

Beware the provider of reckless credit

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1 Introduction

Reckless lending is, conceptually, new to the South African legal system. Credit providers in South Africa must now be aware of what will turn them into reckless lenders and avoid practices which may lead them to suffer the legislative consequences. This is not an easy task, as the concept has never before been dealt with by South African legislation and providers cannot therefore rely on precedent to guide their actions.¹ The concept “reckless lending” has been introduced by the National Credit Act² and many provisions of the act have been devoted to the practice of lending to consumers who, quite simply, cannot afford it. A last-entered credit agreement may have the effect of precipitating a credit consumer into over-indebtedness. The concept of “reckless lending”, to a large extent, works in tandem with that of “over-indebtedness”, both of which will be discussed in this article.

In terms of section 3 of the National Credit Act the purposes of the act include, *inter alia*, the promotion of responsibility in the credit market by encouraging responsible borrowing; the avoidance of over-indebtedness; the fulfilment of financial obligations by consumers; discouragement of reckless credit-granting by credit providers and contractual default by consumers; 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.³ Guidance as to the application of the reckless credit sections of the act for both practitioners and the courts will have to come from the act itself. No local precedent exists. The following comments are thus supported:

“To achieve these goals, the act has added a new dimension to credit regulation by introducing measures aimed at preventing reckless credit-granting, sanctions to be applied in certain instances of reckless credit and debt-relief measures to deal with the problem of over-indebted consumers.”⁴

And also:

“The National Credit Act introduces extremely important provisions which aim at providing a debtor who is over-committed with a ‘second chance’ by rescheduling his debt payments.”⁵

Many of these provisions will have to be interpreted by the courts to give meaning and practical import to their content. The *Oxford English Dictionary* defines “reckless” as “disregarding the consequences or danger etc; rash”.⁶ As will be seen

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¹ “The concepts of ‘reckless credit’ and ‘over-indebtedness’ and the accompanying preventative measures, sanctions and debt relief are new to South African credit legislation as these issues were not addressed in either the Usury Act 73 of 1968 or the Credit Agreements Act 75 of 1980” – Van Heerden in Scholtz (ed) *Guide to the National Credit Act* (2008) 11-1.

² 34 of 2005.

³ s 3(c)(i)-(ii) and (g).

⁴ Van Heerden (n 1) 11-1.

⁵ Otto *The National Credit Act Explained* (2006) 54.

⁶ *The Pocket Oxford Dictionary* (1992).

from the discussion, reckless lending includes not only the act of disregarding the consequences but also the act of not analysing at all, or analysing incorrectly, one's client or potential client in the carrying out of certain prescribed assessments or investigations. While at first blush the test for a consumer's creditworthiness, to the consumer, may appear overly stringent and is calculated to prevent him or her from accessing credit at that point, it is submitted that in the long run a subdued credit market may have a beneficial effect on both consumers as well as price inflation caused by credit. Thus the following view is concurred with:

"Unfortunately, in South Africa, for a lengthy period of time, too many people with too little money have been given too much credit. This ultimately leads to a position of over-indebtedness and results in a never-ending circle of frustration for the consumer, who can never repay his or her debts."⁷

In my view, the act introduces new parameters for the granting of credit in South Africa which will in the long term ensure that consumers will be in a position to relieve over-indebtedness and avoid the granting of reckless credit. The following comment is therefore both relevant and apt:

"In a deteriorating economy, affordability checks should be the No 1 priority. Further checks could be costly for lenders and could lead to a decline in the number of accepted applications, but they would be a small price to pay if it helps to curb bad debt write-offs and personal indebtedness."⁸

2 *Over-indebtedness*

Over-indebtedness is also a new legally employable concept, in the sense that it is now competent for a court upon application to make an order declaring a person over-indebted.⁹ A consumer is considered, in terms of the act, to be over-indebted if, according to the majority of information at the time the determination is made, the consumer will be unable to satisfy all the obligations under the credit agreements which the consumer is already servicing, taking into consideration his "financial means, prospects and obligations"¹⁰ and "probable propensity to satisfy in a timely manner all the obligations under all the credit agreements to which the consumer is a party, as indicated by the consumer's history of debt repayment".¹¹ As Van Heerden correctly points out, a finding of over-indebtedness may thus have implications for almost all the consumer's credit agreements¹² – the only exception is those agreements that were entered into before the act came into operation.¹³

The act defines the terms "financial means, prospects and obligations", for the purposes of this section, as including "income, or any right to receive income, regardless of the source, frequency or regularity of that income other than income received on behalf of another person or held in trust by the consumer for another

⁷ Levenstein "New bill tackles reckless granting of credit" <http://www.busrep.co.za/index.php?fSectionId=553&fArticleId=3190513> (6-11-2008).

⁸ Thompson "Banks and stores under attack for reckless credit card lending" *The Times* (18-06-2008) quoting Linstead, head of personal finance at uSwitch.

⁹ In all other respects, the concept is neither new nor underutilised.

¹⁰ s 79(1)(a).

¹¹ s 79(1)(b).

¹² *Cf* n 2.

¹³ Van Heerden (n 1) 11-4.

person”.¹⁴ Included are the financial means, prospects and obligations of any other adult person that the consumer shares or mutually bears his or her financial means with.¹⁵ Further included in the financial means, prospects and obligations of a consumer is the consideration of the reasonably estimated future revenue flow from the commercial or business purpose which may have motivated the application for the credit agreement.¹⁶ In other words, if the consumer is embarking on a new business or business venture, then this will form part of his “financial means, prospects and obligations”. If the reason for applying for credit is to embark on such a venture, the credit provider will have to analyse the risk factor of the new enterprise – which may perhaps include a feasibility study – in order to assess whether financing the consumer will entail reckless credit.

