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The National Credit Amendment Act: An assessment of progress or platitude for the prevention of reckless credit granting in South Africa?

BY

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Abstract

The National Credit Act 34 of 2005 introduced the concept of reckless lending into the South African credit market. It set out a regulatory framework in chapter 4 part D that provided for the credit provider's assessment of certain aspects relating to the consumer prior to the lending of credit. This assessment, *inter alia*, meant assessing the consumer's financial means and prospects, debt repayment history and general understanding of the risks and obligations. The obligation placed on credit providers to conduct an assessment originally stated that such credit provider must take reasonable steps when assessing the consumer's ability to afford the credit requested. However, it did not state what constituted a reasonable step. More specifically, the provision provided that guidelines would be published to assist a credit provider in creating a suitable assessment mechanism, model or procedure. However, until the first quarter of 2013, no guidelines had been issued. This led to an uncertainty in the credit market and consequently interpretational issues thereof arose.

Eventually, after conducting a policy review, the National Credit Regulator published draft guidelines in May 2013 followed up by more comprehensive guidelines in September that year. The National Credit Amendment Act followed shortly thereafter altering the pre-agreement assessment provisions to state that a credit provider may determine for itself the evaluative mechanisms, models and procedures used to assess a consumer but that such mechanism, model or procedure must not be inconsistent with the regulations published by the Minister. Subsequently the Affordability Assessment Regulations were published, setting out a standard to which all credit providers have to base their assessment mechanism, model or procedure around. The main focus of this dissertation is therefore to investigate the new pre-agreement assessment dispensation, benchmarked against previous interpretational issues.

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Chapter 1
Introduction

1.1 Background information

On 10 August 2014 African Bank investments Limited,[1] a South African credit provider of unsecured loans, was placed under curatorship by Gill Marcus - the former governor of the South African Reserve Bank.[2] This came after the SARB lent African Bank R7 billion (Seven Billion Rand) in an attempt to bail the bank out of financial distress.[3] Allegedly, this financial distress came about as a result of reckless lending practices.[4] The Bank purportedly failed to properly screen debtors, leading to an overwhelming amount of them not being able to pay back loans.[5]

This dissertation will address the issue of reckless lending practices in the South African credit market by investigating the relevant provisions of the National Credit Act,[6] and the amendments made thereto. Specific reference is made to the pre-agreement assessment obligation held in section 81 of the NCA, benchmarked against the African Bank debacle. Reference is also made to the Removal of

[1] Hereafter "African Bank" or "the Bank".

[2] According to the South African Reserve Bank (Hereafter "SARB") website *http://www.resbank.co.za* accessed 20/10/2015:

> The South African Reserve Bank is the central bank of the Republic of South Africa. The primary purpose of the Bank is to achieve and maintain price stability in the interest of balanced and sustainable economic growth in South Africa. Together with other institutions, it also plays a pivotal role in ensuring financial stability.

[3] Business Day TV 'Reigning in reckless lending' (2014) (Hereafter "Business Day TV (2014)") website *http://www.bdlive co.za/business/financial/2014/08/14/business-day-tv-reigning-in-reckless-lending* accessed 04/03/2015.

[4] 'Reckless lending practices' is not specifically defined in the NCA but can be described as a continuous act of lending credit to consumers who cannot afford to pay back money lent, usually a result of not conducting an assessment of the consumers ability to afford such credit. Other reckless lending practices extend to marketing and consumer education on credit. Van Heerden and Renke 'Perspectives on the South African responsible lending regime and the duty to conduct pre-agreement assessment as a responsible lending practice' (2014) IIRJ 11 (Hereafter "Van Heerden and Renke (2014)").

[5] Section 81 of the NCA requires credit providers to conduct a pre-agreement assessment of their debtors prior to granting credit. Fin24 'African Bank fined 20 million' (Hereafter "Fin24 (2015)") website *http://www.fin24.com/Companies/Financial-Services/African-Bank-fined-R20m-for-reckless-lending-20131003* accessed 04/03/2015.

[6] Act 34 of 2005 (Hereafter "NCA" or "the Act").

Adverse Consumer Credit Information and Information relating to Paid Up Judgments Regulations,[7] as far as it relates to this dissertation.

Since the promulgation of the NCA, debt counsellors have lodged numerous complaints to the National Credit Regulator[8] concerning alleged reckless lending practices.[9] In terms of section 14 read together with section 15 of the NCA, the NCR is charged with regulating all credit providers within the credit industry. On the other hand, section 81 of the NCA states that a credit provider wanting to conclude an agreement with a prospective consumer must first do a compulsory pre-agreement assessment of, *inter alia*, the consumer's financial situation. The assessment includes, amongst others, assessing his affordability, debt re-payment history, and his general understanding of the risks and obligations of the agreement.[10] The perception exists that African Bank's current position could perhaps have been avoided had the NCR properly regulated the Bank and enforced the provisions of the NCA.[11] This is as the Bank's assumed failure to conduct suitable pre-agreement assessments of its debtors has contributed to its woes.[12] Subsequently, in 2012 the NCR conducted a policy review of the NCA in order to determine possible legislative improvements.[13]

The policy review revealed that the pre-agreement assessment obligation, which previously allowed credit providers to structure their own affordability assessment models, created certain 'loopholes'.[14] This is as the NCR discovered severe inconsistencies in how credit providers went about developing their affordability assessment models. In some instances no affordability assessment model was in

[7] Published in *Government Gazette* 37386 (Hereafter "Credit Amnesty Regulations").
[8] Hereafter "NCR".
[9] When a consumer cannot pay back debt(s), they have the right in terms of s 86(1) of the Act to approach a debt counsellor for assistance. If the consumer is deemed over-indebted, the counsellor will help the consumer to restructure or rearrange their debt repayments – this arrangement can be made an order of court as per s 86(8)(b) of the Act. However, if the debt counsellor is under the impression that reckless lending has occurred, the debt counsellor can report the credit provider who granted such credit to the NCR. Van Heerden and Renke (2014) 7.
[10] Kelly-Louw and Stoop 'The National Credit Act regarding suretyships and reckless lending' (2011) PELJ 87 (Hereafter "Kelly-Louw and Stoop (2011)").
[11] Business Day TV (2014).
[12] As stated previously.
[13] Preamble to National Credit Amendment Act 19 of 2014. (Hereafter "NCAA").
[14] *Ibid*.

place with the result that no form of credit assessment was conducted prior to the extension of credit.[15] The legislature, through the NCAA, purportedly seeks to alleviate some of these problems by ensuring that credit providers, as a minimum, should adhere to compulsory statutory affordability assessment guidelines.[16]

Furthermore, the Removal of Adverse Consumer Credit Information and Information Relating to Paid Up Judgments Regulations[17] came into effect on 1 April 2014.[18] The credit amnesty regulations are relevant as it, *inter alia,* expressly states therein that a credit provider must not use adverse consumer credit information and information relating to paid up judgments that have been removed in terms of these regulations for any reason, including when conducting pre-agreement assessments.[19]

1.2 Problem statement and research objectives

Studies have shown that consumers commit the larger part of their salaries to the repayment of existing debt, thus creating a shortfall in liquidity to cover basic living expenses.[20] Consequently, consumers seek additional funding to cover this shortfall as a 'necessity' resulting in the creation of further debt.[21]

Credit providers are obliged by section 81 to conduct an affordability assessment prior to extending credit to a consumer.[22] Credit providers may create their own evaluative mechanisms, models and procedures as long as reasonable steps are taken when conducting the assessment.[23] Affordability assessments are conducted according to the credit providers own evaluative mechanisms, models and procedures. Severe inconsistencies arose with regard to the way in which a credit provider conducted the assessment thus facilitating the ease with which a consumer

[15] Otto and Otto 'The National Credit Act Explained' (3rd ed 2013) LexisNexis 74. (Hereafter "Otto and Otto (2013)").
[16] S 24 NCAA amends s 82. Published in *Government Gazette* 38557 Chp 3 Reg 23A.
[17] Published in *Government Gazette* 37386 (Hereafter "Credit Amnesty Regulations").
[18] Kelly-Louw 'The 2014 credit-information amnesty regulations: what do they really entail?' (2015) De Jure 97 (Hereafter "Kelly-Louw (2015)").
[19] Reg 3(d) of the Credit Amnesty Regulations.
[20] Kelly-Louw and Stoop (2011) 66.
[21] *Ibid.*
[22] S 81 NCA.
[23] Kelly-Louw and Stoop (2011) 67.

could attain credit.[24] Accordingly, reckless lending perpetuates reckless borrowing by the consumer and *vice versa*, creating a vicious cycle.[25]

In an attempt to curb this vicious cycle, the NCA introduced the pre-agreement assessment obligation as a preventative measure. This dissertation will investigate the original pre-agreement assessment provisions held in the NCA and the subsequent amendments made thereto. The purpose thereof is to measure whether the amendments have brought about a better dispensation for the South African consumer in the context of preventing reckless credit extending.

