Article

The transformation of the South African credit market

Jürgen Schraten
jueshq@gmail.com

Abstract
South Africa was the first African country to introduce a legal framework for the consumer credit market in 2005. More than six years after its introduction a public debate about over-indebtedness and unsecured lending received public recognition. It was caused by constantly increasing numbers of unsecured loans and growing levels of private indebtedness. Purpose of the research undertaken was the question why this problem arose after the implementation of the National Credit Act (NCA). This article shows that the competitive credit market itself, which was intended with the NCA, contains the tendency towards unsecured lending and, as a consequence, over-indebtedness. As remedies it discusses the option of compulsory credit counselling and the introduction of legal debt discharge. Credit counselling could level the asymmetry of knowledge between creditors and debtors. Strongly regulated options of legal debt discharge would follow an international trend in developed consumer societies with the purpose of reintegrating over-indebted citizens.

Introduction
In March 2012 the National Credit Regulator published an urgent warning on the granting of unsecured personal loans and announced ‘extensive research’ (NCR 2012c:2) after sales figures had increased significantly. The warning was reinforced in September 2012 and justified by determining ‘a continued deterioration in the financial health of consumers’ (NCR 2012e:1). This was a remarkable development because of attacks on banks for abstaining from offering services to the lower income groups during the first decade of the democratic era in South Africa, for instance ‘in October 2000 with nationwide marches to demonstrate against bank discrimination in lending’ (Porteous 2004:7), which was initiated by the Financial Sector
Campaigns Coalition. Expanding inclusion into banking services, especially of lower income groups, of the rural population and of those who had been excluded from equal rights during the apartheid era, was a main motivation behind the introduction of the National Credit Act (34 of 2005) (NCA). Unsecured personal loans as the main concern of the National Credit Regulator (NCR) in 2012 became popular only as a consequence of exactly this legal reform, which was implemented to remedy the exclusion of large parts of the South African citizenship from lending services in the first place. Therefore, the main question raised by this article is how the transformation of the South African consumer credit market by the NCA caused the unsecured lending problem. Starting from an analysis of a public discourse, this article is conducted in the way of an institutional analysis that combines sociology of law with economic sociology.

The main argument is that the increasing tendency towards unsecured lending, and its consequence of over-indebted consumers, is the result of the establishment of a competitive credit market that was intended with the NCA. Hence those who want to prevent over-indebtedness will have to make changes to this Act. This is in full accordance with the estimation of legal specialists concerned with this development (Roestoff and Coetzee 2012:54).

The public debate on over-indebtedness
A public debate on over-indebtedness and unsecured lending received significant public recognition in South Africa in 2012. Responsible governmental agencies replied with intentional remedies. In March 2012 the publication of the quarterly Consumer Credit Market Report was accompanied by an alarming press release of the NCR. It ended with the announcement of ‘extensive research regarding the rapid growth in the unsecured personal loans market’ (NCR 2012c:2). The outcome of this research was published in August 2012 (NCR 2012d). Another sign of the importance of the matter was given on August 27, 2012 when South Africa’s Finance Minister Pravin Gordhan met the country’s chief executives and the chairpersons of banks in order to discuss the unsecured lending problem and bank charges. They concluded that there should ‘be further engagement with financial and non-financial institutions on this issue so that South Africans are not over-indebted’ (Department of Finance 2012a:2). This meeting was followed up by an agreement titled ‘Ensuring Responsible Market Conduct for Bank Lending’ on October 19, 2012 that was published on November 1, 2012 (Department of Finance 2012b).
The transformation of the South African credit market

With these statements governmental agencies explicitly addressed the problem of over-indebtedness. According to Section 79(1) of the NCA over-indebtedness is at stake when a 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 party, having regard to that consumer’s financial means, prospects and obligations’, in other words, when a debtor has lost his or her ability to pay back loans.

