The Prohibition of Reckless Credit Granting as a Measure to Achieve a Responsible Lending Regime: focus on pre-agreement assessment

By

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Summary

The National Credit Act 34 of 2005 has reinvented the South African credit landscape in many respects, most notably in the context of prevention and alleviation of debt relief. In this regard the Act introduced the novel concepts of over-indebtedness and reckless credit and contains provisions that are aimed at preventing reckless credit granting as one of the major causes of consumer over-indebtedness in South Africa.

In its aim to eradicate reckless credit granting the NCA not only prohibits reckless credit granting but also mandates credit providers to conduct a pre-agreement assessment prior to entering into a credit agreement with a prospective consumer. Failure to comply with the pre-agreement assessment set out in section 81 of the Act results in dire consequences for the credit provider as credit that was extended without pre-agreement assessment (or proper pre-agreement assessment) constitutes reckless credit which attracts various sever consequences for the credit provider.

This dissertation aims to investigate and analyse the aspect of pre-agreement assessment in terms of the NCA and spesifically tracks the evolution of the assessment process to gauge what exactly it is that the legislature requires from credit providers in complying with the mandatory pre-agreement assessment obligation and how proper compliance can serve to prevent and alleviate consumer over-indebtedness.

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Chapter 1: Background to the Study

1. Introduction

Credit can be very attractive for both the recipient of the said credit, and for the provider of thereof. The recipient of credit gets to enjoy the items purchased without having the pressure to accumulate a large cash amount in order to pay a lump sum price for the goods, but is afforded the opportunity to pay for goods in instalments spread over a longer period; similarly, the credit provider gets to charge interest for the indulgence granted to the consumer by deferral of the instalments, which seems like a worthwhile reward.

It is trite that there is an uneven playing field between credit providers and consumers when it comes to credit granting.[1] The debtor (consumer) will, in most cases, have very little, if any at all, negotiating power and will be at the 'mercy' of the credit provider- meaning that he will often have to take up credit on the credit provider's terms or otherwise risk not getting credit at all. The consumer is thus often placed in a position where it is a 'take it or leave it'-scenario, with no or very little bargaining power. In most instances, due to the fact that there is actually a "need" and not a "want" on the consumer's part, he usually will take any credit he can get, even on terms which put him at an extreme disadvantage.

From a policy point of view, there will thus always be a need to protect the consumer from being exploited or abused in this uneven relationship. Conversely, there is also a need to ensure that there is a free flow of credit as access to credit is vital to the wellbeing of the economy. The policy makers therefore find themselves engaged in a balancing act, in a premise to appease both positions. The report titled Policy Framework for Consumer Credit[2], which sets out the policy framework leading to the enacting of the National Credit Act[3] (as discussed in more detail below), recognised this need for balancing these two aspects, stating that:

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[1] Stoop "South African Consumer Credit Policy: Measures Indirectly Aimed at Preventing Over-indebtedness" (2009) 21 *SA Merc LJ* 365.
[2] Consumer Credit Law Reform: Policy Framework for Consumer Credit (August 2004)(hereinafter 2004 Policy Framework)

[3] Act 34 of 2005.

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'Excessive onerous and costly compliance requirements, which increase the cost and risk for credit providers, is likely to lead to higher cost of credit for consumers and lower return for providers. A legislative framework should therefore not introduce excessive or unpredictable risk, or introduce excessive or ill-defined compliance requirements. The framework should also not cause reputable credit providers to shun credit seekers, reduce access to finance and increase the cost of finance…It is therefore imperative that the new credit policy balance consumer protection measures with the regulatory burden it imposes on credit providers'[4]

1.1 The South African Credit Market Pre-1994

Prior to South Africa's democratic dispensation which came into operation in 1994, there was unequal access to credit in South Africa. [5] The formal sector of the financial system, also called mainstream providers, such as banks, generally offered credit to middle and high income white consumers. These institutions were sceptical of venturing into extending credit to black consumers, who were mainly low income earners. This latter group of consumers were thus foreclosed from access to mainstream credit and consequently left with no choice other than to approach loan sharks, micro lenders and pawnbrokers who lent money at excessive interest rates. While the formal sector servicing the well-off consumers had a regulatory framework in place in the form of The Usury Act[6] and the Credit Agreements Act,[7] the non-bank credit providers were not subject to this legislation.[8] This, in reality, meant that the

[4] 2004 Policy Framework 23
[5] 2004 Policy Framework 15.
[6] Act 73 of 1968.
[7] Act 75 of 1980.
[8] Towards 1992, government realised that the Usury Act and its stringent limitations on the cost of credit had contributed to inadequate access to credit for the majority of the population. In 1992, to promote better access, government introduced the first Exemption Notice to the Usury Act (GN 3451 of 31 December 1992). This exempted all loans below R6 000.00 from the Act. This Exemption Notice was the main factor that precipitated the establishment of a formal micro-lending industry. Whilst the 1992 Exemption was successful in providing more access to credit, government was concerned about certain abuses and malpractices that developed in this unregulated environment. These malpractices included the retention of bank cards, pins and identity documents by the micro lenders, as well as abusive collection methods. Government introduced a second Exemption Notice in June 1999. In terms of this notice, micro-lenders were still permitted to charge unlimited fees for credit disbursed, but they were required to register with a regulatory entity (Micro Finance Regulatory Council (MFRC)). The Exemption Notice also prescribed minimum standards of conduct and operations that micro-lenders were required to comply with. The MFRC was given authority to monitor and enforce compliance with these standards. The Exemption was limited to loan agreements where the disbursed amount was R 10000.00 or less with a repayment period not exceeding 36 months. The 1999 Exemption Notice was repealed and substituted by Exemption Notice 1407 of 2005.

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poorest consumers were subjected to the highest cost of credit with little or no protection offered to them by law.[9]

Due to the changes in the political landscape of South Africa post 1994, the transformation agenda and affirmative action, thousands of previously disadvantaged consumers gained access to the mainstream credit market. The downside to this was that consumer-over indebtedness increased post 1994 and it became evident that the legal framework regulating the credit market (i.e the Credit Agreements Act and the Usury Act) needed to be changed. Some of the issues that were seen as problematic and that required changing were:[10]

- An oversupply of credit to those who were deemed to be creditworthy, leading to heavy debt burdens;
- The regulatory framework was 30 years old at the time and clearly outdated;
- Unequal access of credit for capital accumulation;
- Frustrations with credit bureaux and the 'blacklisting' process.

Meanwhile, the need for credit and the credit market were being established, a blind eye approach could not be adopted to the fact that the evidence indicated that in many instances credit was given to consumers that perhaps should not have been given credit, which was one of the greatest causes of consumer over indebtedness in South Africa. The legislature thus had to find a solution, in the envisaged comprehensive new National Credit Act[11], to create a better regime that would promote responsible lending practices.

1.2 The National Credit Act

A new era in credit regulation was heralded by the coming into full effective operation on 1 June 2007 of the National Credit Act 34 of 2005 (NCA), which repealed the inadequate credit regulation framework previously provided by the Credit Agreements Act and the Usury Act. The NCA is an innovative and comprehensive piece of credit legislation that has the following objectives:

[9] 2004 Policy Framework 23.
[10] Ibid.
[11] Act 34 of 2005.

