



'A critical examination of reckless and predatory lending and how the National Credit Act 34 of 2005 seeks to prevent these practices.'

by

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DECLARATION

I, Ovayshea Govender, hereby declare that this dissertation, unless specifically indicated otherwise, is my own work and that all references have been properly made. This dissertation has not been submitted to any other university in full or partial fulfilment of the academic requirements of any other degree or qualifications.

Signed at Durban on the 11th day of June 2019.

Signature: Ovayshea Govender

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ABSTRACT

The credit industry has evolved overtime in South Africa. In March 2006, the National Credit Act (hereafter NCA or the Act) was promulgated after repealing and replacing the Usury Act, Exemption Notices and the Credit Agreements Act as it was acknowledged that a single new credit act will regulate the credit industry. The purpose of the NCA as stated in Section 3 of the Act is to promote and advance the welfare of South Africans and to ensure that the credit industry is fair, transparent, effective and efficient. The Act seeks to promote responsible borrowing and discourage reckless credit granting.

This dissertation analyses the practices of reckless lending and predatory lending which are prevalent in the credit market. The aim is to discuss the NCA and see how it imposes strict laws and regulations in relation to the prohibition of these practices. These include adverse consequences for credit providers who are engaging in reckless lending and predatory lending.

Reckless credit lending is new to South Africa and was only introduced when the NCA came into effect. The Act clearly identifies this practice. Although there is no primary definition provided for predatory lending in the NCA, the Act prohibits practices that clearly constitute predatory lending. The Act ensures that consumers would not be disadvantaged in the credit industry and also provides protection for credit providers if they properly follow the rules and regulations stated in the Act.

The NCA has been amended overtime and is in the process of being amended again. This dissertation will also consider the amendments that deal with the issues of reckless credit lending and predatory lending.

The practices of reckless lending and predatory lending are concepts that have caused difficulties in many economies which is why this dissertation will also provide a comparative analysis on laws in some of these jurisdictions in order to see how they deal with the practices of reckless lending and predatory lending.

CHAPTER 1

INTRODUCTION

1.1 Background

Reckless lending and predatory lending have become recognised in recent times as a serious issue in the credit lending sector. These types of lending practices have adversely affected both consumers and the economy. The Department of Trade and Industry (DTI) introduced the National Credit Act (NCA)¹ to help protect consumers and to regulate the credit industry. The NCA repealed and replaced both the Usury Act² and the Credit Agreements Act³ and became effective on 1 June 2007.

The NCA has introduced a number of strict requirements to combat reckless and predatory lending and severe penalties can be imposed on credit providers should they not adhere to these requirements. These measures are intended to enhance South African consumers' access to credit in the marketplace and eliminate any credit practices that are harmful to the economy. Reckless lending behaviour has become endemic in the global credit industry which results in consumers paying a heavy price for the behaviour of credit providers.⁴

One of the reasons the NCA was promulgated was to act as a protective measure for consumers. This purpose is attained by, amongst other things, promoting responsible credit lending so that over-indebtedness can be avoided in the credit industry and by deterring reckless credit granting by credit providers.⁵ This is achieved by ensuring that consumers are educated about their consumer and credit rights and are given

¹ 34 of 2005 (hereafter "NCA" or the "Act").

² Act 73 of 1968.

³ Act 75 of 1980.

⁴ Coetzee H *The Impact of the National Credit Act on civil procedural aspects relating to debt enforcement* (unpublished LLM thesis, University of Pretoria, 2009) 1.

⁵ S 3 (c) (i) – (iii) and (g).

sufficient disclosure of information so that they will be able to make informed choices.⁶

Previously, during the era of apartheid in South Africa, many South African consumers were denied access to simple financial services.⁷ Access to credit is important as it gives consumers the opportunity to access goods and services which they are unable to currently afford.⁸ Hence, having access to credit is essential for everyone.

South Africa is a developing country.⁹ This means that many South African consumers are uneducated (particularly about financial matters) or receive a low-income. Statistics show that poverty is on the rise in South Africa.¹⁰ Factors leading to the increase in poverty levels include low and weak economic growth, high unemployment rates and consumer prices.¹¹ Consumers, who do not have readily available cash, have to resort to credit in order to purchase everyday necessities. Unfortunately, many consumers also resort to credit to purchase unnecessary things that they cannot afford¹² because consumers do not understand concepts such as interest and fees and are unaware of how expensive credit is.¹³ Unscrupulous financial providers take advantage of the large number of unsophisticated consumers in South Africa,¹⁴ which consequently, causes great financial harm to them.¹⁵

The NCA aims to level the playing field between credit providers and consumers by seeking to ensure that consumers have a far better understanding of what

⁶ S 3 (e) (i) - (ii).

⁷ The Borgen Project 'How credit access in South Africa can change lives' available at: <https://borgenproject.org/credit-access-in-south-africa/> (accessed on 18 February 2019).

⁸ Truter A 'Your legal rights under the National Credit Act' (2016) available at <https://m.polity.org.za/article/your-legal-rights-under-the-national-credit-act-2016-07-06> (accessed on 15 February 2019).

⁹ Schmulow A 'Prohibitions on reckless and predatory lending: lessons from South Africa' (Research working paper submitted to Centre for International Finance and Regulation January 2006) available at https://www.researchgate.net/publication/290574594_Prohibitions_on_Reckless_and_Predatory_Lending_Lessons_from_South_Africa (accessed on 15 February 2019).

¹⁰ Stats SA 'Poverty on the rise in South Africa', available at: www.statssa.gov.za/?p=10334, (accessed on 02 May 2018).

¹¹ Ibid.

¹² Fontinelle A '9 reasons to say no to credit' (2018) available at <https://www.investopedia.com/articles/younginvestors/08/purchase-financing.asp> (accessed on 23 February 2019).

¹³ LeRoc M *Cash in with your money* (2012) 16.

¹⁴ Schmulow A Woker T Van Heerden C 'Curbing Reckless and Predatory Lending: An analysis of South Africa's National Credit Act' (2019) 2 *Journal of Business Law* 1.

¹⁵ Carr JH Kolluri L 'Predatory lending: An overview' (2001) *Financial Services in Distressed Communities* 2.

it means to access credit and to provide them with assistance when problems arise.¹⁶ Important provisions of the Act include language requirements, the establishment of regulatory bodies, the regulation of costs and marketing practices and compulsory credit assessments that must be done prior to credit providers extending credit.

1.2 Purpose of the study

The NCA contains detailed provisions related to reckless lending and, although the NCA does not specifically refer to the concept of predatory lending, there are a number of sections in the Act which are clearly directed at preventing predatory lending. A critical analysis of reckless lending and predatory lending (practices that amount to being predatory) in light of the NCA is relevant in the current state of the credit industry. In 2013, a R300 million fine was imposed on African Bank for reckless lending.¹⁷ According to reports, African Bank targeted millions of low-income South Africans¹⁸ and at least 700 loans that were investigated were found to have been granted recklessly.¹⁹ Furthermore, Capitec Bank, one of the top five banks in South Africa, was also investigated in 2016 when it was alleged of performing reckless lending to over-indebted consumers who were incapable of repaying their loans. It was alleged that Capitec Bank had contravened the Act as it had failed to conduct proper credit assessments before providing credit to consumers.²⁰

The purpose of this study is to analyse the impact of the NCA on practices such as reckless lending and predatory lending, as well as the consequences credit providers will face should they not adhere to the provisions set out in the Act.

¹⁶ The banking association of South Africa 'National Credit Act' available at: <https://www.banking.org.za/consumer-information/legislation/national-credit-act> (accessed on 15 February 2019).

¹⁷ Arde A 'Reckless lending: call to fine African Bank R300m' (2013) available at <https://www.iol.co.za/personal-finance/my-money/banking/reckless-lending-call-to-fine-african-bank-r300m-1467063> (accessed on 20 February 2019).

¹⁸ 'African Bank fined R20m for reckless lending' *News24* 03 October 2013 available at: <https://m.fin24.com/financial-services/african-bank-fined-r20m-for-reckless-lending-20131003> (accessed on 19 February 2019).

¹⁹ Ibid.

²⁰ Salie, F 'Capitec taken to court over 'reckless lending' *Finance 24* 04 May 2016 available at: <https://m.fin24.com/Companies/Financial-Services/capitec-taken-to-court-over-reckless-lending-20160504> (accessed on 02 May 2018).

1.3 Research questions

This dissertation will consider the following questions:

- What is reckless lending?
- What is predatory lending?
- How does the National Credit Act seek to prevent reckless lending?
- How does the National Credit Act seek to prevent predatory lending?
- What are the consequences for credit providers who engage in the practice of reckless lending?
- What are the consequences for credit providers who engage in the practice of predatory lending?

The dissertation will also consider laws in some other jurisdictions that seek to prevent reckless and predatory lending in order to establish whether there are lessons which can be learnt from these other jurisdictions.

1.4 Methodology

This research will be conducted by utilising a full desktop research method. The research will entail analysing legislation (primarily the NCA), reported cases and numerous journal articles, as well as website articles. Whilst website articles will be approached with caution, the internet is regarded as a valuable source of information given the fact that the concepts under discussion are very topical issues at present. The research will provide a critical analysis of the resources mentioned above to evaluate the research questions outlined in paragraph 1.3 above.

1.5 Structure of the dissertation

This dissertation is structured as follows:

Chapter One introduces the study, presents the background and objectives of the study and outlines the research questions and explains the methodology used in this study.

Chapter Two considers appropriate definitions of reckless and predatory lending practices and outlines their essential elements. It also identifies practices in the credit market which are generally identified as reckless and predatory.

Chapter Three discusses the NCA. The chapter begins with a short history to the legislation and provides an outline of its main provisions. It then focuses specifically on the provisions which relate to reckless and predatory lending.

Chapter Four presents a comparative analysis focussing specifically on Canada, the United Kingdom (UK) and the United States of America (USA) which have laws that seek to prevent reckless and predatory lending.

Chapter 5 sets out the conclusion and recommendations.

1.6 Concluding remarks

As discussed above, access to credit is essential as it allows consumers to engage in the marketplace. Most people need to take out a mortgage bond to buy a house or access credit to purchase a motor vehicle.²¹ Many students require student loans to pay for their education and consumers need to be able to borrow money to start a small business.²² Because of the state of the economy in South Africa, many consumers need to access credit in order to buy everyday necessities such as food and clothing. Then there are many consumers who use credit to purchase goods which they cannot afford; that are considered to be luxuries.²³ Unfortunately, South African consumers demonstrates a worrying lack of financial literacy which means that consumers do not understand how expensive credit is and how easy it is to become trapped in a lifestyle of debt.²⁴ This problem is not, however, unique to developing countries. There are also consumers in advanced economies who fail to effectively

²¹ Bieber CR 'Why is credit important' (2018) available at <https://www.creditkarma.com/advice/i/why-is-credit-important/> (accessed on 19 February 2019).