1.3 Delineation and limitations

The legislature intended to promote responsible lending practices within the South African credit market through the promulgation of the NCA.[26] Responsible lending practices cover a wide array of measures that can be implemented. This includes consumer education and promotion of financial literacy, responsible marketing, regulation of the cost of credit and conducting pre-agreement assessments of consumers.[27]

This research focuses specifically on prevention and will focus on the responsible lending practice of conducting a pre-agreement assessment.[28] This is assessment is conducted prior to the extending of credit and is considered to be an *ex-ante* measure to prevent reckless credit extending as opposed to an *ex-post* correctional measure.[29] Other responsible lending practices listed above are specifically excluded from this research, to retain focus and avoid a secondary chain of discussions. Furthermore, the Credit Amnesty Regulations will only be discussed in so far as they are relevant to the pre-agreement assessment that a credit provider must conduct.[30]

[24] Business Day TV (2014).
[25] Otto and Otto (2013) 107.
[26] S 3 NCA.
[27] Renke 'An evaluation of debt prevention measures in terms of the National Credit Act 34 of 2005' (2012) LLD thesis chp 8.
[28] As held in s 81 of the NCA and subsequently amended by s 24 of the NCAA.
[29] Van Heerden and Renke (2014) 11.
[30] For a detailed discussion on the Credit Amnesty Regulations see Kelly-Louw (2015).

1.4 Structure

This dissertation will begin with a broad overview of some of the NCA's features, namely highlighting the relevant application and purpose thereof. Once this foundation has been established, a detailed investigation of the progression and development of the pre-agreement assessment will be conducted. This investigation will first deal with the relevant provisions as originally found in the NCA. General observations will be made, including judicial insight into the original pre-agreement assessment provisions. The amendments thereof, as held in the NCAA will then be addressed starting with the recent spate of draft assessment guidelines and regulations will also be considered. Furthermore, note will be taken of the introduction of Credit Amnesty Regulations. In conclusion, specific observations with regard to the progression of the pre-agreement assessment regime will be emphasised.

1.5 Key definitions

The NCA, in section 1, applies the following definitions, which is also the meaning that this dissertation attaches thereto:

> **"consumer",** in respect of a credit agreement to which the NCA applies, means
> (a) the party to whom goods or services are sold under a discount transaction, incidental credit agreement or instalment agreement;
> (b) the party to whom money is paid, or credit granted, under a pawn transaction;
> (c) the party to whom credit is granted under a credit facility;
> (d) the mortgagor under a mortgage agreement;
> (e) the borrower under a secured loan;
> (f) the lessee under a lease;
> (g) the guarantor under a credit guarantee; or
> (h) the party to whom or at whose direction money is advanced or credit granted under any credit agreement.
>
> **"credit",** when used as a noun, means
> (a) a deferral of payment of money owed to a person, or a promise to defer such a payment; or
> (b) a promise to advance or pay money to or at the direction of another person.
>
> **"credit provider",** in respect of a credit agreement to which the NCA applies, means
> (a) the party who supplies goods or services under a discount transaction, incidental credit agreement or instalment agreement;

(b) the party who advances money or credit under a pawn transaction;
(c) the party who extends credit under a credit facility;
(d) the mortgagee under a mortgage agreement;
(e) the lender under a secured loan;
(f) the lessor under a lease;
(g) the party to whom an assurance or promise is made under a credit guarantee;
(h) the party who advances money or credit to another under any other credit agreement; or
(i) any other person who acquires the rights of a credit provider under a credit agreement after it has been entered into.

Chapter 2

Purpose, application and initial reckless credit provisions

2.1 Introduction

The drafters of the National Credit Act[1] submitted that 'South African law provides no effective protection against over-indebtedness.'[2] Furthermore, they correctly identified that over-indebtedness is directly related to reckless lending and borrowing.[3] The drafters intended to curb reckless lending practices by introducing a general requirement that all credit providers should conduct affordability assessments prior to extending credit to consumers.[4] This chapter will investigate the purpose and application of the NCA as well as the original reckless credit provisions. Specific reference is made to the initial pre-agreement assessment obligation placed on credit providers.[5]

The purposes of the NCA are firstly determined in this chapter, followed by a brief outline of the application of the NCA, more specifically the application chapter 4 part D. This is essential as it lays a foundation for subsequent discussions in this research. Once this foundation is established, a detailed analysis of the reckless credit provisions is set out. Reference is made to the types of reckless credit and the consequences of a finding of reckless credit. Finally, the pre-agreement assessment obligation is discussed with focus on the assessment mechanisms, models and procedures provision as originally found in section 82. This is the most important discussion for this dissertation as section 82 has subsequently been amended by the National Credit Amendment Act[6]

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[1] Act 34 of 2005. (Hereafter "NCA" or "the Act").
[2] Department of Trade and Industry South Africa 'Consumer Credit Law Reform: Policy Framework for Consumer Credit' (2004). Website *www.ncr.org.za* accessed 27/07/15 (Hereafter "Policy Framework (2004)"). See also Report prepared for FinMark Trust, South Africa by RP Goodwin-Groen (with input from Kelly-Louw) 'The National Credit Act and its regulations in the context of access to finance in South Africa' (2006) website *http://www.finmark.org.za/wp-content/uploads/NCA_regulations.pdf* accessed 27/07/15.
[3] *Ibid.* See par 1.2.
[4] Policy Framework (2004) 30. See par 1.1.
[5] Namely, s 81-82 NCA.
[6] Act 19 of 2014 (Hereafter "NCAA").

and is the focus of this research. The credit provider's so-called 'complete defence' is briefly discussed.

2.2 Purpose in relation to reckless credit

Any provision in a piece of legislation should be interpreted to give effect to the purpose of that particular legislation.[7] In this regard section 2(1) of the NCA provides that 'this Act must be interpreted in a manner that gives effect to the purposes set out in section 3.' These are:

> To promote and advance social and economic welfare of South Africans; to promote a fair, transparent, competitive, sustainable, responsible, efficient, effective and accessible credit market and industry, and to protect consumers.[8]

There is debate as to what the main purpose of the NCA is. It is alleged that the main purpose of the NCA is to protect consumers by correcting the unbalanced relationship between credit providers and consumers.[9] On the other hand it is held that there is no indication that it is purely consumer legislation and it is argued that the NCA also purports to regulate the credit industry.[10]

Of importance for this research is that the NCA clearly states in section 3(c) that it purports to promote responsibility in the credit market. One of the means put in place to achieve this purpose is the incorporation of reckless credit granting provisions into the NCA.[11] Thus, at the very least, in the context of the Act's reckless credit provisions, one can conclude that the NCA is in place to promote responsibility in the credit market, and that all provisions relating to reckless credit should be interpreted to, amongst others, give effect to this purpose.[12]

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7 Botha 'Statutory interpretation: an introduction for students' (2010) LexisNexis 45 – 50.
8 S 3 NCA. See also Otto and Otto 'The National Credit Act Explained' (2013) LexisNexis (Hereafter "Otto and Otto (2013)").
9 Scholtz 'Guide to the National Credit Act' (2014) LexisNexis 21 (Hereafter "Scholtz (2014)").
10 In *Taxi Securitisation (Pty) Ltd v Nako* case no 19/2010 (ECB) (unreported) par 35, Judge Kemp held that "[t]o interpret the NCA through the lenses of 'the promotion and protection of consumers" loses sight of the NCA's other objectives.
11 Otto and Otto (2013) 67.
12 *Ibid.*

2.3 Application pertaining to reckless credit

Now that the purposes for the NCA's enactment relating to reckless credit have been established, it is imperative to determine the application of the relevant provisions. This is important as the NCA does not regulate all credit agreements in South Africa. Furthermore, part D chapter 4 only applies in certain circumstances.

The general application of the NCA is set out in section 4. The NCA is applicable to every credit agreement between parties dealing at arm's length within the Republic or having effect within the Republic.[13] This means the concept of reckless credit can only apply if the agreement is a credit agreement to which the NCA applies.[14] An agreement will qualify as such if it is a credit facility,[15] credit transaction,[16] credit guarantee[17] or a

[13] Otto and Otto (2013) 45. See also Scholtz (2014) 12.
[14] S 4(1).
[15] S 8(3) determines that an agreement, irrespective of its form but not including an agreement contemplated in subsection (2) or section 4 (6) (*b*), constitutes a credit facility if, in terms of that agreement:
(*a*) a credit provider undertakes—
(i) to supply goods or services or to pay an amount or amounts, as determined by the consumer from time to time, to the consumer or on behalf of, or at the direction of, the consumer; and
(ii) either to—
(aa) defer the consumer's obligation to pay any part of the cost of goods or services, or to repay to the credit provider any part of an amount contemplated in subparagraph (i); or
(bb) bill the consumer periodically for any part of the cost of goods or services, or any part of an amount, contemplated in subparagraph (i); and
(*b*) any charge, fee or interest is payable to the credit provider in respect of—
(i) any amount deferred as contemplated in paragraph (*a*) (*ii*) (*aa*); or
(ii) any amount billed as contemplated in paragraph (*a*) (*ii*) (*bb*) and not paid within the time provided in the agreement.
[16] S 8(4) determines that an agreement, irrespective of its form but not including an agreement contemplated in subsection (2), constitutes a credit transaction if it is—
(a) a pawn transaction or discount transaction;
(b) an incidental credit agreement, subject to section 5 (2);
(c) an instalment agreement;
(d) a mortgage agreement or secured loan;
(e) a lease; or
(f) any other agreement, other than a credit facility or credit guarantee, in terms of which payment of an amount owed by one person to another is deferred, and any charge, fee or interest is payable to the credit provider in respect of—
the agreement; or the amount that has been deferred.

combination thereof as defined by the NCA. The two main elements of a credit agreement are a deferral of payment and the charging of interest or the levying of costs. This can also be seen from section 8(4)(f) which provides:

> any other agreement, other than a credit facility or credit guarantee, in terms of which payment of an amount owed by one person to another is deferred, and any charge, fee or interest is payable to the credit provider in respect of—
> (i) the agreement; or
> (ii) the amount that has been deferred.