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a) promoting the development of a credit market that is accessible to all South Africans, and in particular to those who have historically been unable to access credit under sustainable market conditions;
b) ensuring consistent treatment of different credit products and different credit providers;
c) promoting responsibility in the credit market by;
    I. encouraging responsible borrowing, avoiding of over indebtedness and fulfilment of financial obligations by consumers
    II. discouraging reckless credit granting by credit providers and contractual default by consumers;
d) promoting equity in the credit market by balancing the respective rights and responsibilities of credit providers;
e) addressing and correcting imbalances in negotiating power between consumers and credit providers by:
    I. providing consumers with education about credit and consumer rights;
    II. providing consumers with adequate disclosure standardised information in order to make informed choices; and
    III. providing consumers with protection from deception, and from unfair or fraudulent conduct by credit providers and credit bureaux;
f) improving consumer credit information and reporting and regulation of credit bureaux;
g) addressing and preventing over indebtedness of consumers, and providing mechanisms for resolving over indebtedness based on the principle of satisfaction by the consumer of all responsible financial obligations;
h) providing for a consistent and accessible system of consensual resolution of disputes arising from credit agreements; and
i) providing for a consistent and harmonised system of debt restructuring, enforcement and judgement, which plays priority on the eventual satisfaction of all responsible consumer obligations under credit agreements.[12]

[12] Section 3 of the National Credit Act 34 of 2005

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One can almost draw a tally on the correlation between the gaps identified in the policy framework and the objectives of the NCA. It is clear that the legislature's intentions was to address the shortcomings identified as comprehensively as possible and afford both the consumer and the credit provider with enough protection in accordance with a balanced approach to their respective rights.

One of the most ground-breaking innovations introduced by the NCA is the novel provisions it introduced relating to the prohibition and prevention of reckless credit granting as well as remedies to assist consumers who have been granted reckless credit since the Act came into operation.[13]

1.3 The Rationale behind the Prohibition on Reckless Credit Granting

As pointed out by Van Heerden and Renke, the rationale behind the introduction of the prohibition of reckless credit granting lies in the reasoning that 'prevention is better than cure'.[14] They remark that in view thereof that reckless credit granting is often the cause of over-indebtedness of consumers, the basis of the prohibition against reckless credit is that credit should not be extended to consumers who are unable to afford it.[15]

This prohibition on reckless credit granting also has to do with the greater economy. In a financial system where consumers are extended credit that they cannot afford, the market exposure to risk is too great and slight movement in the market could be disastrous for the stability of such financial system. During the 2008 global financial crisis one of the things which were expressed as having been a good buffer for the South African economy against meltdown was the NCA, and how it focused on reducing household vulnerability, by having stricter controls regarding reckless lending. [16]

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[13] See Scholtz *et al Guide to the National Credit Act* (2008 *et seq*) par 11.5 where it is pointed out that the provisions of the NCA relating to reckless credit do not apply in respect of credit agreements entered into before the Act came into effective operation on 1 June 2007.

[14] Van Heerden and Renke 2015 *International Insolvency Review* 67 (hereinafter Van Heerden and Renke).

[15] Ibid.

[16] *A Safer Financial Sector to Serve South Africa Better'* National Treasury Document, Republic of South Africa 23 February 2011, (*www.treasury.gov.za) at 10.*(hereinafter A Safer Financial Sector to serve South Africa Better). This was not the case in other countries such as the US in respect of which the following was stated (see Treasury Policy Document" A Safer Financial Sector to serve South Africa better" at 10):'In many countries, but in the United States particularly, the "light touch" regulation of the financial sector supported this explosion in the lending and allowed household debt to rise to unsound levels. Abundant credit and scant regulation led to the proliferation of products such as "subprime mortgages". These were targeted at vulnerable households which could only afford to repay their loans on assumption the rapid house prices and income growth would continue…As a result toxic mortgages

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To address the causes of over-indebtedness, Van Heerden and Renke remark that *ex ante* (preventative) measures are to be preferred rather than having to merely apply remedial measures when a consumer ends up in financial difficulty.[17] Even from a socio-economic perspective, the prevention of being swamped in debt is the better option, as high amounts of debt have been known to lead to suicide, depression and even the temptation to commit theft in the workplace.[18]

It must be noted that the prohibition of reckless credit is not the only *ex ante* or preventative measure to preventing over-indebtedness. Customer education, promotion of financial literacy, responsible marketing, regulation of the cost of interest and pre agreement screening and assessment of consumers are all such preventative measures. For purposes of this dissertation however, the discussion will focus on prohibition of reckless credit as a direct measure to prevent over-indebtedness.

Wilson, in her book, '*International Responses to Issues of Credit and Over-Indebtedness in the Wake of the Crisis'*,[19] makes quite important comments relating to responsible lending practices. She states that the following will be the result in the market where reckless credit granting is curtailed:

a) a focus on responsible lending in order to avoid over-indebtedness, rather than responsible borrowing;
b) a focus on consumer credit in general, not limited to residential loans;
c) an encouragement of flexible, individualized credit assessment practices, or at least not an encouragement of rigid or inflexible credit assessment practices; and
d) the existence of a regulatory agency charged with enforcement, which is adequately resourced to properly monitor and enforce compliance with market conduct regulations.

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became deeply rooted in the global financial system. When the housing bubble finally burst the total exposure of all financial institutions around the world to subprime products ran into trillion of dollars.'

[17] Van Heerden and Renke 2015 *International Insolvency Review* 68.
[18]Ross and Armstrong: '*KPMG's Fraud Risk in Difficult Economics, 2016 Report*. According to this report, living above your means and experiencing financial difficulties account for 46% and 30% respectively as common red flags for fraud by employees in the workplace 7
https://home.kpmg.com/content/dam/kpmg/pdf/2016/06/KPMG-Ignite-Fraud-risk-in-difficult-economies.pdf
[19] Wilson, *International Responses to Issues of Credit and Over-Indebtedness in the Wake of the Crisis* April (2013) 42.

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1.4 Scope and nature of the dissertation

It is clear that the promotion of responsible lending practices is a prime objective of the National Credit Act. In this regard the provisions in the Act pertaining to reckless credit play a vital role. The research undertaken in this dissertation will consequently focus on pre-agreement assessment as a direct measure to prevent reckless credit granting and resultant over-indebtedness. In order to contextualize and facilitate this investigation a general discussion of the concepts of reckless credit and over-indebtedness and the requirement to conduct a pre-agreement assessment will first be provided. Thereafter an in-depth discussion of pre-agreement assessment and how this requirement has been dealt with in the NCA, will follow. Finally some conclusions will be drawn and suggestions for reform in the context of pre-agreement assessment will be made.

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Chapter 2: Reckless Credit in Terms of the National Credit Act

2.1 The relationship between over-indebtedness and reckless credit

Over-indebtedness and reckless credit are novel concepts introduced in Part D of Chapter 4 of the NCA. These concepts intersect where reckless credit granting causes a consumer to become over-indebted.[20] Part D of Chapter 4 of the NCA, contains direct relief remedies aimed at preventing reckless credit and preventing and alleviating over-indebtedness.[21] These provisions apply only to natural persons[22] and whereas over-indebtedness can be raised in respect of pre-existing credit agreements, Van Heerden points out that reckless credit can only be raised in respect of credit agreements entered into after 1 June 2007.[23]

It should further be noted that the sections that refer to reckless credit (section 81 to 84 of the NCA) do not apply to:

- A school or student loan;
- An emergency loan;
- Public interest credit agreements;
- An incidental credit agreement; and
- A temporary increase in the credit limit under a credit facility.[24]

Although this dissertation will not focus on "over-indebtedness" it is necessary to understand how the Act views "over-indebtedness" because the primary rationale behind the prohibition against reckless credit granting contained in the NCA is ultimately to prevent consumers from becoming over-indebted.

[20] See Scholtz *et al Guide to the National Credit Act* (2008 *et seq*) par 11.2 where Van Heerden refers to the difference between "general over-indebtedness" and "reckless over-indebtedness."
[21] Scholtz *et al Guide to the National Credit Act* (2008 *et seq*) par 11.2.
[22] Section 1 of the NCA provides that a juristic person includes a partnership, association or other body of persons (corporate or unincorporated), or a trust if there are three or more individual trustees; or the trust is itself a juristic person. The section excludes stokvels (as defined in section 1) from the definition of a juristic person, and therefore stokvels enjoy the full protection of the Act just as natural persons do when they borrow money from third parties, such as banks or micro-lenders. See also Kelly-Louw "A credit provider's complete defence against a consumer's allegations of reckless lending" *SA Merc LJ* (2013) 24 at 25(hereinafter Kelly-Louw *SA Merc LJ*)
[23] Scholtz *et al Guide to the National Credit Act* (2008 *et seq*) par 11.1
[24] Section 78(2). See also regulation 23 of the National Credit Act Regulations that states that any credit extended in terms of a school loan or student loan or emergency loan or public interest credit agreement must be reported by the credit provider to the National Credit Register within 30 business days of signature thereof alternatively at the end of the month in which the agreement was concluded ,by completing and submitting Form 15.

