Regulators all at sea while consumers drown in debt

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Illustration: Colin Daniel

An unresponsive government department, a regulator beset with problems, the unintended consequences of the National Credit Act (NCA), and predatory practices and pricing by unscrupulous credit providers are all contributing to the over-indebtedness of consumers.

Half of South Africa's consumers who use credit have impaired credit records and every month about 6 000 consumers apply for debt counselling. Over the past year, there has been a 53-percent growth in unsecured lending.

After it was widely reported last week that the Registrar of Banks is to launch an investigation into unsecured lending by the banks, Hlengani Mathebula, head of communications at the South African Reserve Bank (SARB), this week said the SARB "is not investigating unsecured lending".

"We have made it a specific focus area that we would like the banks to report on, due to the higher growth rate of the category."

At least two credit experts agree that numerous problems with the NCA and with the enforcement of the Act render you, the consumer, vulnerable to reckless lending.

Dr Penelope Hawkins, managing director of Feasibility, an economic policy research company, says reckless lending continues because consumers are distressed, and distressed consumers are willing to borrow at any price.

"Incentives on both sides encourage credit to be taken even where it may be unaffordable. It's the old demand (distressed borrower) and supply (reckless lender) story."

The National Credit Regulator (NCR) needs to tighten up the enforcement of the Act in terms of the affordability assessments of consumers, Hawkins says.

Consumers are mostly asked by credit providers what their expenses are, "but not in adequate detail", she says. "This is partly because there appears to be little concern that the reckless lending provisions in the Act will actually be enforced," Hawkins says.

Attorney Stephen Logan, who is a credit law expert and an authority on the NCA, says credit providers are under no obligation to check what consumers disclose.

"If a consumer lies to a credit provider (by not disclosing all expenses and/or debts), then the provisions protecting the consumer fall away.

"Many credit providers are only too happy to grant credit and charge a fortune in interest, because they know they can collect (the money), thanks to robust collections mechanisms in South Africa. They have little incentive to do an accurate affordability assessment."

The Department of Trade and Industry (DTI) and the NCR have failed consumers by failing to issue guidelines on how affordability testing should be conducted, he says.

In his book The Credit Guide, Logan writes: "The NCA does not provide an affordability formula, but it is clear that, after a consumer deducts his actual expenses from his actual income, the balance must be sufficient to pay all his monthly debt instalments."

The Act intended affordability assessments to be done in name and substance, but clearly the affordability provisions in the Act are not being properly policed, Logan says. And credit providers have shirked their moral responsibility, he says.

Hawkins says there is space for the NCR to issue a guideline that says credit providers should take note of living standards measures, which are sensitive to the number of people in a household, as well as income and expenses.

"There are no guidelines as to what constitutes reckless lending, as there is no guidance from the regulator. The reliance on debt counsellors to identify reckless lending is unrealistic. Debt counsellors are unlikely to move to try to get a reckless lender out of the system when there is no incentive to do so. My understanding is that even when reckless lending cases have been identified, the parties settle before getting to court," Hawkins says.

When the NCA was introduced, there was much hype about the establishment of a national register of credit agreements. But five years on, it has yet to be established.

The Act requires that credit providers record information about all credit agreements on the national register. This is supposed to help credit providers assess your level of indebtedness accurately, and prevent reckless lending.

Logan is scathing of the regulator's failure to establish the register and the DTI's failure to address the unintended consequences of and problems with the Act. He says the NCR and other key stakeholders have made detailed and repeated submissions to the DTI, but it has failed to act on them.

"When 50 percent of consumers have an impaired credit record, you can't say that the NCA is working or that the NCR is doing its job well."

Despite the maximum interest rates introduced by the NCA in 2007, the cost of credit is still high, Logan says. A review of pricing – of both fees and interest rates – is long overdue, Logan says.

The NCA prescribes the maximum interest rates and fees that credit providers can charge you, based on the repo rate (the rate at which the SARB lends money to the commercial banks).