The second part of this section,¹⁷ which refers to the consumer’s “probable propensity to satisfy in a timely manner all the obligations under all the credit agreements to which the consumer is a party, as indicated by the consumer’s history of debt repayment”, is somewhat less enlightening. “Propensity” is defined in the *Oxford English Dictionary*¹⁸ as “inclination or tendency”. This appears to be a somewhat retrospective term, in the sense that “propensity” appears to address the likelihood of the consumer paying his or her debts in light of his tendencies or inclinations. These may only be surmised, it is submitted, by looking at the repayment history of the consumer and thus his or her “habit” of paying his or her debts. The determination whether the consumer is over-indebted or not must be made at the time the determination is being made.¹⁹

The legislative definition of over-indebtedness is somewhat theoretical in that the courts will be hard pressed to translate the legislative wording into practical implementation. Accordingly, the courts may have to look to other jurisdictions and research bodies in order to gain assistance in developing the essence of over-indebtedness in South Africa, both through foreign examples and local statistical indicators. While concerns regarding over-indebtedness are common in most countries around the world, there is no globally accepted definition of over-indebtedness. Examples may thus be drawn from various foreign jurisdictions. In Austria, for example, a commonly used definition of over-indebtedness was developed by a debt counselling agency called the *IFS Schuldnerberatung*. This agency defined individuals or households to “be regarded as over-indebted if, after deduction of current cost of living expenses like food, clothes, rent, social and cultural needs/requirements, they are not able to discharge all payment obligations”.²⁰

Courts will also have to consider indicators related to indebtedness collated and published by various government and private institutions. For example, the South African Reserve Bank provides information for tracking financial stress indicators,

¹⁴ s 78(3)(a).

¹⁵ s 78(3)(b).

¹⁶ s 78(3)(c).

¹⁷ s 79(1)(b).

¹⁸ (n 6).

¹⁹ s 79(3).

²⁰ Wilhelm FinMark Trust “Overindebtedness – when does debt become a burden?” www.finmark.org.za/documents/Brief_overindebtedness.pdf (17.12.08).

while Statistics South Africa (“StatsSA”) publishes income and expenditure data with variables used by analysts outside of StatsSA in models used to determine over-indebtedness. StatsSA also collates data with regard to judgments and liquidations which are incorporated as indicators. Furthermore, studies by banks, accounting firms and academic institutions contribute to the list of indicators which may assist in the understanding of over-indebtedness. Finally, much of the burden will fall on the national credit regulator which, in terms of the act, is charged with developing all relevant credit information in order to assist credit providers when making assessments of potential consumer-clients.²¹

3 *Reckless credit*

The following observation by Otto is relevant:

“The provisions in the National Credit Act dealing with the prevention and consequences of reckless credit are not only far reaching, but also extremely important to all concerned. The provisions contain a huge amount of detail ...”²²

Part D of chapter 4 is the section of the National Credit Act concerned with over-indebtedness²³ and reckless lending. It must be noted that this part does not apply to a credit agreement in respect of which the consumer is a juristic person, thus the provisions for reckless credit will only be considered when the consumer is a natural person.²⁴ Furthermore, the procedures in place for the prevention of reckless credit, the assessment mechanisms to be used in assessing the obligations of the credit consumer by the credit provider, the power of the court to suspend reckless credit agreements and the effects of suspension of such agreements – that is, sections 81 to 84 of the act – do not apply to the following agreements:²⁵

²¹ S 69(1) provides that the minister *may* require the national credit regulator (“NCR”) to establish a single national register of outstanding credit agreements based on information provided to it. The rest of s 69 directs how this information should be supplied to the NCR. This section has come into operation but the register will only become effective once the NCR has created it and it is approved and confirmed by an independent auditor: “In other words, the ‘physical’ coming into operation of the Register has been delayed”, that is until the minister declares a date by notice in the *Government Gazette* (item 3 sch 3). See also Kelly-Louw “Prevention and alleviation of consumer over-indebtedness” 2008 *SA Merc LJ* 221.

²² Otto (n 5) 65.

²³ A consumer is over-indebted if the information available indicates that he or she is unable to satisfy in a timely manner all the obligations under the credit agreements to which he or she is a party having regard to his or her financial means, prospects and obligations and the consumer’s debt repayment history (s 79 (1)).

²⁴ s 78(1). For a definition of a juristic person see s 1. This is an important definition to understand as it carries a unique meaning distinct from that which was previously understood to be a juristic entity in the South African context. It is submitted that the new meaning of juristic person will not “leak” into South African common law but will remain for the purposes of the National Credit Act only. The impact of this section is considerable: every juristic person will not be legislatively subject to the sections discussed in this article, which in effect means that a juristic entity’s financial means, prospects and obligations need not be assessed by the credit provider before extending credit. While this may be a welcome relief to some juristic consumers it may also provide a loophole for abuse for a “desperate” non-juristic person seeking credit. Incorporating a company or a close corporation or forming a partnership is not a difficult task and may be used to gain access to credit where this has been denied to the natural person without the guise of the corporate veil.

²⁵ s 78(2).

- (i) a school loan²⁶ or student loan;²⁷
- (ii) an emergency loan;²⁸
- (iii) public interest credit agreements;²⁹
- (iv) an incidental credit agreement;³⁰ and
- (v) a temporary increase in the credit limit under a credit facility.³¹

Where credit is extended in terms of a school or student loan, an emergency loan or a public interest facility, the act requires that it be reported to the national credit register in the prescribed manner and form.³² The act does not specify who must report this. It is submitted, however, that it is likely that the onus will be on the credit provider given that it will be the credit provider which is otherwise at risk of lending recklessly. Furthermore, where an emergency credit loan is involved, reasonable proof of the existence of the emergency must be obtained and retained by the credit provider.³³ These are very important requirements and the onus is on credit providers to ensure that they abide by them, as providers will be able to circumvent any

²⁶ A school loan, it is submitted, is where an institution pays money to a primary or secondary school on account of school fees or other school-related costs for the benefit of the consumer's child or other dependant or where the primary or secondary school defers payment of all or part of the school fees or related costs. The definition of school loan is divided into two sections: while the second section is apparently straightforward, the first part of the definition implies that another party, other than the consumer parent or guardian, has paid the money to the school and thus created a loan relationship with the consumer parent. The words "on account" could mean that the school fees are paid by the parent on an account system – that is, every month or other determined period, the consumer parent pays a certain quantum to the school. However, this is none other than part or full deferment of payment of the fees and could not, it is submitted, be the correct interpretation given that the word "or" divides section (a) and section (b) of the definition of school loans. It is accordingly submitted that the words "on account" simply mean that the money is paid *for* the school fees or other related expenses. Some confusion is created, however, by the fact that "credit provider" is not mentioned in part (a) – while in the definition of student loan it is. See the footnote below.