²² Ibid.

²³ Page V 'The psychology behind why people buy luxury goods' (2019) available at <https://www.investopedia.com/articles/personal-finance/091115/psychology-behind-why-people-buy-luxury-goods.asp> (accessed on 29 March 2019).

²⁴ 'South Africans struggling with financial literacy' *Property 24* 13 April 2017 available at <https://www.property24.com/articles/south-africans-struggling-with-financial-literacy/25681> (accessed on 29 March 2019).

grasp these principles.²⁵ Reckless and predatory lending practices take advantage of consumers who do not understand the severe consequences of being unable to repay debt. The NCA has been introduced to promote responsible lending and to prohibit reckless lending and other unfair practices.²⁶ It is therefore very important to establish what practices are regarded as reckless and predatory so that these practices can be eliminated from the marketplace. The next chapter focuses on identifying these unfair practices.

²⁵ Zucci K 'Why financial literacy is so important' (2018) available at <https://www.investopedia.com/articles/investing/100615/why-financial-literacy-and-education-so-important.asp> (accessed on 29 March 2019).

²⁶ The Banking Association of South Africa 'National Credit Act' available at <https://www.banking.org.za/consumer-information/legislation/national-credit-act> (accessed on 15 February 2019).

CHAPTER 2

RECKLESS AND PREDATORY LENDING

2.1 Introduction

During the last century, the credit industry has witnessed a substantial growth in reckless lending and predatory lending practices. Many consumers who are not considered creditworthy have been approved credit they are unable to afford or have been misled into entering credit agreements under the misapprehension that it would help them. The objective of this chapter is to understand the practices of reckless lending and predatory lending. This chapter, therefore, attempts to explain the practices in greater detail and to determine the specific elements with these practices. Furthermore, the chapter also seeks to illustrate examples which are considered to be reckless and predatory. Chapter Three will then focus on how the NCA deals with these practices.

2.2 The definition of reckless lending

Although reckless lending is new in South African law, it is a practice that is identified in many jurisdictions. The *Oxford English Dictionary* explains reckless as 'disregarding the implications of your actions'.²⁷ This definition is regarded as being relevant as it explains a scenario where a credit provider recklessly enters into a credit agreement purposely ignoring the possible consequences of their actions.

Reckless lending can be regarded as gross negligence as the result of engaging in the practice could harm the consumer by making them become over-indebted.²⁸ The reason being, that credit providers not only ignore the consequences of potential consumers, but negligently fails to conduct pre-assessment checks to ensure that the consumer is financially capable of repaying the loan.²⁹ In the USA, reckless lending is

²⁷ Information regarding this definition can be found on the Oxford Learners Dictionary available at https://www.oxfordlearnersdictionaries.com/definition/american_english/reckless (accessed on 12 September 2018).

²⁸ Schmulow Woker Van Heerden (2019) *Journal of Business Law* 2.

²⁹ Vessio, M.L 'Beware the provider of reckless credit' (2009) 22 (2) *Tydskrif vir die Suid-Afrikaanse Reg* 274-289.

defined by the Federal Deposit Insurance Corporation (FDIC) as 'the lack of a fair exchange of value or loan pricing that reaches beyond the risk that a consumer represents or other customary standards.'³⁰

2.2.1 The elements of reckless lending

It is important to identify the elements of reckless lending as it will indicate whether a particular loan has been granted recklessly. These elements include:

- Failure to conduct a credit assessment;
- Reckless intention; and
- An agreement.

(a) Failure to conduct a credit assessment

Credit providers fail to carry out simple financial checks on potential consumers' financial backgrounds prior to granting them new loans and credit cards.³¹ Consumers are often offered sweetheart loans which are loans which have low-interest rates for a limited duration. This motivates consumers to apply for credit even if it is unaffordable. This occurs especially, when interest rates revert back to their normal rates.³² Moreover, reckless lending frequently results when credit providers fail to ask the correct questions and fail to consider all the information when they decide to whom to lend. Jordaan points out that an agreement will also be considered as being reckless if the credit provider enters into the agreement with the consumer even after knowing that the consumer fails to understand and appreciate the risks of the credit agreement.³³ Therefore, the conducting of pre-assessments are just as important as ensuring that consumers understand the financial implications under the agreement

³⁰ Porteous D 'Policy Focus Note 2: Consumer protection in credit markets' (2009) Financial Access Initiative available at <https://www.microfinancegateway.org/p/site/m/template.rc/1.9.41468> (accessed on 23 September 2018).

³¹ Salmon J and Burton J 'In debt? Reckless banks will still offer you a loan: lenders are failing to carry out basic checks on consumers' (2017) available at <https://www.google.co.za/amp/s/www.dailymail.co.uk/news/article-46666186/amp/In-debt-Reckless-banks-offer-loan.html> (accessed on 03 October 2018).

³² Ibid.

³³ Jordaan P *The credit law of South Africa: A guide to consumers, credit users and credit grantors* (2007) 57.

prior to granting credit. If credit providers purposely disregard this, agreements may result in being reckless.³⁴

Credit providers tend to act recklessly towards consumers when it comes to the granting of credit³⁵ because they earn extra revenue when they charge consumers excessive rates and fees. Fitzsimons points out that 'lenders are seen to be utterly blasé about the risks of those consumers falling into the red'.³⁶ Mann explains that even if lenders know that loans are likely to send consumers into debt and may even eventually be written off, they do not care because they make their money back quite quickly by charging huge interest rates and fees. Once this point passes, lenders are 'content to let the chips' of their irresponsible loans 'fall where they may', indifferent to the harm that this may cause to debtors and how this may impact on society around those debtors.³⁷

(b) Reckless intention

Pottow states that

credit agreements are proved to be reckless if the credit provider knew or was reckless to the fact that the consumer will not be able to repay the loan and that the default was not only a foreseeable risk but a reasonably expected result of the debt.³⁸

Fitzsimons concurs with Pottow who indicates that credit providers instead of obeying the rules which consist of reducing risk and preventing default, grant credit to consumers where there is a possibility that they are unable to afford it.³⁹ Hence, this

³⁴ Nortje A 'Reckless credit: Obligations of the credit provider and consumer' (2016) available at <https://www.schoemanlaw.co.za/reckless-credit-obligations-credit-provider-consumer/> accessed on 01 October 2018.

³⁵ Kelly-Louw M 'The prevention and alleviation of consumer over-indebtedness' (2008) 20 *South African Mercantile Law Journal* 204.

³⁶ Fitzsimons J 'Opinion: BoE cannot continue to tolerate reckless lending' available at home.bt.com/lifestyle/money/savings-banking/opinion-boe-cannot-continue-to-tolerate-reckless-lending-11364193702635 accessed on 20 October 2018.

³⁷ See Mann R *Cards, Consumer Debt and bankruptcy Texas Law Review* 2006 quoted by Pottow JAE 'Private liability for reckless consumer lending' (2007) 1 *University of Illinois Law Review* 405-465.

³⁸ *Ibid.*

³⁹ Pottow JAE (2007) *Univ. Ill. Law Rev* 414.

causes credit providers to irresponsibly make decisions and disregard the implications of which they are aware.

(c) An agreement

When reckless lending is determined, the first thing that is established is whether there has been an agreement between the consumer and the credit provider as this indicates the reason the consumer became over-indebted. When reckless credit lending is being investigated, it is always important to look at when the credit provider entered into the agreement as this determines whether or not the consumer was financially able to afford the credit.⁴⁰ Many consumers will become over-indebted due to unforeseen problems such as retrenchment or illness.⁴¹ In such situations, the consumer's financial difficulties cannot be attributable to the actions of the credit provider. Thus, it is necessary to take into account the financial position of the consumer when the agreement was entered into and whether this financial position was contemplated prior to the loan being granted. This means, bearing in mind all monthly commitments with regards to the credit agreement.⁴² Thereafter, the conditions included in the agreement must be reviewed. Pottow explains that the problem is the result of reckless lending by credit providers and not reckless borrowing by consumers.⁴³

2.2.2 Examples of reckless lending practices

Reckless lending is a topical issue in many other jurisdictions. In order to understand the practice from a practical perspective, it is beneficial to examine how other jurisdictions regard these practices.

⁴⁰ Slot PJ 'Reckless credit practice guideline for debt counsellors' (2016) available at <https://www.dcasa.co.za> (accessed on 12 October 2018).

⁴¹ Paile K *The impact of the National Credit Act on household debt levels in South Africa* (unpublished LLM thesis, University of Witwatersrand, 2013) 9.

⁴² Arde A 'Credit providers must properly test affordability' (2015) available at <https://www.iol.co.za/personal-finance/credit-providers-must-properly-test-affordability-1835207> (accessed on 20 January 2019).

⁴³ Pottow JAE (2007) *Univ. Ill. Law Rev* 418.

In 2008, the USA was trending worldwide as the country had incurred a severe financial crash. The crash occurred after the collapse of one of the biggest investment banks namely, Lehman Brothers.⁴⁴ Lehman Brothers was an international financial firm whose bankruptcy, it is alleged, contributed to the recession.⁴⁵ The financial crash was considered to be a catastrophic financial disaster since the Great Depression which transpired in 1929.⁴⁶ The result of the collapse caused chaos in many global economies. Commentators stated that the recession was due to a lack of regulatory frameworks in USA credit markets.⁴⁷ This lack of regulation permitted credit providers to engage in reckless behaviour when it came to credit lending.⁴⁸ Studies demonstrated that 60 per cent of reckless lending practices that occurred in the USA between 2005 and 2007, originated from mortgage loans.⁴⁹ It was further indicated, that banks provided credit to consumers with questionable credentials.⁵⁰ There are certain protocols in place which involves conducting credit checks on consumers prior to granting loans, mortgage bonds or credit, but credit providers disregarded these protocols and still granted credit to consumers who could not afford repayments.

Moreover, before the recession took place, banks were found guilty of lending money to consumers freely on the basis of collateral which in turn resulted in more lending being granted.⁵¹ The lack of regulation and failure to deter practices such as reckless lending is what led to the financial system becoming volatile.⁵² Thus, the system was not strong enough and exposed the American economy to significant risks.⁵³

⁴⁴ Okte MKS 'The financial crisis of 2008 in the USA: An overview' (2012) 62 (1) *Istanbul University, Faculty of Economics* 81.

⁴⁵ Kenton W 'Lehman Brothers' (2018) available at <https://www.investopedia.com/terms/l/lehman-brothers.asp> (accessed on 25 January 2019).