As a main reason for the emerging problem, the statements designate unsecured lending. This refers to a category that is under special observance of the NCR. ‘Unsecured lending transactions include all transactions in respect of which the lender does not have any security (other than credit facilities or short-term credit)’ (NCR 2008:12, 2012a:14). It is defined in Section 39(3) of the regulations of the NCA. Unsecured credit is unleashed by private loans and by the usage of so called credit facilities like credit cards, store cards and bank overdrafts. Credit facilities offer loans only on a short-term basis. Usually their accounts have to be balanced within a month. They can be seen as a way of permanently ‘saving up’ and ‘saving down’ (Rutherford 1999:30). Hence this article will focus on unsecured loans because they consist of deliberately signed contracts, which lead to longer lasting indebtedness. In distinction from a mortgage, which is secured by an immovable object, or a secured credit, which may be backed by a car, the default of the repayment of an unsecured loan immediately leads to indebtedness as there is no asset that could be seized by the creditor in order to balance the account (Niemi-Kiesiläinen et al 2003:3). In case of a payment default the stage of over-indebtedness will soon be reached. For a democracy longer lasting over-indebtedness is problematic, because it excludes debtors from participation in the economy and inhibits incentives to earn money as a higher income would only be used to serve the creditors.

The landscape of financial services, credit and debt that was addressed by the Minister in his meeting is the result of the NCA and its regulations which were put into effect between June 2006 and June 2007. So the follow-up question arises as to why over-indebtedness became a problem after a legal framework was put into place that aimed at an ‘accessible credit market’ and promoted ‘to protect consumers’ (Section 3 of NCA).

sequestration, and the absence of any other forms of relief for the debtors (Roestoff and Coetzee 2012). These findings are combined here with an analysis of the economic system, which reveals the competitive credit market and the use of fees on financial services as source of another dynamic leading to extensive usage of unsecured loans. The economics of consumer credit causes the tendency towards unsecured lending, and therefore towards over-indebtedness as these products are more profitable than their secured alternatives. This article discusses two political measures in order to remedy the dissonances of the NCA. The first option would consist of compulsory credit counselling before concluding an unsecured loan. The second option would consist in the introduction of an option of legal debt relief as is common in many countries with a developed market of consumer credit.

**Change of credit from an emergency tool to a democratic claim**

In order to understand current debates on over-indebtedness and consumer bankruptcy it is necessary to recognise the basic change in the social character of credit during the past 30 years. This had a broad influence on the South African debate that led to the implementation of the NCA. In the United States and in Europe the regulatory environment of loans changed in the late 1970s and early 1980s (Kilborn 2007:6ff, Niemi-Kiesiläinen et al 2003:2). Until then access to consumer credit even in the developed economies of North America and Europe was restricted. Ordinary citizens were to make a down payment of a fifth or more before they had access to a loan of the rest of the sum (Kilborn 2007:6, Burton 2008:68). This had three effects: the banks had security in form of a prepayment. They had evidence that the customer was able to serve monthly instalments – first as savings, then as repayments. Finally they could take control over the object of the loan. Hence it can be said that this kind of credit was based on back-up deriving from advance payments, and the responsibility for the soundness of a loan was attached to the lender.

Three historic developments can be identified with reference to the dissemination of credit. At first, the purchase of expensive consumer goods like cars and electronic household machines was not feasible without loans (Burton 2008:34-37). Then, the mass production of these goods brought regular and predictable wage payments which enabled consumers to afford instalments and loans (Kilborn 2007:53). Finally, restrictions of consumer credit were lifted in order to stimulate economic growth after the economic
The transformation of the South African credit market
downturn of the 1970s (Kilborn 2007:7). This changed the character of credit so much that the ideal types (Weber 1922:10) of an old and a new type of credit can be drawn (Burton 2008:67).

In the old concept loans were associated with rampant consumption. In the new type, the availability and usage of credit is perceived as a matter of course, ie in advertisements that already incorporate the option of instalments and loans. In former times the granting of consumer credit was the business of the trusted relationship of banks that had a long-term relationship with their customers. Nowadays banks advertise easy access to credit as a way to attract new customers (Burton 2008:67). In the past the decision on a loan was based on a personal estimation of the creditworthiness of a customer by a bank clerk; in the present the decision is made by credit scoring, ie a mathematical calculation based on statistical data on age, income, area of living, education, job prospect, credit history etc (Burton 2008:53-57). In the old credit landscape, loans were provided from the assets that a housing bank acquired from savings of other customers and from central bank money; the new type of credit is supplied by a complex credit market and by options of credit securitisation (Langley 2008).