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"Over-indebtedness" is defined in section 79 of the Act and refers to a situation where on the preponderance of available information, at the time that the determination is made, the particular customer is or will be unable to satisfy in a timely manner all the obligations under all the credit agreements to which that consumer is a party[25]. In order to establish whether a customer is over-indebted as contemplated in section 79, it is important to evaluate the consumers financial means, prospects and obligations[26], and probable propensity to fulfil, in time, all his or her obligations under all the credit agreements to which the consumer is a party[27].

Consumer over-indebtedness as explained above can in many instances be traced back to credit that was granted recklessly to such over-indebted consumer. "Reckless" according to the English dictionary is an adjective meaning: 'to be heedless of danger or the consequences of ones actions; to act rashly or impetuously'. Thus it can be said that the granting of reckless credit is the granting of credit without a proper analysis being conducted of the dangers and consequences of such credit or with a disregard of any indicators that the extension of particular credit will make a consumer over-indebted. "Reckless" thus actually refers to the *manner* in which the credit is granted and not to the credit or credit agreement itself.

2.2 Prohibition on reckless credit granting

Logically speaking, there can only be two reasons why a consumer is over-indebted or is materially failing to meet their financial obligations. The first reason could be that there is an adverse change in the circumstances of the consumer for example; they are no longer receiving a regular income due to loss of employment or their business suffers irreparable damage and cannot produce sufficient income. The second is that credit was granted to a consumer who should never have received such credit

[25] Section 79(1)(a).
[26] Section 78(3) defines "financial means, prospects and obligations" with respect to a consumer or prospective consumer to include-
"(a) income, or any right to receive income, regardless of the source, frequency or regularity of that income, other than income that the consumer or prospective consumer receives, has a right to receive, or holds in trust for another person;
(b) the financial means, prospects and obligations of any other adult person within the consumer's immediate family or household, to the extent that the consumer, or prospective consumer, and that other person customarily-
(i) share their respective financial means; and
(ii) mutually bear their respective financial obligations;
and
(c) if the consumer has or had a commercial purpose for applying for or entering into a particular credit agreement, the reasonably estimated future revenue flow from that business purpose."
[27] Section 79(1)(b).

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because the consumer is unable to afford the credit, for example the income is of such a limited nature that it is clear that the consumer will not be able to pay the instalments required under the credit agreement.

The NCA is clear: credit providers may not enter into reckless credit granting agreements with consumers[28]. This is an important prohibition in the Act in that, firstly, never before in South African legislation has there been such a prohibition, and secondly, the Act has introduced explicit and far reaching consequences of granting reckless credit, which provisions have been purposely inserted so as to deter such conduct.

2.3 Mandatory pre-agreement assessment

In order to prevent reckless credit granting the Act not only prohibits reckless credit but also imposes a mandatory obligation on credit providers to do a pre-agreement assessment of the consumer to determine whether specific credit should be granted to that consumer. This pre-agreement assessment is set out in section 81(2) of the Act. It entails that a credit provider is under an obligation, prior to entering into a credit agreement with a prospective consumer, to take reasonable steps to assess the following:

- The proposed consumer's general understanding and appreciation of the risks and costs of the proposed credit, and of the rights and obligations of a consumer under a credit agreement;
- The proposed consumer's debt repayment history as a credit provider under credit agreements;
- The proposed consumer's existing financial means, prospects and obligations
- And, if there is a reasonable basis to conclude that any commercial purpose may prove to be successful, if the consumer has such a purpose for applying for that credit agreement.

It is further important to note that the consumer also has obligations with regard to the prevention of reckless credit. Section 81(1) obliges a consumer, when applying for a credit agreement and while that application is being considered by the credit provider,

[28] Section 81 of the National Credit Act.

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to fully and truthfully answer any requests for information made by the credit provider as part of the section 81 pre-agreement assessment.

The consumer's failure to provide full and truthful answers during a pre-agreement assessment may have dire consequences for the consumer if he later wishes to rely on the reckless credit provisions of the NCA. Section 81 (4) provides that it is a complete defence, on the part of the credit provider, to prove that during the assessment, the consumer failed to answer fully and or truthfully the questions or requests for information made by the credit provider at that stage[29]. However in order for the credit provider to rely on these provisions, he will have to meet certain requirements. The credit provider will have to prove the materiality of the actions of the customer in that his failure to answer fully and truthfully impacted on the results of assessment in such manner that the credit provider was unable to conduct a proper assessment and subsequently concluded that the consumer, was eligible for the credit when in fact he was not.[30]

It should however also be noted that the credit provider's obligation to conduct a pre-agreement assessment plays a very important role in the context of the defence in section 81(4) as has been illustrated by case law. An example in point is the matter of *ABSA v CoE Family Trust*[31] where a trust entered into a mortgage loan agreement. The trust later defaulted on its obligations in terms of the loan agreement and the credit provider issued summons and applied for summary judgement against the trust and the two sureties. One of the defences raised by the Trust was that the credit was recklessly granted as a pre-agreement assessment was not conducted as required by the NCA. The credit provider relied on clause 11 of the agreement which stated that the borrower confirms that entering into the agreement will not make him over-indebted as contemplated in the NCA and that he answered fully and truthfully to all or any requests for information. Based on the papers before the court, there was no indication that an assessment had ever been done. The court confirmed that the NCA gave creditors a complete defence against reckless credit as per section 81(4) but

[29] *Desert Star Trading 145 (Pty) Ltd and Another v NO II Flamboyant Edleen CC and Another* 98/10 2010 ZA SCA 148 (28 November 2010) at 26.
[30] The onus will rest on the creditor to prove it has a valid defence in terms of section 81 of the National Credit Act.
[31] 2012 (3) SA 184 (WCC).

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held that if no assessment was conducted, then this defence was irrelevant. Further, it pointed out that the credit provider's reliance on the standard terms of the agreement to ascribe onerous obligations to a consumer could not be permitted unless it was brought to the consumer's attention.[32]

From the aforementioned case one may deduce that even if a credit assessment was done by the credit provider prior to entering into a specific credit agreement but such assessment was not done properly in accordance with the NCA, then the credit provider will not be able to raise a defence against reckless credit if it later transpires that the consumer lied about material aspects during such assessment. As is clear from section 81(4) a court or the National Credit Tribunal (NCT) must make the determination regarding whether the credit provider will be afforded a complete defence against reckless credit on whether the consumer's failure *materially* affected the credit provider's pre-agreement assessment on the consumer. The question of 'materiality' was however left open in *Horwood v First Rand Bank*[33] where the following was stated by Meyer J[34]:"Section 81 (1) of the NCA obliges a prospective consumer to fully and truthfully answer any requests for information made by the credit provider as part of the assessment required by section 81. Absent indications that would reasonably alert a credit provider to the contrary, which has not been established on the facts of this matter, a credit provider is, in my view, entitled to accept for this purpose the veracity of the information provided to it by or on behalf of a prospective consumer. The respondent, in my view, on the facts and circumstances of this matter acted reasonably in accepting the correctness of the information furnished to it on behalf of the applicant."

2.4 Types of Reckless Credit

The determination of reckless credit has to be done with reference to the time that the agreement was made (entered into).[35] Thus the time of entering into the agreement is the determining stage when assessing whether specific credit has been extended recklessly. According to section 80 of the Act, there are three circumstances in which reckless credit granting can be said to have occurred, namely:

[32] At 190.
[33] [2011] JOL 27913 (GSJ).
[34] At para 14 and 15.
[35] Section 80(2).