²⁷ A student loan is a credit agreement where a credit provider pays a tertiary education institution for education fees or related costs for the benefit of the consumer student or consumer parent – on which the student is dependent; or it involves a credit agreement where the tertiary education institution defers payment of all or part of the consumer's education fees or related costs.

²⁸ This is a credit agreement which is entered into by a consumer to finance costs arising from or associated with a death, illness or medical condition, unexpected loss or interruption of income, or catastrophic loss of or damage to a home or property due to fire, theft or natural disaster.

²⁹ This involves a credit agreement where the minister whether by declaration or publication of regulation declares credit agreements in specific circumstances or for specific purposes or during specific periods or until the declaration or regulation is repealed to be public interest agreements. The act gives no further suggestions as to what these may entail (s 11).

³⁰ An incidental credit agreement is defined as "an agreement, irrespective of its form, in terms of which an account was tendered for goods or services that have been provided to the consumer, or goods or services that are to be provided to a consumer over a period of time and either or both of the following conditions apply: (a) a fee, charge or interest became payable when payment of an amount charged in terms of that account was not made on or before a determined period or date; or (b) two prices were quoted for settlement of the account, the lower price being applicable if the account is paid on or before a determined date, and the higher price being applicable due to the account not having been paid by that date" (s 1).

³¹ This is an agreement whereby the credit provider agrees to provide goods or services on credit or loans an amount or amounts of money to the credit consumer from time to time and defers payment or parts of payment or bills periodically and charges a fee or interest for the deferral in payment or when the payment is not paid within the stated time (s 8 (3)).

³² s 78(2)(f). Reg 23 provides that where credit is extended in terms of a school or student loan, an emergency loan or a public interest credit agreement, this must be reported by the credit provider to the national credit register within 30 business days of signature thereof, or alternatively at the end of the month in which the agreement was concluded, by submitting form 15.

³³ s 78(2).

accusations of reckless lending, in these instances, only if they have duly reported these to the national credit register and, in case of emergency loans, produce at trial the necessary proof of the existence of the emergency.³⁴ These exclusions apply to reckless credit only and not to over-indebtedness: accordingly, a natural person who enters into a credit agreement and has entered one of the above agreements (for example a school loan) will be able to raise the issue of over-indebtedness and may be afforded the relief sought.³⁵

The act places an onus on the credit consumer when applying for credit: while the application is being considered by the credit provider, the consumer must fully and truthfully answer any requests for information made by the credit provider as part of the assessment.³⁶ The wording of this section is interesting in that the positive responsibility appears to be on the credit provider to ask the correct information-gathering questions. The consumer is saddled with merely answering “fully and truthfully”.³⁷ Accordingly, it is submitted that credit providers be fully advised as to what questions they should be posing to their potential clients and the forms that they request their potential clients to complete should be comprehensive in scope.³⁸

It is, however, a complete defence to an allegation that a credit agreement is reckless if the credit provider establishes that the consumer failed to fully and truthfully answer any requests for information made by the credit provider as part of the assessment required by the act. However, a court or tribunal must determine that the consumer’s failure to do so materially affected the ability of the credit provider to make a proper assessment.³⁹ Accordingly, the submission made in the preceding paragraph that the credit provider should provide comprehensive forms to potential clients is emphasised, as this would ensure that all material information regarding the consumer or potential client is gathered by the credit provider.

A credit provider is prohibited from entering into a credit agreement without first taking reasonable steps to assess the consumer’s understanding and appreciation of the risks and costs of the proposed credit, and of the rights and obligations of the consumer under that credit agreement.⁴⁰ Rather than “assess”,⁴¹ it is suggested that the provider is better advised to simply inform the consumer of these risks, rights and

³⁴ It is submitted that photographs of damage or documentary recordings by, for example, insurance institutions that have inspected the premises would suffice.

³⁵ Van Heerden (n 1) 11-3.

³⁶ s 81(1).

³⁷ Referring to the United States, a spokesman for the Consumer Credit Counseling Service (a debt charity) said: “The lack of basic checks is a worry. As the credit crunch takes its toll on consumers’ finances, many people may be tempted to lie on credit application forms. It is vital there are rigorous checks put in place to ensure more credit is not given to borrowers who are already overstretched.” While the National Credit Act will not come to the rescue of a consumer who has provided false information to a credit provider in order to gain access to credit, a credit provider will be left with little comfort should he have to join the long queue of other credit providers who are attempting to execute on the consumer’s property (www.itweb.co.za/sections/financial/2007/0701221032.asp?A=COV&S=Cover) (6-11-2008).

³⁸ The onus thus falls on legal practitioners to correctly advise and ensure that the credit provider is carrying out proper risk analysis on the prospective client, otherwise the credit provider may find that when it does try and enforce the agreement, the magistrate will find that it lent recklessly and suspend the payments or restructure the consumer’s debt. This may result in a reduction of the repayments to the credit provider and an extension of the credit agreement.

³⁹ s 81(4)

⁴⁰ s 81(2)

⁴¹ An assessment of the understanding and appreciation of the risks and costs of the proposed credit is a very subjective exercise and credit providers may find it difficult to do so. Instead, a proactive approach to ensuring understanding and appreciation is required in the manner suggested in n 42.

obligations.⁴² The credit provider must further take reasonable steps to assess the consumer's debt repayment history as a consumer under credit agreements, as well as that consumer's existing financial means, prospects and obligations and whether there is a reasonable basis to conclude that the commercial venture for which the consumer is making the application will succeed.⁴³ It is important to note that this section prohibits the credit provider from entering into *any* credit agreement prior to having followed the abovementioned assessment procedures.