However, this research is limited to the provisions of reckless credit only and in this regard reckless credit is specifically dealt with in part D chapter 4 of the NCA. One important provision is that the reckless credit provisions do not apply when the consumer is a juristic person.[18]

Therefore the provisions in respect of reckless credit must only be considered when the consumer is a natural person. In terms of the NCA, an extended definition of 'juristic person' is held, namely:

> It 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 trustee itself is a juristic person, but does not include a *stokvel*.[19]

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[17] S 8(5) determines an agreement, irrespective of its form but not including an agreement contemplated in subsection (2), constitutes a credit guarantee if, in terms of that agreement, a person undertakes or promises to satisfy upon demand any obligation of another consumer in terms of a credit facility or a credit transaction to which this Act applies.

[18] S 78(1) part D chp 4. See also Kelly-Louw and Stoop 'The National Credit Act regarding suretyships and reckless lending' (2011) PELJ 67. (Hereafter "Kelly-Louw and Stoop (2011)").

[19] Stokvel means a formal or informal rotating financial scheme with entertainment, social or economic functions, which—
(a) consists of two or more persons in a voluntary association, each of whom has pledged mutual support to the others towards the attainment of specific objectives;
(*b*) establishes a continuous pool of capital by raising funds by means of the subscriptions of the members;
(*c*) grants credit to and on behalf of members;
(*d*) provides for members to share in profits from, and to nominate management of, the scheme; and
(*e*) relies on self-imposed regulation to protect the interest of its members;

Furthermore the provisions for reckless credit do not apply where the credit is in respect of:[20]

(a) a school loan or a student loan;
(b) an emergency loan;
(c) a public interest credit agreement;
(d) a pawn transaction;
(e) an incidental credit agreement; or
(f) a temporary increase in the credit limit under a credit facility.[21]

2.4 Initial reckless credit provisions

Now that the purposes and application of the NCA have been discussed it is imperative to provide a broad overview of the 'reckless credit' concept. This is important because the NCA does not specifically define reckless credit. Instead, the NCA defines specific circumstances where the extending of credit is considered to be reckless.[22] Thereafter, if a court confirms that a particular credit agreement was granted recklessly, certain consequences may be imposed on the credit provider who granted such credit agreement.[23]

In section 80, the NCA makes provision for three types of reckless credit extension. It determines that a credit agreement is reckless where:[24]

(a) The credit provider failed to conduct an assessment as required by the Act, irrespective of what the outcome of such an assessment might have concluded at the time;[25]
(b) The credit provider, having conducted an assessment, entered into the credit agreement with the consumer despite the fact that the information available to the credit provider indicated that the consumer did not generally understand or appreciate the consumer's risks, costs or obligations under the proposed credit agreement;[26] and
(c) The credit provider, having conducted an assessment, entered into the credit agreement with the consumer despite the fact that the information available to

[20] S 78(2) NCA. See also Otto and Otto (2013) 84.
[21] S 80 read with s 119(4) NCA. The draft guidelines for the NCA indicate a reason for excluding these specific types of credit but for purpose of this research merely stating the exclusion is sufficient.
[22] S 80 NCA.
[23] S 83. See also Kelly-Louw and Stoop (2011) 87.
[24] S 80.
[25] Hereafter "type 1".
[26] Hereafter "type 2".

> the credit provider indicated that entering into that credit agreement would make the consumer over-indebted.[27]

The NCA, in section 83, sets out the courts' powers when an agreement is declared as reckless.[28] Should the court find any one of the first two types of reckless credit to be present, the court may set aside all or part of the consumer's rights and obligations under that agreement,[29] or suspend the force and effect of that credit agreement.[30] Should the court find the third type[31] of reckless credit to be present then the court may suspend the force and effect of that credit agreement until a date determined by the court, and further order a restructuring of the consumer's credit agreement(s).[32]

Section 81(4) holds that it is a complete defence to an allegation of reckless credit lending if the consumer failed to fully and truthfully answer any requests for information made by the credit provider as part of the assessment required by section 81. However,

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[27] Hereafter "type 3". See Otto and Otto (2013) 25. The NCA defines over-indebtedness in s 79(1):

> A consumer is over-indebted if the preponderance of available information at the time a determination is made indicates that the particular consumer is or will be unable to satisfy in a timely manner all the obligations under all the credit agreements to which the consumer is a party, having regard to that consumer's-
>
> (a) financial means, prospects and obligations; and
>
> (b) 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.

[28] It is submitted that s 83 poses a major problem as the consequences of a finding of reckless credit are not satisfactorily set out in the Act. For example, if an agreement is declared reckless and is set aside by the court, what happens with the object of security? As s 83 was not amended by the NCAA, it is not of relevance for this research however it is important to note as it is submitted that an amendment to this section is necessary. See Van Heerden and Boraine 'The money and the box: Perspectives on reckless credit in terms of the National Credit Act 34 of 2005' (2011) De Jure 44 Volume 2.

[29] If an agreement is set aside, the credit provider has no legal right to claim any outstanding amount owed by the consumer and has no right of return of goods that were purchased by the consumer on credit. Setting aside means that the consumer does not have to perform his obligations at all. Otto and Otto (2013) 67.

[30] S 83.

[31] Where the credit provider, having conducted an assessment, entered into the credit agreement with the consumer despite the fact that the information available to the credit provider indicated that entering into that credit agreement would make the consumer over-indebted.

[32] Restructuring may include lengthening of the term of the agreement and/or a reduction in the monthly payment by the consumer. See also Scholtz (2014) 11-77.

a court must determine whether the consumer's failure to answer fully and truthfully, materially affected the credit provider's ability to conduct a proper assessment.[33] The NCA does not specifically mention what would be considered 'material'. In summary, this complete defence is only available to a credit provider who can prove that both requirements are present, namely that the consumer failed to answer fully and truthfully and that such failure was material to the credit provider's decision to extend credit.[34]

2.5 Initial pre-agreement assessment provision

As section 80 determines that it would be reckless to extend credit without conducting an assessment of certain aspects relating to the consumer seeking credit, it is important to consider what such an assessment entailed prior to the enactment of the NCAA. These pre-agreement assessment obligations were detailed in section 81 and section 82 of the NCA.

Before a credit provider and a consumer enter into a credit agreement, the credit provider is obliged by section 81 to conduct an affordability assessment of the consumer and whether the consumer has an understanding of the risks and obligations of the agreement being entered into.[35] This is only applicable where the proposed agreement falls within the application of the NCA and where the reckless credit provisions are applicable.[36] Should a credit provider fail to conduct such an assessment, the agreement may be declared reckless.[37]This section was incorporated to fulfil one of the objectives of the NCA, namely the promotion of responsibility in the credit market.[38]

Section 81(2) reads as follows:

> A credit provider must not enter into a credit agreement without first taking reasonable steps to assess-
> (a) the proposed consumer's-
> (i) general understanding and appreciation of the risks and costs of

[33] S 81 (4)(a) – (b).
[34] Otto and Otto (2013) 77.
[35] The NCAA has not altered this obligation.
[36] S 4(1). Par 2.3.
[37] S 83. Par 2.4.2.
[38] Preamble NCA. Policy Framework (2004) 30. See 2.1.

the proposed credit, and of the rights and obligations of a consumer under a credit agreement;

(ii) debt re-payment history as a consumer under credit agreements;

(iii) existing financial means, prospects and obligations; and

(b) whether 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.

Section 82 initially stated 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. The NCR could have pre-approved the evaluative mechanisms, models and procedures in respect of proposed developmental credit agreements. Furthermore, the NCR could have published guidelines proposing evaluative mechanisms, models and procedures applicable to other credit agreements. A guideline published by the NCR was not binding on a credit provider. Section 61(5) of the NCA re-iterated that a credit provider may determine for itself any 'scoring or other evaluative mechanism or model' to be used in the affordability assessment. Such 'mechanism or model' should not be based on any ground of unfair discrimination prohibited in terms of section 9(3) of the Constitution.[39]

If the National Consumer Tribunal[40] found that a credit provider had repeatedly failed to meet its obligations under section 81, or customarily used evaluative mechanisms, models or procedures that did not result in a fair and objective assessment, the Tribunal, on application by the NCR, may have required that credit provider to- (a) apply any guidelines published by the NCR or apply any alternative guidelines consistent with prevailing industry practice, as determined by the Tribunal.[41]

[39] Constitution of the Republic of South Africa 1996.
[40] Hereafter "NCT".
[41] S 82(4).