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"80.(1) A credit agreement is reckless if, at the time that the agreement was made, or at the time when the amount approved in terms of the agreement is increased, other than 10 an increase in terms of section 119(4)-

(a) the credit provider failed to conduct an assessment as required by section 81(2), irrespective of what the outcome of such an assessment might have concluded at the time; or

(b) the credit provider, having conducted an assessment as required by section 81(2), entered into the credit agreement with the consumer despite the fact that the preponderance of information available to the credit provider indicated that-

(i) the consumer did not generally understand or appreciate the consumer's risks, costs or obligations under the proposed credit agreement

(ii) entering into that credit agreement would make the consumer over indebted."

As explained by Van Heerden, the first kind of reckless credit granting occurs when the credit provider fails to do an assessment of the consumer as mandated by section 81(2) prior to entering into a credit agreement[36]. This type of reckless credit is per se wrong and the very thing that the NCA purports to rid the credit market of. It is viewed as total infringement and an utter disregard of not only the NCA's objective to avoid reckless credit granting and resultant over-indebtedness but also of the underlying regulatory atmosphere that the NCA seeks to promote, namely to encourage responsible lending practices. In this scenario, the consumer's actions or financial position is not even brought into question:

Van Heerden states that the financial position of the consumer is irrelevant to this type of reckless credit. Even if the consumer was perfectly able to afford the credit and the assessment would have merely confirmed the lack of pre-agreement assessment the credit that was extended qualifies as reckless credit.[37]

The second type of reckless credit occurs where the credit provider actually conducted a pre-agreement assessment but disregarded the fact that the preponderance of the information gathered indicated that the consumer that he sought to contract with did

[36] Section 80(1).
[37] At 73.

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not generally understand his risks, costs and obligations under the proposed credit agreement. The third type of reckless credit occurs when a credit provider does conduct a pre-agreement assessment as required by section 81(2) but then disregards the outcome of the pre-agreement assessment that indicates that he should not enter into a credit agreement with that consumer because entering into that specific credit agreement would make the consumer over-indebted.

The NCA further provides that when a determination is made whether a credit agreement is reckless or not, the person making that determination must apply the criteria set out in section 80(1) and as described above, as they existed "at the time that the agreement was made and without regard for the ability of the consumer to meet the obligations under that credit agreement; or understand or appreciate the risks, costs and obligations under the proposed credit agreement". According to Van Heerden this means that even if the consumer became able at a later stage to afford the credit that was initially recklessly extended to him or even if he later became educated about his risks, costs and obligations as a consumer under that agreement, it will not undo the fact that reckless credit was extended at the time that the parties entered into the agreement.[38]

2.6 Sanctions for reckless credit granting

Not only does the NCA seek to prevent reckless credit granting by expressly prohibiting same and labelling it as prohibited conduct but it also seeks to deter reckless credit granting by imposing a number of severe sanctions. These sanctions entail that a credit provider who is found to have extended credit recklessly can receive a hefty administrative fine and can also risk having its license cancelled by the National Consumer Tribunal.[39]

A court or the National Consumer Tribunal may also impose the following civil sanctions upon declaring a specific credit agreement reckless:[40]If credit has been extended recklessly without the credit provider having conducted a pre-agreement assessment (or having conducted an incorrect or inadequate assessment) or despite having conduced an assessment the credit provider ignored the facts that showed that

[38] Section 80(2)(a) and (b).
[39] See section 57 of the National Credit Act regarding cancellation of registration and section 151 regarding imposition of administrative fines.
[40] Section 83 of the National Credit Act.

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the consumer does not understand the risks, costs and obligations involved in entering into that credit agreement then the Court or Tribunal has the discretion to make an order setting aside all or part of the consumer's rights and obligations under that specific agreement, as the court determines just and reasonable in the circumstances; or suspending[41] the force and effect of that specific credit agreement.[42]

If the credit that has been extended subsequent to an assessment but with disregard of the facts that showed that the consumer would become over-indebted as a result of entering into that specific credit agreement, then the court or Tribunal has the discretion to make an order suspending the force and effect of that credit agreement until a date determined by the Court or Tribunal and in addition to restructure the consumer's obligations under any other credit agreements in accordance with section 87 of the NCA.[43]

2.6 Conclusion

Reckless credit granting is viewed in a very serious light by the legislature as is clear from the comprehensive provisions of the NCA aimed at preventing credit granting read together with the severe sanctions imposed on a credit grantor who engages in such prohibited conduct as well as from the relief afforded to a consumer to whom reckless credit has been extended. This all speaks to the fact that the legislature through these provisions seeks to encourage responsible lending in respect of credit agreements governed by the NCA. Pivotal in this context is the pre-agreement assessment that serves to act as a primary mechanism in the prevention of reckless credit granting in line with the notion that prevention is better than cure.

While the Act creates a dual responsibility on the creditor and debtor to prevent reckless credit granting by engaging in pre-agreement assessment to screen

[41] Section 84 of the National Credit Act deals with suspension of credit agreements as a result of reckless credit. It entails that during the period of suspension the consumer is not required to make any payment required under the agreement; no interest or other charge under the agreement may be charged to the consumer and the credit provider's rights under the credit agreement, or under any law in respect of that agreement, are unenforceable, despite any law to the contrary. After the suspension ends all of the respective rights and obligations of the credit provider and consumer under that credit agreement are revived and are fully enforceable except to the extent that a court or the Tribunal may order otherwise. However no amount may be charged to the consumer by the credit provider with respect to any interest, fee or other charge that were unable to be charged during the suspension. See also Van Heerden and Boraine" The money or the box : perspectives on reckless credit in terms of the National Credit Act 34 of 2005" (2011) *De Jure* 24.
[42] Section 83(2)(a) and (b) of the National Credit Act.
[43] Section 83(3) of the National Credit Act.

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instances where credit should not be granted, it is clear that the greater burden and more prescriptive responsibility is placed on the credit provider. The consumer is under no obligation to supply or volunteer any information if not specifically asked by the credit provider and even in instances where the credit provider has complied with the NCA and it is the consumer who has provided incomplete or untrue information, the materiality of this must be established by the court or National Credit Tribunal (NCT) failing which the credit provider will not be able to raise the complete defence against reckless credit provided by section 81(4) of the Act.

Accordingly it can be concluded that credit providers bear the brunt of the responsibility for conducting proper pre-agreement assessment hence it is of extreme significance that they should not falter at meticulously carrying out such assessments failing which they may be held accountable for having granted reckless credit. In the next chapter the focus will thus be on developments regarding the conduct of pre-agreement assessments in compliance with the NCA in order to establish how exactly these assessment are required to be properly conducted.

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Chapter 3: Focus on pre-agreement assessment

3.1 Introduction

As mentioned in Chapter 2, the NCA requires that a creditor wanting to conclude a credit agreement with a prospective consumer must conduct an assessment to assess affordability, debt repayment history and must assess the consumer's general understanding of the risks, costs and obligations under the intended agreement. The assessment is theoretically meant to be a tool to assess whether the applicant for credit is in a position to afford such credit or conversely, whether he or she cannot afford the actual credit, thus whether giving them such credit will make them over indebted or not. It is thus clear that the section 81 assessment has an important role namely to prevent credit being granted recklessly and causing the consumer to become over-indebted.[44]

It can therefore be said that the pre agreement phase, and spesifically the conduct of a pre-agreement assessment, is just as important as the actual contracting when it comes to the lifecycle of the credit relationship between the creditor and debtor. This is so because if things are not done as prescribed in this phase then it could spell grave trouble at a later stage of the relationship, which could have been avoided had there been compliance with the mechanisms put in place by the NCA to avoid reckless credit granting. The legislature, in its efforts to create a responsible lending regime, endeavoured to create a situation where if the creditor applies his mind properly and undertakes the credit assessment correctly, in instances where credit should not be granted, then such credit will not granted and over indebtedness can be curbed even before it begins.