⁴⁶ Amadeo K 'The causes and costs of the worst crisis since the great depression' (2018) available at <https://www.thebalance.com/2008-financial-crisis-3305679> (accessed on 20 October 2018).

⁴⁷ Roubini N '2008 U.S and Global Economic Outlook and Implications for Financial Markets' (2008) available at www.roubini.com (accessed on 20 October 2018).

⁴⁸ Edwards S 'A new debt crisis? Assessing the impact of the financial crisis on developing countries' (Report presented for the Jubilee Debt Campaign) United Kingdom (March 2009).

⁴⁹ Ibid.

⁵⁰ Stossel J 'Governments reckless lending putting US on track for another housing bubble' (2015) available at <https://www.google.co.za/amp/www.foxnews.com/opinion/2015/04/01/governments-reckless-lending-putting-us-on-track-for-another-housing-bubble.amp.html> (accessed on 03 October 2018).

⁵¹ Stiglitz JE 'Interpreting the causes of the great recession of 2008' (2010) in Bank for International Settlements, *Financial System and Macroeconomic Resilience: Revisited 2*.

⁵² Ibid.

⁵³ Ibid.

Reckless lending not only helped to precipitate the collapse, it also left a legacy of toxic debt that has dramatically depressed the world economy.⁵⁴ The most concerning factor was that the credit providers were aware when they had participated in reckless risk-taking and had taken huge gambles.⁵⁵ They knew that they had created a bubble that would eventually burst.⁵⁶

Another example of reckless lending was identified by the Governor of the Bank of England, Mark Carney, in the UK in 2017. He found that automobile dealers were granting credit to consumers who were unemployed and who had questionable credit ratings.⁵⁷ The Bank of England's financial director, Alex Brazier, stated that when credit providers engage in reckless lending practice 'could lead to a spiral of complacency that was similar to the financial crash that occurred in the USA in 2008.'⁵⁸

Research in the UK found that it is a common practice for motorists to apply for credit for new cars and then fail to make repayments. In a recent investigation, it was found that car finance institutions provided £5.5 billion of risky loan debt to financiers.⁵⁹ One example of reckless lending occurs when dealers utilise a contract called the Personal Contract Price (PCP). According to the contract, the dealer contributes around £1000 to purchase price of the car. The contract consists of establishing the value of the car at the outset of the contract, and subsequently, this value is deferred until the termination of the agreement.⁶⁰ The advantage of this contract is that the motorist is given the opportunity to pay a lower value to use the motor vehicle than if they had purchased it on the day. The disadvantage, however, entails the motorists being allowed to have a new car for a number of years in exchange for monthly repayments.⁶¹ At the end of the contract, the motorists are offered the possibility to

⁵⁴ Ibid.

⁵⁵ Stiglitz JE 'Lessons from the global financial crisis of 2008' (2010) 23 (3) *Seoul Journal of Economics* 325.

⁵⁶ Ibid.

⁵⁷ Oliver-City M 'Banks told to reveal reckless lending tactics' (2017) available at <https://www.dailymail.co.uk/news/article-4744918/Mark-Carney-orders-banks-reveal-lending-tactics.html> (accessed on 03 October 2018).

⁵⁸ Ibid.

⁵⁹ Keogh G Norton J Bentley P 'Reckless car loan salesmen exposed: How dealers are luring young drivers into massive debt by offering them top-brand cars with no cash up front' (2017) available at <https://www.dailymail.co.uk/news/article-4659746/Reckless-car-loan-salesmen-offer-new-cars-unemployed.html> (accessed on 18 January 2019).

⁶⁰ Charles Hurst Group 'Personal Contract Purchase' available at <https://www.charleshurstgroup.co.uk/finance/pcp/> (accessed on 18 January 2019).

⁶¹ Keogh G Norton J Bentley P 'Reckless car loan salesmen exposed: How dealers are luring young drivers into massive debt by offering them top-brand cars with no cash up front' (2017) available at

pay off the remainder of the motor vehicle and become the lawful owner or to return the motor vehicle.⁶² The finance company is granted a remedy which consists of making an application for an order called the County Court Judgement. This order allows the finance company to repossess the motor vehicle if the driver defaults in their payment. Moreover, this order also allows for the balance to be taken out regularly from the consumers' income. Such an agreement permits consumers to purchase cars that they in actually cannot afford and this can lead to a debt cycle with the repayments being deducted from their monthly salaries leaving them with a reduced amount for living expenses.⁶³ This then leads to a cycle of debt as consumers then have to borrow more money to pay for their everyday expenses.

There is also a model of lending which is referred to as 'originate and distribute'. This practice permits banks to sell or securitise loans instead of it being retained on their records.⁶⁴ Unfortunately, this practice promotes reckless lending.⁶⁵ The model has two characteristics. Firstly, 'credit providers do not retain the loans and mortgages they originate hence, profits are earned on the securitisation fee rather than loan interest paid over the duration of the loan.'⁶⁶ Secondly, 'since originators do not retain any interest in the loans and mortgages, they have a reduced reason to ensure the credit quality of the consumer is stable.'⁶⁷ This proves how the model encourages financial organisations to endorse reckless lending which then has an adverse effect on consumers.

It is apparent that reckless lending can have dire implications and the financial crisis that has transpired in the USA has obviously revealed this.⁶⁸ Reckless lending means that money is lent to consumers who are incapable of repaying their loans. With these loans, consumers purchase houses, cars or goods that they cannot afford, and when they fail to make repayments, they suffer severe repercussions which include being

<https://www.dailymail.co.uk/news/article-4659746/Reckless-car-loan-salesmen-offer-new-cars-unemployed.html> (accessed on 18 January 2019).

⁶² Ibid.

⁶³ Ibid.

⁶⁴ Conghui Chen *The incentive structure of the originate-to-distribute model of lending, bank credit supply and risk taking behaviour of U.S. commercial banks* (unpublished PhD thesis, University of Nottingham, 2015) 1.

⁶⁵ McIlroy DH 'Regulating risk: A measured response to the banking crisis' (2008) 9 *Journal of Banking Regulations* 288.

⁶⁶ Palley TI 'From Financial Crisis to Stagnation: The destruction of shared prosperity' (2013) *Business and Economics* 25.

⁶⁷ Ibid.

⁶⁸ McIlroy DH (2008) *Journal of Banking Regulations* 288.

entangled in substantial debt and entering a vicious circle of debt.⁶⁹ Reckless lending not only affects society; it creates a risk which can affect the financial stability of the economy.⁷⁰

Reckless lending occurs because lenders, rather than concentrating on granting good standard loans and customer services, become fixated on the lending volumes.⁷¹ Reckless lending is a practice that has a harmful effect on both consumers and the economy overall and it can eventually lead to the demise of a credit lender as demonstrated in the case of African Bank.⁷²

2.3. The definition of predatory lending

According to the *Oxford English Dictionary*, the term 'predator' is defined as a 'person who ruthlessly exploits others.'⁷³ In credit lending practices, a predatory lender is regarded as a credit provider who uses deceptive methods to persuade a consumer into concluding a credit agreement which is unnecessary and can lead consumers into being exploited.⁷⁴ Predatory lending is a dangerous practice; the results of which are not felt immediately.⁷⁵ It can take many years for consumers to realise that they cannot afford to make their repayments as they had been deceived into entering a 'too good to be true' credit agreement.⁷⁶

It is generally the consumers who are poor and vulnerable that are easily targeted as they are seen to be easily manipulated. Therefore, legislative protection is essential in the credit market.⁷⁷ The FDIC explains the practice as 'enforcing credit terms that

⁶⁹ Ibid.

⁷⁰ Ibid.

⁷¹ Wallace T 'British banks returning to reckless lending warns banking chief' (2015) available at <https://www.telegraph.co.uk/finance/11687143/British-banks-returning-to-reckless-lending-warns-banking-chief.html> (accessed on 18 January 2019).

⁷² Arde A 'Reckless lending: call to fine African Bank R300m' (2013) available at <https://www.iol.co.za/personal-finance/my-money/banking/reckless-lending-call-to-fine-african-bank-r300m-1467063> (accessed on 15 November 2018).

⁷³ The definition can be found on the Oxford Living Dictionary website available at <https://en.oxforddictionaries.com/definition/predator> (accessed on 30 September 2018).

⁷⁴ Brooks C 'What is Predatory Lending' (2013) available at <https://www.businessnewsdaily.com/4348-predatory-lending.html> (accessed on 20 December 2018).

⁷⁵ Roos D 'Effects of Predatory lending' (2007) available at <https://money.howstuffworks.com/predatory-lending2.htm> (accessed on 16 August 2018).

⁷⁶ Ibid.

⁷⁷ DTI 'Making Credit Markets Work, A policy framework for consumer credit' available at www.ncr.org.za/publications/Background_NCA_docs/CreditLawReview.pdf (accessed on 15 November 2018).

result in being unfair and abusive on consumers.⁷⁸ Engel and McCoy describe predatory lending as harsh practices that generally prey on weak consumers and lead to personal losses, such as economic failure, poverty, and foreclosure.⁷⁹ To further expand this statement, Goldstein defines predatory lending as comprising three sets of traits:

Those relating to the terms and consequences of the loan; the manner in which the consumer obtained the loan; and the power imbalance between the lender and the consumer, with reference to the consumer's experience and access to information.⁸⁰

2.3.1 The elements of predatory lending

For the purpose of understanding the practice of predatory lending, it is essential to first identify the elements of the practice. These include:

- Misrepresentation;
- Intention to defraud; and
- Prejudice or potential prejudice to consumers.

(a) Misrepresentation

The concept of misrepresentation is defined as a 'perversion or distortion of the truth.'⁸¹ Credit providers can deceive consumers into believing that they are acting in the best interests of the consumers when in reality they are, indeed profiting themselves.⁸² A classic practice occurs when the credit provider depicts insufficient or incorrect facts to consumers or deliberately disguises the actual costs, risks and conditions of a credit agreement. The credit provider is seen to ignore information in order for the consumer to enter into an agreement. In particular, the credit provider

⁷⁸ HG Legal Resources 'Understanding Predatory Lending' available at <https://www.hg.org/legal-articles/understanding-predatory-lending-23288> (accessed on 17 January 2019).

⁷⁹ Engel KC McCoy AP 'A Tale of Three Markets: The Law and Economics of Predatory Lending' (2002) *Boston College Law School* 1260.

⁸⁰ Goldstein I 'Why the Poor Pay More: How to Stop Predatory Lending' in Gregory DSquires (ed), *Business & Economics* (2004) 40.

⁸¹ Snyman *Criminal Law* 5th ed (2008) 532.

