



**INSOL**  
INTERNATIONAL



# Secured creditors; encumbered asset accounts; free residue account

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# Types of assets

The Insolvency Act ( IA) distinguishes between two types of assets: encumbered/security and free residue.

## ***Secured Assets / Encumbered Assets***

Criteria for a thing to qualify as security:

- It must be an asset in the insolvent estate
- A creditor has a preferent right over the asset ( creditor will have the right to be paid first from the proceeds of the asset )
- ***Free Residue***
- Asset is **NOT** subject to a preferent right based on a mortgage, pledge, hypothec or a right of retention.
- All free residue assets are reflected in one single free residue account

## Different classes of Creditors

- Determine the
  - Rights of creditors
  - How the balance of proceeds of the assets are distributed amongst the creditors,
  - and who is liable to pay for any contribution

## Secured Creditors

A secured creditor is entitled to the benefits that originate from his security, for example, rental income and interest earned on the deposit of the purchase price of the property

- Creditors have a “secured right” over specific assets
- These assets are “encumbered” assets
- Each encumbered asset is dealt with separately in its Encumbered Asset Account (EAA) in the liquidation account
- All costs relating to the specific assets will also be reflected in the specific EAA
- All income earned on the specific assets will also form part of the security

Types of Secured Creditors:

# 1) Special Mortgage Bond over immovable property

- Bond must be registered in the Deeds Office – Deeds Registries Act to create the secured right over the property
- Bond registered over a house – to secure the home loan
- Bondholder – secured creditor
- One property can have more than one mortgage bond
- The date of registration of the bonds will determine the ranking of payment of bonds.
- Bondholder will be paid from the proceeds of the sale of the house
- Proceeds minus all section 89 costs relating to the sale of the property will be the bondholder's secured dividend.

## 2) Special Notarial Bond – over specific identified movable assets

- Notarial bond registered in the Deeds Office in terms of the Security by Means of Movable Property Act ( Act 57 of 1993) on or after 7 May 1993 and
- registered under the Notarial Bonds ( Natal Act ( Act 18 of 1932) before 7 May 1993
- Secured creditor – if the following requirements are met:
  - Registered in the Deeds Office
  - Must be movable – tangible assets
  - Movables must be specified and described to be identified

### 3) Pledge of corporeal movable assets

- Where a movable asset is delivered to a creditor as a pledge
- Does not require registration in the Deeds Office
- The creditor must remain in possession of the assets to have security and be recognized as a secured creditor

## 4) Pledge of incorporeal Asset - Cession

- Personal right is pledged by ceding the right to the creditor as security for a claim
- E.g. cession of book debt, shares in a company, rights under an insurance policy
- Two theories:
  - Out-and-out cession – debtor fully transfers his personal right to the creditor – ownership passes to the creditor.  
Once the debt has been paid – the creditor must re-transfer the right to the debtor.  
If the debtor sequestrated before – the ceded claim is not part of the debtor's estate.



## Pledge of incorporeal Asset – Cession - continued

- Pledge theory –
  - Ownership of the right remains vested in the debtor.
    - The creditor has a security ( like a pledge). If the debtor is sequestrated, personal right is an asset in the estate, and the creditor will be a secured creditor.

In the current position, if not structured as an out-and-out cession, the default position will be the pledge theory.

## 5) Landlords Legal Hypothec

The landlord/ Lessor has a hypothec over the movable property and all fruits and crops yielded by the property

- Landlord is a secured creditor for outstanding rent
- Landlord must perfect his hypothec by :
  - Sue the Tenant for payment of outstanding rent and include an automatic rent interdictor
  - To attach the property
- Includes:
  - Movable property that belongs to the Tenant
  - Movable property of subtenant if property of Tenant not sufficient
  - Third parties' movables on premises
    - Excluded:
      - Movables subject to Instalment Sale Agreement
      - Movables covered by Notarial Bond – ito Security by Means of Movables Property Act
- Refer to the limits of security in notes
- Rental after date of sequestration- Administration costs