These assessment mechanisms and procedures that have to be adopted by the credit provider may be determined by the credit provider⁴⁴ provided that they result in a fair and objective assessment.⁴⁵ The national credit regulator may publish guidelines proposing evaluative mechanisms, models and procedures to be used when making a section 81 assessment.⁴⁶ In terms of developmental credit agreements the national credit regulator may pre-approve the evaluative mechanisms, models and procedures to be used by the provider to make an assessment in terms of section 81.⁴⁷

The situation may thus be summarised as follows: the credit provider is in terms of the act⁴⁸ prohibited from entering into *reckless* credit agreements with a prospective consumer. A credit agreement is reckless in the following circumstances:

- i If at the time that the agreement was made or at the time when the amount approved in terms of the agreement was increased⁴⁹ the credit provider failed to conduct an assessment as described in the preceding paragraph⁵⁰ irrespective of what the outcome of such an assessment might have concluded at the time.
- ii If the credit provider carries out the assessment as required by the act but enters into the agreement with the consumer despite the preponderance of the information gathered indicating that the consumer did not generally understand or appreciate the risks, costs or obligations under the proposed agreement.⁵¹

⁴² This may be done by a letter or memo or notice provided to the consumer and the contents should be explained to him or her in the same way that onerous clauses in contracts should be pointed out to the contracting party. This will also involve comprehensive staff training for the provider. Van Heerden suggests, as an example of this type of reckless credit, an instance in which "a credit provider enters into an agreement with a consumer without advising him properly about the interest to be charged or how the amounts of monthly instalments are to be calculated". She submits that the section implies that the credit provider has a duty to inform the consumer of the latter's risks, costs and obligations under the agreement ((n 1) 11-22).

⁴³ s 81(2).

⁴⁴ s 82.

⁴⁵ It is submitted that these are largely vague terms and a court will have to pronounce and thus determine what "fair and objective" procedures entail.

⁴⁶ s 82(2)(a).

⁴⁷ s 82(2)(b).

⁴⁸ s 81(3).

⁴⁹ Except where such amount was increased in terms of s 119(4) of the act which deals with increases in credit limits under credit facilities.

⁵⁰ in terms of s 81(2).

⁵¹ s 80(1). Otto (n 5) 66 n 41: "The criteria to determine over-indebtedness are those which applied at the time the agreement was concluded, or at the time that the amount approved is increased (s 80(2)). The consumer's financial position at a future stage, for better or for worse, is irrelevant." The reason for this may be that at the time the determination by the provider was conducted the consumer may have been able to afford the credit for which he was making application but may at a later stage become unable to meet these obligations due to, for example, retrenchment. This situation is differentiated from that in which entering into the agreement became the event which caused the consumer to become over-indebted (Van Heerden (n 1) 11-4).

- iii When a credit provider enters into a credit agreement with a consumer who has applied for debt re-arrangement and the re-arrangement still subsists.⁵²

Thus, it is submitted, when entering or considering an application to enter into a credit agreement with a potential consumer a credit provider must assess the credit consumer in terms of section 81(2) – failing which the agreement will be considered to be reckless regardless of whether the assessment information demonstrated that the consumer was aware of the risks, costs and obligations and that by entering into the credit agreement the consumer was not and would not be rendered over-indebted. Therefore, a credit agreement is automatically rendered a reckless credit agreement if no assessment is conducted by the credit provider. Accordingly, the following comment is concurred with:

“This section is penal in nature. Even if it turns out that the credit granted was not reckless in nature by any means, it will nonetheless be treated as such simply because the credit provider did not undertake a proper assessment. This is to prevent credit providers from taking shortcuts by simply accepting an apparently creditworthy debtor on face value.”⁵³

The issues of reckless credit and over-indebtedness, both relatively new legislative terms in the South African context, have resulted in an endeavour to create sub-labels. Van Heerden attempts to differentiate between “general over-indebtedness” and “reckless over-indebtedness” as follows: “General” over-indebtedness refers to the situation in which a consumer is not over-indebted when he or she enters into a credit agreement, but becomes over-indebted at a later stage. “Reckless” over-indebtedness refers to the situation in which the consumer becomes over-indebted the moment he enters into a credit agreement. It is submitted that this differentiation will, in the long run, prove artificial and inconvenient. This is because the labels of “general” and “reckless” over-indebtedness blur the concepts of “indebtedness” and “reckless lending” and thereby confuse attributes that have specifically and statutorily been assigned, *independently*, to the credit consumer and the credit provider. The credit provider is statutorily prohibited from lending recklessly.⁵⁴ If the credit provider does so and the consumer becomes over-indebted, the consumer is *generally* over-indebted or quite simply over-indebted with regard to all his or her credit agreements. That the credit agreement last entered into caused his or her over-indebtedness does not alter this fact. It is the credit provider that has lent recklessly. An investigation into the provider’s actions will be conducted and this will determine the effects of a re-arrangement of the consumer’s credit agreement relating to that specific provider. This specific credit agreement re-arrangement will be affected by whether the credit provider lent recklessly and such credit agreement may be suspended pending the repayment by the consumer of the other credit agreements which he or she has entered into, thereby removing the adverse effect to those credit providers who did not lend recklessly as well as the need for re-structuring.⁵⁵

⁵² *ie* other than a consolidation agreement as contemplated in s 88. A fuller discussion of s 88 can be found in the penultimate paragraph of this article.

⁵³ Otto (n 5) 66.

⁵⁴ s 80.

⁵⁵ The reader is again referred to the differentiation made between debt re-arrangement and debt re-structuring in n 67.