It would follow then that both the credit provider and consumer have a vested interest in part-taking in the pre-agreement assessment as they both have something to gain during and/or as a result of this process. If the pre-assessment reveals that the credit provider may proceed and grant credit to the consumer, he then gains a new debtor and therefore new business and the consumer receives the credit which he has applied for to use and enjoy. If the results of the assessment reveal that the consumer should not receive the said credit then the credit provider is informed beforehand that

[44] Renke and van Heerden: 'The duty to assess the credit worthiness as primary debt prevention measure – Comparative perspective' paper presented at 2014 University of Pretoria International Consumer Law Conference (Pretoria).

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the debtor is already overly committed and/or has an unfavourable repayment history and this saves him from having to later have the very same debtor default on repayments resulting in costly recovery and litigation.

Vessio recommends that legal practitioners correctly advise and ensure that the credit provider is carrying out a proper risk analysis on prospective clients, if not, the credit provider may experience difficulties when trying to enforce the credit agreement and will be found to have lent recklessly. She points out that while the credit seeking consumer is given the responsibility by the Act, to answer fully and truthfully to the credit providers request for information; this obligation on the consumer is less onerous than the obligations imposed on the credit provider to prevent reckless credit granting. Therefore the greater responsibility rests on the credit provider, in that, he is required to ask the correct questions in order to solicit whether or not the consumer understands the consequences of the credit that is being given, the risks thereof and all the costs involved.[45] The exercise of assessing a customer is thus not a simple task as it subjective and dependent on other factors, such as the literacy of the consumer, their responsiveness and the customer's intentions, amongst other things.[46]

The definition of reckless credit as set out in section 80 has certain elements to it that are important when considering the nature and extent of pre-agreement assessment required by the Act, as discussed below.

3.1.1 Element 1: A general understanding of the risk and costs and rights and obligations

It has previously been submitted by Van Heerden and Boraine that such a general understanding can be objectively achieved by inserting a clause into the credit application indicating that the risks and costs of the credit and the consumer's rights and obligations as a consumer under a credit agreement have been explained to him or her by the credit provider and that the consumer expressly acknowledges that he or she understands and appreciates same.[47] It is however submitted that unless the consumer actually did understand his risks, costs and obligations under the credit agreement, such a clause will not be sufficient to ward of a claim of reckless lending.

[45] ML Vessio '*Beware the provider of reckless credit'* (2009) *TSAR* 274-289 at 279
[46] ML Vessio '*Beware the provider of reckless credit'* (2009) *TSAR* 274-289 at 279
[47] Van Heerden and Boraine 'The money or the box: perspectives on reckless credit in terms of the National Credit Act 34 of 2005' (2011) *De Jure* 24

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Credit becomes reckless credit where the credit provider fails in his responsibility to carry out a pre-assessment on the financial position of the consumer at the time of entering into a credit agreement or does carry out the a pre-assessment as required and, but disregards the fact that even though outcome of the test indicate the consumer is overly indebted already or will become so as soon as such credit is granted, the credit provider still goes ahead and grants the credit to such consumer.[48]

The assessment contemplated in section 81(2) is compulsory in terms of the NCA and a failure to conduct such assessment thus immediately labels a credit agreement as reckless credit, without any further investigation or questions asked. It is to be noted that even if a credit provider purports to conduct such an assessment prior to entering into a credit agreement but it is subsequently found that the assessment did not constitute a proper assessment, he will be regarded as not having conducted an assessment and thus having granted per se reckless credit.[49] Credit providers must therefore be prudent in complying with this pre agreement assessment requirement when conducting their business involving entering into a new credit agreement or increasing an existing facility. Failure by the credit provider to conduct a pre-agreement assessment could also present a loophole for mala fide consumers who would want to escape their obligations under the said credit agreement. Such a failure by the credit provider could be all the *'saving grace'* such a consumer could utilize.

In *Absa Bank v CoE Family Trust*[50] it was stated that section 81 (2) involves a three pronged test. Firstly it would be necessary to look at the current status of the consumer before the consumer can enter into the credit agreement for which he or she is applying, secondly it must be determined whether if after the credit is granted the consumer would still be able to afford and service all his or her debts and the third and final duty, is to embark, by taking reasonable steps, on an investigation on the repayment history of the consumer.[51]

It is clear from the above case as well as the provisions of sections 80 and 81 that the credit provider has a duty to inform the customer all of her rights and responsibilities and also the risks associated with entering into the agreement. A mere tick box

[48] Section 81(1)(b).
[49] Scholtz *et al Guide to the National Credit Act* (2008 *et seq*) par 11.2.
[50] 2012 (3) SA 184 (WCC).
[51] 2012 (3) SA 184 (WCC) para 5-25.

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exercise will not indemnify the credit provider from this obligation, and rightly so, as the credit provider must be able to provide assurance as to whether the consumer has read the information and more importantly that the consumer has understood the consequences of taking up the specific credit. Taken a step further, it is submitted the clause quoted in the agreement in the *CoE Family Trust* –case above should not under any circumstances, be allowed. It undermines the very objective of the NCA, and more specifically the combating of reckless credit objective, as the credit provider avoids doing a proper assessment but instead relies on the consumer to confirm whether the specific credit agreement will or will not make him or over-indebted. This was clearly not the intention of the legislature because if it was, the legislature would not have gone through the trouble of making proper pre-assesment a non-negotiable step prior to concluding a credit agreement.

3.1.2 Element 2: Debt repayment history under other credit agreements

The repayment history of a consumer can be obtained by the credit provider from credit bureaux but the rights of the consumers in terms of having their confidential credit information treated as confidential must be upheld and cannot be violated.[52] Before the NCA came into operation consumers were often blacklisted without their knowledge and without an opportunity to challenge the correctness of adverse information reported to the credit bureaux.

Initially thought to be a once-off occurrence, the first credit amnesty, with very limited application, was enacted in 2006. However, on the 1st April 2014 the Credit Amnesty Regulations, which constituted the second credit amnesty, came into operation. The main purpose of the credit amnesty regulations was to enable a once-off removal of certain adverse consumer credit information details[53]. The information that would be removed, entailed the classification of subjective consumer behaviour for example: ‘default’ or ‘slow paying’; the classification of enforcement action taken for example:

[52] These bureaux are required to be registered, after fulfilling certain entry criteria, with the National Credit Regulator (NCR). They are regulated by the same body and are required to keep and maintain an accurate data base of credit active consumers.

[53] The following adverse information is removed:

- Adverse classifications of consumer such as classification of human behaviour eg. Delinquent, slow payer, etc
- Adverse classification of enforcement action taken by credit provider eg. Legal action, write-off, etc
- Details and results of disputes lodged
- Adverse consumer credit information contained in the payment profile.

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'handed over for collection and recovery' or 'legal action'; and details and any disputes by consumers. This would, in turn, allow blacklisted consumers, whose financial circumstances have changed, to be able to access credit again. The regulations also make provision for ongoing removal of information relating to certain information, for example, the removal of 'paid up' judgments.[54]

The intention with the credit amnesty provisions is that there would be a 'clean slate' approach to the consumer's credit history and the records maintained for this purpose. Clearly this course of action has great advantages in that it will allow certain consumers to be able to obtain credit or employment which they could not obtain before due to an adverse listing at a credit bureau.

The credit amnesty however proves to be a double edged sword. While it may seem to enable a fresh start for consumers, it also has raised the question of how the consumer's credit history information will be assessed with the credit amnesty wiping the credit slate clean? It is submitted that the drawback of the credit amnesty from the perspective of prevention of reckless credit granting through pre-agreement assessment is that the credit amnesty has the potential to create a situation where credit defaulters and other credit delinquents are overlooked by the credit provider resulting in the risk of credit providers giving credit to consumers that they ordinarily would not have given such credit to had they been privy to their complete credit history.

Further it may be asked whether wiping the slate clean by means of credit amnesty will not perpetuate the seemingly uncontrollable behaviour of some consumers, who should in essence view this as a life line, to instead go on yet another scourge to pile on new debts?