Finally as a result of this change, the availability of loans turned into a fundamental democratic claim: ‘Access to financial services has become an integral part of being included in contemporary consumer society, and there is recognition that those who are excluded are severely disadvantaged’ (Burton 2008:60). This resonated in the South African debate on financial services after the advent of democracy. Access to financial services especially for lower income groups was a crucial demand raised during the Nedlac Financial Sector Summit on 20 August 2002 and in the Financial Sector Charter of 2003 (Porteous with Hazelhurst 2004:9-10). The access of the low income segment of the population to loans built an important part of these claims (Porteous with Hazelhurst 2004:77-99). Hence one of the main reasons for the Department of Trade and Industry to introduce a National Credit Act was the purpose of a regulatory framework for consumer credit institutions and consumer credit agreements, ‘in which access to finance [ie credit] is improved, particularly for development purposes’ (Department of Trade and Industry 2003:4).

**Purpose and function of the National Credit Act**
In the past, the South African credit market was regulated by the Usury Act 73 of 1968 and the Credit Agreements Act 74 of 1980. Initially the economic
impact of the Usury Act with its interest rate caps had prevented lower income groups from getting access to credit at all because it was not attractive to grant low interest loans to high risk customers without the prospect of extraordinary earnings (Goodwin-Groen 2006:24-30; Kelly-Louw 2008:206). A first Exemption Notice from 1992 excluded loans under R6,000 from the interest rate caps and resulted in an unregulated small-loans market which produced high levels of indebtedness, followed up by harsh money-collecting procedures (James 2013). ‘Excessive interest rates have caused heinous socio-economic hardships and suffering for low-income individuals and communities’ (Campbell 2007:252). A second Exemption Notice in 1999 softened this effect without solving the problem (Kelly-Louw 2008:202).

The Credit Agreement Act contrary to its name ‘dealt with instalment-sale transactions and did not apply to money-lending transactions’ (Kelly-Louw 2008:203). So despite these two laws the credit market was barely regulated and ‘was characterised by discrimination, a lack of transparency, limited competition, high costs of credit, and limited consumer protection’ (Kelly-Louw 2008:205). This was the initial situation in which the NCA was established.

As a consequence, the NCA aimed juridically at creating ‘a single system of credit regulation’ (Kelly-Louw 2008:208). However, the economic objective of this legal regulation consisted more in ‘promoting the development of a credit market that is accessible to all South Africans, and in particular to those who have been unable to access credit under sustainable market conditions’ (Section 3a NCA). This was to be achieved by the establishment of a new legal framework that should be supervised and performed by the NCR and the National Consumer Tribunal. One of its core characteristics is the principle of sanctity of contracts (Campbell 2007:254).

The NCR was assigned to a number of accountabilities, as it is charged with promoting ‘a fair, transparent, competitive, sustainable, responsible, efficient, effective and accessible credit market and industry, and to protect consumers’ (Section 3 NCA). But already in the outline of the aims in Section 3 of the NCA, a preference for expanding the credit industry becomes noticeable. Consumer protection is barely noticeable as its main task because a huge part of the responsibility in existing credit agreements is clearly allocated to the consumer. It lists ‘the fulfilment of financial obligations by consumers’, ‘discouraging [...] contractual default by consumers’, aims at correcting the power imbalances between credit providers and consumers by recommending that the latter take on education and urges them to ‘make
The transformation of the South African credit market

informed choices’. Section 3(g) states that the Act is ‘providing mechanisms for resolving over-indebtedness based on the principle of satisfaction by the consumer of all responsible financial obligations’, and repeats this tenet in regard to debt restructuring ‘which places priority to the eventual satisfaction of all responsible consumer obligations under credit agreements.’ According to Section 3(h) disputes shall be resolved ‘consensual[ly]’. Even the reckless lending rule is embedded in this principle of consumer responsibility as will be shown below. In this tendency the NCA is in accordance with the Insolvency Act No. 24 of 1936 (Roestoff and Coetzee 2012: 55-59).

The economic focus of the NCA is confirmed from a legal point of view when Kelly-Louw states that the NCR

…must particularly address the needs of historically disadvantaged persons, low-income persons, and remote, isolated or low-density communities. It also must monitor the availability of credit, pricing and market conditions, trends in access to credit and indebtedness, market conduct and competition. (Kelly-Louw 2008:209)

A research project on the behalf of the NCA again approved this estimation and revealed the dangers attached to it by stating that ‘the current credit market framework is geared towards encouraging access to credit and there is an inherent likelihood that large numbers of consumers will face challenges in meeting their debt commitments’ (NCR 2012d:12). So the NCR has to develop a competitive credit market in the first place where subsequently consumers may act responsibly in order to avoid over-indebtedness. Quite soon after its implementation, the NCA transformed the structure of the South African credit market. It resulted mainly in a replacement of informal money lenders by institutionalised banks and in the substitution of personalised lending procedures by technical assessments of credit-worthiness.