## 6) Right of Retention

Two types:

### 1. Enrichment lien

- Storage lien – expenses incurred prevented the market value from decreasing
- Improvement liens – expenses incurred increased the market value

Limitations:

- Only necessary expenses
- The smaller of actual expenses or the amount by which the owner was enriched

Rankings:

Enrichments claim rank before other securities created earlier

# Right of Retention – continued

## 2. Debtor- creditor lien

- Expenses incurred into a contract
  - Creditor may remain in possession of the property until being paid for the services rendered
  - The creditor must still be in possession of the property unless handed over to the Trustee
    - Rankings:  
Will be paid after other securities created earlier in time

## 7) Instalment Sale Agreement- Sec 84 of IA

- Ownership remains with the Seller until the full purchase price has been paid
- Agreement must comply with requirements of Sec, i.e.:
  - Movable property sold
  - On more than one instalment over a period of time
  - Possession and use transferred to the debtor/consumer
  - Ownership passes when the full purchase price is paid
  - Interest, fees and charges are paid to the creditor

Effect of sec 84 on sequestration:

- Ownership passes from creditor to insolvent estate
- In exchange for ownership, the creditor gets a hypothec = secured creditor
- If the Trustee sells the property – the trustee will sell subject to the hypothec

## Realization of Securities by Secured creditor

- Creditors who hold movable property as security must, before the second meeting of creditors, give written notice thereof to the Master and the Trustee
- A creditor can realize its security in the manner and conditions set down in the Act,
- If sold by a creditor, the creditor must
  - Immediately pay the net proceeds to the Trustee
  - Proof of its claim against the estate at a meeting of creditors

If not sold by creditor, the creditor must hand over security to Trustee to be sold as provided for in the IA

## Realization of Securities by Trustee

- Sec 47 of IA – If the creditor hands over possession of the property to the estate
- Creditor does not lose security if handed over to Trustee to sell
- Trustee must then sell for the benefit of the creditor – with the authority of the Master of creditors
- The trustee must examine all claims after being proved at a meeting of creditors and investigate the security
- The trustee can also abandon the secured asset to the secured asset in full and final settlement of his claim against the estate.

## Secured Creditor – relied on Security

- A Secured creditor is entitled to a concurrent claim if his full claim is not settled from the proceeds in the EAA
- If the Secured creditor relied on security when he proved his claim at a meeting of creditors
  - creditor will only receive the secured award of the dividend.
  - The remainder of the claim will then be the deficiency.
  - The creditor will also not be liable to pay contribution
- If the Secured creditor did not rely on its security,
  - he can share with the concurrent creditors from the Free residue for his shortfall.
  - he will be liable for contribution
- If the secured creditor was paid in full, including all his interest, and there is still a balance left for distribution in the specific EAA , then the balance is transferred to the Free Residue Account.



## Interest – Creditors

- Secured Creditors
  - Arrear interest
    - Interest-bearing creditor – limited to two years prior to the date of Sequestration – also part of the secured claim
    - Compounded interest allowed
  - Interest after the date of sequestration
    - Sec 95 ( 1) – entitled to interest from the date of sequestration until the date of payment
    - Simple interest – not compounded
    - Rate as per the loan agreement – if not provided for – Sec 103(2) – limited to 8 %
    - Advances on dividends to prevent interest

# Encumbered Asset Account (EAA) in Liquidation and Distribution Account

## Proceeds

- Each secured asset will be reflected in a separate EAA
- Proceeds of the Encumbered Asset and all the fruits, e.g., rental income or interest earned on the sale, will be reflected in the specific EAA

## Section 89 (1) Cost

- All costs for maintaining, conserving and realizing the asset will be recorded as the expenses in the specific EAA
- Cost will include auctioneer commission, valuation fees, security guards or rental payments if rent is paid after sequestration to preserve the asset.
- Trustee's remuneration on the specific asset sold
- Pro rata share of the:
  - Bond of Security provided by the Trustee,
  - Master's Fees
  - All Levies outstanding, as confirmed by the Body Corporate – must be paid before they can be transferred in the Deeds Office
  - Fees due to Homeowners' Association
  - Rates & Taxes
    - Due and payable after the date of sequestration until transfer
    - Tax as defined in sec 89(5) - Not exceeding two years prior to the date of sequestration ( older than two years is a concurrent claim)
    - Plus interest and penalties
    - All other chargers that are not Tax, only limited to prescription – three years prior to the date of sequestration.