3.1.3 Element 3: Existing financial means, prospects and obligations

This remains one of the most important aspects to consider in order to avoid reckless credit granting. This is due to the fact that the credit provider must make a clear and unbiased decision as to whether the current financial means, prospects and obligations of the customer justifies the new credit which the consumer now seeks. Thus the credit provider has to assess the consumer's monthly or weekly income and prospects of obtaining more income and determine the extent of the consumer's

[54] Michelle Kelly-Louw, 'Perspectives on the Draft Affordability Assessments' Presentation slide 10

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obligations (i.e the deductions that will have to be made from this income) in order to establish what the amount is that the consumer will be left with and that can be used towards paying off the new credit that he wants to take up. If this part of the assessment shows that the consumer will be able to afford the new credit without defaulting on any of his other commitments and whilst still being able to maintain his reasonable living expenses and obligations then the credit provider can generally extend the consumer the credit without fear of same constituting reckless credit. However if it is clear that the consumer will not be able to afford the credit without drastically and unrealistically cutting down on his living expenses and/or defaulting on his other existing credit agreements the assessment clearly indicates that the consumer cannot afford the new credit that he wants to take up and it should be a definite signal to the credit provider that extending such credit would be reckless.

In *Absa Bank v De Beer and Others*[55], which is referred to by Van Heerden as the first proper reckless credit case,[56] the court held that according to section 81 (2) of the NCA, the credit provider was required to assess the proposed consumer's existing means, prospects and obligations. This assessment, the court stated, needed to be done reasonably and not irrationally.[57]

3.1.4 Element 4: Whether there is a reasonable basis to conclude that any commercial purpose may be successful if the consumer has such a purpose for applying for the credit

In terms of the NCA the credit provider has the responsibility to consider all the circumstances of any consumer individually, including the reason behind why he requires the credit being applied for[58]. Where the consumer indicates that the credit sought will, for instance, be used for a new business venture, then the credit provider is required to look into the viability and prospects of success of such business when making a determination of whether or not to extend such credit. Obviously this means that the credit provider will at least have to be provided with a business plan which indicates the set-up costs, monthly overheads and other charges and a projection of the profits that are expected to be made by the business. In the *De Beer*[59] matter

[55] 2016 (3) SA 432 (GP).
[56] Scholtz *et al Guide to the National Credit Act* (2008 *et seq*) par 11.2
[57] Ibid para 60.
[58] Section 73(3)(c) of the National Credit Act.
[59] *Absa Bank v De Beer and Others* 2016 (3) SA 432 (GP).

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referred to above, the defendants had entered into several mortgage agreements in respect of a farm which the defendant planned to convert into a profitable small scale lucerne and poultry business. The Court commented on the recklessness of the bank in that it failed to comprehend how on the figures presented, the bank could conclude that the farming venture proposed by the defendants, would be at all profitable taking into account the size of the farm, the age of defendants and also in view thereof that there was no proof that at the time of the different mortgage applications, whether or not the farm had started yielding any money.[60]

3.2 The importance of individual assessment

Pre-agreement assessment in terms of section 81(2) indeed appears to be the most important step in preventing reckless credit granting. However it is also important to bear in mind that the outcome of such assessment will differ from customer to customer depending on their personal financial situation and level of financial literacy which is of course informed by whether such consumer had previously been a party to credit agreements. In *SA Taxi Securitization v Mbatha*[61] it was stated:

'While one purpose of the NCA is to discourage reckless credit, the Act is also designed to facilitate access to credit by borrowers who were previously denied such access. An over critical armchair approach by the courts towards credit providers when evaluating reckless credit, or the imposition of excessive penalties upon lenders who have recklessly allowed credit, would significantly chill the availability of credit especially to the less affluent members of society.' [62]

Therefore the courts have agreed that indeed each case must be looked at according to its own merits and there must be cognisance of the fact the granting of credit cannot be a 'one size fits all'.

3.3 The initial approach to pre-agreement assessment

The pre-agreement assessment requirement in section 81 of the NCA has to be read with section 82 of the NCA, which in its original format, stated that a credit provider may use his own assessment models and procedures to do the pre-agreement assessment mandated by the NCA with the condition that the result of the assessment

[60] Ibid para 62 – 64.
[61] 2011(1) SA 310 (GSJ).
[62] Ibid para 37.

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must be fair and objective. The NCR was given the authority to pre-approve assessment models but the NCA did not make this pre-approval by the NCA mandatory as it utilized the word 'may'[63]. It is submitted that leaving the credit provider to his own devices opened the door to much abuse and improper assessment models. Even more puzzling was the fact that the NCR was given the power to issue non-binding guidelines on assessment models and procedure thus relying on the good faith of the credit provider in following such guidelines, even though it was non-binding in nature. In any event, the NCR did not take up this opportunity to issue guidelines in the first couple of years after the Act came into operation, thus meaning that credit providers were left largely to their own devices regarding pre-agreement assessment for a number of years after the NCA came into operation.[64] It is to be noted that section 82(4) stated that if the Nation Consumer Tribunal (NCT) found that a credit provider had repeatedly failed to meet its obligations under section 81, or customarily used evaluative mechanisms, models or procedure that did not result in a fair and objective assessment, the NCT on application by the NCR could require the credit provider to (a) apply any guideline published by the NCR or (b) apply any alternative guidelines consistent with prevailing industry practices, as determined by the Tribunal.[65] However as no guidelines were published by the NCR it appears that nothing much came of section 82(4) as is clear when one glances over the types of matters that served before the Tribunal in those years.

Although the NCA placed significant emphasis on pre-agreement assessment as a mechanism to avoid reckless credit it was however not prescriptive about how such an assessment had to be conducted, save for stating in section 81(2) which broad aspects must be considered during such an assessment.[66] It did not lay out in detail how the credit provider should go about assessing each of these aspects and especially in the context of affordability this appeared to be problematic as there were no basic rules to be applied by credit providers as to how to calculate whether a consumer could afford specific credit. Thus there was lack of a broad uniform approach to affordability assessment.

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[63] Section 82(2)(a) of the National Credit Act.
[64] Van Heerden and Renke 2015 *International Insolvency Review* 67.
[65] Section 82(4) of the National Credit Act.
[66] Van Heerden and Renke 2015 *International Insolvency Review* 67.

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The aspect of pre-agreement assessment however underwent some radical reforms since 2012 as the process has become much more prescriptive with regard to especially the assessment of affordability. The process of prescribing in significantly more detail how affordability pre-agreement assessment should be conducted in compliance with section 81 of the NCA, gained appreciable momentum in 2012. Representatives of the major retail banks, the Banking Association of South Africa (BASA) and the National Treasury met on 19 October 2012, which resulted in an agreement popularly known as the "BASA Statement'.[67]

The meeting identified several concerns about lending practices by certain unscrupulous operators. These included:

- Excessive lending to households even when such loans were unaffordable;
- Illegal collection practices such as keeping ID documents, bank cards, and pins;
- Selling inappropriate credit products to maximise margins;
- Extending unaffordable loans to pensioners and other social grants recipients; and
- Abuse of debt and garnishee orders and payroll deductions.

Even though the signatories were insistently clear that they did not engage in this practices the facts relating to household indebtedness were of great concern, so too was the low number of retail borrowers in good standing.[68]

It was agreed that although there were at that stage no systemic risks related to secured and unsecured lending, certain market conduct behaviour could result in households, particularly poorer ones, getting caught in a debt spiral.

The BASA Statement recorded, *inter alia*, the following pertaining to affordability assessment as agreed at the meeting by the parties: BASA and its member banks were going to review their approach to the assessment of affordability in order to prevent future indebtedness and address over-indebtedness. Also, BASA, the National Credit Regulator (NCR) and the National Treasury would formulate a standard to measure affordability, which could then be incorporated into regulation

[67] Scholtz *et al Guide to the National Credit Act* (2008 *et seq*) par 11.2.
[68] The South African Reserve Bank's September 2012 Quarterly Bulletin showed the ratio of household debt to disposable income was high at 76.3%.

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thereby setting a minimum standard. It was further agreed that BASA members would load payment data onto the various credit bureau systems as soon as possible, preferably overnight.