4 Powers of the courts

A court which has before it proceedings relating to a credit agreement in terms of the National Credit Act may determine that such agreement is reckless in terms of chapter 4 part D of the act.⁵⁶ Where a court finds that a credit agreement is reckless due to the fact that a credit provider failed to conduct an assessment as required by the act⁵⁷ or where the credit provider conducted an assessment but entered into the credit agreement with the consumer despite the fact that it was evident from the information gathered that the consumer did not generally understand or appreciate the consumer's risks, costs or obligations under the proposed agreement,⁵⁸ the court may make an order setting aside all or part of the consumer's rights and obligations under that agreement⁵⁹ or may suspend the force and effect of that credit agreement until a date determined by the court.⁶⁰

Where a court declares a credit agreement to be reckless because the credit provider, despite having conducted the required assessment, nevertheless entered into the agreement with the consumer despite the preponderance of the information

⁵⁶ s 83(1). The author concurs with Otto's submission that the wording of this section implies that a court may act *mero motu* in this regard and may thus take the initiative to determine whether an agreement is reckless (n 5) 67. The wording of s 83 and 85 refers to any court and not specifically to the magistrate's court. It has been suggested that once s 85 is read in context with the references it contains to s 86(7) and s 87 (which sections both specifically refer to magistrate's courts) it appears that the legislature intended that the actual debt restructuring be undertaken by a magistrate's court, and that "although any court may refer the matter to a debt counsellor or declare a consumer is over-indebted, the actual process of debt-restructuring appears to have been allocated exclusively to Magistrate's Courts" (Van Heerden (n 1) 11-17). It makes fiscal sense that the costs of a debt-restructuring order be kept at magistrate's court level but any court and not just a magistrate's court will be empowered to re-arrange a reckless credit agreement by setting it aside or suspending the force and effect of the agreement until a determined date. If the high court is intending merely to re-arrange the reckless agreement it may do so. If, however, it intends to re-structure all the consumer's debts then it must in terms of s 87 refer the matter to a magistrate's court. Note the difference in the meanings of re-structure and re-arrangement (*cf* n 67). An example would be where a credit provider institutes action against a consumer for a credit agreement where the capital loan amount is R200 000 in the high court, given that the quantum exceeds the jurisdiction of a magistrate's court. Should during the proceedings the consumer allege that the credit agreement under dispute was in fact a reckless one, the high court could then make any of the orders as set out in s 83. The dilemma arises when the consumer faces being over-indebted, as the high court would then have to refer the matter to the magistrate's court. It is submitted that the defendant consumer would in this instance have to declare and prove that "but for" the R200 000 loan by the plaintiff provider, he or she the consumer would not be over-indebted and thus request the court to suspend or set aside the offending agreement. This would obviate the need for debt re-structuring.

⁵⁷ s 80(1)(a).

⁵⁸ s 80(1)(b)(i).

⁵⁹ The provision is phrased so as to include the words "as the court determines just and reasonable in the circumstances". This, it is submitted, will require much direct involvement by the magistrate and the court will more than likely have to request various documents in order to assess the consumer's current financial situation as well as the expense, loss and liability which the credit provider may have or will incur. This may involve postponements so that the parties may return with the necessary documentation and information. It is further submitted that the consumer's financial situation will far outweigh any considerations for the provider's situation, given that the tasks of the magistrate are first to determine whether the consumer is over-indebted and, if the court finds that he or she is, then the court will restructure or suspend his or her obligations. The responsibility imposed on magistrates is not to be underestimated: they will be asked to look into their "crystal balls" and make assumptions and conclusions based on information available to them in order to assist over-indebted consumers without causing too much loss to (surely disgruntled) credit providers.

⁶⁰ s 83(2).

gathered indicating that entering into such an agreement would have the effect of rendering the consumer over-indebted,⁶¹ the court must consider whether the consumer is over-indebted at the time of those court proceedings. If the court concludes that the consumer is indeed over-indebted at that time, the court may make an order suspending the force and effect of that credit agreement until a date determined by the court and may restructure the consumer's obligations under any other credit agreement.⁶²

The court is directed to restructure the consumer's obligations under any other credit agreement "in accordance with section 87". Prior to restructuring the consumer's obligations and/or suspending any of the consumer's obligations under a credit agreement where a court has found that the credit agreement was reckless, the court is obliged to consider the following:⁶³

- (i) the consumer's current means and ability to pay;
- (ii) the consumer's current financial obligations which already existed at the time the agreement was entered into; and
- (iii) the expected date when any such obligation under a credit agreement will be fully satisfied assuming the consumer makes all payments required by the order.

If it is alleged that the consumer under a credit agreement is over-indebted, the court may either refer the matter to a debt counsellor with a request that the counsellor evaluate the consumer's circumstances and make a recommendation to the court with regard to the consumer's over-indebtedness or declare that the consumer is indeed over-indebted. Then an order will be made to re-arrange the consumer's obligations.⁶⁴ Where a debt counsellor makes a proposal to the magistrate's court or where a debt counsellor rejects an application by a consumer to be declared over-indebted and the consumer applies to the magistrate's court for such an order, the magistrate must conduct a hearing. The court may make any of the following orders:

⁶¹ s 80(1)(b)(ii). This will have to be an objective test and not "our institution was of the view that extending credit in this manner would not be reckless". An accepted percentage will have to be developed with regard to the amount of "free" cash a consumer must retain after he has met his or her commitments, to contribute to the cost of the credit for which he or she is making application. For example, an 80% norm may be developed. Say consumer X is earning R20 000. His living expenses including bond, levies, water and lights, vehicle, insurance, domestic groceries and so forth add up to R17 500. Mr X has an average amount of R2 500 "free" cash every month. This amount, however, will always be somewhat of a "guesstimate" as some expenses, eg groceries, do not always add up to a precise figure, and at times there are unforeseen expenses. The financial institutions will have to develop a model which states that the free cash is the residue after expense and obligations have been deducted. So if Mr X intends purchasing a vehicle for his son, he will not be able to afford a credit agreement where the repayments exceed R3 125 per month.

⁶² s 83(3).

⁶³ s 83(4).

⁶⁴ s 85. This may entail that a trial within a trial is conducted by the court, a burden which may not be attractive to the already over-loaded magistrates. It is submitted that the magistrates will more than likely rely heavily on the assessment report of the debt counsellor. The question remains, however, who will bear the costs of the debt counsellor's services in these instances – that is, where it is the court that refers the assessment and not the consumer himself.