**ENCUMBERED ASSET ACCOUNT NO 1.**

Immovable property known as Erf 130, Constantia ,Gauteng; subject to a mortgage bond in favor of creditor no 1 (ABSA Bank)

**Receipts:**

Date	Description	Voucher	Debit	Credit
6/5/2012	Immovable property known as Erf 130, Constantia ,Gauteng sold by public auction by ABC Auctioneers	R2		1 800 000
	Total received			1 800 000

**Disbursed:**

Date	Description	V	Debit	Credit
5/3/04	ABC Auctioneers commission for selling the immovable property.	R 2	90 000	
	Advertisement Costs	R 1	10 000	
	Trustees Fees		54 000	
	Total disbursed			154 000
	Amount available for distribution (R 1 800 000 – R 154 000 = R 1 646 000)			1 646 000 = X as per Distribution Account
	Reconciliation total			1800000
	Calculation of creditor's claim: Capital + Interest = Total claim Shortfall: [Amount transferred to free residue]		= S As per distribution Account	

## FREE RESIDUE ACCOUNT

Free residue", means that portion of the estate which is not subject to any right of preference by reason of any special mortgage, legal hypothec, pledge or right of retention;

- The free residue account is the general administration account and all costs which cannot be set-off against the proceeds of a security in terms of section 89(1), are included in this account.
- Assets which are reflected in the free residue account are those assets which are not subject to a right of preference by reason of a special mortgage, legal hypothec, pledge or right of retention.
- This includes the surplus from the proceeds of a security. No further fees calculated on amount transferred from EAA

# Payments in the Free Residue Account / Order of preference

## Preferent Creditor

- Creditors with a statutory preference created by the Insolvency Act ( IA)
- Paid first out of the Free Residue Account before Concurrent Creditors.

**First, the STATUTORY PREFERENT CREDITORS**

## Payments in the Free Residue Account / Order of preference - Continued

### Sec 96 - Funeral and deathbed expenses of

- insolvent if he died before confirmation of the first liquidation and distribution account
- wife or minor child within three months of sequestration
- R 300 for funeral expenses and
- R 300 for deathbed expenses

## Sec 97 - Cost of sequestration

- sheriff charges first  
    attachments and drafting of inventory,
- then Masters Fees ( refer to notes on how the Masters Fees are calculated).

## Other costs rank equally =

- the cost of the application for sequestration- as taxed by the Registrar of the High Court
- cost for completion of the Statement of affairs
- Trustee remuneration as determined into the Tariffs in the Schedule of the IA
- Administration costs, bond of security
- Advertisement costs for the creditor's second meeting
- Salary /wages by persons employed by Trustee – not in his employment
- Postage and Petties – Chief Master directive



# Costs - continued

- Section 73 Legal Costs
  - with the written permission of the creditors or, if urgent, the Master -
  - Written agreement re fees.
  - If there is no agreement / or dispute
    - – Taxing Master of the High Court
  - Attach affidavit to Bill of cost
    - Was duly authorized
    - Work as specified was performed
    - Disbursements as reflected were made
    - That attorneys did not overcharge

## Payments in the Free Residue Account / Order of preference – Continued – Trustees remuneration

The trustee's fee/liquidator's fee is determined in accordance with section 63, read with Tariff B of the Second Schedule to the Insolvency Act.