One of the main tools of the NCR is the compulsory registration of credit providers with more than 100 credit agreements or with outstanding credit agreements of more than R500,000 (Section 40, 42 (1) NCA). This way it cuts out the informal market of money lenders because ‘a credit agreement entered into by a credit provider who is required to be registered […], but who is not so registered is an unlawful agreement and void’ (Section 40 (4) NCA, Vessio 2008:235). As a consequence, those who do not want to be registered are restricted to a very limited business volume. Money lenders work by arranging the time schedules of loans they admitted with the
repayments of loans (Baecker 2008:22-33). Unlike a bank they usually do not build deposits from stored savings. This results in a limitation of monetary resources and they therefore depend on the number of their clients and the total amount of their loan repayments. The legal limitation of these options disadvantages their business to a high degree. In competition with big retailers and business banks, they were no longer competitive and lost their market share. Observation of this development is difficult though because these money lenders are not obliged to register. However, the expanding presence of banks in the business districts of cities and the omnipresence of loan advertising in the streets and in the mass media, documents the development.

To protect the consumer from over-indebtedness there are mainly four rules of the NCA to be mentioned: the reckless lending rule, the compulsory disclosure of credit costs, the codification of the \textit{in duplum} rule, and debt counselling.

\textbf{The reckless lending rule}

The reckless lending rule is introduced in Section 80 of the NCA. It cannot be applied to school or student loans, emergency loans, public interest credit agreements, pawn transactions and incidental credit agreements (Section 78(2) NCA). There are two possible reasons for an agreement to be characterised as reckless, either if the credit provider undertakes no steps to assess the consumer’s understanding of the agreement and ability to pay back the loan, or if the lender still entered into the agreement despite contradictory results of these assessments. If a credit agreement is declared reckless the court may ‘set [...] aside all or part of the consumer’s rights and obligations under that agreement’ (Section 83(2)(a) NCA) or ‘suspend [...] the force or effect of that credit agreement’. (Section 83(2)(b) NCA) In all other cases, the effect of reckless lending only consists in a moratorium of repayments. Hence, the NCA follows the principle of sanctity of contracts in every case in that an agreement is not obviously unlawful. Section 84(2) of the NCA clearly states that after ‘a suspension of the force and effect of a credit agreement ends all the respective rights and obligations of the credit provider and the consumer under that agreement are revived and are fully enforceable except to the extent that a court may rule otherwise’. In other words, the borrower may be relieved from unlawful interest rates and fees and will not be charged with further payment requirements for the period of the suspension. The rest of the contract, however, will remain in force.
Disclosure of credit costs
An important section of the NCA deals with the disclosure of costs of a credit agreement. These agreements have to be in plain and understandable language (Section 64 NCA) and ‘a credit provider must supply a consumer with a pre-agreement disclosure statement that includes the main features of the proposed agreement and a cost quotation of the credit’ (Kelly-Louw 2008:213). Those who do not comply may face a heavy administrative fine (Section 151 NCA). By this measure the legislator intends to prevent carelessly taken loans by the consumers. Therefore, this rule must be seen in context with the efforts to support consumer education (Kelly-Louw 2008:210f).

However, the costs of credit according to Section 101 of the NCA may comprise up to seven different elements: the principal debt, interest, an initiation fee, service fees, a credit insurance, administration charges and collection costs. To make things worse, according to the Regulations of the NCA these seven elements may be applied to seven different forms of credit, most of them with a different maximum interest rate: mortgage agreements, credit facilities, unsecured credit transactions, developmental credit agreements, short term credit transactions, incidental credit agreements, and other credit agreements. (Section 42(1),(2) Regulations of the NCA)

As a result, limited literacy and numeracy in South Africa are not the only obstacles for operationalising the disclosure rule. Even if customers understand the outlined facts of a contract, it may still be difficult to understand the financial consequences of these facts (some of which will be discussed below). The complexities of the regulations may even bring down a charge according to the reckless lending rule. Section 81(4) of the NCA provides that ‘it is a complete defence to an allegation that a credit agreement is reckless if the credit provider establishes that the consumer failed to fully and truthfully answer any requests for information made by the credit provider’. Consequently, if a consumer assures the affordability of a loan under the condition of rightfully outlined but wrongly interpreted details of a credit agreement, this may result in the dismissal of a charge.