3.4 The May 2013 Guidelines

Subsequent to the BASA-statement the National Credit Regulator issued draft affordability assessment guidelines in May 2013. These guidelines were very concise and stipulated as follows**:**

(a) credit applicants must prove their claimed discretionary income when it is above the norm for a person with their gross income and that such norms be determined as a percentage of gross income bands;

(b) credit providers must consider all the credit applicant's income, expenses and debt repayments when doing an affordability assessment;

(c) credit providers must refrain from lending to the maximum of the consumer's discretionary income and leave a margin of at least 25 percent of their discretionary income for adverse changes in the economy or the consumer's circumstances.

(d) credit providers must use the credit applicant's current information as stored on one or more credit bureaux;

(e) credit providers must process applications for credit within seven days from assessing an applicant's credit information as stored on credit bureaux; and

(f) credit providers must share credit application information on credit bureaux to allow for better affordability assessments to be made by other credit providers and to reduce credit application fraud.

As remarked by Renke and Van Heerden these guidelines marked the direction that the NCR intended to take with regard to affordability assessment and although the various aspects that it "recommend" to be observed during pre-agreement assessment were quite broad it paved the way for a more interventionist approach, as indicated below.[69]

3.5 The September 2013 guidelines and the 2014 draft regulations

[69] Renke and Van Heerden 2015 *International Insolvency Review* 67.

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A more comprehensive set of affordability assessment guidelines was thereafter released in September 2013 *inter alia* introducing annual living expense norms that had to be taken into account in calculating the consumer's discretionary income that could be utilised towards paying for the new credit that the consumer applied for and also distinguishing between secured and unsecured credit agreements, the latter being branded as reckless if affordability assessment was not properly conducted.[70]

The BASA statement emphasised the need for regulations, and not merely guidelines, which would set minimum standards for the conduct of the pre-assessment required by section 81 of the NCA. Accordingly the September 2013 guidelines were followed by draft regulations published for comment in August 2014 where the living expense table was changed from an annual expense table to a monthly living expense table setting out the minimum monthly expenses that were allowed to be taken into account during pre-agreement assessment of consumers in certain identified income bands. Notably the draft regulations did not distinguish between secured and unsecured credit for purposes of reckless credit granting as was previously done in the September 2013 guidelines.[71]

During this time the National Credit Act was also amended to make provision for the introduction of affordability assessment regulations by the Minister of Trade and Industry, as discussed below.

3.6 Amendments to the National Credit Act to facilitate the introduction of affordability regulations

The National Credit Amendment Act (NCAA) was approved a couple of months after the September 2013 Draft Guidelines but was not put into operation at that stage.[72] The Act was only put into operation on 13 March 2015.[73] The NCAA amended section 48 of the NCA to provide that the Minister of Trade and Industry may prescribe criteria and measures to determine the "outcome" of affordability assessments.[74] It obliges the Minister, on recommendation of the National Credit Regulator, to make affordability assessment regulations. Sections 82(3) and (4) of the Act are deleted and

[70] Ibid.
[71] Ibid..
[72] Act 19 of 2014.
[73] Proc R10,2015, GG 38557 of 13 March 2015.
[74] Section 15 of the NCAA.

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section 82(1) and (2) substituted to provide that a credit provider may determine for itself the evaluative mechanisms or models and procedures to be used in meeting its assessment obligations under section 81, provided that any such mechanism, model or procedure results in a fair and objective assessment which" must not be inconsistent with the affordability assessment regulations" made by the Minister.[75]

Van Heerden points out that the effect of the aforesaid amendments is that the evaluative models used by credit providers will have to be aligned with the final affordability assessment regulations issued by the Minister, as discussed below.[76] She states that these affordability assessment regulations will now be binding on credit providers, contrary to the previous position under section 82(3) that guidelines published by the National Credit Regulator were not binding, and the regulations will provide a benchmark against which a credit provider's compliance with its pre-agreement assessment duty in terms of section 81 will be measured.[77]

3.7 The 2015 National Credit Regulations including Affordability Assessment Regulations

In March 2015, the final National Credit Regulations including Affordability Assessment Regulations were published and were put into effect with the National Credit Amendment Act.[78] Subsequently the Minister of Trade and Industry extended the operative date of these affordability assessment regulations specifically for six months until 13 September 2015 in order to give credit providers the opportunity to align their assessment models with the regulations.

Chapter 3 of the National Credit Regulations including the Affordability Assessment Regulation contain the 'Criteria to Conduct Affordability Assessments'. Regulation 2 of Chapter 3 states the instances in which these affordability assessments need to be complied with. The Regulation firstly states that these assessments do not apply, if the consumer is a juristic person and excludes the following types of credit agreements, which are also excluded from reckless credit as per section 78(2) of the NCA , namely school or student loans, emergency loans, public interest credit agreements, pawn

[75] Section 24 of the NCAA.
[76] Scholtz *et al Guide to the National Credit Act* par 11.2.
[77] Ibid.
[78] Government Gazette No. 38557 of 13 March 2015.

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transactions , incidental credit agreements and temporary increases in credit limits under a credit facility [79]. In addition the Regulations have added some exclusions not spesifically contained in section 78(2) of the NCA, namely a pre–existing credit agreement[80], any change to a credit agreement and/or any deferral or waiver of an amount under an existing credit agreement[81] as well as mortgage credit agreements that qualify for finance linked subsidy programmes developed by the Department of Human Settlements[82] and for credit advanced for housing that falls within the threshold set from time to time[83].

While it is logical that the same exclusion contained in the Act are now also in the 2015 Regulations as well, the additions made by the 2015 Regulations as further exclusions also seem to make sense of in terms of pre – existing agreements, changes in credit agreement or the qualifying mortgage agreements. What is rather disturbing is that the exclusion is also extended to unilateral credit limit increase. It is submitted that this allows for credit providers on their own accord; decide to increase a consumer's credit facility without having to do an assessment. This appears rather contrary to the intentions of the NCA that introduces mandatory pre – assessment to evaluate the means and obligations of the consumer before providing him or her with credit. Further, the exclusion in not clear on the amount at which the increase should be capped and it is submitted that this allows for a situation where the consumer could find that he has been extended credit that he would not have qualified for when the initial affordability assessment was concluded.

The 2015 Regulations state that the credit provider must take 'practicable steps'[84] to assess the discretionary income of the consumer[85]. The Regulations have however not left it entirely up to the credit provider to decide what is practicable when it comes to verification of income. The Regulation**s** address the instances where the consumer

[79] Chapter 3 Regulation 23A(2).
[80] Chapter 3 Regulation 23A(2)(i).
[81] Chapter 3 Regulation 23A(2)(j).
[82] Finance Linked Individual Subsidy Program, better known as FLISP, was developed by the Department of Human Settlement to enable sustainable and affordable first time home-ownership opportunities to South African citizens and legal permanent residents earning between R3 501 and R15 000 per month, (the "affordable" or "gap" market).
[83] Chapter 3 Regulation 23A(2)(k).
[84] 'Practical steps' means those steps that are reasonable and practical. A step is practical if it is possible and capable of being done.
[85] Chapter 3 Regulation 23A(3).