(i) rejecting the debt counsellor's recommendations or consumer's application to be declared over-indebted;⁶⁵ or (ii) declaring any credit agreement to be reckless and making an order setting aside all or part of the consumer's rights and obligations under that agreement or suspending the force and effect of that credit agreement or restructuring the consumer's obligations under any credit agreement;⁶⁶ (iii) re-arranging⁶⁷ the consumer's obligations by⁶⁸ (a) extending the period of the agreement and reducing the amount of each payment due accordingly; or (b) postponing during a specified period the dates on which payments are due under the agreement; or (c) extending the period of the agreement and postponing during a specified period the dates on which payments are due under the agreement; or (d) recalculating the consumer's obligations because of certain contraventions by the consumer.⁶⁹ The court may make an order containing any combination of the above.⁷⁰

The national credit regulator may not intervene before the magistrate's court when a matter is referred to it in terms of this section.⁷¹ Only a court is empowered to declare a consumer over-indebted and to determine that a credit provider lent recklessly. It will be seen in the following paragraph that a debt counsellor is not empowered to declare a consumer to be over-indebted or that a credit agreement amounts to reckless lending but is empowered only to investigate, through debt review, and to make determinations and recommendations in this regard.⁷²

5 Powers of debt counsellors

The consumer may apply to a debt counsellor⁷³ to have himself or herself declared over-indebted.⁷⁴ The act prescribes the manner and form by which the application must be made.⁷⁵ The consumer, however, is prevented from making such an

⁶⁵ s 87(1)(a).

⁶⁶ s 87(1)(b)(i).

⁶⁷ It is submitted that there is a distinction between "restructuring" of a consumer's obligations and a "re-arrangement" of a consumer's obligations under a credit agreement. The former appears to include the re-shuffling of the consumer's obligations vis-à-vis other obligations, while the latter concept refers more specifically to the extension, postponement or recalculation of the repayment of a particular credit agreement or even a number of credit agreements. Essentially, the "re-arrangement" will look at each agreement specifically while "restructuring" is a broader concept which will look at the consumer's situation as a whole.

⁶⁸ s 87(1)(b)(ii).

⁶⁹ These are contraventions of part A and B of ch 5 and part B of ch 6, namely unlawful credit agreements and provisions, and non-compliance with disclosure, form and effect of credit agreements and collection and repayment practices. These contraventions are not merely consumer contraventions but include provider contraventions.

⁷⁰ s 87(1)(b)(iii).

⁷¹ s 87(2).

⁷² s 86 and Van Heerden (n 1) 11-6.

⁷³ A debt counsellor is defined in reg 1 as "a natural person who is registered in terms of section 44 of the Act offering a service of debt counselling and debt counselling as performing the functions contemplated in section 86 of the Act". Anyone who is not registered as a debt counsellor in terms of s 44(2) may not practise as one.

⁷⁴ Reg 24 sets out the information and documentation which the applicant consumer must submit to the counsellor for these purposes.

⁷⁵ s 86(1).

application if at the time of that application the credit provider has proceeded to take steps contemplated in terms of section 129 to enforce the agreement.⁷⁶

The debt counsellor is entitled to charge the credit consumer an application fee,⁷⁷ but may not require or accept a fee from the credit provider for an application made by a consumer.⁷⁸ Upon receipt of the application the debt counsellor must provide the consumer with proof of the receipt of the application and notify in the prescribed manner and form all the credit providers that are listed in the consumer's application and every registered credit bureau.⁷⁹

The consumer and all the credit providers are expected, in terms of the act, to comply with any reasonable requests which may be required by the debt counsellor in order to facilitate the evaluation of the consumer's state of indebtedness and the prospects for responsible debt re-arrangement; and further to participate in good faith in the review and in any negotiations designed to result in responsible debt re-

⁷⁶ s 86(2). The wording in this section is interesting. In such instances the consumer may approach a debt counsellor at the same time as the s 129 notice is sent out by the credit provider. The question the courts will face is when the s 129 notice is posted on, say, the tenth day of the month and the consumer approaches a debt counsellor on the tenth day of that same month, whether the shorter period for the s 129 procedure initiated by the credit provider will prevail (namely 20 days) or whether he will have to wait for the seventy days in terms of s 86(10). It is submitted that the court will have to look closely at the course and sequence of events, and if the debtor has approached the debt counsellor after the dispatch of the s 129 notice then the shortened period should be applied but where a debtor has approached the debt counsellor on the same day or before then the longer period should be applied. It is submitted that the court will have to determine when the notice was actually posted and not the date of the notice – as the consumer should not, it is submitted, be prejudiced by internal delays of the credit provider.

⁷⁷ The Debt Counselling Association of South Africa (DCASA) has proposed fee guidelines for debt counselling. These guidelines are as follows: "1. The Debt Counsellor may receive the following amounts in respect of consumers with an individual gross income of more than R2 500 per month or household income of more than R3 500 per month: 1.1. An application fee, recoverable directly from the consumer upon receiving an application for debt review, limited to the amount prescribed in terms of sch 2(2) of the act; 1.2. A rejection fee of R300 (excluding vat) in respect of consumers whose applications have been rejected in terms of s 86(7)(a); 1.3. A restructuring fee of the lesser of the first instalment of the debt re-arrangement plan or R3000 (excluding vat), in respect of a consumer whose application has been accepted in terms of ss 86(7)(b) or 86(7)(c). Should a joint application be required the fee can be increased to R4000 (excluding VAT). The fee is payable as follows: 1.3.1 100% of the fee is payable at the first instalment. 1.4. Should a Debt Counsellor fail to submit proposals to Credit Providers or refer the matter to a tribunal or a magistrate's court within 60 business days from date of the debt review application the Debt Counsellor has to refund 100% of the fee paid by the consumer. 1.5. A monthly after-care fee of 5% (excluding vat) of the monthly instalment of the debt re-arrangement plan up to a maximum of R300 (excluding vat), for a period of 24 months, thereafter reducing to 3% (excluding vat) of the monthly instalment, to a maximum of R300 (excluding vat), for the remaining period of the debt re-arrangement plan. 1.5.1. Payment of the monthly after-care fee is to commence in the 2nd month after the amount in 1.3.1 above has been paid. 1.6. Should the consumer withdraw from the process after completing stages 1.3 above a fee equal to 75% of the restructuring fee as per 1.3 above is payable by the consumer; 1.7. Legal fees, if and when they occur, may be recovered from the consumer provided the amount of such fees are disclosed up-front to the consumer and agreed to in writing by the consumer. 1.8. The fee structure will be reviewed in January 2009. These guidelines have been taken directly from the National Credit Regulator web site and it is assumed that they have thus been approved by the National Credit Regulator" (<http://www.ncr.org.za/Guidelines.html>) (7-1-2008). It is submitted that the agreed fees appear somewhat expensive, given that a person who may be earning R2 800 per month (and who may have dependants) will have to pay a debt counsellor up to R3 000 excluding vat upfront and thereafter a monthly aftercare fee of 5% of the monthly instalment. It is assumed that reference to "the act" in these guidelines is reference to the National Credit Act; however, there is no sch 2(2) in the act.