2.7 Conclusion

The main purpose of the NCA is debated. However, as far as reckless credit provisions are concerned, it is submitted that it strives to promote responsibility in the credit market.[42] In order to achieve this purpose the NCA incorporated reckless credit provisions aimed at the prevention of the extension of reckless credit.[43] The NCA is only applicable in certain circumstances and the reckless credit provisions are further limited in their application.[44]

The reckless credit provisions provide for three types of reckless credit agreements.[45] The court is granted the power to declare a credit agreement reckless should it meet the definition of one of these three types of reckless credit agreements.[46] Should an agreement be found reckless, a court has the power to set aside; suspended or restructure such an agreement.[47] A credit provider may have a defence if the credit agreement is found to be reckless and the consumer failed to answer any questions fully and truthfully. Such failure must materially affect the credit provider's ability to make a proper assessment.[48]

A credit provider must in terms of section 81 perform an affordability assessment of a consumer prior to the extending of credit.[49] The provision provides that the credit provider must take reasonable steps to assess the consumer but did not set out exactly what constituted a reasonable step. However, it specified in section 82 that the credit provider itself could determine the mechanisms and procedures taken to perform an affordability assessment. This was subject to the NCR's ability to publish guidelines on the mechanisms, models and procedures used.[50] Now that a basic foundation has been

[42] Par 2.2.
[43] Par 2.2.
[44] Par 2.3.
[45] See type 1, type 2 and type 3 discussed in par 2.4.1.
[46] Par 2.4.1.
[47] Par 2.4.2.
[48] Par 2.4.4.
[49] Par 2.5.
[50] Par 2.6.

laid with regard to the concept of reckless credit, specific investigations can be made into the original pre-agreement assessment provisions.

Chapter 3

Considerations of the initial pre-agreement assessment provision

3.1 Introduction

The National Credit Act,[1] which became fully effective on 1 June 2007, provides the regulatory framework for the South African credit market. Furthermore, it introduced the concept of reckless credit.[2] The most important reckless credit provision for purposes of this dissertation is the section 81 pre-agreement assessment obligation that is placed on credit providers.[3]

In order to properly investigate the original pre-agreement assessment provisions, this chapter will firstly set out some general observations thereof, in order to provide a broad overview of some of the main features of the original dispensation. Specific issues thereof will then be investigated as well as judicial insight into how the courts dealt with the interpretation of the pre-agreement assessment provisions. The credit provider's complete defence is briefly discussed as and when it arose within the judicial system. Finally, the African Bank investment limited[4] debacle is considered so as to put any alleged interpretational issues with the original provisions into context.

3.2. General observations

A brief summary of the reckless credit provisions, already discussed - is set out so as to bring the subsequent evaluation of the original pre-agreement assessment provision into context.[5] Section 81 of the NCA sets the foundation for the prevention of reckless credit extension.[6] This is done with the aim of promoting responsibility in the South African credit market.[7] The pre-agreement assessment obligation is found in chapter 4

[1] Act 34 of 2005 (Hereafter "NCA" or "the Act").
[2] Par 2.4.
[3] S 81 NCA. Par 2.5.
[4] Hereafter "African Bank" or "the Bank."
[5] *Ibid.*
[6] Par 2.4.
[7] S 3 NCA. Par 2.2.

part D of the NCA and is only applicable in certain circumstances.[8] Furthermore, it does not apply where the consumer is a juristic person.[9] The court has the power to declare a credit agreement reckless should a credit provider fail to comply with the pre-agreement assessment obligation. However, if the consumer fails to answer fully and truthfully when being assessed by a credit provider and such failure materially affects the credit provider's decision to grant credit, then such credit provider has a complete defence against a finding of reckless credit.

Section 81 states that a credit provider should take reasonable steps to perform an assessment prior to the extending of credit.[10] The assessment required is broader than a mere affordability assessment as the credit provider was required to ensure that the consumer understood the risks, costs and obligations of entering into such an agreement.[11] The consumer's debt repayment history also needs to be considered.[12] Section 82(1) states that a credit provider may determine for itself evaluative mechanisms, models and procedures to assess a consumer seeking credit; provided these mechanisms and procedures resulted in a fair and objective assessment. This right was subject to the right of the NCR to publish guidelines proposing evaluative mechanisms, models and procedures to be used in respect of granting credit.[13]

Whilst this pre-agreement assessment provisions are necessary in a credit market that seeks to promote the well-being of consumers, it lacked clarity. More specifically, a credit provider must take 'reasonable steps' to assess a prospective consumer but the NCA did not expressly state what would constitute such reasonable steps. The

[8] Par 2.3.
[9] Par 2.3.
[10] Par 2.4.3.
[11] S 81(3). See also Kelly-Louw and Stoop 'The National Credit Act regarding suretyships and reckless lending' (2011) PELJ 87 *(*Hereafter "Kelly-Louw and Stoop (2011)").
[12] *Ibid.* The introduction of the removal of adverse consumer information and information relating to paid up judgments regulation from 1 April 2014 has directly affected a credit provider's ability to assess the consumer's debt repayment history and will be discussed in more detail in chp 4.
[13] S 82(2) NCA. See also Van Heerden and Boraine 'The money and the box: Perspectives on reckless credit in terms of the National Credit Act 34 of 2005' (2011) De Jure 44 Volume 2 398: A guideline published by the NCR is not binding on a credit provider, except with regard to developmental credit or if so ordered by the National Credit Tribunal.

provision was subject to the Nation Credit Regulator's[14] ability to publish guidelines for credit providers to use when creating their own evaluative mechanisms, models and producers. However, until the first quarter of 2013, no guidelines had been published.

From the above it is clear that the legislature intended that the NCR play a role in ensuring that credit providers comply with their assessment obligations.[15] In this regard it was stated that should a credit provider repeatedly fail to meet its obligations under section 81, the NCR would be tasked with applying to the National Consumer Tribunal[16] for an order in terms of section 82(4). Briefly, this section states that should the Tribunal find the credit provider guilty of reckless lending then an order could be made forcing such credit provider to comply with any guidelines published by the NCR to properly conduct pre-agreement assessments.[17] However, as previously stated no guidelines had been published. As a result, credit providers were obligated to conduct pre-agreement assessments without any guidance and the Tribunal was unable to fully carry out its mandate as it could not hold a credit provider subject to guidelines that did not exist.[18]

Further to the above, Otto and Otto submit a pertinent point in that the NCA, in requiring a credit provider to conduct an assessment before granting credit, places an increased burden on the credit provider.[19] This is for two reasons: firstly, implementation of an affordability assessment can be costly. This means that smaller, less profitable micro lenders suffer.[20] Secondly, the credit provider's complete defence only protects a credit provider if reasonable steps were conducted to assess the consumer. However, the

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14 Hereafter "NCR".
15 Van Heerden and Renke 'Perspectives on the South African responsible lending regime and the duty to conduct pre-agreement assessment as a responsible lending practice' (2014) IIRJ 8 (Hereafter "Van Heerden and Renke (2014)").
16 Hereafter "NCT" or "the Tribunal".
17 *Ibid.*
18 Van Heerden and Renke (2014) 9.
19 Otto and Otto 'The National Credit Act Explained' (3rd ed 2013) LexisNexis 74. (Hereafter "Otto and Otto (2013)").
20 *Ibid.*

provision was unclear as to what constituted a reasonable step.[21] Subsequently, some credit providers conducted the pre-agreement assessment with an over cautious approach to ensure that the requirement of a 'reasonable step' was met.[22] This created a problem in that consumers who could afford the prospective credit were denied on the basis of an overly strict mechanism, model or procedure.[23]

3.3 Judicial insight

As the NCA did not specifically lay down the requirements for conducting a pre-agreement assessment, other than the already discussed broad features, certain problems arose with the interpretation of what exactly constituted a reasonable step on the part of the credit provider. As such, this has been dealt with on a case-by-case basis as and when it arose within the judicial system.[24] The courts have been required to provide guidance as to what exactly constituted a proper assessment. Case law is thus discussed as it illustrates some of the difficulties that resulted from the original framework of the pre-agreement assessment.

In *Horwood v FirstRand Bank*,[25] the consumer argued that the assessment of her second mortgage amounted to reckless credit granting by the credit provider (FirstRand Bank) as the credit provider had failed to conduct a proper assessment. The credit provider alleged that the consumer had lied when giving information relating to her income and expenses and that the credit provider relied on this information to approve her second mortgage.[26]

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21 *Ibid.*

22 While an over-cautious approach may on the surface appear to be a good thing, it ultimately excludes consumers from being granted credit where such credit could possibly be afforded.

23 *SA Taxi Securitisation (Pty) Ltd v Mbatha* 2011 (1) SA 310 (GSJ) (Hereafter "SA Taxi v Mbatha").

24 In *Horwood v FirstRand Bank* Ltd (2010/36853) [2011] ZAGPJHC 121 (Hereafter "*Horwood v FirstRand Bank*") it was held that whether or not a credit grantor has taken the required reasonable steps to meet its assessment obligations, in the light of the wording of section 81(2) and 82(1), is to be determined objectively on the facts and circumstances of any given case.

25 Par 3.5.

26 *Horwood v FirstRand Bank* par 23.