Codification of the in duplum rule
The in duplum rule laid down in the NCA says that ‘the amounts [...] that accrue during the time that a consumer is in default under the credit agreement may not in aggregate exceed the unpaid balance of the principal debt under that credit agreement as at the time that the default occurs’.
(Section 103(5) NCA) It is one of a few options of debt relief that was included into the NCA. It prevents the consumer from staying caught in a debt spiral due to demand of steadily rising interest and fees after he pays his principal debt (Kelly-Louw 2007).

**Principles of debt counselling**
Debt counselling is constructed as a mediating process that exists in between the law and educational explanation. Over-indebted consumers themselves, as well as courts, are able to appoint a debt counsellor. However, the function of a debt counsellor is not to effect a change in the credit agreement. ‘Debt counselling is a form of consumer education and thus information transfer’ (Goodwin-Groen 2006:56). According to Sections 84-88 of the NCA, debt counselling may result in a temporary suspension of the credit agreement and a restructuring of the debts through extending the period of repayment and reduced instalment payments, and in case of wrongdoing of the creditor, a recalculation of the debts may take place. Debt counselling and the application of the reckless lending rule sometimes may even result in higher earnings for the credit providers if the instalments are reduced and repayment periods extended whereas the fees and interest are maintained at the same time. As a result, the debtor will pay lower monthly amounts over a longer period of time, accruing a higher aggregate amount of repayments. That way the lender will earn more. But debt counselling will not lead to a reduction of the principal debt unless the creditor agrees. Of course counselling is applied only after a consumer already has got into financial difficulties. It may save the debtor from legal action against him because the credit provider is obliged to inform a defaulting debtor about his intention to sue him and ‘must draw the latter’s attention to the fact that he or she has a right to make use of various alternative dispute-resolution mechanisms’ (Kelly-Louw 2008:225). But debt counselling will under no circumstances reduce the debts.

In summary, it can be said that the four main mechanisms of debt relief under the NCA may protect the debtor from legal action, it may give a moratorium and more time to pay back loans in lower instalments but it will reduce debts or the amount of legally charged interest and fees only due to consent of the lender.

**The political economy of consumer credit**
Four important consequences ensue. First of all, the total cost of a loan may remain obscure despite existing regulations. Secondly, the NCA encourages
The transformation of the South African credit market

credit providers to sell unsecured loans and, thirdly, it attracts low-income and risk-bearing lenders to take them out. Finally the reckless lending rule is that it can only be applied with regard to the settlement day of a loan contract, a major failing.

**Concealment of credit costs**
At a first glance, the cost of credit seems to be strictly limited and the regulations seem to be significantly improved in comparison to the previous situation before the NCA. As mentioned above, the possible components of a loan are limited to seven. The Regulations of the NCA in Section 42(1) cap the maximum interest rate of different loan types, too. But then there is an initiation fee (Section 101 (1)b NCA) that is limited to R1,000 or 15 per cent of the principal debt according to Sections 42(2) and 43(3) of the Regulations of the NCA. Remarkably it remains unclear for what purpose this initiation fee exactly is paid (Campbell 2007:257). This missing rationale is of importance because there are service fees too (Section 101c NCA). They are limited to R50 per month (Section 44 Regulations of the NCA), which look small in relation to a bigger loan but taken monthly they may total up to a significant part of a small loan.

The main problem with these fees is that especially low-income borrowers will not have the money for them in advance; after all they apply for a loan because they are in need of money.

These people are thus forced to allow the initiation fee to be capitalised and re-paid, possibly in the same number of instalments as the initial loan, subject to the same interest rate as the initial loan. [...] It is also possible that the initiation fee could be regarded as a separate short term or unsecured loan, attracting interest at the prescribed rate and subject to the standard service fee of R50 per month permitted by the Act, which would make the initial loan even more expensive. (Campbell 2007:260)