Even with the repo rate having come down (to 5.5 percent), Logan says the question is: what is it appropriate to charge now? What is usurious or exorbitant now?

Logan echoes the call of former SARB governor Tito Mboweni for a review of the three-percentage-point pricing gap between the repo rate and the prime lending rate.

“The NCR should have taken Mboweni’s cue and done a detailed study,” he says.

It is the NCR’s job to make sure that pricing is fair for consumers and to reduce predatory pricing, Logan says. Surely the regulator’s role is to review pricing on an ongoing basis, he says.

According to Hawkins, there is also a need for:

* Consumers to be educated about the rights that they have been granted by the NCA.

* Consumers to be informed properly at the point of sale and to be able to obtain quotations prior to the transaction.

* Stricter disclosure requirements in respect of the terms and conditions of a credit agreement and the total cost of credit over the term of the contract.

* Simplified contracts. She says contracts are too long and are in legalese. Everything the consumer needs to know – rates, fees, total cost, repayment period, penalty interest and the costs of defaulting – can be put on one page.

* Greater clarity of the consequences of defaulting.

* Mandatory disclosure of credit life assurance in the agreement.

CASE FOR ANOTHER AMNESTY

In light of the number of consumers with impaired credit records and how this affects the cost of credit, Stephen Logan says there may be a case for granting another credit amnesty.

The first amnesty, in 2007, allowed for a once-off removal of certain information from consumers’ credit reports.

“I expect the regulator to look into impairment and consider whether another credit amnesty would reduce predatory pricing.

“One of the goals of the National Credit Act (NCA) was to give the poor access to affordable credit. Before the NCA, the rich paid the least for credit and the poor paid the most. The Act has been in force for five years and the poor are still being excluded or charged the highest interest rates,” Logan says.

This is partly because of impaired records, he says. “Adverse information on a consumer’s credit record is used against him or her to price prejudicially. So credit providers have a perverse incentive to hand over accounts to collectors or to take legal action and then list adverse information, because it entitles them to charge you more interest than if you had a clean record, Logan says.

“Our concern should be for the poorer in our society; they have few places to go for credit. Once a credit provider has them (as a client in default), it ‘owns’ them and holds them to ransom. They can’t get credit elsewhere, so they become trapped.” This is one of the unintended consequences of the Act, he says.

Logan says: “Credit providers should be required to remove adverse information listings once the account is paid. They will still be able to price using the consumer’s monthly payment profile.

“Credit impairment is so high, yet credit extension is so aggressive. This is because you are charged prime plus X percent when you have an impaired record. We need to ask: how is impairment affecting price?”

PROBLEMS AT THE NCR

After the departure in January 2011 of Gabriel Davel, the first chief executive officer (CEO) of the National Credit Regulator (NCR), his post stood vacant for almost a year. In November 2011, cabinet approved the appointment of Nomsa Motshegare as CEO.

According to inside sources, however, Motshegare has yet to receive her letter of appointment from the Department of Trade and Industry and hence has “no authority” to do her job.

Since Davel’s retirement, two senior officials at the NCR have been suspended and at least one key official has resigned.

In May last year, senior manager for education and strategy Peter Setou was suspended. The NCR did not provide him with the reasons for his suspension. Setou and the NCR are locked in a legal dispute. Setou was said to be a strong contender for the position of CEO.

The latest NCR official to be suspended is chief financial officer Sivo Pather, who is facing allegations of nepotism, tender fraud and abuse of NCR resources. Advocate Jan Augustyn, who headed investigations and enforcement at the NCR, resigned earlier this year.

NCR’s RESPONSE

Darrell Beghin, manager for credit information and research at the National Credit Regulator (NCR), responds to criticism levelled at the NCR this week.