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is receiving a receiving a regular salary, a three (3) month payslip and three (3) bank statements showing the salary deposits[86]. In instances where the consumer is not receiving a salary a document detailing their three (3) months proof of payment and three (3) months bank statements are required[87], while for self-employed consumers, bank statements of three (3) months and the latest financial statements are required[88]. The Regulations also state that where the consumer's income show material variances an average maybe utilized over a three (3) month period.[89]

The consumer is also required to contribute towards the accuracy of the assessment by being obliged to accurately disclose all financial obligations to enable for a proper affordability assessment to be conducted.[90]

3.7.1 Existing financial obligations

The methodology to be applied by the credit provider in conducting the assessment is also catered for in the regulations. Regulation 12 states a credit provider, when conducting an affordability assessment, must:

i. calculate the discretionary income;
ii. take into account all monthly debt repayments; and
iii. take into account maintenance obligations.[91]

The credit provider thus has the responsibility to do a calculation of the consumer's existing financial obligations, means and prospects. As part of this exercise a minimum expense norm table has been included in the regulations which credit providers are compelled to use in calculating a consumer's discretionary income.[92] The methodology requires that a credit provider that:

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[86] Chapter 3 Regulation 23A(4)(a).
[87] Chapter 3 Regulation 23A(4)(b).
[88] Chapter 3 Regulation 23A(4)(c).
[89] Chapter 3 Regulation 23A(5).
[90] Chapter 3 Regulation 23A(6).
[91] Chapter 3 Regulation 23A(12) (a)-(c)
[92] Table 1: Minimum expense norms

Minimum	Maximum	Minimum monthly Fixed Factor	Monthly Fixed Factor = % of Income Above Band minimum

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i. a credit provider must ascertain the consumer's gross income;
ii. a credit provider must arrive at net income by deducting statutory deductions and minimum living expenses (as per the specific applicable income band on the living expense table); and
iii. when existing debt obligations are taken into account, the credit provider must calculate discretionary income to enable him or her to satisfy the new debt.[93]

It should also be noted that where a consumer is adamant that his living expenses are less than that permitted for the specific income band within which he falls, the credit provider can avoid strictly applying the Table to calculate that consumer's monthly living expenses. This can be done by ensuring that the consumer properly completes the prescribed questionnaire attached to the Regulations in which he can then set out his actual living expenses so that the credit provider can see and can have written record of these lower expenses that he can then use in the calculation of the consumer's discretionary income.

3.6 Debt repayment history

R0.00	R800.00	R0.00	100%
R800.01	R6,250.00	R800.00	6.75%
R6,250.01	R25,000.00	R1,167.88	9.00%
R25.000.01	R50,000.00	R2,855.38	8.20%
R50,000.01	Unlimited	R4,905.38	6.75%

[93] Chapter 3 Regulation 23A(10) (a)-(c).

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The Regulations further state that a credit provider must take into account a consumer's repayment history as a consumer under credit agreement held by a registered credit bureaux.[94]

3.7.2 Avoiding double-counting in calculating Discretionary Income

It often happens that consumers take out a new loan in order to pay of a number of smaller credit agreement debt. Such a loan is commonly referred to as a consolidation loan. Where a credit agreement is entered into on a substitutionary basis in order to settle off one or more existing credit agreement, according to the Regulations the credit provider must record that credit is to replace other existing credit agreements[95] and take practicable steps to ensure that such credit is properly used for such purpose.[96]

It can however be remarked that ultimately the responsibility will lie with the consumer to indeed settle those debts as stated in their credit application. Unless the credit provider is involved in the settling such as when purchasing a new motor vehicle and trading in the previous one, there is not much a credit provider can do to ensure that the consumer does with the credit what he said or ought to do.

3.7.3 Disclosure of credit cost multiple

The Regulations stipulate that it is the responsibility of the credit provider to disclose the "credit cost multiple" and the "total cost of credit" in the pre-agreement statement and quotation.[97] Such disclosure must thus be must be done before or prior to entering into a credit agreement and its purpose is obviously so that the consumer is informed of the financial implications of the credit agreement he seeks to enter into. Further, the Regulations have clarified the issue regarding the 'small print' clauses that can easily be overlooked by the consumer and the 'catch-all' clauses that in *Absa Bank v CoE Family Trust*[98] as it is now stated that the credit provider must ensure that the attention of the prospective consumer is drawn to the credit multiple costs and these cost are understood.[99] The total costs to be disclosed include:

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[94] The Regulations state the credit provider must do this within seven (7) business days prior to approval or with fourteen (14) days for mortgages.
[95] Chapter 3 Regulation 23A(14)(a).
[96] Chapter 3 Regulation 23A(14)(b).
[97] Chapter 3 Regulation 23A(15)(a)
[98] 2012 (3) SA 184 (WCC).
[99] Chapter 3 Regulation (15)(c).

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- principal debt
- interest
- initiation fee
- service fee aggregated to the life of the loan
- credit insurance aggregated to the life of the loan[100]

It is noteworthy that the Regulations have taken cognisance of the need for total transparency on the part of credit providers regarding all cost of credit. Further not only must they disclose all cost but also draw the attention of consumers ensuring that they are understood as consequences of accepting the credit.

3.7.4 Outcome of Affordability Assessment

The Regulations have provided for recourse for any consumer that may feel aggrieved by the outcomes of an affordability assessment. This process entails that the consumer should first approach the credit provider to try and sort the matter out. Aggrieved consumers at any time may lodge a complaint in terms of section 134[101] and 136[102] of the NCA with the credit provider.[103] The credit provider is the required to settle this dispute within fourteen (14) business days. If the matter is not settled satisfactorily, the consumer can then approach the NCR for assistance.[104] Regulation 23A (17) provides that the credit provider “must” resolve the complaint within 14 “business” days and adds the clarification that these days must be calculated with reference to “receiving notification of the complaint from the ombud in terms of section 134”. If the grievance is not addressed by the credit provider “within the period referred to in sub-regulation 10A (15)”, the consumer can approach the National Credit Regulator.[105]

3.7.5 Non compliance

Non-compliance with the Regulations is dealt with in Chapter 6 of the Regulations. The chapter very briefly states that these Regulations are binding to the extent of the application and that non-adherence with these Regulations will be dealt with in terms of the remedies and procedures of the NCA.[106] As the Regulations now set down

[100] Chapter 3 Regulation 23A(15)(d)(i)-(v)
[101] This section deals with dispute resolution.
[102] This section deals with consent orders.
[103] Chapter 3 Regulation 23A(16).
[104] Chapter 3 Regulation 23A(17) and (18).
[105] Van Heerden and Renke 2015 *International Insolvency Review* 67.
[106] Chapter 6 Regulation 1.

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affordability assessment standards that credit providers have to comply with it appears that such non-compliance would be regarded as failure to conduct a proper pre-agreement assessment as per the NCA- and thus the credit provider who fails to abide by the prescriptions of the regulations would be granting reckless credit.

3.8 Conclusion

The NCA can be described as ground-breaking credit legislation which has significantly changed the South African credit landscape. One of the most significant measures introduced by the Act is the prohibition of reckless credit granting in order to combat over-indebtedness of consumers. In this context the recognition of the need to introduce a process at the initial stage when credit is applied for which can be used to ensure that credit is not granted recklessly, is laudable. If this process is properly applied it can nip reckless credit granting in the bud and avoid the need for costly intervention at a later stage when the consumer has already been drawn into the web of over-indebtedness.

It is indeed so that the Affordability Assessment Regulations are not necessarily perfect as it may be argued that they can have the consequence of foreclosing access to those consumers who fall in that very low income band where the Regulations do not permit the granting of credit at all. However it is submitted that those persons who fall outside the already very low income bands that can accommodate repayment of credit should be assisted by the Government by means of state aid rather than pulling them into circumstances where they are allowed to take up credit but where it is abundantly clear that they cannot afford such credit. Opening up the credit market to these persons would indeed be irresponsible. In any event some flexibility has been built into the affordability assessment process in that persons can complete the prescribed questionnaire attached to the Regulations if they assert that their monthly living expenses is lower than that for their spesific income band as reflected in the Table. A consumer also has the opportunity to challenge the outcome of the affordability assessment and the Regulations spesifically provide a process that has to be followed in such instance.

It is further submitted that credit providers should view this pre-agreement assessment in a positive light and should make sure that they comply with this process including

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the obligations imposed on them by the Regulations in the context of affordability assessment. By conducting proper pre-agreement assessments and paying proper attention to calculate a consumer's affordability, the credit provider will nt only be making sure that only those consumers who can actually afford the credit are granted such credit but they will also be protecting their own business because they will not have to fear that allegations of reckless credit granting will sour their lives and eat up their profits due to legal costs that they will have to expend in defending themselves against claims of reckless credit. If they extend credit only to consumers who can afford it then they will also not have to worry about dealing with the issue of over-indebted consumers and they will eventually contribute to a culture of responsible lending in South Africa.

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