⁷⁸ s 86(3).

⁷⁹ s 86(4).

arrangement.⁸⁰ Upon receipt of an application from a consumer the debt counsellor must determine in the prescribed manner and within the prescribed time⁸¹ whether the consumer appears to be over-indebted, whether the consumer is seeking a declaration of reckless credit, or whether any of the consumer's credit agreements appear to be reckless.⁸² However, if after conducting the assessments the debt counsellor concludes that the consumer is not over-indebted the debt counsellor must⁸³ reject the application even where the counsellor has concluded that a particular credit agreement was reckless at the time it was entered into. If the debt counsellor rejects the application in this manner then the consumer, with leave of the magistrate's court, may apply directly to the magistrate's court in the prescribed manner and form⁸⁴ for an order that the consumer be found over-indebted and that one or more of the consumer's credit agreements be declared reckless and that one or more of the consumer's obligations be re-arranged.⁸⁵

Where a counsellor concludes that a consumer is not over-indebted but is experiencing or is likely to experience difficulty in satisfying his or her obligations under his or her credit agreements in a timely manner then the counsellor may recommend that the consumer and respective credit providers voluntarily consider and agree on a plan of debt re-arrangement.⁸⁶ Where the consumer and each credit provider accept the proposal such proposal must be recorded in the form of an order and where the consumer and each credit provider have consented to the proposal then this must be filed as a consent order.⁸⁷ Where the counsellor is unable to secure a consent form then he or she must refer the matter to the magistrate's court with the recommendation.⁸⁸

Where a debt counsellor finds that a consumer is in fact over-indebted the counsellor may issue a proposal recommending that the magistrate's court make either or both of the following orders:

- (i) that one or more of the consumer's credit agreements be declared reckless; and
- (ii) that one or more of the consumer's obligation's be re-arranged by:
 - (a) extending the period of the agreement and reducing the amount of each payment due accordingly;⁸⁹

⁸⁰ s 86(5).

⁸¹ In terms of reg 24(6) a debt counsellor must make a determination within 30 business days after receiving an application in terms of s 86(1) of the act.

⁸² s 86(6).

⁸³ The wording is clear: the debt-counsellor does not have an option.

⁸⁴ In terms of reg 26 the consumer may approach the court within 20 business days (by good cause shown the court may extend this period), and must do so by using form 18. The use of forms may assist the consumer in initiating the court process personally without the assistance of legal representation.

⁸⁵ as per s 86(7)(c) and (9).

⁸⁶ s 86(7)(b). Given that it is wholly impractical for the various credit providers to be putting forward a debt re-arrangement for the consumer, it is assumed that it will be part of the debt counsellor's duties to actually provide a plan for the debt re-arrangement. Reg 24(9) provides that such arrangement must be reduced to writing and signed by all parties – that is, the credit providers mentioned, the debt counsellor and the consumer.

⁸⁷ In terms of s 138. Where a debt counsellor finds in terms of s 86(7)(a) that a consumer is not over-indebted, he must in terms of reg 25 provide the consumer with a letter of rejection containing prescribed information.

⁸⁸ s 86(8).

⁸⁹ This will have the effect of increasing the cost of the credit and the credit provider's profit, which will somewhat compensate for the fact that the payment period has been extended. Although, if that particular credit provider was found to have lent recklessly, then it is submitted that the court may consider not allowing extra interest to run for that agreement.

- (b) postponing during a specified period the dates on which payments are due under the agreement;
- (c) extending the period of the agreement and postponing during a specified period the dates on which payments are due under the agreement; or
- (d) recalculating the consumer's obligations because the credit agreement was unlawful or contained unlawful provisions⁹⁰ or due to contraventions of part A of chapter 6.

Where a consumer is in default under a credit agreement that is being reviewed the credit provider may still give notice to terminate the review in the prescribed manner to the consumer, the debt counsellor and the national credit regulator at any time, but at least 60 business days after the date on which the consumer applied for debt review.⁹¹ Where a credit provider proceeds to enforce the agreement by repossession or judgment⁹² the magistrate's court hearing the matter may order that the debt review resume on any conditions which the court considers to be just in the circumstances.⁹³

6 *The effects of suspension, debt review or re-arrangement*

During the time that a credit agreement is suspended in terms of the National Credit Act, the consumer is not required to make payment under the agreement and no interest, fee or other charge under the agreement may be charged to the consumer and despite any law to the contrary the credit provider may not enforce its rights under that credit agreement. However, when the suspension ends all the respective rights and obligations of both the consumer and credit provider are revived and become fully enforceable except in so far as a court orders otherwise. The act is very specific that there are to be no charges, fees or interest charged to the consumer during the time of the suspension and furthermore the act specifies that no such charges may be calculated retrospectively after the suspension has ended.⁹⁴

Where a consumer has filed an application with a debt counsellor to be declared over-indebted or has alleged in court that he is over-indebted the consumer may not thereafter incur further charges under a credit facility or enter into any further credit agreement, except for a consolidation agreement with a credit provider. This prohibition stands until the time period for filing an application with the magistrate's court where a debt counsellor has rejected an application by the consumer to be declared over-indebted expires, or until such time as a court has determined that he or she is not over-indebted, has rejected the debt counsellor's proposal or the consumer's application or where an agreement has been reached between the consumer and the credit providers which agreement re-arranges the consumer's obligations or until all the consumer's obligations are fulfilled or until the court has made an order.⁹⁵ Where a consumer has entered into a credit agreement other than a consolidation agreement with a credit provider and the consumer has applied for debt re-arrangement and the re-arrangement subsists – all or part of the new agreement

⁹⁰ in terms of part A and B of ch 5.