⁸² Ibid.

may make incorrect statements or intentionally disregard the fact that the information is incorrect.⁸³ A research study has revealed that almost 70 per cent of recent defaults in the USA consisted of fraudulent misrepresentation within the application.⁸⁴ Moreover, from 1997 to 2006, in the USA studies have indicated that nearly three million loans that contained misrepresentations were five times more likely to go into default.⁸⁵ Unfortunately, because several consumers trust professionals, credit providers tend to, intentionally, fail to reveal relevant information to consumers with the purpose of making a profit.⁸⁶

(b) Intention to defraud

The intention to defraud generally occurs when credit providers intend to deceive consumers.⁸⁷ There is a specific intention to cheat consumers which causes them financial loss whilst bringing financial gain to the lender.⁸⁸ The defrauding of consumers is the primary problem that results from predatory lenders scheming to defraud and deceive innocent consumers.⁸⁹ In the USA, most fraud related issues are associated with mortgage fraud. Mortgage fraud has become more prevalent over time and is beginning to be a big concern for many consumers.⁹⁰ Mortgage fraud is defined as deliberate deception and misrepresentation where one party deceives another by distorting data, facts and figures.⁹¹ Fraud is a common predatory practice and as will be seen in Chapter Four, there are strict legislative practices in place to deal with this in South Africa.

⁸³ Oaktree Law 'Broker and lender misrepresentation' available at <https://oaktreelaw.com/real-estate/broker-lender-misrepresentation/> (accessed on 18 January 2019).

⁸⁴ HG Legal Resources 'Understanding Predatory Lending' available at <https://www.hg.org/legal-articles/understanding-predatory-lending-23288> (accessed on 17 January 2019).

⁸⁵ Ibid.

⁸⁶ McFarlin LLP 'Broker and Lender misrepresentation' available at <https://www.mcfarlinlaw.com/business-advocate/real-estate-litigation-business/broker-and-lender-misrepresentation/> (accessed on 19 January 2019).

⁸⁷ USLegal 'Intent to defraud law and legal definition' available at <https://definitions.us.legal.com/i/intent-to-defraud/> (accessed on 18 May 2019).

⁸⁸ Ibid.

⁸⁹ Steele EH 'Fraud, dispute, and the consumer: responding to consumer complaints' (1975) 123 *University of Pennsylvania Law Review* 1107.

⁹⁰ 'Mortgage Loan 'What is mortgage fraud' available at <https://www.mortgageloan.com/mortgage-fraud/about> (accessed on 18 May 2019).

⁹¹ Finney D 'Mortgage fraud: understanding and avoiding it' available at <https://www.investopedia.com/articles/mortgages-real-estate/10/how-mortgage-fraud-affects-markets.asp> (accessed on 18 May 2019).

(c) Prejudice to consumers

Prejudice occurs in situations where for example, a credit provider lies about certain facts and it results in a consumer being harmed.⁹² It is recognised that predatory credit providers often target a certain category of consumers precisely, consumers that are identified with low income, the elderly and less-illiterate households.⁹³ This is due to the fact that predatory lenders know that such consumers usually have limited access to loans and other services⁹⁴ and their lack of financial education means that they are unaware of the dangers of taking out such loans.

To further illustrate this point, predatory credit providers persuade consumers who are financially vulnerable into believing that their financial situations will be improve if they enter into credit agreements, but in actuality, the agreements may result in being abusive, deceptive and unfair which can cause consumers to become prejudiced.

Credit providers often argue that such loans have higher interest rates, stringent terms and conditions and higher fees because these vulnerable communities indicate higher risk factors⁹⁵ and are often incapable of providing any security for their loans.

2.3.2 Predatory lending practices identified in other jurisdictions

In order for predatory lending to be properly understood, it is important to note how other jurisdictions interpret the concept.

In the USA, predatory lending is prominent in the subprime lending industry and is defined as 'granting credit to consumers who display qualities representing a considerably higher risk of default than conventional bank lending consumers.'⁹⁶ Subprime lending and predatory lending are very similar in that both practices can cause potential abuse of consumers. A common feature they both entail is charging consumers higher than standard interest rates.⁹⁷ Stillitz points out that one of the causes of the 2008 economic recession was because legislators failed to take any

⁹² Snyman *Criminal Law* 5th ed (2008) 535.

⁹³ Ferguson AB 'Predatory lending: Practices, remedies and lack of adequate protection for Ohio consumers' (2000) 48 *Cleveland State Law Review* 615.

⁹⁴ Ferguson AB (2000) *Clev. St. L. Rev.* 615.

⁹⁵ Ibid.

⁹⁶ Interagency Guidance on Subprime Lending March 1999.

⁹⁷ Ibid.

action against the persuasive practice of predatory lending.⁹⁸ Higher interest rates made it difficult for many consumers to repay their loans or even refinance their mortgage loans when balloon payments were due.⁹⁹ Balloon payments are payments which, when due, are equal to or greater than the principal amount of the loan.¹⁰⁰ This eventually leads to a continuous, vicious debt cycle as consumers have to borrow more money in order to pay off existing debt.¹⁰¹

In Australia, there is a concept called fringe credit. Fringe credit is high-cost credit that is granted by non-mainstream credit providers to consumers.¹⁰² This practice has a high risk of being predatory or resulting in abusive lending practices.¹⁰³ Furthermore, this practice is regarded as being 'essentially opportunistic' because it permits credit providers to exploit consumers' weaknesses.¹⁰⁴ Fringe credit has fewer standards for unemployed or low-income consumers and does not necessarily exclude a consumer from receiving credit.¹⁰⁵ Consequently, this practice is regarded as being similar to payday lending.

Payday lending is when credit providers grant a small loan to a consumer if they are temporarily finding it financially difficult.¹⁰⁶ These loans enable consumers to borrow a certain sum of money, generally a small amount which is possible to repay when they receive their monthly income. The predatory feature is exposed when credit providers give consumers the opportunity to extend the loan. This results in additional costs, as consumers become further indebted and find themselves in a position where they cannot afford to repay the original loan at a later date.¹⁰⁷ Consequently, payday lending is seen to be predatory because no financial checks are done prior to providing these loans. Thus, it is easy for consumers who are in a financial dilemma to become vulnerable.

⁹⁸ Stiglitz JE (2010) *Financial System and Macroeconomic Resilience: Revisited* 9.

⁹⁹ Ibid.

¹⁰⁰ Ferguson AB (2000) *Clev. St. L. Rev.* 611.

¹⁰¹ Ibid.

¹⁰² Ali P McRae M Ramsay I 'The politics of payday lending regulation in Australia' (2013) 39 (2) *Monash University Law Review* 416.

¹⁰³ Ibid.

¹⁰⁴ Ibid.

¹⁰⁵ Ibid.

¹⁰⁶ Pritchard J 'What you need to know about payday loans' (2018) available at: <https://www.thebalance.com/payday-loans-315516> (accessed on 24 August 2018).

¹⁰⁷ Ibid.

Payday lenders often intimidate consumers into extending their loans and harass consumers who are heavily indebted.¹⁰⁸ Consumers are unable to determine what constitutes being predatory which is why they become easily targeted. Therefore, in order for the practice of predatory lending to be restricted, it is vital to identify what practices are regarded as predatory lending.

2.3.3 Practices that are regarded as being predatory

In the USA, the practices below are primarily recognised as predatory lending practices. These include:

- a. Equity stripping;
- b. Rate-risk disparities; and
- c. Excessive foreclosures.

(a) Equity stripping

Equity stripping is a set of strategies designed to reduce overall equity in property. When used as a predatory lending mechanism, equity stripping is exercised against homeowners facing foreclosure.¹⁰⁹ For example, a predatory investor buys the property from the homeowner under the threat of foreclosure and agrees to lease the property back to the homeowner who may then continue to use the property as a residence. This is a predatory practice because the predatory investor takes advantage of property owners who are vulnerable as they have limited resources and information.¹¹⁰

(b) Rate-risk disparities

Rate-risk disparities occur when consumers are charged fees that are considered to be unreasonable. For example, credit providers might charge consumers interest rates

¹⁰⁸ Ibid.

¹⁰⁹ Chen J 'Equity Stripping' (2018) available at <https://www.investopedia.com/terms/e/equity-stripping.asp> (accessed on 19 May 2019).

¹¹⁰ Ibid.

that are higher than what their credit histories would show is acceptable.¹¹¹ These disparities are commonplace in the subprime market. A study which was conducted in the USA, indicated that subprime loans charge an extra one per cent in interest that could not be explained by credit risk.¹¹²

(c) Excessive foreclosures

Many consumers lose their homes due to high foreclosure rates by predatory lenders. Credit providers grant consumers loans even if they are aware that consumers cannot afford to make repayments causing consumers in losing their homes as they are unable to pay the excessive rates that have been charged.¹¹³ When many homes are sold following foreclosure this will have an effect on surrounding neighbourhoods as well because the value of many homes will decrease.¹¹⁴ The equity held by neighbouring homeowner's drops as a result of high rates of foreclosure.¹¹⁵

Although the above-mentioned are classified as primary predatory practices, the practice can be acknowledged by other methods, such as high-interest rates which occurs when interest rates reach an immoral stage.¹¹⁶ Predatory loans often have high-interest rates that surpass the amount required, it includes excessive fees, recurring fees and even disregarding the consumer's capability to repay the debt.¹¹⁷ If consumers are finding it difficult to repay their debts, credit providers promote the option of refinancing their debt with a larger loan but these loans often comprise in consumers owing more after having paid further fees. This practice is known generally as loan flipping.¹¹⁸

¹¹¹ Stein E 'Quantifying the economic cost of predatory lending' (2001) available at <https://www.responsiblelending.org/pdfs/Quant10-01.pdf> (accessed on 02 October 2018).

¹¹² Ibid.

¹¹³ Drury, LL 'Predatory lending and its impact on consumer credit' (2009) 10 *Loyola Journal of Public Interest Law* 142.

¹¹⁴ Stein E 'Quantifying the economic cost of predatory lending' (2001) available at <https://www.responsiblelending.org/pdfs/Quant10-01.pdf> (accessed on 02 October 2018).

¹¹⁵ Ibid.

¹¹⁶ Ferguson AB (2000) *Clev. St. L. Rev.* 611.

¹¹⁷ Forrester JP 'Still mortgaging the American dream: Predatory Lending, pre-emption, and federally-supported lenders' (2006) 74 (4) *University of Cincinnati Law Review* 14.

¹¹⁸ Ibid.

2.4 The impact of reckless lending and predatory lending

As indicated above, the practices of reckless lending and predatory lending has a massive effect on consumers which thereafter tends to have a chain reaction in which credit providers and the economy suffers.

