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18 December 2012

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Attention: Secretary of Parliament – M.G. Oriani-Ambrosini, MP

Dear Mr Oriani-Ambrosini

Comments on the Private Members Bill:
The Draft National Credit Act Amendment Bill

The Banking Association South Africa is a trade association representing all registered banks in South Africa. These include both South African and international banks. The Banking Association South Africa is the mandated representative of the sector and addresses industry issues on behalf of its members.

At the outset we wish to bring to the attention of Honourable Oriani-Ambrosini, the current consumer credit policy review being undertaken by the Department of Trade and Industry (dti). The dti is currently reviewing the policy behind the National Credit Act 34 of 2005 (NCA). The policy review began in the middle of 2012 and entailed extensive engagement with the credit industry. The dti contracted the University of Pretoria (Business Enterprises) to undertake this review of consumer credit policy and the review entailed meeting with the various credit players, not only credit providers, to acquire their views of the efficacy of government's consumer credit policy, as well as the NCA.

It is our understanding that the policy review attempts to find the underlying causes of various problems in the consumer credit market, in particular the policy review wishes to ascertain whether the issues currently faced are due to how the NCA gives effect to the original policy, interpretation and implementation of the NCA, or the consumer credit policy itself.

We understand that the dti will study the report from the University of Pretoria (Business Enterprises) and use the findings to develop a White Paper on consumer credit policy which in turn will form the basis for any amendments to the legislation. A wholesale review of this kind is preferred to a piecemeal approach to remedying any defects in the NCA. It is our position that piecemeal amendments to the NCA are to be avoided in order to prevent confusion in the market and to reduce compliance costs associated with multiple legislative changes. In view of the dti's policy process, the proposed amendment Bill is also premature.

Nevertheless, we have outlined the position of our members on the proposed amendments below.

1. **Clause 1: Amendment of section 1 of Act 34 of 2005:**

1.1 In light of the stated objectives of the Bill, it *would appear* that the proposed definition of consumer was purposefully drafted so as to:

1.1.1 exclude any consumer who entered into a credit agreement, for purposes other than personal use;

1.1.2 irrespective of the value of the transaction; and

1.1.3 irrespective of the asset value or annual turnover of such consumer.

1.2 The members of The Banking Association South Africa fully support such an amendment.

1.3 Notwithstanding the aforesaid, the wording of the proposed amendment in the Bill will result in difficulties as:

1.3.1 the Bill contains the following sentence after subsection (a) which gives the impression it finds reference in the NCA. The incorrect wording is as follows: "*agreement, but does not include a default administration charge; co-operative principles;*" and accordingly must be removed;

1.3.2 the addition to the definition of "consumer" contain principles such as "*such person's intended consumption*" and "*business-to-business transaction*", which principles are not defined and may lead to confusion and problems in its application;

1.3.3 the proposed definition would also complicate the process for a credit provider to establish whether the NCA is applicable to a specific credit agreement, as the credit provider may not be aware whether the money, goods or services would be used for personal or business purposes;

1.3.4 the proposed amendment either directly or indirectly impacts the following sections of the NCA and its regulations, however the impact has not been considered in the Bill:

- Section 4 (Application of Act);
- Section 8 (Credit Agreements);
- Section 10 (Developmental Credit Agreements);
- Section 13 (Development of Accessible Credit Market);
- Section 78 (Application and Interpretation of this Part);
- Section 81 (Prevention of Reckless Credit); and
- Regulation 42 (Maximum Prescribed Interest and Initiation Fees).

1.4 We propose that the stated objectives as outlined in the Bill can be achieved by:

1.4.1 Amending the definition of "*juristic person*" as follows:

"juristic person" includes a partnership, association or other body of persons, corporate or unincorporated, <u>a trust and a sole proprietorship</u> but does not include a stokvel";

1.4.2 Amending the definition of "consumer" as follows:

"consumer" in respect of a credit agreement to which this Act applies, means a person who is not a juristic person and who is–

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 other credit agreement;"

1.4.3 We do however highlight that there are various other sections of the National Credit Act and its regulations that will be impacted by this proposed amendment. Accordingly due regard must be had to such further amendments. It is for such reasons that we would rather support a wholesale review to a piecemeal approach to remedying any defects in the NCA.