Relying on the above facts, the credit provider then raised the complete defence and alleged that the consumer failed to fully and truthfully supply the credit provider with the requested information during her pre-agreement assessment.[27] The credit provider relied on this information at the time when the credit was extended. The court took into account that the consumer was an existing client of the credit provider and that information supplied by the consumer would be similar to the previous information supplied for other credit agreements. The court found that there was no suggestion that would alert a credit provider to a contrary conclusion of the correctness of the information supplied by the consumer and concluded that the credit provider had met its pre-agreement assessment obligation.[28]

The above judgment is problematic as it suggests that there is little obligation on the credit provider to actually verify information supplied to it by a consumer. So long as a credit provider can prove that a pre-agreement assessment was conducted, little or no further steps were required to be taken from this point.[29] Kelly-Louw submits that credit providers did not query the blatant understatement of expenses by consumers applying for credit.[30]

In the case of *ABSA Bank v COE Family Trust*,[31] a trust entered into a mortgage agreement as a consumer. The trust then defaulted on payments and ABSA, as the credit provider, issued summons and subsequently applied for summary judgment. The consumer alleged that the mortgage agreement amounted to reckless credit as ABSA did not assess the creditworthiness of the trust as required by the NCA.[32] According to

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27 *Horwood v FirstRand Bank* par 12.
28 *Ibid.*
29 Kelly-Louw 'A credit provider's complete defence against a consumer's allegation of reckless lending' (2014) SAMLJ 24–59.
30 *Ibid.*
31 *ABSA Bank V COE Family Trust* 2012 (3) SA 184 (WCC). (Hereafter "*ABSA Bank v COE Family Trust*").
32 Chapter 4 part D does not apply to juristic persons. See par 2.3 'a trust if there are three or more individual trustees or the trustee itself is a juristic person.'

ABSA, the consumer had failed to be honest in that it had agreed that entering into such credit agreement would not amount to the consumer becoming over-indebted.[33]

The mortgage agreement contained a clause that provided as follows:

> The borrower states that . . . entering into this agreement will not cause him to become over-indebted as contemplated in the National Credit Act; . . . he has fully and truthfully answered all and any requests for information made of him by or on behalf of the bank leading up to the conclusion of this agreement.[34]

ABSA relied on the above clause and argued that it had a complete defence in terms of section 81(4) against an allegation of reckless credit in terms of the NCA.[35] However, the court found no indication that ABSA had conducted a proper assessment. It was pointed out that ABSA could not rely on the standard terms of the agreement unless the clause being relied upon had been specifically brought to the consumer's attention.[36] Thus it was found that merely placing a clause in a credit agreement does not comply with the requirement of 'reasonable steps' to assess a consumer.

Furthermore, section 81(4) envisaged that it be of importance whether the consumer answers truthfully or not.[37] This judgment ultimately resulted in such section being redundant and of no relevance as the court failed to take into account the fact that, upon application for credit, the consumer had been dishonest.[38]

In the case of *Standard Bank of South Africa Ltd v Kelly*,[39] the court rejected the allegation by the consumer that he had not been properly informed of the risks of the credit agreement. The consumer signed Standard Bank's standard document prior to entering into a credit agreement in which a party acknowledged that he/she understood

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[33] *ABSA Bank v COE Family Trust* par 12.
[34] *Absa Bank v COE Family Trust* par 2.
[35] S 83 NCA.
[36] *Absa Bank v COE Family Trust* par 24.
[37] Counsel attempted to rely on this section and it is submitted that the Court failed to take this provision into account at all.
[38] Van Heerden and Renke (2014) 10.
[39] *Standard Bank of South African Ltd v Kelly and Another* (23427/2010) [2011] ZAWCHC 1 (Hereafter "*Standard Bank v Kelly*").

the risks thereof. The form went beyond merely asking if the consumer had answered all questions put to him fully and truthfully. The court accepted that the standard form was a 'reasonable step' in the assessment of a consumer.[40]

3.4 African Bank debacle

African Bank is, amongst other things, a South African credit provider of unsecured loans. Prior to 1998, African Bank operated as a small commercial bank and thereafter listed on the Johannesburg Stock Exchange.[41] In June 2015, the Bank was placed under business rescue in an attempt to recover from the severe financial distress that the Bank was under. Supposedly, this was due to the fact that the Bank lent numerous consumers credit without properly screening them. This led to a number of the consumers becoming over-indebted and unable to repay their loan. This debacle is discussed in order to put the above discussed observations raised by authors and the courts into perspective.[42]

In 2013, African Bank was fined R300 million for reckless lending by the National Consumer Tribunal.[43] Debt councillors have referred numerous credit agreements granted by the Bank to the NCR.[44] It was not until the NCR received an overwhelming amount of complaints were received by the NCR that an enquiry into the Bank's lending practices took place. The NCR discovered sever inconsistencies in how the Bank approved consumers for credit.[45] Eventually enough of a case was built up and the matter was referred to the Tribunal. It was found that over 700 credit agreements had been granted recklessly.[46] The Bank attempted to blame staff, who they accused of

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[40] *Standard Bank v Kelly* par 25.
[41] African Bank website *https://www.africanbank.co.za/about-us/history* accessed 29/10/2015.
[42] Par 2.2 – 2.3.
[43] Hereafter "the Tribunal". Business Day TV 'Reigning in reckless lending' (2014) (Hereafter "Business Day TV (2014)") website *http://www.bdlive co.za/business/financial/2014/08/14/business-day-tv-reigning-in-reckless-lending* accessed 04/03/2015.
[44] Business Day TV (2014).
[45] *Ibid.*
[46] Fin24 'African Bank fined 20 million' (Hereafter "Fin24 (2015)") website *http://www.fin24.com/Companies/Financial-Services/African-Bank-fined-R20m-for-reckless-lending-20131003* accessed 04/03/2015.

failing to conduct a proper affordability assessment according to the Bank's guidelines.[47] Furthermore, staff members were receiving illicit payments for approving loans allowing consumers to secure credit that was not affordable.

According to the Bank's previous credit granting policy, the following measures were in place to conduct an assessment of a consumer: [48]

1. The NCA clearly stated that a credit provider must ensure the consumer has a general understanding of risks, costs and obligations of the prospective credit agreement.[49] To meet this requirement, the Bank previously had a consumer sign a document that set out the risks, costs and obligations of the credit to be lent.
2. The NCA required that the debt repayment history of the consumer be assessed. In order to meet this requirement, the Bank referred to the consumer's credit bureau record as well as any record of the consumer's credit history held by the Bank itself.
3. The consumer's existing financial means, prospects and obligations were required to be assessed. To do so, the Bank reviewed the consumer's payslip and required them to sign an expense declaration. However it appears that in the 700 cases reported by the NCR in 2013, this policy was ignored and no affordability assessment was conducted.[50]

As previously stated, no guidelines had been published by the NCR. As such, it is not practical to assert whether the above credit granting policies are in line with 'reasonable steps' as intended by the legislature.

3.5 Conclusion

In terms of the section 81 pre-agreement assessment obligation it is clear that the intention of the legislature was to create a comprehensive regulatory framework for

[47] *Ibid.*
[48] Website *https://www.africanbank.co.za/about-us/heritage-and-values* accessed 25/01/2015.
[49] S 81(2).
[50] Business Day TV (2014).

monitoring the credit market. The assessment required that a credit provider not only take into consideration the consumer's ability to afford such debt, but also have regard to whether the consumer was able to fully understand the consequences of obtaining credit, as well as the consumers credit repayment history.[51]

The NCA initially did not contain any provisions dealing with how the section 81 pre-agreement obligation should be conducted.[52] The only detail provided was of a very broad basis with which the credit provider had to consider when assessing a consumer prior to lending them credit.[53] This was evidenced by the court cases that dealt with a number of credit providers who had in fact conducted a pre-agreement assessment but which assessment failed, in the eyes of the courts, to be deemed a proper assessment.[54]

The lack of clarity as to what constituted a reasonable step meant a lack in certainty as to what a court would ultimately consider reasonable. A court's decision to find a credit agreement reckless was purely circumstantial and based on the facts of each case. Furthermore, the courts correctly held the stance that while one purpose of the NCA is to discourage reckless credit lending, it was also designed to allow the previously denied access to credit facilities.[55] Thus, an over-critical approach toward credit lenders would ultimately lead to the hindrance of credit lending as credit providers would become over wary and cautious when providing credit.[56]

Full and truthful disclosure is a requirement placed on the consumer in terms of the NCA.[57] There is thus a twofold duty. On the one hand, the credit provider must conduct an affordability assessment and on the other hand the consumer must answer any questions put to him in this assessment fully and truthfully. However, the duty ends

[51] Par 3.2.
[52] Par 3.2.
[53] Par 3.2.
[54] Par 3.3.
[55] Par 3.3.
[56] *SA Taxi Securitisation (Pty) Ltd v Mbatha* 2011 (1) SA 310 (GSJ).
[57] S 81(4).

there. No requirements were placed on the credit provider further than this point to ensure the validity of such information provided.[58]

From the above discussion regarding African Bank, it is difficult to allege whether the NCR failed to act timeously and according to their mandate or whether the Bank itself failed to put in place a proper internal regulatory framework to conduct pre-agreement assessments.[59] Whichever the case may be, it is evident that some form of guidance in the creation of a pre-agreement assessment was required.