(a) Impact on consumers

Reckless lending impacts consumers who have become over-indebted as they cannot afford to meet their monthly obligations.¹¹⁹ When over-indebted consumers defaults on their payments, it results in them being in arrears and paying more interest.¹²⁰ This then causes their debts to increase even in circumstances where they may be trying to pay off their debts.

Poverty is prevalent in many jurisdictions and is seen to be a contributing factor to over-indebtedness.¹²¹ It is recognised that reckless lending leads to over-indebted consumers. It is usually vulnerable consumers who are targeted which means that over-indebted consumers' debt repayments and living expenses exceed the consumers' income.¹²² Therefore, consumers can easily fall into a poverty trap, as their debt spirals and becomes widespread.

Predatory lending has a negative impact on consumers' finances. Credit providers profit from this practice however, consumers are exploited and deceived, which makes it difficult for them to repay their debts.¹²³ This practice involves credit providers granting exorbitant loans and profiting when consumers default.¹²⁴ Predatory lenders

¹¹⁹ Potgieter M 'The negative impact of reckless lending on consumers' (2014) available at <https://www.debtsafe.co.za/negative-impact-reckless-lending-consumers/> (accessed on 20 August 2018).

¹²⁰ Zero Debt 'Be weary of reckless lending when applying for credit' available at <https://www.zerodebt.co.za/weary-reckless-lending-applying-credit/> (accessed on 13 November 2018).

¹²¹ Information regarding this can be found on 'Effects of Over-Indebtedness' available at reckless-lending.co.za/effects-of-over-indebtedness/ (accessed on 24 November 2018).

¹²² 'You may be in a debt trap due to reckless lending' (2010) *Personal Finance* 16 May 2010 available at <https://www.iol.co.za/personal-finance/you-may-be-in-a-debt-trap-due-to-reckless-lending-99848> (accessed on 24 November 2018).

¹²³ Kirkham E 'Run from these 7 predatory lending warning signs' (2016) available at <https://studentloanhero.com/featured/predatory-lending-warning-signs/> (accessed on 18 August 2018).

¹²⁴ Kirkham E 'Run from these 7 predatory lending warning signs' (2016) available at <https://studentloanhero.com/featured/predatory-lending-warning-signs/> (accessed on 20 December 2018).

benefit from consumers who are unable to access loans through legitimate financial institutions.¹²⁵ Usually, such credit providers offer loans that are exorbitant (but this is often hidden from the consumer) and with exceptionally high-interest rates. Some such loans may even be unlawful.¹²⁶ Even though many informal credit providers are prominent when it comes to engaging in predatory lending, large legitimate financial institutions are also involved in predatory lending. An example is Wonga Finance which is a financial institution that functions in South Africa, the UK, Poland and Spain. Wonga Finance which is the UK's largest payday lender, allegedly charged vulnerable consumers excessive rates.¹²⁷ In 2014, the company had to write off a large number of loans that had been provided to consumers after admitting that it had granted loans to consumers who were unable to afford them.¹²⁸ In the same year, the Financial Conduct Authority (FCA), in the UK, came to a decision to introduce firmer measures when it came to affordability assessments and implementing a cap on payday loans.¹²⁹ South Africa too has introduced stringent measures to regulate these practices which is discussed in Chapter Four.

Consumers who cannot obtain credit at legitimate financial institutions can seek financial assistance from illegal lenders, and in South Africa, from credit providers who are referred to as *mashonisas*. Mashonisas are regarded as informal creditors who provides small loans to consumers in the community¹³⁰ and if consumers fail to get loans granted by them, they may further seek service from micro-lenders. Micro-lenders are credit providers who provide small loans to consumers in need which is generally known as micro-credit,¹³¹ and even though they play a beneficial part in society, these loans are generally considered to be predatory. It is important to note that micro-loans are an authentic form of credit that enhance the economy and offer

¹²⁵ Ali McRae Ramsay (2013) *Monash Univ. Law Rev.* 416.

¹²⁶ Simon JM 'Beware of predatory lending' (2007) available at <https://www.creditcards.com/credit-card-news/predatory-lending-practices-1265.php> (accessed on 20 August 2018).

¹²⁷ 'UK's payday lender Wonga collapses with 'few tears shed' *Business Day* 31 August 2018 available at <https://www.businesslive.co.za/bd/companies/2018-08-31-uks-payday-lender-wonga-collapses-with-few-tears-shed/> (accessed on 15 November 2018).

¹²⁸ Stickings M 'Payday loans firm Wonga collapses into administration after a surge in compensation claims' (2018) available at <https://www.dailymail.co.uk> (accessed on 08 September 2018).

¹²⁹ *Ibid.*

¹³⁰ McCain N 'Mashonisas make good profit on loans' (2018) available at <https://m.news.24.com/SouthAfrica/Local/City-Vision/mashonisas-make-good-profit-on-loans-20180606> (accessed on 20 August 2018).

¹³¹ Pritchard J 'Micro lending definition and examples' (2018) available at <https://www.thebalance.com/microlending-315625> (accessed on 22 August 2018).

assistance to low-income consumers. Although, the issue at hand is that in these loans high-interest rates and extra fees, are purposely concealed and it results in a detrimental effect on the financial health of consumers. This not only has an impact on the consumers themselves but will also impact on their families and society at large.

(b) Impact on credit providers

The practice of reckless lending may also have serious consequences for credit providers, which will occur when consumers default on payments. Financial firms cannot reclaim their costs when consumers default on payments.¹³²

African Bank in South Africa, in 2014, collapsed due to reckless lending because it granted credit to over-indebted consumers.¹³³ In addition, the bank paid a substantial fine when it was referred to the National Consumer Tribunal for a hearing into reckless lending. The National Credit Regulator also requested that the National Consumer Tribunal order that:¹³⁴

- a. Loans to be written off where they were granted at a time consumers could not afford the credit;
- b. The records of affected consumers be cleared by the credit bureaus; and
- c. Any court judgements obtained by African Bank against consumers who were victims of reckless lending be rescinded.

It is clear from the above order that African Bank would suffer serious financial implications as a result of engaging in reckless lending.¹³⁵ Moreover, investors will be wary when investing in such a bank. As an additional punitive measure, African Bank's

¹³² Salmon J and Burton J 'In debt? Reckless banks will still offer you a loan: lenders are failing to carry out basic checks on consumers' (2017) available at <https://www.google.co.za/amp/s/www.dailymail.co.uk/news/article-46666186/amp/In-debt-Reckless-banks-offer-loan.html> accessed on (03 October 2018).

¹³³ 'Cash repayments part of African Bank collapse' *Finance 24* 15 September 2014 available at <https://m.fin24.com/Companies/Financial-Services/Cash-repayments-part-of-African-Bank-collapse-20140915> (accessed on 17 January 2019).

¹³⁴ Arde A 'Reckless lending: call to fine African Bank R300m' (2013) available at <https://www.iol.co.za/personal-finance/my-money/banking/reckless-lending-call-to-fine-african-bank-r300m-1467063> (accessed on 17 January 2019).

¹³⁵ When a bank is put under curatorship, a curator is appointed to take control over the full management functions of the bank with the purpose of rehabilitation. (Rossouw J 'What happens when a bank is put into curatorship' (2018) <https://mg.co.za/article/2018-03-18-what-happens-when-a-bank-is-put-into-curatorship> accessed on 26 January 2019).

shares were suspended from the JSE, and the institution was placed under curatorship.¹³⁶

Another example of the problems of reckless lending occurred in 2016 when Viceroy Research, a USA firm, accused Capitec Bank of being an institution that 'massively understated defaults and disguising as a community microfinance provider.'¹³⁷ The result of the accusation led to a 25 per cent decline in its share price in 24 hours.¹³⁸

Another vital factor is the issue of bankruptcy. Increased consumer debt contributes significantly to bankruptcy.¹³⁹ The 2008 financial crash in the USA produced a worldwide catastrophe in many economies internationally. Reckless lending and predatory lending practices were viewed as contributing factors towards the financial crash. When Lehman Brothers filed for bankruptcy with almost \$700 billion of debt, many investors became sceptical of helping the firm reform.¹⁴⁰ Since the company was internationally recognised, it meant that investors internationally lost their money as a result of the bankruptcy. Financiers in the USA had engaged in subprime lending, and when consumers began to default, the risk on the financial institutions began to rise. This meant that financial lending institutions began to charge excessive rates and when consumers defaulted, the institutions lost money which resulted in the company filing for bankruptcy. Not only were investors hesitant but so were consumers as the crash 'shook the market confidence to its core and caused people to believe the whole system could blow up.'¹⁴¹

¹³⁶ Giamporcaro S 'Lest we forget-lessons from African Bank' (2017) available at <https://gsb.uct.ac.za/pr-lessons-from-african-bank> (accessed on 18 January 2019).

¹³⁷ Mkentaye L 'Capitec bank accused of being a loan shark' (2018) available at <https://www.iol.co.za/business-report/companies/breaking-capitec-bank-accused-of-being-a-loan-shark-13008646> accessed on (20 January 2019).

¹³⁸ Mchunu S 'Capitec share price hit hard after Sarb investigation' (2018) available at <https://iol.co.za/business-report/companies/capitec-share-price-hit-hard-after-sarb-intervention-1581239> accessed on (20 January 2019).

¹³⁹ Pottow JAE (2007) *Univ. Ill. Law. Rev.* 409.

¹⁴⁰ Chu B 'Financial crisis 2008: How Lehman Brothers helped cause the worst financial crisis in history' (2018) available at <https://www.independent.co.uk/news/business/analysis-and-feature/financial-crisis-2008-why-lehman-brothers-what-happened-10-years-anniversary-a8531581.html> (accessed on 25 January 2019).

¹⁴¹ Straders A 'The Lehman Brothers collapse and how it's changed the economy today' (2018) available at <https://www.thestreet.com/markets/bankruptcy/lehman-brothers-collapse-14703153> accessed on (25 January 2019).