2. Clause 2: Amendment of section 86 of Act 34 of 2005:

2.1 The Bill reads as follows:

*"(i) that one or more of the consumer's credit agreements be declared to be reckless credit, if the debt counsellor has concluded that those **...?***

*(ii) that one or more of the consumer's obligations be re-arranged by **counsellor reasonably concludes that agreements appear to be reckless; and**" (Own emphasis.)*

It seems as if there was an omission in section 86(7) (c) (i) which was included at the end of section 86(7) (c) (ii). We would propose that this error should be corrected.It should end with the words "… *agreements appear to be reckless*…"

2.2 Some of the purposes of the NCA (section 3) are to promote a responsible credit market by promoting responsibility by encouraging the fulfillment of financial obligations by consumers; promoting equity by balancing the respective rights and responsibilities of credit providers and consumers; providing mechanisms for resolving over-indebtedness based on the principle of satisfaction by the consumer of all responsible financial obligations; and providing for debt restructuring, enforcement and judgment, which places priority on the eventual satisfaction of all responsible consumer obligations under credit agreements. The amendment conflicts with the purposes of the NCA and should therefore be excluded.

2.3 Currently, the Banking Association South Africa members subscribe to certain industry concessions to reduce interest rates and to extend the period of the credit agreements. The status quo should remain and it should not be left in the hands of a debt counselor and a court to do so.

2.4 It is important to acknowledge that where the credit provider granted the credit recklessly, the NCA has sufficient provisions that allow a court to set aside all or part of the consumer's rights and obligations or to suspend the

force and effect of that agreement. In cases where the agreement is suspended, the consumer is not required to make any payments, the credit provider cannot impose any interest, fee or charge during this period and the credit providers' rights are unenforceable.

2.5 The suspension of interest would have a significant financial and economic impact on a credit provider, even in circumstances where the credit agreement was granted responsibly.

2.6 The proposed amendment does not define "*suspending the accrual of interest*" and therefore creates uncertainty as to whether interest will be suspended to the effect that a credit provider will not be allowed to charge interest for a specified period and thereafter will be able to recover the interest that accrued during the suspension period OR whether if interest is suspended a credit provider will be unable to recover and will not be entitled to the interest in terms of the contractual relationship with the consumer, even after the suspension period. In particular, for credit providers which are banks, the proposed amendment creates a threat of being in conflict with the principles proposed in the Basel III Capital Accord. In terms of Basel III further capital holding requirements will be placed on banks, which will affect the cost of credit, as well as a bank's ability to provide credit. The Basel III Capital Accord comes into force in January 2013.

2.7 The proposed amendment would lead to unintended consequences, which *inter alia* include the following:

- Credit providers will continue to incur and bear the cost of holding the credit agreement (cost of capital), while not earning any income;
- The proposed amendment may change credit lending behaviour of credit providers to cater for the risk should a consumer apply for debt review and a suspension of interest ordered, in that stricter credit lending criteria may be applied which would make credit less accessible for consumers;
- The proposed amendment may impact and increase the cost of credit charged by credit providers to cater for the risk should a consumer apply for debt review and a suspension of interest is ordered by the magistrate; and
- The proposed amendment may negatively impact mortgage and vehicle asset finance lending as the risk should a consumer apply for debt review and a suspension of interest ordered would greatly impact this type of lending and may even result in this being an unsustainable lending proposition.

2.8 The amendment does not set out the criteria the Magistrate would use to determine whether to grant the suspension of interest.

2.9 The proposed amendment does not take into account the risk principle when affording credit. At the outset it must be understood that there is a difference between secured and unsecured lending as it relates to risk. The current regulatory framework does not differentiate between types of credit providers; types of credit agreements, or between secured and unsecured lending. This has been highlighted as one of the areas which need to be addressed in the consumer credit policy review.

2.10 The current regulatory framework does not recognise that the majority of credit providers are banks; and that banks are subject to strict prudential regulation in respect of lending activities. Prudential regulation treats different

types of lending differently resulting in differing costs of lending across different types of loans, as well as different business models between bank and non-bank credit providers.