It is submitted that the NCA attempted to prevent reckless credit granting in the form of a pre-agreement assessment obligation placed on credit providers. However the lack of guidelines to provide clarity on what exactly would constitute a proper assessment meant that such efforts were stifled.[60] A more clearly set out legal framework from which a credit provider could create an evaluative mechanism, model or procedure was clearly needed. Thus it is now pertinent to investigate the new pre-agreement assessment provision in light of the observations made herein.

[58] Par 3.3.
[59] Par 3.4.
[60] Par 3.2.

Chapter 4

Overview and consideration of the new pre-agreement assessment dispensation

4.1 Introduction

Various interpretational issues with regard to some of the provisions of the National Credit Act;[1] arose during the initial years from its enactment. The most relevant of these for purposes of this dissertation relates to the pre-agreement assessment obligation which raised many questions. Namely, credit providers were left wondering what constituted a 'reasonable step' in the assessment of a consumer prior to the granting of credit.[2] The National Credit Amendment Act,[3] that strives to address some of these questions, came into effect on 13 March 2015. This chapter will consequently investigate the new pre-agreement assessment provision. The aim is to make general observations to establish whether some of the interpretational issues of the original dispensation have been addressed by the amendments.[4]

In this chapter an investigation into the new pre-agreement dispensation will be set out. However, before this can be done, a brief explanation needs to be had on the draft guidelines issued in relation to the old dispensation. This will bring subsequent discussions into context. An exposition on the NCAA with specific reference to the amendments it makes to the pre-agreement assessment provision will then follow. This discussion will evidently set out the new provision. It is important to clearly set out the progression from draft guidelines to the eventual amendments so as to highlight the focus areas from which observations are made. These observations will provide a general overview of the interplay between the 'Affordability Assessment Regulations'[5] and the new pre-agreement assessment provisions. The insertion of section 71A into the NCA and the publishing of the Removal of Adverse Consumer Credit Information

[1] Act 34 of 2005 (Hereafter "NCA"). Van Heerden and Renke 'Perspectives on the South African responsible lending regime and the duty to conduct pre-agreement assessment as a responsible lending practice' (2014) IIR 14 (Hereafter "Van Heerden and Renke (2014)").
[2] S 82(1) NCA.
[3] Act 19 of 2014. (Hereafter "NCAA").
[4] Par 3.4.
[5] Published in *Government Gazette* 37882. (Hereafter "Affordability Assessment Regulations" or "the Regulations").

and Information relating to Paid Up Judgments Regulations are referred to only in so far as it relates to the pre-agreement assessment provision.[6]

4.2 Background information

The need to improve the pre-agreement assessment provisions gained momentum after a shared media statement was released in November 2012 by the chairperson of the Banking Association of South Africa[7] and the Minister of Finance.[8] The statement entitled 'Ensuring Responsible Market Conduct of Bank Lending' announced that BASA, its member banks and others would evaluate the procedures currently in place when conducting affordability assessments of consumers.[9] Subsequently an agreement was reached in that the National Credit Regulator, [10] the National Treasury and BASA would generate a standard affordability assessment model to be used by all credit providers. These discussions allowed for momentum in that shortly thereafter, draft guidelines setting out reasonable measures to assess a consumer's affordability were published by the NCR in May 2013.[11] These guidelines were then updated in September that year in a circular entitled 'Affordability Assessment Guidelines'.[12] The September guidelines were more comprehensive than its predecessor.[13]

It must be briefly noted that the draft guidelines were of relevance to credit providers as the Department of Trade and Industry published a notice on 21 August 2015 confirming the suspension of the Affordability Assessment Regulations for a period of six calendar months effective from 13 March 2015.[14] Thus the guidelines were important to note as it was further indicated that until the suspension was lifted on 13 September 2015, the

[6] Published in *Government Gazette* 37386. (Hereafter "Credit Amnesty Regulations").
[7] Hereafter "BASA." Van Heerden and Renke (2014) 11.
[8] Joint Statement 'Ensuring Responsible Market Conduct for Bank Lending' (2012) website *http://www.treasury.gov.za/comm_media/press/2012/2012110101.pdf* accessed 29/10/2015.
[9] *Ibid.*
[10] Hereafter "NCR".
[11] Van Heerden and Renke (2014) 11.
[12] Affordability Assessment Guidelines website *www.ncr.org.za* accessed 29/10/2015 (Hereafter "September draft guidelines").
[13] Van Heerden and Renke (2014) 11.
[14] Published in Government Gazette 39127.

affordability assessment guidelines that were published by the NCR in September 2013 were in force.[15]

4.3 Amendments to the pre-agreement assessment provisions

The guidelines were applicable in the framework of the original pre-agreement assessment and during a brief transitional period. However, subsequent amendments have been made thereto and they are no longer applicable. The NCAA has significantly altered the pre-agreement assessment provision. The amendments thereto are now highlighted.

Section 24 of the NCAA which amended section 82 of the NCA as follows:

(a) by the substitution for subsections (1) and (2) of the following subsections, respectively:
    (1) [Subject to subsections (2)(a) and (3), a] 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 and must not be inconsistent with the affordability assessment regulations made by the Minister.
    (2) The Minister must, on recommendation of the National Credit Regulator, make affordability assessment regulations; and
(b) by the deletion of subsections (3) and (4).

From the above, it is apparent that the Minister must, on recommendation of the NCR, make affordability assessment regulations.[16] Section 82(3) and (4) of the original provision is deleted. Section 82(1) and (2) still state that a credit provider may determine for itself the evaluative mechanism, model or procedure to be used when conducting an affordability assessment - so long as such mechanism, model or procedure is fair and objective. However, the new provision differs as it now ends by saying that such

[15] *Ibid.*
[16] Van Heerden and Renke (2014) 13.

mechanism, model or procedure *must not be inconsistent with the affordability assessment regulations* published by the Minister.[17]

4.4 Affordability Assessment Regulations

Now that it has been established that the amendments require a credit provider to, *inter alia*, create a mechanism, model or procedure that is not inconsistent with the regulations published by the Minister, it is important to further investigate these regulations.[18] This will take place by first setting out some key definitions introduced, where after, the Affordability Assessment Regulations are discussed so as to establish a greater understanding of the scope and impact thereof. The application of these regulations is set out, as not all credit agreements are bound by the provisions held therein.

Chapter 1 of the Affordability Assessment Regulations applies the following definitions, which are also the meanings that this dissertation attaches thereto:

> "**Credit Cost Multiple**" means the ratio of the total cost of credit to the advanced principal debt, that is, the total cost of credit divided by the advanced principal debt expressed as a number to two decimal places;
>
> "**Credit Record**" means the consumer's payment profile including, adverse information on a credit profile held by a credit bureau;
>
> "**Discretionary Income**" means Gross Income less statutory deductions such as, income tax, unemployment insurance fund, maintenance payments and less Necessary Expenses (at a minimum as defined herein); less all other committed payment obligations as disclosed by a consumer including, such as may appear from the applicant's credit records as held by any Credit Bureau which income is the amount available to fund the proposed credit Installment;
>
> "**Gross Income**" means all income earned without deductions from whatever source;

[17] Van Heerden and Renke (2014) 13.
[18] Par 4.3.

"**Joint Consumers**" means consumers that are co-principal debtors who are jointly and severally liable with regard to the same credit agreement and apply jointly for the credit agreement excluding the surety or a credit guarantor under a credit guarantee;

"**Necessary Expenses**" means the consumer's minimum living expenses including maintenance payments if applicable as determined in accordance with Regulation 23A(9) excluding monthly debt repayment obligations in terms of credit agreements as reflected on the prospective consumer's credit profile held by a credit bureau;

The Regulations are generally applicable to all credit providers and credit agreements that the NCA applies to, however they are not applicable where the consumer is a juristic person as defined by the NCA.[19] Furthermore, the Regulations provide that they are not applicable to the following credit agreements:

(a) a developmental credit agreement;
(b) a school loan or a student loan;
(c) a public interest credit agreement;
(d) a pawn transaction;
(e) an incidental credit agreement;
(f) an emergency loan;
(g) a temporary increase in the credit limit under a credit facility;
(h) a unilateral credit limit increase in terms of sections 119(1)(c);119(4); and 119(5) of the Act under a credit facility;
(i) a pre-existing credit agreement in terms of Schedule 3 Item 4(2) of the Act;
(j) any change to a credit agreement and/or any deferral or waiver of an amount under an existing credit agreement in accordance with section 95 of the Act; and
(k) mortgage credit agreements that qualify for the Finance Linked Subsidy Programs developed by the Department of Human Settlements and credit advanced for housing that falls within the threshold set from time to time.[20]

Prior to concluding a credit agreement, a credit provider has always been required to provide the consumer with a quote. [21] The credit provider must disclose the credit cost

[19] Reg 23A(1). Par 2.3.
[20] Reg 23A(2). *Ibid.*
[21] Before concluding a credit agreement, the credit provider must give to the consumer, free of charge, a statement and quotation in the form prescribed by the Regulations (Form 20 to the Regulations, in the case of small credit agreements). No agreement is entered into at this stage; the consumer does not have to sign anything or pay any fee. This is a new development in the law, designed to protect consumers. This document must contain the

multiple[22] and the total cost of credit[23] in the quote as well as the credit agreement if it is concluded. When providing a consumer with a quote and/or credit agreement, a credit provider must take practicable steps to assess the consumer or joint consumer's discretionary income to determine whether the consumer has the financial means and prospects to pay the proposed credit installments.[24]

The Regulations in essence require credit providers to consider the following when taking practical steps to assess the consumer, before granting credit:

(a) Three months bank statements or payslips;
(b) A consumer's credit profile as contained at a credit bureau; and
(c) Calculation of consumer's necessary expenses such as accommodation, transport, medical, education, food, water and electricity.[25]

Furthermore, the credit provider must take reasonable steps to assess the consumers financial means and prospects.[26] This is done by obtaining and verifying the information from the consumer's bank statements or pay slip. Where the consumer has varying income, at least six months bank statements must be assessed and the average income therein should be considered.