(c) Impact on the economy

Over-indebtedness results in lower productivity rates in companies. If there is no contribution being made to the workplace, it can affect the progress and success of companies.¹⁴² Due to great competition in the credit industry, credit providers participate in reckless practices disregarding the fact as to how it would impact on the financial condition of the economy.¹⁴³

The consequences of predatory lending are underrated. The practice has resulted in loss for both individuals and the economy.¹⁴⁴ Specifically, when financial institutions go through suspension or become insolvent, many employees become retrenched and unemployed. This becomes problematic for many households as breadwinners are no longer in stable financial positions; leading consumers to resort to extreme measures such as applying for numerous loans they know they cannot afford. As discussed, predatory lending in the USA is predominant in the subprime mortgage market where consumers used the collateral in their homes for debt consolidation or other consumer credit purposes.¹⁴⁵ This practice was underestimated as it targeted and manipulated a specific population group.¹⁴⁶ Research indicated that high foreclosure rates on subprime loans and other predatory practices demonstrated that predatory lending was a serious problem facing lower income, minority and elderly families in both rural and urban areas in the USA.¹⁴⁷

More efficient policies that enable consumers to ascertain immediately when they are being misled need to be in place to eradicate this practice. Predatory practices can every so often lead to income inequality between individuals in the economy which is detrimental because it shows unfairness amid people who are wealthy and those who

¹⁴² Information regarding this can be found on 'Effects of over-indebtedness' available at reckless-lending.co.za/effects-of-over-indebtedness/ (accessed on 13 October 2018).

¹⁴³ Ibid.

¹⁴⁴ Roos D 'Effects of Predatory lending' (2007) available at <https://money.howstuffworks.com/predatory-lending2.htm> (accessed on 18 January 2019).

¹⁴⁵ Fishbein A Bunce H 'Subprime market growth and predatory lending' (2000) *Housing Policy in the New Millennium* 273.

¹⁴⁶ Goldstein D 'Understanding predatory lending: Moving towards a common definition and workable solutions' (2000) *Harvard Civil Rights-Civil Liberties Law* 7.

¹⁴⁷ Fishbein Bunce (2000) *Housing Policy in the New Millennium* 273.

are not.¹⁴⁸ This can cause poor economic growth, a rise in crime rates and even increased levels of poverty.

2.5 Conclusion

From the above discussion, it is evident that while the practices are regarded as being similar, they are distinctive practices. Thus, many researchers discuss both reckless and predatory lending. Reckless lending disregards a consumer's situation while predatory lending preys upon those situations.¹⁴⁹ Predatory lending usually leads to reckless lending as vulnerable consumers are persuaded into taking out loans and then when they do apply for loans, credit providers fail to conduct proper background checks to see whether or not they are creditworthy.

As a result, many jurisdictions have implemented laws to control such practices. Participating in these practices is considered as being negligent and morally unacceptable which is why there needs to be stricter legislation for the modern credit landscape.¹⁵⁰

The implications of reckless and predatory lending has supposedly caused the tragedy of the Marikana massacre in South Africa in 2012.¹⁵¹ Mine workers employed at the Lonmin Mine were on strike because they were demanding a minimum wage of R12 500. The inquiry indicated that these demands was made because mine workers were over-indebted that their entire salaries were used to repay their debt.¹⁵² Therefore, they required an increase in salary. The mine contended that the miners was, as a matter of fact, being paid well over the minimum wage but since they have emoluments attachment orders on their salaries, the money they had left was sometimes close to nothing and as a result had to obtain further loans from micro-lenders and caused the workers to enter a spiral of debt. The disputes between mine

¹⁴⁸ Demanyank Y 'Income Inequality: Time for predatory lending laws?' (2005) available at <https://www.stlouisfed.org/publications/regional-economist/october-2006/income-inequality-time-for-predatory-lending-laws> (accessed on 12 October 2018).

¹⁴⁹ Schmulow Woker Van Heerden (2019) *Journal of Business Law* 3.

¹⁵⁰ Ibid.

¹⁵¹ Bateman M 'Microcredit and Marikana: How they are linked' (2012) *Independent Online* available at: <https://www.iol.co.za/the-star/microcredit-and-marikana-how-they-are-linked-1385126> (accessed on 24 August 2018).

¹⁵² Steyn L 'Marikana miners in debt sinkhole' *Mail and Guardian Online* 07 September 2012 available at <https://mg.co.za/article/2012-09-07-00-marikana-miners-in-debt-sinkhole> (accessed on 13 November 2018).

workers and the police had resulted in a massacre where eight innocent people lost their lives.¹⁵³

With regards to this event, the Minister of Finance, Praveen Gordhan, stated that 'predatory lending produces overly-indebted consumers, endangers livelihoods, and can trap people in a cycle of poverty.'¹⁵⁴This is why the NCA was implemented; to address such practices. The intention of the Act is to ensure that consumers are effectively protected and that the prevention mechanisms set out in the Act are economically sustainable.¹⁵⁵ The next chapter will focus on the NCA by explaining the history of South Africa's consumer credit, the extensive consumer protection measures of the Act and the consequences for guilty credit providers who engage in reckless and predatory practices.

¹⁵³ Schmulow Woker Van Heerden (2019) *Journal of Business Law* 16.

¹⁵⁴ Ibid.

¹⁵⁵ Ibid.

CHAPTER 3

THE NATIONAL CREDIT ACT

3.1 Introduction

The National Credit Act (NCA) was introduced into South African law in order to regulate the granting of credit. The regulation of reckless and predatory lending is among the main purposes of the Act; therefore the purpose of this chapter is to discuss how the NCA regulates these practices. The chapter will commence with a short history of the legislation; then it will focus specifically on those provisions that deal with reckless and predatory lending. The chapter concludes with a discussion of the consequences for credit providers who engage in these prohibited practices.

3.2 A short history to the NCA

Prior to the introduction of the NCA, there were several different Acts which regulated the credit industry. It is important to understand the concept of credit and these Acts themselves to know why they were repealed.

Credit is a crucial tool for the growth of an economy and has been in use for centuries.¹⁵⁶ In many countries, access to credit benefits poor consumers who are unable to buy goods immediately.¹⁵⁷ Otto explains that the term credit refers to 'a deferral of payment of a sum of money or a promise to advance or pay money.'¹⁵⁸

Many consumers are unable to purchase expensive items with cash such as houses or furniture; therefore having access to credit enables consumers to purchase goods or facilities before the full amount is paid¹⁵⁹ although, consumers will typically have to pay a levy known as interest. Credit has evolved over time, so legislation in the credit

¹⁵⁶ Keats R 'Understanding the role of credit in the economy' (2015) available at <https://marketrealist.com/2015/09/understanding-role-credit-economy> (accessed on 15 November 2018).

¹⁵⁷ Kagan J 'Consumer Credit' (2019) available at <https://www.investopedia.com/terms/c/consumercredit.asp> (accessed on 15 May 2019).

¹⁵⁸ Otto JM 'The National Credit Act explained' (2006) 12.

¹⁵⁹ DTI 'Making Credit Markets Work, A policy framework for consumer credit' available at www.ncr.org.za/publications/Background_NCA_docs/CreditLawReview.pdf (accessed on 15 November 2018).

market needed to be amended. Many credit providers used deceptive marketing practices that resulted in consumers entering into credit agreements that were both unnecessary and unaffordable. Owing to a need to replace existing legislation, the DTI introduced the NCA.

The NCA introduced a whole new law for regulating the granting of credit in South Africa.¹⁶⁰ The Act became fully operative in June 2007 and the legislation which the NCA repealed and replaced included:

- The Credit Agreements Act 75 of 1980
- The Usury Act 73 of 1968
- The Exemption Notices

The list illustrates the different pieces of legislation which governed different aspects of credit agreements prior to the introduction of the present Act. The Credit Agreements Act governed the purchase of specific moveable property and the Usury Act governed the interest which could be charged on loans of money. In particular, the Usury Act placed a limit on the amount of interest which could be charged. This limit then discouraged credit providers from lending money to poor consumers who were regarded as high-risk consumers.¹⁶¹ Consequently, many poor consumers did not have access to credit and often turned to unregulated and unscrupulous money lenders.¹⁶² In order to encourage regulated credit providers, such as the banks, to lend to poor consumers, the government then introduced the Exemption Notices to the Usury Act. The Exemption Notices granted an exemption from the stringent conditions imposed by the Usury Act to those credit providers who were prepared to grant small loans to consumers. Credit providers were not restricted by the limitations on the amount of interest which could be charged; implying that credit providers could seek any interest rate they wished to have.¹⁶³ The rationale behind this was because of the difficulties consumers were facing when trying to access credit.¹⁶⁴

¹⁶⁰ *Desert Star Trading 145 (Pty) Ltd v No 11 Flamboyant Edleen CC* 2011 2 SA 266 (SCA) 268

¹⁶¹ Kelly Louw (2008) *SA Merc Law* 204.

¹⁶² Botha LG *A discussion of access to credit in South Africa with specific reference to reckless lending and over-indebted consumers* (unpublished LLM thesis, University of Kwa-Zulu Natal, 2014) 11.

¹⁶³ *Ibid.*

¹⁶⁴ *Ibid.*

3.2.1 The Credit Agreements Act¹⁶⁵

The Credit Agreements Act (CAA) was introduced in 1980 but only applied to a limited number of credit purchases including the sale or lease of goods that were movable¹⁶⁶ where the purchaser paid for their goods in instalments. The CAA did not apply to contracts for the rendering of services¹⁶⁷ and was enacted because there was a need to introduce legislation that covered a broader scope of credit transactions.¹⁶⁸ This was due to the many problems that had arisen concerning credit contracts.¹⁶⁹ The CAA introduced the requirement of a deposit. If a deposit could not be produced, the consumer could not enter into the agreement.¹⁷⁰ The rationale behind this requirement was to determine whether or not a person could afford to enter into a credit transaction.¹⁷¹ The aim of having the deposit requirement was to safeguard consumers from becoming over-indebted when they would purchase goods they could not afford.¹⁷² The CAA also introduced an appropriate prescribed period in which the debt had to be repaid to prevent over-indebtedness.¹⁷³ The CAA focused on the contractual aspects of a credit agreement whereas the Usury Act regulated the financial aspects in a credit agreement.¹⁷⁴

3.2.2 The Usury Act¹⁷⁵

The term 'usury' is defined as a practice which involves the lending of money at unreasonably high rates of interest.¹⁷⁶ In the context of credit lending, it is regarded as being unlawful for credit providers to take advantage of consumers by charging

¹⁶⁵ Act 75 of 1980.

¹⁶⁶ Otto JM The history of consumer credit legislation in South Africa (2010) 16 *Fundamina* 257.

¹⁶⁷ Grove NJ Otto JM *'Basic principles of consumer credit law'* 2 ed (2002) 22.

¹⁶⁸ Otto JM *'The National Credit Act explained'* (2006) 2.

¹⁶⁹ Nagei CJ *Commercial Law* 3 ed (2006) 241.

¹⁷⁰ S 5 of the Credit Agreements Act 75 of 1980.

¹⁷¹ Kelly-Louw (2008) *SA Merc Law Journal* 203.

¹⁷² Renke S, Roestoff M & Haupt F 'The National Credit Act: New parameters for the granting of credit in South Africa' (2007) 28 (2) *Orbiter* 229-270.