Another non-transparent part of credit costs are credit life insurance cover. Credit providers are allowed to demand the inclusion of such an insurance policy but the consumer is free to choose his own policy. Costs average 7.6 per cent per year of the loan (NCR 2012d:73). This proviso is dubious even according to a consideration of an internal report of the NCR: if the higher maximum interest rate of an unsecured credit is legitimised by the fact that there are no assets to back it up, this justification becomes obsolete by the signing of an additional insurance contract as a form of security (NCR 2012d:72ff).
At first glance the three components in consideration look insignificant. But the research report on behalf of the NCR shows that the initiation fees contribute 11.2 per cent to the total revenues from unsecured loans, the service fees add 9.7 per cent and, finally, the insurance policies contribute another 11.2 per cent (NCR 2012d:63). Soon after the introduction of the NCA, Jonathan Campbell raised the question if these fees are not a way of obscuring the real costs of a loan (Campbell 2007:263ff), and this still seems to be a matter of concern. Maurer emphasises that this belongs to a global trend because ‘where retail banking is concerned, interest rate arbitrage and credit are not so important to revenues anymore […]. Instead, the money in money, so to speak, has been [shifted to] fees’ (Maurer 2012:475). Moreover even these calculations still disregard the effect of compounding.

Compounding designates the practice of levying interest on interest. A hidden option in Section 40(1) of the Regulations of the NCA states that interest ‘may be calculated daily and may be added to the deferred amount monthly, at the end of the month’. The ‘deferred amount’ includes other loan components and, more importantly, the increase of the principal debt by the interest added to it during the months before (Section 39(1) Regulations of the NCA). This amount becomes even higher with the option of payment holidays, offered by many credit providers at the beginning of a loan contract or at times where consumers find it difficult to make payments.³ During this period the loan will accumulate interest and capitalised fees (NCR 2012d:68-69). The allegedly helpful ‘holidays’ turn into an additional burden for the borrower.

To counter the demonstration of the complexity of the real price of credit, the need for consumer education as a means of preventing over-indebtedness (Vessio 2008:231, Kelly-Louw 2008:210-1, Stoop 2009:273-5) and further disclosure of credit costs (Campbell 2007:270-1, Stoop 2009:376, Stoop 2010), is often raised. However remedies in this direction are likely to remain insufficient. It is especially unclear how the effects of these complex rulings can realistically be formulated in ‘plain and understandable language’ as required by Section 64 NCA without becoming misleading at the same time. As a conclusion, more responsibility concerning affordability assessments must be transferred to the credit providers because of their asymmetric advantage of specialised knowledge.

It may seem that the Ministry of Finance and the BASA (Banking Association of South Africa) are already tackling the problem of informational asymmetry. On November 1, 2012 they stated that to ‘prevent future
The transformation of the South African credit market

indebtedness and address current over-indebtedness where practical BASA and its member banks will review their approach to the assessment of affordability, and ensure the selling of appropriate credit products to their customers’ (Ministry of Finance 2012b:3). But this promise is somewhat contradicted by the NCA’s continued aim of encouraging a competitive credit market. The development of a diversified credit market that has been promoted by the NCA, consisting of many different forms of secured as well as of unsecured credit products, is financially beneficial to lending institutions. ‘The move to risk-based pricing has meant that the higher risk a consumer presents, the higher the price of credit becomes’ (Burton 2008:69). The proof of this assumption can be taken from the five different maximum interest rates which are outlined in Section 42 of the Regulations of the NCA. The basement of all calculations is the repurchase rate of the South African Reserve Bank multiplied by 2.2. Additionally there is a premium which is 5 per cent for a mortgage loan and 20 per cent for an unsecured loan. A bank or financial institution that aims at strengthening its competitiveness will develop an intrinsic interest in selling unsecured credit instead of secured loans or mortgages because of the higher returns.4

Preference for low-income customers
The former preference for certain customer profiles has changed as well. ‘It has long been recognized that the most profitable customers are those who pay the minimum monthly payment each month and continue to pay high interest rates on outstanding balances’ (Burton 2008:58). Evidence can be found with the African Bank Investment Ltd and Capitec Bank Holdings Ltd, two banks, which specialise in unsecured lending towards lower income consumers with very high growth rates compared to other South African banks (NCR 2012d:23-24).

The consequences have been observed by the NCR and obviously motivated the agenda of the meeting leading to the agreement between the Finance Minister and the banks from October 19, 2012. By the end of 2013 this began to show a beneficial effect.

