FINANCIAL SECTOR TRANSFORMATION COUNCIL

GUIDANCE NOTE GN100

on

CODE SERIES FS100, STATEMENT 100

RULES GOVERNING THE PROVISION OF BLACK BUSINESS GROWTH FUNDING: OWNERSHIP

The provision of risk capital to support black business was negotiated as part of the Financial Sector Code (the "FSC"), as an alternative to section 3.5.2.1 of the previous FSC. The 2017 amended FSC recognises that the financial sector is uniquely positioned to create sustainable wealth across a broad base by leveraging the allocation of resources from savers to those needing capital for growth. The FSC allows that this can be achieved through equity equivalent programmes as contemplated in FS100, Statement 103. These equity equivalent contributions include, but are not limited to, NDP aligned initiatives, growth of black business, enterprise development, empowerment financing and access to financial services. This guidance note sets out the rules governing the provision of Black Business Growth Funding (BBGF) as allowed for in the Ownership element of the FSC.

The provisions of section 3.9.1.2 of Statement 100 of the FSC are intended to unlock funding for black entrepreneurs, black industrialists, black asset managers, black financial brokers and other black people in business in the financial services and other key sectors of our economy. The aim is to support the transformation of the economy in general and the financial services sector in particular by providing financial and non-financial support to black owned and black women owned enterprises in line with the objectives of Broad-Based Black Economic Empowerment (B-BBEE).

The overall objective that the FSC is seeking to support is new and existing black-owned companies that create jobs within the economy.

The financing must support businesses that meet the following criteria:

(a) Black people (as defined in the B-BBEE Amendment Act of 2013) must be directly involved in the origination and creation of the business and/or must through the transaction become intimately involved in the management and operation of the business going forward.
(b) The enterprise should be or become a financially sustainable business or cooperative that results in the creation or preservation of jobs in the local economy.

In terms of the FSC, measured entities can make use of BBGF as follows:

Ownership

(a) Under table 2b of FS100, local subsidiaries or branches of multinational or external companies may utilise BBGF as part of the Ownership scorecard.
(b) Under 3.9.1.2 of FS100 banks and life offices can top up the shortfall in ownership points through the provision of BBGF as an equity equivalent.
(c) FS103 of the FSC sets out the criteria for the recognition of equity equivalents under the Ownership scorecard, and specifically includes BBGF as a form of Equity Equivalent.
(d) The above will be under the Equity Equivalent Investment Program under Statement 103 of the Amended Codes of Good Practice

Conditions to be met prior to the eligibility of Banks and Life Offices for the Ownership elements of Black Business Growth Funding after the sale or loss of shares by black participants:

(a) Measured Entities (other than multinationals that are subject to global policy restrictions on the accommodation of local ownership in South African subsidiaries or branches) should have done a direct ownership transaction that created net value and met the minimum ownership criteria as negotiated in the FSC, i.e.,

(i) For bank and life offices, refer to paragraph 3.9.1 and 3.9.2 of code 100 of the FSC

(ii) For other measured entities, section 3.9.3 of code 100 of the FSC

(b) Multinationals that are subject to global policy restrictions on the accommodation of local ownership in South African subsidiaries or branches, are entitled to apply equity equivalents in terms of this guidance note, based on 25% of the value of their South African operations as defined in statement 103, provided approval has been obtained from the DTI, to apply equity equivalents.

Further conditions that need to be met by the measured entity to claim points pursuant to the above clauses:

(a) Financing can be counted for scorecard purposes on an irrevocable commitment either via:

(i) a formalised capital allocation to an internal business unit structured in accordance with the principles below; or

(ii) a commitment letter to an external party structured in accordance with the principles contained in this guidance note;

(iii) for multinationals businesses once they have approval from the Minister.

(b) Each tranche of committed capital must be fully deployed within 5 years of the commitment date.

(c) For irrevocable commitments within the first 3 years post the FSC gazetting, the internal business unit or external party responsible for managing all the key activities related to fund management must be 51% black owned and managed or 30% black female owned and managed.

(d) Post 3 years after the FSC gazette, the internal business unit or external party must be 75% black owned and black managed or 51% black female owned and managed.

(e) The above ownership thresholds are based on the Flow Through Principle.

(f) In the event that the allocation is managed via an external party the management provisions contemplated in clauses (c) & (d) above would not apply to the measured entity but rather the external party.

(g) The internal business unit or external party must be appropriately licensed according to the nature of the financing activities undertaken.