The trustee's fee is determined by the type of assets found in a specific estate. The tariff is as follows:

- On movable property, promissory notes, book debts, rent, interest and other income: 10%
- On immovable property, shares, stock, policies and mortgage bonds: 3%
- On cash, cheques, postal orders, current, savings and other accounts, fixed and other deposits: 1%
- Business sales: 6%
- Compromise: 2% on amount distributed in terms of a compromise
- Movable assets taken over: 5%
- Minimum fee: R2 500.00

## Trustees remuneration - continue

- In terms of section 63, the Master may reduce or increase the fee if good reason exists for doing so. (complexity, degree of difficulty, time spent etc)
- A trustee may also claim value added tax (VAT) on his fee if he is a registered VAT vendor.
  - Refer to notes for the formula on the calculation of VAT on fees
- Joint –Trustees – must agree and split fees
- Special Fees – all joint trustees must apply and motivate
- Not entitled to charge additional fees for work done by

## Payments in the Free Residue Account / Order of preference - Continued

### Sec 98 – Costs of execution

- taxed fees of sheriff for execution before sequestration
- taxed fees of Attorney for attachment before sequestration – limited to R 50
- must still be in the hands of the sheriff at the date of sequestration

## Payments in the Free Residue Account / Order of preference - Continued

Section 98 A 1(a)

(i )The salaries or wages of former employees of the insolvent in arrears for

- a period not exceeding **three months**
- the maximum amount allowed under this provision being **R12 000**;

A claim for salary or wages enjoys preference above claims for leave and retrenchments below.

The following preferential claims, within their respective order of preference, thus rank equally if sufficient funds in the free residue are abated in equal proportions if such funds are insufficient to pay all such claims in full.

## Payments in the Free Residue Account / Order of preference - Continued

- (ii) payment in respect of any period of leave or holiday due to the employee which has accrued as a result of his or her employment by the insolvent
  - in the year of insolvency or the previous year
  - maximum amount allowable under this provision being **R4 000**;
- (iii) Any payment due in respect of any other form of **paid absence**
  - for a period not exceeding **three months** prior to the date of sequestration
  - the maximum amount allowed under this provision being **R4 000**; and

## Section 98 A – Continued

- (iv) any severance or retrenchment pay due to the employee in terms of any law, agreement, contract, wages / or as a result of termination in terms of section 38
  - the maximum amount allowed under this provision being **R12 000**
  - In terms of section 38(11) of the Act read with the amended section (1)(a)(iv), employees whose contracts of service have terminated are entitled to this preference.
  - The claim must be calculated in terms of section 41 of the Basic Conditions of Employment Act 75 of 1997;
- (v) a maximum amount of **R12 000** payable thereafter in respect of any contributions payable by an insolvent, including
  - contributions payable in respect of his employees, to any pension or provident fund, medical aid or unemployment fund
  - or any similar scheme or fund

## Section 98 A - continued

- No formal claim is necessary for the above preferential claims. Affidavit will suffice
- The balance of any claims not covered by section 98A will be claimed concurrently with that owed to the general unsecured or concurrent creditors, and the employees must prove a claim in terms of section 44 for this part of their claims.
- Directors of insolvent companies and members of insolvent close corporations, as well as independent contractors, are excluded from the term 'employee' for the purposes of this section



## Section 98 A - continued

After the above Sec 98 A(1) (B)

Preference towards Contributions to Funds

- R 12 000 preference to any individual employee in respect of schemes or the funds
- for any contributions payable by an Insolvent, including contributions payable by an insolvent's Employee, which were immediately prior to the sequestration of the estate, owing by the insolvent in their capacity as an employer to any pension, provident, medical aid, holiday, unemployment or training scheme.
- The claims by the funds or schemes rank equally and abate equally

# Payments in the Free Residue Account / Order of preference - Continued

## Section 99 - Statutory Preference

- Contributions payable to funds by an insolvent employer to certain government and other institutions
  - Claims in terms of this section rank equally and must abate in equal proportions

e.g.

the Compensation for Occupational Injuries and Diseases Act 130 of 1993;