Considerations of the consumer's expenses must be had. When calculating a consumer's necessary expenses, the following table is taken into account:[27]

financial details of the proposed agreement (like the amount of credit provided, the number and amount of instalments payable, interest and other fees, deposit required and credit insurance). Consumers must accept or reject the quotation within five days, giving them a chance to shop around for better or cheaper credit. Once the consumer has accepted the quotation, the credit agreement itself can then be concluded.

[22] See definition already set out par 4.4.

[23] This is not only the capital amount of credit but includes the Interest rates, initiation fees and service fees.

[24] Reg 23A(3). Van Heerden and Renke (2014) 13.

[25] Reg 23A(4). Van Heerden and Renke (2014) 13.

[26] Reg 23A(7).

[27] Reg 23A(11).

Monthly Gross Income		**Minimum Monthly Fixed Factor**	**Monthly Fixed Factor + 0% of Income Above Band Minimum**
Minimum	Maximum		
R0.00	R800.00/± £45,60	R0.00	100%
R800.01/± £45,60	R6,250.00/± £356,25	R800.00/± £45,60	6.75%
R6,250.01/± £356,25	R25,000.00/± £1425	R1,541.67/± £87,83	9.00%
R25,000.01/± £1425	R50,000.00/± £2850	R3,375.00/± £192,37	8.20%
R50,000.01/± £2850	Unlimited	R5,425.00/± £309,22	6.75%

Lastly, it must be briefly noted that a consumer can lodge a complaint with the credit provider if they are aggrieved by the outcome of the assessment, after which the consumer can approach the NCR if they do not agree with the outcome of the complaint.[28] This will not be discussed in detail as it is an 'after-the-fact' recourse measure available to a consumer who is unhappy with the outcome of their pre-agreement assessment and does not form part of the actual screening process.

4.5 Credit Amnesty Regulations

According to the Regulations, a credit provider must consider a consumers credit profile as held by a credit bureau.[29] It is therefore necessary to at least refer to the amendments to section 71 of the NCA and the subsequent Credit Amnesty Regulations. However, this discussion will not be exhaustive so as to avoid consequent debates.[30]

Section 71A states that credit providers and credit bureaux must remove any adverse credit information of a consumer once the consumer has paid its debts in full, giving the consumer a "clean slate". Previously settlement of an adverse credit account would still show on a consumers' credit profile, but now the amendment says that within seven

[28] Reg 23A(20).
[29] Par 4.4.
[30] For a detailed discussion see Kelly-Louw 'The 2014 credit-information amnesty regulations: what do they really entail?' (2015) De Jure 97 (Hereafter "Kelly-Louw (2015)").

days of the credit bureaus receiving information that a debt has been settled, the adverse information should be removed.[31]

The Credit Amnesty Regulations became effective on 1 April 2014 and held that credit bureaus had to remove all adverse credit information within two (2) months. Therefore, credit bureaus are now prohibited from displaying or providing information that ought to be removed in terms of the Regulations. The credit bureaus were required, within thirty (30) days after May 2014, to submit a report by an independent auditor confirming that all such information had been removed. Previously, the consumer had to apply to have adverse credit information removed.[32] Now it is a straight forward requirement on the credit bureaus.[33]

4.6 General observations

The Affordability Assessment Regulations, *inter alia*, clarified that the pre-agreement assessment obligation comprises more than just assessing whether a consumer will default on payments. It set forth 'calculation norms' to be considered by the credit provider when applying in the assessment of a consumer prior to the granting of credit.[34]It is submitted that the Regulations will bring some level of responsible lending and borrowing into the credit granting process.[35] Previously a lot of consumers, with the complicity of credit providers, were under-declaring their living expenses and that created over-indebtedness. Now the Regulations set minimum expense norms per income category; require income to be verified and require credit providers to ensure that consolidation loans are actually used to settle other debt.[36]

There are of course practical implementation challenges with regard to the new pre-agreement assessment dispensation. For example, online and possibly smaller credit providers may suffer. This is because the process enforced by the amendments and set

[31] *Ibid.*
[32] Kelly-Louw (2015) 71.
[33] Van Heerden and Renke (2014) 20.
[34] *Ibid.*
[35] Van Heerden and Renke (2014) 21.
[36] Van Heerden and Renke (2014) 21.

out in the Regulations to conduct a pre-agreement assessment is difficult to carry out when a consumer applies online. Wonga is a small credit provider who offers 'fast free loans' online.[37] Smaller credit providers will find conducting such an exhaustive assessment time consuming and costly, thus not financially justifiable. This means access to small loans will become difficult and/or costly for the consumer who will ultimately have to fit the bill for the extra costs incurred by a small lending facility.

Despite the implementation problems that may arise, there are also possible practical issues to be considered. For example, the insertion of section 71A and the subsequent Credit Amnesty Regulations essentially means that the notion of "credit history" or good and bad credit records will be a thing of the past. Although this may be good news for consumers that are struggling to secure homes and other credit funded actions, it is not helpful to credit providers that used to rely on a consumer's credit history in order to determine whether or not to grant credit, how much credit and at what interest rate. The Affordability Assessment Regulations require a credit provider to take into account a consumer's credit profile but with the new amendments this profile will not be complete.

4.7 Conclusion

It is evident that, while some clarity as to what constituted a 'reasonable step' to assess a consumer was needed in the original pre-agreement assessment dispensation, the amendments thereto are not without criticism. The guidelines published could perhaps be categorized as 'a little too late.'[38] Furthermore, they are now superfluous and ineffective as they have been replaced by the Affordability Assessment Regulations.[39]

It is interesting to note that the scope of the Regulations differs from the NCA in that it specifically excludes a larger number of credit agreements. It has not been mentioned why such delineation is extensive. Perhaps the reason can be found in the nature of the extra credit agreements listed. For example, a credit agreement that is already in existence.[40]

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[37] *Ibid.*
[38] Par 4.2.
[39] Par 4.4.
[40] Par 4.3.

The Regulations are issued by the Minister in accordance with recommendations put forward by the NCR. From the perspective of a credit provider, they appear cumbersome and somewhat 'over-reaching.' Smaller credit providers will find meeting such strict assessment standards tiresome and difficult. This directly affects the consumer as it may have the negative effect of denying consumers smaller loans. On the other hand, a benchmark from which to work from that calls for strict compliance by a credit provider means the consumer is afforded better protection when being granted credit. Credit providers can longer step around the NCA and place blame on the fact that they have not been properly guided in formulating evaluative mechanisms, models and procedures. The Affordability Assessment Regulations are straightforward and easy enough to comprehend.

Section 71A introduces a new burden on credit bureaux to ensure they remove certain information from a consumer's credit profile. This could lead to incomplete credit information and information that is unreliable.[41] Whilst this provision is a progressive step towards ensuring better access to credit, such step only really benefits the consumer. Credit providers may be hindered in their assessments.[42] This is further problematic as, if a credit provider receives incomplete information with regard to a consumer's credit profile and subsequently a finding of reckless lending is found by the court, to what extent is the credit provider liable? Ultimately the credit provider would for all purposes have conducted an assessment according to the Regulations but it is unclear if in this circumstance the credit provider will be liable.

[41] Par 4.6.
[42] *Ibid.*

Chapter 5
Conclusion

5.1 Objectives and general observations

The National Credit Regulator[1] is the institute charged, in terms of the National Credit Act,[2] with the responsibility of regulating the credit market in South Africa.[3] In an attempt to apply their mandate more effectively, the NCR conducted numerous policy and statistical reviews of the credit market. Of note, a recent review revealed that South African consumers incur high levels of debt.[4] This was due to the fact that, amongst other problems, consumers were previously granted credit they could not afford. Income was spent on paying back debt and more credit was required to cover basic living expenses. A number of these consumers then experienced difficulty in repaying their additional credit as they became over-indebted as a result thereof.[5] One of the main factors that aided this vicious cycle was the fact that credit providers previously conducted inefficient pre-agreement assessments of consumers, prior to extending credit. Such failures amounted to the extension of reckless credit in terms of section 80 of the NCA.[6]

This dissertation intended to review the initial prevention of reckless credit provisions within the framework of the NCA and the subsequent amendments made thereto. This was achieved by first providing an overview of the responsible lending regime found in South Africa - as held in the NCA. The main focus thereof was the pre-agreement assessment obligation placed on credit providers, wherein a credit provider is required to conduct an assessment of a prospective debtor prior to the extending of credit. The main issue raised therein was the fact that legislation merely provided that reasonable steps needed to be taken in the assessment of a consumer but did not elaborate on what would constitute such a reasonable step.