¹⁷³ S 6 (a) of the Credit Agreements Act 75 of 1980.

¹⁷⁴ Otto JM (2010) 16 *Fundamina* 257.

¹⁷⁵ Act 73 of 1968.

¹⁷⁶ Amadeo K 'Interest rates and how they work' (2018) available at

<https://www.thebaiance.com/what-are-interest-rates-and-how-do-they-work-3305855> (accessed on 17 November 2018).

excessive interest rates.¹⁷⁷ The Usury Act covered the financial aspects of money-lending contracts, the sale and lease of movable goods and the rendering of services.¹⁷⁸ The Usury Act governed the granting of credit of up to R500 000 and only capped the interest rates for these loans. Credit providers were required to make certain basic disclosures, but not all credit costs had to be revealed to consumers.¹⁷⁹ The Usury Act was not only seen to be a complicated piece of legislation, but it failed to provide for any penalties in cases of non-compliance.¹⁸⁰ Many credit providers failed to comply with the requirement of disclosing fees which resulted in consumers being bound to credit agreements in the circumstances where they did not understand how expensive this credit was.

The Usury Act interest cap rate was in place for almost a century.¹⁸¹ There was a sub-market which consists of almost any type of credit where consumers are not 'prime clients' or do not have very good security to offer. The cap on the charging of interest did not allow credit providers to cover their operational costs, the perceived risks related to lending to unsecured consumers and to earn a sufficient margin for it to be financially viable to lend to such consumers.¹⁸² Credit providers also earned an income, by charging credit life insurance or several other fees. Hence, the actual cost of borrowing could be substantively more than the interest rate and is not transparent to consumers. This factor is seen to contribute to both reckless and predatory lending by certain credit providers.¹⁸³

Access to finance remained a problem. It affected small and micro businesses and hindered progress in important parts of national economic transformation.¹⁸⁴ The Usury Act was criticised for being unable to adequately deal with complex credit transactions, credit cards and unregistered micro-lenders.¹⁸⁵ Due to the lack of

¹⁷⁷ Peterson R 'Credit providers who over-charge may have to repay consumers' available at <https://www.financialinstitutionslegalsnapshot.com/2015/02/credit-providers-who-overcharge-may-have-to-repay-consumers/> (accessed on 15 December 2018).

¹⁷⁸ Otto JM (2010) 16 *Fundamina* 257.

¹⁷⁹ Keily-Louw (2008) 20 *SA Merc LJ*.

¹⁸⁰ *Ibid.*

¹⁸¹ The DTI Credit law review (summary of findings of the technical committee August 2003) 19.

¹⁸² *Ibid.*

¹⁸³ The DTI Credit law review (summary of findings of the technical committee August 2003) 20.

¹⁸⁴ Goodwin-Groen RP (2006) The National Credit Act and its regulations in the context of access to finance in South Africa - Prepared for FinMark Trust, South Africa November (2006).

¹⁸⁵ Dave A 'How the NCA came about' (2008) available at <https://www.theforums.co.za/forum/showthread.php/1441-how-the-nca-came-about> (accessed on 16 November 2018).

enforcement, together with the increasing use of credit by low-income consumers, there was an urgent need for a closer analysis of the credit legislation.¹⁸⁶

3.2.3 Exemptions Notices

The first exemption notice was issued in 1992 in terms of section 15A of the Usury Act 1968. This exemption allowed credit providers to charge unregulated interest on small loans. The aim of the exemption was to increase the growth in lending to micro and medium-sized enterprises.¹⁸⁷

The government introduced the exemption notice to enable consumers who were not able to provide security for their loans to access credit. The exemption created a formal industry overnight and resulted in micro-lenders establishing businesses all over the country.¹⁸⁸ In terms of this notice, loans under R6000 were exempt from the provisions of the Act, and the interest rates that could be charged on these loans were uncapped.¹⁸⁹ The reason behind the uncapping of the interest rate was to encourage credit providers to lend to the unsecured market. Unsecured consumers are regarded as high-risk consumers; therefore, credit providers generally were reluctant to lend to this market.¹⁹⁰ In order to encourage credit providers to lend to unsecured consumers the government uncapped interest rates which made such lending more attractive to the lender.

Uncapping the interest rate resulted in the emergence of a largely unregulated micro-credit industry. The unregulated growth in the micro lending industry meant that predatory lenders entered the credit market.¹⁹¹ The problem was that very poor consumers started to access credit in order to support their immediate consumption

¹⁸⁶ The DTI Credit law review (summary of findings of the technical committee August 2003) 9.

¹⁸⁷ Whittaker M 'South Africa's National Credit Act: A Possible Model for the Proper Role of Interest Rate Ceilings for Microfinance' (2008) 28 (3) *Northwestern Journal of International Business and Law* 570.

¹⁸⁸ Mohane H Coetzee GK Grant W. 'The effects of the interest rate ceilings on the micro lending market in South Africa' (2000) 39 (4) *Agrekon* 2.

¹⁸⁹ Kelly-Louw (2008) 20 *SA Merc LJ* 202.

¹⁹⁰ Chen J 'Unsecured loan' available at: <https://www.investopedia.com/terms/u/unsecuredloan.asp> (accessed on 30 May 2019).

¹⁹¹ Schoombe A 'South African banks and the unbanked: progress and prospects' (2004) 72 (3) *South African Journal of Economics* 583.

needs.¹⁹² These were extremely expensive loans and small loans quickly translated into large debts as a result of uncapped interest rates, as well as the many different fees which credit providers attached to these loans. Many consumers are victims of this practice. In one example, it was reported that a consumer had borrowed R3000 and ended up repaying an amount of R60 000.¹⁹³ In another case, a consumer purchased a television set and stove from Barnett's furniture store for R2779.88 but, by the time she left the store, the amount had doubled and the final amount she owed Barnett's was R6468.89. People who buy goods on credit expect to pay interest on the outstanding amount. What they are not prepared for is the charges for credit and life and other insurances that are sold during the financing process.¹⁹⁴

Before the Exemption Notices were introduced, furniture shops sold furniture in terms of the Credit Agreements Act. Consumers were thus obliged to pay a deposit before they could purchase something like a lounge suite or television set. If a consumer wanted to purchase a fridge for R20 000, the consumer was required to have the prescribed deposit. If he did not have enough money for the deposit, he would have to buy a cheaper fridge or live without it.¹⁹⁵

An unintended consequence of the exemption notice was that credit providers were capable of making large profits as there was very little control over the conduct of credit providers.¹⁹⁶ Minimal regulation led to the exploitation of consumers by credit providers.¹⁹⁷ Another unintended consequence was that the notice created a catastrophe by separating the market and excluded lower-income people from obtaining loans from the more formal credit sector which included the banking sector.¹⁹⁸ The Minister of Trade and Industry observed that poor and low-income

¹⁹² Bateman M 'Microcredit has been a disaster for the poorest in South Africa' (2013) *The Guardian* available at <https://www.theguardian.com/global-development-professionals-network/2013/nov/19/microcredit-south-africa-loans-disaster> (accessed on 15 December 2018).

¹⁹³ Fisher-French M 'The murky world of loan sharks' (2018) available at <https://citypress.news24.com/Personal-Finance/the-murky-world-of-loan-sharks-20180126> (accessed on 23 January 2019).

¹⁹⁴ Stokes G 'Who the National Credit Act really helped' (2008) available at <https://www.fanews.co.za/article/compliance-regulatory/2/nca-national-credit-act/1165/who-the-national-credit-act-really-helped/3963> (accessed on 15 December 2018).

¹⁹⁵ Botha LG *A discussion of access to credit in South Africa with specific reference to reckless lending and over-indebted consumers* (unpublished LLM thesis, University of Kwa-Zulu Natal, 2014) 9.

¹⁹⁶ *AAA Investments (Pty) Ltd v Micro Finance Regulatory Council* 2007 (1) SA 343 (CC).

¹⁹⁷ *Ibid.*

¹⁹⁸ *Ibid.*

South Africans were being charged excessively high-interest rates. Thus, the government introduced a second exemption notice and created the Micro-Finance Regulatory Council. (MFRC).

The Micro-Finance Regulatory Council was formed in 1999 when the second exemption notice came into effect.¹⁹⁹ The new notice stated that loans up to 'R10 000 that could be repaid in less than 36 monthly instalments were exempted from the provisions of the Usury Act and that the interest rates were now capped'.²⁰⁰ The intention of the new notice was to regulate the micro-finance industry.²⁰¹

The 1999 Exemption Notice outlawed unfair practices such as credit providers being permitted to retain consumers' bank cards and identification numbers for repayment purposes.²⁰² The purpose behind the establishment of the MFRC was to regulate the micro-finance industry and micro-lenders had to register with the council so that there would be control over their practices.²⁰³ Micro-lenders who were not registered were obliged to follow the regulations set out in the Usury Act. Unfortunately, however, the regulations were not properly enforced, and micro-lenders continued to operate despite not being registered.²⁰⁴

The ineffective enforcement of the Credit Agreements Act and the Usury Act enabled credit providers to engage in unscrupulous practices that exploited consumers.²⁰⁵ Even after the second exemption notice was implemented, consumers continued to be highly indebted as many credit providers continued to engage in predatory and reckless practices.²⁰⁶ Although the legislation was improved, these improvements proved to be inadequate. The legislation failed to adequately address existent concerns in the credit market such as reckless lending, over-indebtedness and

¹⁹⁹ Kelly-Louw (2008) 20 SA Merc LJ.

²⁰⁰ Ibid.

²⁰¹ Ibid.

²⁰² DTI 'Making Credit Markets Work, A policy framework for consumer credit' available at www.ncr.org.za/publications/Background_NCA_docs/CreditLawReview.pdf (accessed on 15 November 2018).

²⁰³ Ibid.

²⁰⁴ Botha LG *A discussion of access to credit in South Africa with specific reference to reckless lending and over-indebted consumers* (unpublished LLM thesis, University of Kwa-Zulu Natal, 2014) 14.

²⁰⁵ DTI 'Making Credit Markets Work, A policy framework for consumer credit' available at www.ncr.org.za/publications/Background_NCA_docs/CreditLawReview.pdf (accessed on 15 November 2018).