1. Reckless lending is rampant. “Only a court can declare a credit agreement reckless, but the NCR can assess whether a proper affordability assessment has been conducted. There are measures in the National Credit Act (NCA) to prevent and rectify reckless credit. There is a duty on debt counsellors to establish whether consumers applying for debt counselling are seeking declarations of reckless credit.

“There is also a duty on the credit provider in terms of the NCA, and the credit provider cannot merely accept the word of the consumer. The credit provider must take reasonable steps to assess [a consumer’s] debt repayment history under existing and past credit agreements and [his or her] existing financial means.”

2. The NCR needs to tighten up enforcement in respect of affordability assessments. “The NCA allows credit providers to develop their own assessment mechanisms and models which should result in a fair and objective assessment. The NCR may publish guidelines on evaluative mechanisms, but these are not binding on credit providers – in terms of Section 82 (2 and 3) of the Act. The complexities in developing guidelines for the credit industry cannot be underestimated as inappropriate guidelines could result in further issues such as uncertainties in interpretation and irrelevance in some instances.”

3. The Act requires credit providers to register credit information on a national register of credit agreements, but there isn’t one. “The NCA states that the Minister [of Trade and Industry] may call for the creation of the National Register of Credit Agreements (NRCA). The mandate given to the NCR in May 2011 calls for a statistical (not credit-vetting) database to be established. This project is under way within the NCR. However, it must be noted that the Act also states that credit providers may list information on either registered credit bureaus or on the NRCA; thus the challenge of a totally comprehensive view of all financial obligations on all consumers would still not necessarily be achieved, even if the NRCA were a total replication of the already existing credit bureau environment."

4. The NCR needs to review pricing. "Research into the cost of and access to credit informs the NCR about the interest rates applied by credit providers."

5. There's a case for another credit amnesty. "The call for an amnesty has already been raised with the NCR and is being attended to."

DEBT: YOUR FRIEND OR FOE?

Debt can be used to increase your wealth, but debt can also destroy your long-term financial security if it is used indiscriminately for the wrong things. Debt can be divided into three main categories:

* Good debt, which is used to finance an asset, such as your home, that tends to increase in value over the long term. Debt to finance furthering your education is also good debt, because education can increase your earning power.

* Needs-based debt, which is used to finance items that you need, such as a motor vehicle so you can travel to and from work or a refrigerator to ensure that your food stays fresh. Remember, there is a difference between a want and a need. All you need to get to work is a Volkswagen Golf, not a BMW. Wants should be bought with cash.

* Consumption debt is debt that is bad for you. It is used to finance items, ranging from food to furniture, that lose value once you have purchased them. The more of this type of debt you take on, the more likely you are to experience financial difficulties.

There are eight signs that you are in financial difficulty. They are:

1.You owe more than you own;

2. Your spending, including what you spend to repay debt, exceeds your income;

3. Your bank has rejected a debit order in the past three months because there were insufficient funds in your bank account;

4. Your bank account has been closed, or you have been asked to return a credit or a store card;

5. You juggle your bills to decide which ones you will pay first every month;

6. You have bills that are more than two or more months in arrears;

7. You consider unused credit facilities to be part of your wealth; and

8. One of your creditors has obtained a debt judgment against you.

HOW TO GET OUT OF DEBT

Getting out of debt is tough. Here is how you must do it:

* Cut out all but the most essential spending: no movies, no meals out, no smoking, no drinking, no new clothes.

* Do not borrow any more money.

* Cut up your credit cards and store cards.

* Speak to the people who have lent you money and tell them how you intend to repay it.

* Prioritise repaying high-interest, short-term debt first.

* Sell expensive items, such as a luxury motor vehicle. Downgrade or use public transport.

* Channel all the money you can into repaying debt. Don’t save or invest money if you can avoid it while you are over-indebted.

* Be very careful when dealing with debt consolidators; they can cost you more, with the result that you will remain in debt for longer.

* Remember the difference between a want and a need. A want is something you do not need in order to survive.