[1] Hereafter “NCR”.
[2] Hereafter “NCA” or “the Act”.
[3] S 14 and s 15 NCA
[4] Par 1.3.
[5] *Ibid.* See chp 2 fn 28.
[6] Par 2.4.

The pre-agreement assessment obligation was subject to the fact that the NCR could publish guidelines providing a benchmark for credit providers to ensure that such assessment became aligned with generally accepted best practice. However, until the first quarter of 2013, somewhat eight years later since the introduction of the NCA, no guidelines had been published. This led to several inconsistencies in the manner in which credit providers developed their mechanisms, models and procedures. In an attempt to correct this oversight, the legislature first published draft guidelines in 2013 – some eight years later - and was all 'a little too late' as an Amendment Bill for the NCA was already in the works. This chapter seeks to summarise the overviews, observations and findings of this dissertation to emphasise the progression from the original pre-agreement assessment to the current dispensation.

5.2 Summary of findings

Prior to the enactment of the NCA, the South African credit industry lacked a regulatory framework that effectively monitored the credit market.[7] The drafters of the NCA stated there was no effective protection for over-indebtedness in this dispensation and the need for reckless lending prevention arose.[8] As such, the NCA became effective and operational in June 2007. The Act is only applicable to credit agreements concluded within the Republic of South Africa. A credit agreement can, in summary, be defined as an agreement wherein money is lent in advance and interest or a cost multiple is charged therein.[9] It is also important to note that a credit agreement is not regulated by the NCA if the consumer to the agreement is a juristic person.[10]

Chapter 4 part D of the NCA ultimately introduces the concept of reckless credit. There are three types of reckless credit agreements provided for in this structure. Namely, where a credit provider does not conduct a pre-agreement assessment; or where the credit provider enters the agreement knowing the consumer does not understand the risks and obligations placed on him/her therein; or where the credit

[7] Par 2.1.
[8] Ibid.
[9] Chp 2 fn 16.
[10] Par 2.3.

provider enters the credit agreement knowing the consumer will become over-indebted upon conclusion thereof.[11]

A credit agreement cannot simply 'be' a reckless credit agreement. The court must declare that such an agreement amounts to reckless credit. Once declared a reckless credit agreement, a court may set aside, suspended or restructure such agreement. However, if upon declaring an agreement reckless it becomes evident that the credit provider did conduct a pre-agreement assessment but that the consumer lied therein, the credit provider may have a complete defence. This is only possible where the consumer failed to answer truthfully and fully and such failure amounted to a material fact that the credit provider relied thereon.[12]

A credit provider must, in terms of section 81 of the NCA, perform a pre-agreement assessment of a consumer prior to the extending of credit. The provision clearly states that the credit provider must take reasonable steps to assess the consumer and that the credit provider could determine for itself the evaluative mechanisms, models and procedures taken to perform a pre-agreement assessment. Prior to the NCA's amendment the only condition was that such assessment had to be fair and objective. It was also subject to the right of the NCR who could have published guidelines providing supervision as to what constituted a reasonable step.[13] These guidelines perhaps should have been compulsory for some providers.

The ability of credit providers to determine their own evaluative mechanisms, models and procedures resulted in severe inconsistencies in how mechanisms, models and procedures were developed. The courts had to decide on a case-by-case basis whether a credit provider had taken 'reasonable steps' in the assessment of a consumer. Initially it appeared as if it was not necessary for a credit provider to verify if the information provided by a consumer was correct.[14]Furthermore, it was not considered a 'reasonable step' in the assessment of a consumer if a clause denying over-indebtedness was placed in the credit agreement and such clause was not

[11] See type 1, type 2 and type 3 discussed in par 2.4.
[12] Par 2.4.
[13] Par 2.5.
[14] *Horwood v FirstRand Bank* Ltd (2010/36853) [2011] ZAGPJHC 121 (Hereafter "*Horwood v FirstRand Bank*").

brought to the attention of the consumer.[15] On the other hand, the courts found that should the form go beyond merely asking if the consumer was aware of the risks and obligations and actually contained further information, than such form was considered a 'reasonable step.'[16]

The NCA's slack carrying out of the pre-agreement assessment provisions apparently contributed to the African Bank Investment Limited financial debacle.[17] African Bank is a South African credit provider of unsecured loans who was fined R300 million in 2013 for reckless lending practice, as enforced by the National Consumer Tribunal.[18] Notably, 2013 was the first year any forms of guidelines were published by the NCR. It was established that over 700 credit agreements had been granted recklessly by the Bank. However, a supposed defence by the Bank was that staff had failed to conduct affordability assessments according to the Bank's internal framework and was furthermore supposedly receiving illicit payments in lure of granting loans allowing consumers who could not afford such debt.[19]

Whilst the NCA is commemorated for its attempt to prevent reckless credit granting through the preventative measure of a pre-agreement assessment provision, the lack of guidance as to what constituted a reasonable step in the assessment of a consumer meant such efforts were stifled. A more binding legal framework from which a credit provider could formulate evaluative mechanisms, models and procedures was required.

The National Credit Amendment Act[20] was promulgated on 19 May 2014. The effective date has been tabled as 13 March 2015. This came after a spate of draft guidelines had been published in terms of the original pre-agreement provisions. As previously discussed, non-standardised affordability assessments, amongst other

[15] *ABSA Bank V COE Family Trust* 2012 (3) SA 184 (WCC). (Hereafter "*ABSA Bank v COE Family Trust*").
[16] *Standard Bank of South African Ltd v Kelly and Another* (23427/2010) [2011] ZAWCHC 1 (Hereafter "*Standard Bank v Kelly*").
[17] Hereafter "African Bank" or "the Bank".
[18] Hereafter "NCT".
[19] Par 3.4.
[20] Act 19 of 2014 (Hereafter "NCAA" or "the Amendment Act").

things, led to an increase in the extension of reckless credit.[21] The draft guidelines were meant to provide clarity therein. However, upon the enactment of the NCAA, the position with regard to formulating an assessment mechanism, model or procedure had been significantly altered.

According to the new pre-agreement assessment provision, a credit provider can still determine for itself the evaluative mechanisms, models and procedures used to conduct an assessment, but such assessment cannot be inconsistent with the regulations.[22] The Affordability Assessment Regulations came into effect on 13 March 2015. These Regulations make it mandatory for credit providers to "take practicable steps" to assess the consumer's discretionary income in order to determine whether the consumer has the financial means and prospects to pay back the credit requested.[23]

Furthermore, the Regulations state that a credit provider must take into account a consumers credit profile as held with a credit bureau. However, with the insertion of section 71A, it is submitted that the quality and integrity of credit information may be affected. This is of importance to credit providers as they originally relied on credit profiles when conducting their assessments. The introduction of this section may effectively reduce access to credit or raise the cost of consumer credit.[24] It is suggested that the NCR should offer guidance regarding the weight that credit providers should place on certain adverse credit information when performing their compulsory assessments.[25]

5.3 Concluding remarks

The NCA was and still is a welcomed addition to the South African credit market. Such legislation was necessary in developing the regulatory framework within the credit market. However, certain provisions of the NCA raised interpretational issues and not all provisions were able to fully carry out their intended purpose. It introduced the concept of reckless lending but did not set out a clear definition of

[21] Par 3.4.
[22] Par 4.4.
[23] Par 4.4.
[24] *Ibid.*
[25] Par 4.5.

what constitutes reckless lending. For the most part, reckless credit agreements have been defined. However, reckless lending goes beyond the finding of an agreement to be reckless. It is suggested that a clear and definitive meaning be set out to clarify the concept of reckless lending.

It is apparent from the African Bank debacle that having clear pre-agreement assessment guidelines is not sufficient in ensuring a responsible lending institution. Staff members need to be effectively monitored to ensure fraud and illicit activities are stamped out. Perhaps it would be useful for the NCR to publish further guidelines on a 'checks-and-balances' system that ensures one staff member alone does not have full power to grant credit.[26]

While it is submitted that the NCR has a duty placed on them by the NCA to regulate credit providers and their lending practices, the newly introduced Affordability Assessment Regulations mean credit providers no longer have an 'excuse' for not taking 'reasonable steps.' They are now required to ensure that the mechanism, model or procedures they put in place are not inconsistent with the Regulations. Clarity is now needed in terms of whether full compliance with the Regulations will afford a credit provider a further defense in the finding of a reckless credit agreement.

It is evident that stricter assessment standards mean progress for the consumer. The NCA is still a work in progress. The Act is a relatively new piece of legislation and clarification is still required on some of the provisions therein. The NCAA has made a small but significant step toward overcoming some of the issues raised. However, not all problem areas have been addressed. It is probable that over the course of the next five years constant further changes will be recommended.

[26] Par 3.4.

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