Financing Rules

In recognition of the fact that it is currently a challenge for financial institutions to find enterprises to invest in that already have a significant black shareholding, the measured entity can deploy the funding to beneficiaries over time, based on the formulation detailed below:

1. Within 1 year of the commitment noted above, 25% of the funding should be deployed to the benefit of companies that are 75% Black Owned as defined, and 10% of the funding should be deployed to the benefit of 51% Black Women owned companies as defined.
2. Within 2 years of the commitment noted above, 40% of the funding should be deployed to the benefit of companies that are 75% Black Owned as defined, and 20% of the funding should be deployed to the benefit of 51% Black Women Owned companies as defined.
3. Within 3 years of the commitment noted above, 60% of the funding should be deployed to the benefit of companies that are 75% Black Owned as defined, and 30% of the funding should be deployed to the benefit of 51% Black Women Owned companies as defined.
4. Within 4 years of the commitment noted above, 70% of the funding should be deployed to the benefit of companies that are 75% Black Owned as defined, and 35% of the funding should be deployed to the benefit of 51% Black Women Owned companies as defined.
5. Within 5 years of the commitment noted above, 80% of the funding should be deployed to the benefit of companies that are 75% Black Owned as defined, and 40% of the funding should be deployed to the benefit of 51% Black Women Owned companies as defined.

For the avoidance of doubt, the funding that is provided above is intended to provide growth capital to operational black businesses and not create passive empowerment stakes in non-black owned businesses. In addition, the majority of the capital is intended to be used to remain in the business to support growth as opposed to funding buy-outs of untransformed partners.

Higher Education Funding

A maximum of 20% of all funds committed, can also be provided to support funding of higher education for schemes and individuals that meet the affordability thresholds defined by the higher education ministerial task team, formed in 2016, in response to the National Student Funding crisis.

For the avoidance of doubt, all funding initiatives in this context, will require approval from the FSC Council.

Types of funding to be provided

Many financial institutions are subject to capital reserving requirements. Banks are for instance subject to BASEL III, Insurers to SAM, Stockbrokers to JSE requirements, etc. It is thus important that a balance is found between the systemically necessary regulatory requirements imposed on the sector, and the need to create access to affordable funding for black business and higher education.

For the above reasons, the categories of funding with lesser risk profiles attached, and thus less primary capital reserves in terms of BASEL III, have been down-weighted in the benefit matrix overleaf. Conversely, funding which implies significant risk to the provider, and thus additional primary capital reserves, receives a larger weighting in the benefit factor matrix below.

In addition, in order to incentivise the provision of a full suite of support to Black business, as well as target priority sectors at the request of the DTI, certain other categories of grant-based support, as well as job creation incentives, are also included.

The BBGF Benefit Factor Matrix below should be applied:

DEBT

Risk							
	Stage/Size>>		**EME**	**QSE**	**Small**	**Large**	**Higher**
			<10m	**<50m**	**<200m**	**>200m**	**N/A**
	Securi	**Effective Rate^**					
Risk	<80%	Prime or less	200	175%	125	75%	200%
	<80%	Less than Prime + 5%	175	150%	100	50%	175%
	<80%	More than Prime + 5%	100	75%	50%	0%	100%
	>80%	Prime or less	175	133%	100	50%	175%
	>80%	Less than Prime + 5%	150	100%	50%	25%	150%
	>80%	More than Prime + 5%	50%	25%	0%	0%	50%

OTHER

Stage/Size>>	**EME**	**QSE**	**Small Generic**	**Large Generic**	**Higher Education**
	<10m	**<50m**	**<200m**	**>200m**	**N/A**
Equity	200%	175%	100%	50%	200%
Grants	200%	175%	125%	50%	200%
Support Services	175%	150%	100%	50%	175%

Notes

(a) Ownership BBGF funding can only be counted to the extent that it was issued post the date of the gazetting of the FSC.

(b) For every job created and proven through the provision of funding, an extra R100k of deemed funding is claimable based on definitions in the FSC. If an investee business is in a formal business rescue or turnaround process, the same R100k funding bonus provision will apply to job preservation.

(c) For multinationals once they are approved by the Minister they get 25 fixed points for the period of recognition and there are no bonus points. This assuming funding is provided based on the value of 25% of SA operations. Proportionate points will be provided for less than 25% of SA operations subject to a minimum of 10% of SA operations.

(d) When in doubt as to the nature of funding, (e.g. debt or equity) and which of the above categories to classify it against, the capital provisioned/held by the Measured Entity against investment to determine the category should be utilised.

(e) In order to incentivize funding of priority sectors, the above benefit factors can be multiplied by 1.2, if the funding is provided to companies operating in the manufacturing sector (as per SARB reports).

(f) In the event that capital is committed to a third-party provider it is the nature of capital provided by the Measured Entity to the third-party provider that should determine the BBGF Benefit Factor Matrix classification. The intention is for the underlying investee enterprises of the BBGF to receive preferential financial terms on a risk-reward basis relative to traditional commercial funding. In the event that it is not clear that such funding is preferential at a 3rd party manager mandate level, the instruments provided to the underlying investee enterprises can be further interrogated by rating agencies to verify the nature of capital.

(g) Support Services in the BBGF Benefit Factor Matrix would use the Overhead Costs definition in the Enterprise and Supplier Development Benefit Factor Matrix FS400 (B) annex as a guideline for verification but these cannot be double counted across BBGF & ESD.

(h) This guidance note will be subject to review by the FSC Council, within 12 months of publication.