Previously the Consumer Credit Market Report of the NCR showed some worrying figures during the last years. The number of unsecured credit agreements as well as the amount of granted unsecured credit had doubled between 2007 and 2012. The share of unsecured lending of all credit granted had risen from below eight per cent to almost 25 per cent in the fourth quarter of 2012, 12 per cent more than a quarter before and 10 per cent more than a year before (NCR 2012b:4). In the fourth quarter of 2013, however, the
amount of unsecured loans had decreased to less than 19 per cent (NCR 2013:4). Yet the share of low income customers still had increased (NCR 2013:15). And while the usual period of repayment in 2007 was between two and three years, the majority of used unsecured loans now had a repayment period between 3.1 and five years. (NCR 2012b:14) This did not change significantly after the agreement (NCR 2013:14). There was a growing disposition to give credit to persons with a monthly income lower than ZAR 3,500. The majority of loans covered a sum of more than ZAR 15,000 while the upper limit in 2007 mostly was ZAR 10,000 (NCR 2008:13, 2012b:15). This can be summarised by the single statement that much more credit was granted for a much longer term of repayment to those customers at a much higher risk of getting over-indebted.

An additional future danger consists in the current low interest rates. ‘Consumers have benefitted [sic] from relatively low rates, which could, in future, increase thereby increasing the debt repayment commitments of the consumers across a broad base’ (NCR 2012d:30). Since interest rates of credit agreements as shown above are directly linked to the repurchase rate of South Africa’s Reserve Bank, determined in turn largely by conditions in a competitive world economy, there seem to be no governmental options left to prevent credit costs rising due to uncontrollable higher interest rate levels. In the face of a current historical low of these rates, there is a very high probability that this will happen in the future.

The research report of the NCR states that even on a domestic economic level a ‘significant section of the South African credit market is vulnerable to changing economic conditions’ (NCR 2012d:31). Next to the interest rate, other important factors are the development of income levels, expenditure behaviour and the rate of unemployment. In this regard another report shows a continual high degree of consumer financial vulnerability (Bureau of Market Research 2012:1-2). A crucial insight of Jason Kilborn should be kept in mind: ‘Borrowing when job prospects are good and employment is stable is risky. Borrowing when job prospects are not so good and employment is uncertain is a recipe for disaster’ (Kilborn 2007:7). The tendency towards unsecured credit for lower income groups is not a result of the failure of the National Credit Act but the consequence of a competitive credit market. The danger that derives from this is not a bubble as the financial situation of most banks is sound but rather a ‘hollow economy’ (NCR 2012d:19) in that consumer demand may suddenly break down because of over-indebtedness, accompanied by the inevitable loss of investor confidence.
Disregard of changing circumstances
A further main problem in regard to the political economy of credit concerns the reckless lending rule. According to Section 80(1) NCA this rule is applied in regard to ‘the time that the agreement was made’. No changes in the circumstances of the debtor may justify the unburdening measures of the reckless lending rule, as is explicitly outlined in Section 80(2). This can be interpreted as a problem in regard to the non-contractual elements of a contract clarified by Emile Durkheim (1997). This term refers to the fact that not every condition that contributes to the circumstances of the contracting parties during the period of the contract can be negotiated in advance and explicitly agreed upon. Instead both contracting parties depend on an unspoken form of solidarity in assuming that any change of circumstances does not materially affect the contract. Governmental agencies have to keep an eye on these non-contractual elements; they have to enforce traditional rules that contribute to the fulfilment of contracts.

Thus in any case the role of society cannot be reduced to a passive one of seeing that contracts are carried out. It also has to determine in what conditions they are capable of being executed and, if the need arise[s], restore them to their normal form. [...] There are rules of justice that social justice must prevent being violated, even if a clause has been agreed by parties concerned. (Durkheim 1997:162-3)

This demand stems from sociological theory rather than the South African constitution. But the maintenance of the principle of sanctity of loan contracts should be reconsidered in case of unforeseeable events such as unemployment, disease, disability or divorce. With Durkheim it can be argued that in these cases, ‘the regular working of social organs’ (Durkheim 1997:162) is endangered. It cannot be desirable to enforce certain contracts if the result is a general instability of social arrangements and traditions that embed the state of law. Consequently, one should think about the option of a rearrangement of principal debts in case of unintended events that disable the debtor from the repayment of a loan. This is a ‘clear trend’ (Niemi-Kiesiläinen et al 2003:13) in developed credit-driven consumer societies.

