB has received a guarantee from National Treasury and SARB has lent money to commercial banks at the repo rate plus 0.5%. The commercial banks then on-lend the money to struggling businesses at the repo rate plus 3.5%. The conditions of the funding were, amongst other things, that the businesses needed to:

- have a turnover of less than R300 million;
- be existing bank clients;
- be financially distressed as a result of the Covid-19 pandemic;
- be registered with the South African Revenue Services (SARS);
- apply for only one loan; and
- repay that loan over a five-year period.

Despite Government's hope that the Scheme would provide much needed relief to depressed business and boost the economy, by July 2020, only a small portion of the available funds had been disbursed to businesses. As at July 2020, of the approximately 35,000 entities that applied for loans, only 8,000 received funds under the Scheme.

National Treasury believed that the slow uptake was due to a critical flaw in the Scheme's design. Ultimately, the commercial banks that were tasked with disbursing loans to qualifying candidates were using their traditional creditworthiness checks. This was problematic as the purpose of the Scheme was to assist businesses financially distressed due to Covid-19, yet those businesses that so desperately required assistance did not qualify for such assistance. The Scheme failed to address the requirement to ease creditworthiness assessments, whilst still ensuring that the banks could provide credit in a responsible manner to candidates that are likely to be able to repay the loans.

Another serious critique of the Scheme was the slow processing of loan applications. Considering that the purpose of the loans was to assist distressed businesses with paying pressing obligations, such as salaries and rentals, the long processing time meant that the Scheme was not as useful to businesses as had been expected prior to its launch.

Covid-19 Loan Guarantee Scheme: Phase II

As a result of the slow uptake of the potential R200 billion in funding, the Scheme was revised to make loans more attractive to businesses. On 26 July 2020, Treasury, SARB and BASA announced various changes to the Scheme to make funds more accessible to the public. The most notable change to the Scheme was the cancellation of the requirements for applicants to have a turnover of less than R300 million. Instead of the turnover limitation, the Scheme has introduced a maximum loan amount of R100 million per business. Banks have the option to syndicate funding greater than R50 million, thereby distributing the risk of larger loans across multiple banks.

Whilst banks cannot disregard their internal credit assessment methods, they have agreed to embrace the emergency spirit and object of the Scheme by being more discretionary when determining the creditworthiness of candidates. In that vein, another amendment to the Scheme was introduced, namely, the relaxation of the good standing requirement. Provided that a business was in good standing with its bank as at December 2019, instead of February 2020, the business would have passed the good standing check. Another, more attractive feature of the revamped Scheme is that businesses can access the loans over six months, instead of the original requirement that the loan be used within three months. Importantly, the Scheme has extended the capital and interest repayment holiday to six months after the last utilisation, effectively doubling the previous payment holiday period of three months after final utilisation.

Projected success

Despite the improvements to the Scheme, BASA has indicated that it does not envision a significant uptake of loans, as many businesses are hesitant to increase their debt exposure during a financial crisis. BASA estimates that between R24.4 billion and R43.7 billion, of the potential R200 billion, will have been distributed to businesses by January 2021. Another contributing factor to the lack of success of the Scheme may be the various payment holidays provided by lenders and landlords to businesses outside of the Scheme, as a result of Covid-19. It appears that businesses are pursuing alternative routes to lessen the financial impact of the pandemic.

Finance Minister Tito Mboweni speculates that South Africa's drop to Level 2 of lockdown may spur increased economic activity and appetite for credit in the market. National Treasury, SARB and BASA noted that they are committed to have ongoing conversations about ways to improve the Scheme and ensure that it is reflective of the needs of the market.

It is possible that businesses may make a decision to use the Scheme once they have had an opportunity to properly assess the longer term impact of the economic downturn on their operations, or once initial payment holidays and employee Temporary Employer/Employee Relief Scheme payments have been fully used.

Despite the changes introduced under Phase II of the Scheme, further improvements are still required, such as incentivising commercial banks to process more loans by allowing them to make a profit from the loans disbursed under the Scheme. Currently the 3.5% margin charged by banks is being allocated to cover defaults of the loans and to minimise the losses faced by banks and National Treasury. Another beneficial amendment to the Scheme would be to remove the restrictions on the use of the loan. Under the Scheme, qualifying businesses may only use the funds for operational expenses, however, more businesses may be inclined to apply for a loan if the uses were not so limited.

As business begin resuming commercial activity, there is potential for banks to disburse more loans under the Scheme. The jury is still out on the overall success of this stimulus initiative.

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