⁹¹ s 86(10).

⁹² in terms of part C of ch 6.

⁹³ s 86(11).

⁹⁴ s 84.

⁹⁵ s 88(1).

may be declared reckless credit whether or not the circumstances set out for reckless credit in terms of section 80 apply.

Section 88(5) is a confusing section in light of the fact that section 88(4) renders an agreement entered into contrary to section 88 reckless. It states that if a consumer applies for or enters into a credit agreement contrary to section 88, the provisions of part D of chapter 4 will not apply to that agreement. Van Heerden submits that by entering or even applying for credit when under debt-rearrangement or review he or she “divests” himself or herself of the protection afforded by the act.⁹⁶ A credit agreement entered into under these circumstances may not then be declared reckless and suspended or set aside. While the agreement may be reckless the consumer by virtue of section 88(5) divests himself or herself of the protection of the act by entering into the agreement contrary to section 88. According to section 88(5) the provider in this event will then be able to proceed against the consumer as in the normal course of events as prescribed by the rules of court, take judgment and execute against the consumer. This situation is, however, not viable as it will prejudice the credit providers that have respected the debt re-arrangement order or who are awaiting the outcome of a debt review. The sections are contradictory and a court will have to determine their import and hierarchy vis-à-vis each other.⁹⁷

7 Conclusion

Although new in South African legislation, the concept of reckless credit is well concretised by the National Credit Act and its implications for credit providers are far-reaching. Part D of chapter 4 of the act places a great onus on credit providers to become more responsible in their credit lending services. A greater responsibility is placed on the credit provider to comprehensively check that a consumer is creditworthy and in a position to repay the deferred capital loaned. Furthermore, credit providers have a responsibility to ensure that the correct answers are elicited from their would-be clients, in that although a consumer is obliged to answer fully and truthfully, a provider would only be able to use the lack of information provided by the consumer as a complete defence if a court or tribunal finds that such information or rather misinformation was material. Accordingly, it has been submitted that credit providers need to ensure that proper forms are provided to would-be consumers in order to obtain the necessary material information for these purposes and that beyond these forms the correct checks are carried out, for example, with the relevant credit bureaus – and, once it is established, against the register.

The responsibility of the credit provider does not stop with eliciting and obtaining the correct background and current information with regard to the credit consumer’s financial situation at the time he or she applies for credit, but extends beyond these investigative criteria to ensuring that a credit consumer has an understanding and appreciation of the risks and costs of the proposed credit and of his or her rights and obligations.

The consequences of lending recklessly are far-reaching. A credit provider may find that a consumer’s rights and obligations in terms of a credit agreement are set aside completely, or a provider may find that a court decides it just and reasonable to suspend the effect of a credit agreement, in which event no fees, interest or charges

⁹⁶ Van Heerden (n 1) 11-19.

⁹⁷ The legislature may consider revisiting these two sections.

may be charged to the consumer either during or after the suspension for the time during which the agreement is suspended.

The biggest potential effect of part D of chapter 4 on a credit provider is that, despite it not having lent recklessly, due to an over-indebted consumer's debt restructuring by a court the agreement entered into by that credit provider may be re-arranged. For example, the court may order that the periodic repayments might be made over a longer period and thereby lessened on a monthly basis. The total interest repayable will ensure that the credit provider does not lose its profit in these instances, provided it did not lend recklessly. While the effects of part D are dramatic, more especially for credit providers, consumers are also affected by being forced to take much greater care when borrowing. Consumers are limited as to the amount of credit they may borrow, and in the event that they find themselves over-committed the act provides an avenue for debt relief in the form of debt restructuring – or, if there is a particular offending reckless credit agreement, for the re-arrangement of this agreement. Much emphasis has been placed on South African courts (more especially magistrates' courts), and, without immediate and intensive training, re-structuring and re-arrangement orders may have the effect of persuading “burnt” credit providers to withdraw credit from the market. This will have the net effect of credit being made available to a privileged few, which in turn will raise the cost of credit. All of these consequences will have the effect of depriving the smaller consumer of access to credit. Ironically, this is not quite the intention of the legislature.

SAMEVATTING

WEE DIE VERSKAFFER VAN ROEKELOSE KREDIET

Die artikel ondersoek die konsep en gevolge van roekelose krediet en oorverskuldigheid, soos omvat in die Nasionale Krediet Wet, asook die implikasies vir kredietverskaffers en verbruikers. Deel D van hoofstuk 4 van daardie wet plaas 'n verpligting op kredietverskaffers om meer verantwoordelik op te tree in hul kredietvoorsieningsdienste, met insluiting van die verantwoordelikheid om 'n omvattende ondersoek te doen na die kredietwaardigheid van 'n verbruiker en die vermoë van die verbruiker om die skuld te delg. Die kredietverskaffer moet verder verseker dat die verbruiker die risiko's en kostes verbonde aan asook sy regte en verpligtinge ten opsigte van die voorgenome kredietooreenkoms ten volle verstaan en waardeer.

Indien bevind word dat die verbruiker oorverskuldig is, kan sy regte en verpligtinge ingevolge die kredietooreenkoms ter syde gestel word of die werking van die kredietooreenkoms kan opgeskort word. Opskorting behels dat geen fooie, rente of kostes van die verbruiker verhaal kan word tydens die termyn van opskorting nie. Die gevolge van deel D affekteer egter sowel die kredietverskaffer as die verbruiker. Die verbruiker se vermoë om krediet te bekom, word nou beperk aan die hand van sy middele en inkomste. Die onus val nou op die Suid-Afrikaanse houe, en in die besonder op die landdroshoue, om die Nasionale Krediet Wet te interpreteer en te implementeer.