The legal regulation of over-indebtedness is not easy to manage because legal and economic principles are contradictory. From a legal point of view the fulfilment of contracts is a substantial imperative. From an economic point of view, the consumer’s over-indebtedness and long-term inability to pay is unfeasible as such a person is neither able to participate in the economic exchange nor has an interest in once again earning money (Niemi-
Kiesiläinen et al 2003:4,6). This contradiction results in the development of significantly different legal solutions for consumer bankruptcy and over-indebtedness. ‘One consistent theme ran through all of these discussions [on legal solutions]: the need for balance in offering an appropriate level of relief while avoiding the moral hazard of inviting consumers to escape from their legitimate legal obligations’ (Kilborn 2007:9).

The creation of the NCA was conducted with reference to similar legislation in other countries (Goodwin-Groen 206:8). But with its multiple emphasis on fulfilment of contracts and its missing option of debt discharge, the law follows the role model of French regulation amongst the most rigid in the world in terms of debt repayment at the time when the NCA was created (Kilborn 2007:20, 27-33). In contrast to this, the United States, the United Kingdom, Denmark, Sweden, Austria, the Netherlands and Germany offer some kind of reduction or complete discharge of debts under strictly stipulated conditions, and often as a once-in-a-lifetime option. The main justification is the reasoning that longer lasting over-indebtedness of citizens is an impediment to work and entrepreneurial activity and goes against the logic of a society that is based on risk taking (Niemi-Kiesiläinen et al 2003:13). Even for those who defend the sanctity of contracts, two arguments should be considered: state-driven debt collecting procedures aimed at citizens caught in a debt spiral is expensive and tends to be in vain. Furthermore the chance of a reduction or relief of debts can contribute to the benefit of the creditor as it re-introduces incentives for the debtor to earn money again and so be able to make payments to his contractual partners (Kilborn 2007:10).

**Conclusion**

The tendency towards unsecured lending and over-indebtedness of consumers in South Africa is the result of a competitive credit market that was the main objective of the NCA. The reason for this legal structure was to provide cheap and easily accessible loans to large parts of society precluded from accumulating assets during the apartheid era. But figures show that this opportunity leads to a significant number of citizens who are no longer able to serve their payment commitments. In the worst case this may affect gross domestic demand as a whole.

An agreement on remedies between the South African Treasury and the Banking Association of South Africa remain inadequate so long as credit providers are urged to compete with each other and are given an intrinsic motivation to sell loans of higher priced credit products for longer repayment
The transformation of the South African credit market

periods. A research report on behalf of the NCR cannot contribute to correction so long as it precludes legal changes (NCR 2012d:12).

Changes to the Act are seen as inevitable here for two reasons. First of all, there will always be an asymmetry of knowledge about the consequences of a loan contract between creditor and debtor that can only surmounted by legal regulations. Secondly, the principle of the sanctity of contracts that underpins the regulations may lead to an undermining of the state of law in general. Over-indebted citizens are not only excluded from monetary exchange and lack incentives to earn money, they also lose the main resource that is necessary for a democratic and constitutional state, ie trustworthiness.

As a solution, two measures should be considered, one of them specifically relevant to South Africa while the other one would follow a global trend. First, instead of placing too much hope in debt counselling that only takes place after a consumer is immersed in financial trouble, compulsory credit counselling needs to take place before signing a credit contract. It should be applied as soon as the principal sum exceeds a set amount of the monthly income. This way the asymmetry of knowledge could be reduced, problems of literacy, numeracy, language barriers and interpretation overcome. Many customers would prefer to get advice from an independent person anyway (Kelly-Louw 2008:212). Secondly, the global trend of combining payment plans with the option of debt discharge (Niemi-Kiesiläinen et al 2003:9, Kilborn 2007) should be followed for the following reasons: first of all, a certain degree of over-indebtedness is an inevitable consequence of an accessible credit market as some of its main causes are unforeseeable. Secondly, relief from debts offer the only incentive for highly stressed debtors to re-enter the monetary system again. Finally, debt discharge may become an important tool to prevent a ‘hollow economy’ in case of unwanted but inescapable economic developments.

Notes
1. I would like to thank two anonymous reviewers for their very helpful hints, which allowed me to improve my argument.
2. But they range from 2.8 per cent to 32 per cent, depending on credit provider and product.
3. A major South African bank includes this even as a standard component of its loans: ‘When money is tight, take a break... Take a break from your payments in January. FNB understands that the beginning of the year is tough and sometimes cash is not readily available when you need it most. Now you can take-a-break from paying your instalment every January’. (FNB 2014)
4. The implementation of new banking rules by the Bank for International Settlements which calls for higher rates of capital deposits is another incentive for banks to strive for higher returns.

References


The transformation of the South African credit market