- taxes deducted by employers in terms of the Income Tax Act 58 of 1962 and not yet paid to SARS - PAYE;
- Import Taxes to SARS -customs excise and sales duty in terms of the Customs and Excise Act of 1964;
- VAT, interest, fines or penalties in terms of the Value Added Tax Act 89 of 1991;
- UIF Contributions due by Employers for UIF and for UIF deducted from salaries of Employees

## Payments in the Free Residue Account / Order of preference - Continued

Section 100 - Salaries and certain fees- for estates sequestrated prior to 1/9/2000

Section 101 – Outstanding personal Income Tax due by Insolvent

Section 102 - Preference under a general bond - movables

- if perfected before sequestration= pledge= secure creditor

If not perfected – only a preferent creditor

# Concurrent Creditor

**CONCURRENT CREDITORS** reflected in the distribution account only = non-preferent claims (section 103)

- Creditors who hold no form of secured right – unsecured creditors
- All unencumbered assets are dealt with in one Free Residue Account in the liquidation account
- Paid after all preferred creditors have been paid in full

# Free Residue - *Form requirements – Section 92*

DATE	DETAILS	V	DEBIT	CREDIT
Date on which amount is received	<u>RECEIPTS</u>			
	Full description of asset for identification; person by whom sold; method of sale	Voucher no		Gross proceeds
Date when payment made	<u>PAYMENTS</u>			
	To whom paid; reason for payment	Voucher no	Amount of payment	

# Calculation of MASTER'S FEES 2018

The Master's fee is calculated on the gross value of the assets in the estate. The gross value is determined by adding the proceeds of all assets in the Free Residue and all the Encumbered Assets accounts

The new tariff is applicable to all insolvent estates where the final order was given on or after 1 January 2018 or voluntary resolution, which was registered after this date.

- Gross value of the assets – below R 5000 – no MF payable
  - (a) is R5 000 or more, but less than R50 000  
= R250,00
  - (b) If it is R50 000 or more, but less than R150 000  
= R1 000
  - (c) R150 000 or more, for each complete further R5 000 when the gross value exceeds R150 000, a further R275,00
- subject to a maximum fee of R275 000,00

# Master's fees before 2018

## Sequestrated estates

- *Up to R5 000.00: No Master's fees payable.*
- *R5 000.00 to R15 000.00: R100.00.*
- *Plus: R25.00 for each completed R5 000.00 above R15 000.00,*
- *with a maximum fee of R25 000.00.*

## Companies and close corporations in liquidation

- *In the case of a company or close corporation in liquidation, Master's fees are calculated in terms of section 15(g) of the Companies Act read with Annexure CM 103. In terms of the Annexure, Master's fees are calculated as follows:*
- *Up to R15 000.00: R100.00*
- *Plus: R25.00 for each completed R5 000.00 above R15 000.00,*
- *with a maximum fee of R25 000.00.*

## Master's fees /example R355 000

Example: Gross value is R355 000

R 355 000 minus R150 000                      R1 000  
= R205 000

divide by

R5 000 x R 275 =                      R 11 275

Total Master's fees:                      R 12 275.00



# Apportioning the Master's fee and the premium of the bond of security.

$$? = \frac{X}{Y} * Z$$

<u>ACCOUNT</u>	<u>GROSS</u> <u>PROCEEDS</u>	<u>MASTER'S FEE</u>	<u>BOND PREMIUM</u>
Encumbered asset 1	X R256,000.00	? 1,285.73	? 741.76
Encumbered asset 2	X R2,840.48	? 14.27	? 8.24
Free Residue			
TOTALS	Y R258,840.48	Z R1,300.00	Z R750.00

## The contribution account

- The contribution account refers to the contribution payable in terms of section 106 of the Insolvency Act and deals with the case of insufficient funds to pay the expenses reflected in the free residue account.
- The contribution account forms part of the L&D Account by adding a contribution column in the distribution account.
- Applicant creditor is always liable to pay contribution
- Concurrent creditors pay pro rata according to their claim amount.
- Secured creditors who did not rely on their security will pay pro rata on the concurrent portion of their claims.
- Secured creditor who relied on its security will only pay a contribution when there is no other creditor or applicant creditor.