2.11 Credit is issued based on the risk profile of a consumer. Further the cost of the credit, which includes the interest rate, is worked out according to the risk profile of that consumer. The risk profile of a consumer allows a bank to manage its prudential requirements. Where financial terms of a credit agreement are adjusted, such adjustments have to be managed in such a manner that it does not pose a risk to the overall financial stability of a credit provider. Banks being the majority of credit providers play a vital role in ensuring that their behaviour in the credit market does not lead to systemic risk in the financial sector.

2.12 The result of the NCA not distinguishing between the two forms of credit is that secured credit agreements end up in the debt review process which leads to unintended consequences. One of these unintended consequences is the incentivising of unsecured lending over secured lending. One of the policy objectives of the consumer credit policy is to generate wealth among consumers. Secured credit which is used to purchase wealth-generating assets such as vehicles and properties is often one of the higher if not the highest loan repayments of a consumer. Such loan repayments are prejudiced by debt counsellors in the debt restructuring process. Further such loans tend to have longer terms of repayment, the common practice in debt review is to have these loan terms extended or have these loan repayments lowered which results in a situation where the consumer is almost never rehabilitated. The distinction has been raised as an area which needs to be debated in the consumer credit policy review.

2.13 The proposed amendment does not resolve the constraints found within debt review. The proposed amendment falls within the section dealing with debt review, and before any amendment can be made to this section the current problems within the debt review space must be taken into account. It should be noted that there are several issues with debt review, which contribute to the lack of appropriate rehabilitation of consumers. In particular, debt review does not meet its statutory objectives in practice due to a combination of (i) severe capacity and process constraints in the system, particularly in Magistrates Courts, (ii) misinterpretation of and failure to enforce certain provisions of the NCA, and (iii) deficiencies in the application of the process by debt counsellors and credit providers.

2.14 To allow a Magistrate the discretion to suspend the accrual of interest for up to 5 years poses a potential threat to financial stability. The discretion the potential amendment provides to Magistrates is too wide, particularly when taking into account that Magistrates do not necessarily possess the necessary skill to be able to assess a consumer's risk profile and whether affording a suspension of the accrual of interest would be appropriate in a specific consumers' case or the impact on the credit provider.

2.15 It has been further noted in the consumer credit policy review, that one of the obstacles to the success of debt review is the process in the Magistrates' Courts. There is a severe backlog of debt review cases currently in the Magistrates' Courts. The backlog in cases results in consumers being stuck in the rehabilitation process and not being afforded speedy resolution of their over-indebtedness. The proposed amendment to the NCA will not alleviate the backlog and may result in a further increase in cases, as there is a danger of the proposed amendment being open to abuse.

2.16 The proposed amendment may have perverse consequences. The unintended consequences of the manner in which debt review has been implemented is perversely an increase in credit risk, restrictions in credit access for marginal borrowers and an increase in the cost of credit for higher loss ratios. Any amendment to the debt review provisions should take into account that the whole purpose of debt review is rehabilitation. Due to the current inefficiencies in the debt review process and the opportunity for abuse, any amendment to the debt review process must attempt to address all the highlighted obstacles that debt review currently faces.

2.17 Should the proposed amendment to the NCA come into effect it may create further perverse incentives for consumers to enter the debt review process and impact materially on credit access and terms for the affected debt categories. Due to the fact that credit is priced at risk, by implementing such an amendment would mean that the risk of affording consumers credit would be higher, resulting in an increase in the cost of credit.

2.18 It should be noted that currently credit providers engage in voluntary concessions, and negotiate lower interest rates to assist an over-indebted consumer on a case by case basis. The Banking Association of South Africa is opposed to codifying the voluntary concessions in legislation. The negotiation of lower interest rates is based on variables which change over time due to fluctuations in the credit market. The proposal has the potential to be abused in the debt review process, as there is a threat of this proposal being used as a "blanket" proposal when applying for debt restructuring. As stated above because the orders given by Magistrates' would not be based on the risk profile of the consumer there is a threat of this practice having a detrimental impact on the financial stability of the market.

We extend an open invitation to you to contact us to continue these discussions further, if required.

Yours faithfully

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Nicky Lala-Mohan
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