²⁰⁶ Ibid.

predatory lending.²⁰⁷ Ms Ludin (the then Deputy Director General of Consumer & Corporate Regulation) pointed out that amongst the issues that were distorting the consumer credit market, the legislation served to increase both over-indebtedness and unpalatable market practices and that there were unequal 'rationed' access to credit.²⁰⁸

In 2002, the DTI found that the existing credit market was inadequate as many consumers were either unsophisticated or uneducated consumers. The legislation was untenable, and many consumers failed to understand financial concepts such as interests and fees.²⁰⁹ This resulted in credit providers demonstrating predatory behaviour with the knowledge that consumers would be unable to repay their debts.²¹⁰ The DTI conducted research in 2004 which indicated that a change needed to occur in the credit market as it has been developed over a period of 40 years. The findings established that many consumers, particularly black consumers found it difficult to access credit, the costs were excessively high, and consumer protection was limited; therefore credit legislation needed to be restructured to implement change and better regulation.²¹¹ Thus, the review of the credit market led to the enactment of the National Credit Act.²¹²

3.2.4 The National Credit Act

The legislation that existed before the NCA was introduced was complicated, poorly enforced and failed to address unscrupulous lending practices.²¹³ The decision to have a single piece of legislation that covered a wider scope of credit transactions was regarded as necessary for both consumers and credit providers.²¹⁴ The growth of over-

²⁰⁷ Dave A 'How the NCA came about' (2008) available at <https://www.theforums.co.za/forum/showthread.php/1441-how-the-nca-came-about> (accessed on 16 November 2018).

²⁰⁸ Trade and Industry Portfolio Committee 'Consumer Credit Policy Reform' (2003) available at <https://pmg.org.za/committee-meeting/2853/> (accessed on 27 December 2018).

²⁰⁹ Schmulow Woker Van Heerden (2019) *Journal of Business Law* 1.

²¹⁰ Ibid.

²¹¹ DTI 'Policy Framework for Consumer Credit in 'Consumer Credit Law Reform' (2004) available at <http://pmg-asset.s3-website-eu-west-1-amazonaws.com/docs/2005/050608consumer.pdf> (accessed on 15 January 2019).

²¹² Schmulow Woker Van Heerden (2019) *Journal of Business Law* 2.

²¹³ Dave A 'How the NCA came about' (2008) available at <https://www.theforums.co.za/forum/showthread.php/1441-how-the-nca-came-about> (accessed on 16 November 2018).

²¹⁴ Otto JM *The National Credit Act Explained* (2006) 2.

indebtedness among consumers had reached a point where the government believed that new legislation was required. The previous laws were seen to be outdated and required substantial revisions as the credit market was changing rapidly.²¹⁵

The NCA is legislation that encapsulates a broader framework having 173 sections, various schedules and a set of strict regulations.²¹⁶ When the South African government introduced the NCA, the intention was to eradicate practices such as reckless lending and predatory lending²¹⁷ which was regarded as being prevalent in the credit market regulated by the previous credit legislation. Although the NCA has been criticised by the courts as having many drafting errors and inconsistencies which makes it difficult to interpret, it is also regarded as 'one of the best researched pieces of legislation yet introduced into South African law.'²¹⁸ Regardless of the criticisms faced by the NCA, the Act has introduced provisions that seek to prevent reckless and predatory lending that are regarded as innovative.²¹⁹

3.3 Reckless credit lending

The NCA is legislation that intends to protect consumers by providing measures that prevent practices such as reckless lending and over-indebtedness from occurring. The purpose of the Act clearly sets out how the Act promotes responsible borrowing and discourages reckless credit granting by credit providers.²²⁰ The Act defines reckless credit as credit being granted to a consumer under a credit agreement concluded in the circumstances described in section 80 which are discussed in more detail below.

3.3.1 Reckless lending provisions²²¹

Credit providers are regarded as granting credit recklessly if they grant credit in three different circumstances. It is regarded as reckless credit granting if, at the time that the

²¹⁵ Kelly-Louw (2008) 20 *SA Merc LJ* 201.

²¹⁶ *Ibid.*

²¹⁷ Schmulow Woker Van Heerden (2019) *Journal of Business Law* 123.

²¹⁸ Kelly-Louw M *Consumer Credit Regulation in South Africa* (2012) 5.

²¹⁹ Schmulow A Woker T Van Heerden C 'South Africa's National Credit Act: successes (and failures) in preventing reckless and predatory lending' (2019) 2 *Journal of Business Law* 2.

²²⁰ S 3 (c) (ii).

²²¹ See Van Heerden C.M, Boraine A 'Some Observations Regarding Reckless Credit in Terms of the National Credit Act 34 of 2005' (2010) 73 *Tydskrif vir Hendendaagse Romeins-Hollandse Reg* 650-656.

credit agreement was made, the credit provider failed to conduct an assessment of the consumer's current financial status.²²² This applies regardless of the findings of such an assessment might have been at the time.²²³ It is also regarded as reckless credit to grant credit after conducting an assessment, and the information indicates that the consumer did not generally understand or appreciate the risks, costs or obligations under the proposed credit agreement.²²⁴ Finally, it is reckless to grant credit if, after having conducted an assessment, the credit provider finds the consumer unsuitable for credit but still goes ahead and enters into the credit agreement disregarding the information that the consumer would become over-indebted.²²⁵

Having regard to the credit assessment conducted by the credit provider is one of the most important elements when evaluating recklessness. A credit provider is prohibited from entering into a credit agreement with a consumer without first taking reasonable steps to assess the consumer's.²²⁶

- a. General understanding and appreciation of the risks and costs of the proposed credit;²²⁷
- b. Debt repayment history;²²⁸
- c. Existing financial means, prospects and obligations²²⁹

The Act further provides for the establishment of the National Consumer Tribunal (NCT). The purpose of the NCT is to arbitrate matters which are prohibited under the Act. For instance, on reckless lending matters. The NCT is permitted to impose certain remedies indicated in the Act inclusive of administrative penalties.²³⁰

One of the matters which came before the Tribunal involved Shoprite Checkers.²³¹ In this case, the supermarket was fined R1 million after being found guilty of engaging in reckless lending to consumers. The Tribunal found that Shoprite had granted loans to consumers for the purchasing of furniture and other goods without conducting proper

²²² S 80 (1) (a).

²²³ Ibid.

²²⁴ S 80 (1) (b) (ii).

²²⁵ S 80 (1) (b) (iii).

²²⁶ S 81 (2) (a).

²²⁷ S 80 (2) (i).

²²⁸ S 80 (2) (ii).

²²⁹ S 80 (2) (iii).

²³⁰ Schmulow Woker Van Heerden (2019) *Journal of Business Law* 15.

²³¹ *National Credit Regulator v Shoprite Investments Ltd* (NCT/32946/2015/140(1)) [2017] ZANCT 98 (5 September 2017).

background checks on those consumers. Nomsa Motshegara, the CEO of the National Credit Regulator, pointed out that Shoprite had issued loans 'without conducting a reasonable and objective assessment of the consumers' ability to afford the loans.'²³²

The NCA also establishes the National Credit Regulator (NCR) which is responsible for ensuring that the credit industry is fair, transparent, competitive, and specifically serves the needs of those consumers who were historically disadvantaged by racial discrimination. The duties of the NCR include monitoring the credit market to prevent prohibited conduct and to investigate contraventions of the NCA.²³³

3.3.2 Steps credit providers are obliged to take to ensure reckless lending does not occur

The Act prohibits a credit provider from entering into a reckless credit agreement with a consumer.²³⁴ The assessment criteria that are included in the Act initially allowed credit providers to use their own means of evaluation provided these were fair and objective.²³⁵ Unfortunately, there was still evidence that showed, with their evaluative mechanisms, that credit providers continued to grant loans to consumers where the background information showed that consumers would be unable to afford repayments.²³⁶ For this reason, the legislature amended the NCA to introduce more stringent requirements for conducting assessments. These amendments which occurred in 2015 introduced certain mandatory requirements which credit providers have to follow. Credit providers are required to check and verify consumers' three most recent payslips and bank statements and applying the 'minimum expense norms' to what consumers declare as their essential monthly expenses.²³⁷ This means that now credit providers are required to obtain more detailed information from consumers when they apply for credit. Furthermore, credit providers are obliged to check consumers'

²³² Yoder W 'Shoprite found guilty if reckless lending' (2017) available at: <https://www.groundup.org.za/article/shoprite-found-guilty-reckless-lending/> (accessed on 24 October 2018).

²³³ Schmulow Woker Van Heerden (2019) *Journal of Business Law* 15.

²³⁴ S 81 (2) (a) (i)-(iii).

²³⁵ JM Otto 'The National Credit Act Explained' (2006) 66.

²³⁶ Arde A 'Reckless lending continues unabated' (2015) available at <https://www.iol.co.za/personal-finance/reckless-lending-continues-unabated-1818082> (accessed on 24 January 2019).

²³⁷ Arde A 'How credit law amendments affect you' (2015) available at <https://www.iol.co.za/personal-finance/how-credit-law-amendments-affect-you-1946570> (accessed on 26 January 2019).

credit reports in the seven business days before approving credit or increasing an existing credit limit.²³⁸ Previously, the NCA obliged credit providers to consider consumers' debt repayment history. Now, the Act requires that consumers' credit information be recorded on a credit report known as a payment profile which shows if the consumer has defaulted on any of their credit agreements over the past 24 months.

The purpose of these stringent regulations is to prevent reckless lending which usually begins when credit providers fail to process the application for credit properly.²³⁹ Many credit providers were not happy with these stringent requirements and in *Truworths Limited and Others v Minister of Trade and Industry and Others* case,²⁴⁰ three retailers namely Truworths, Foschini and Mr Price, challenged the new requirements.

The retailers argued that the apparent credit assessment did not decrease the levels of reckless credit being granted.²⁴¹ In particular, the applicants challenged sections 23A (4) (5) and (7), but the entire challenge was mainly aimed at section 23A (4), in summary, sets out the practicable steps for credit providers to take to validate the consumer's gross income. The applicants sought to challenge the regulation on various grounds such as:

- a. Unfair discrimination and unreasonableness;
- b. Failure to take into account relevant considerations;
- c. That they were *ultra vires* the Act;
- d. Procedural unfairness.²⁴²

The reason for these grounds is that there is a large proportion of the South African population that is discriminated against because they are poor, less privileged and do not have access to a bank account.²⁴³ Section 23A in particular was regarded as inappropriate and in many cases impossible to follow because it required bank statements to be furnished. The court in its judgment used the example of a parent

²³⁸ Ibid.

²³⁹ Ibid.

²⁴⁰ *Truworths limited and Others v Minister of Trade and Industry and Others* (4375/20160 [2018] ZAWCHC 41; 2018 (3) SA 558 (WCC).

²⁴¹ *Truworths* para 8.

²⁴² *Truworths* para 44.

²⁴³ Crouth G 'High court ruling removes barriers to credit' (2018) available at <https://www.ioi.co.za/personal-finance/high-court-ruling-removes-barriers-to-credit-14031958> (accessed on 15 February 2019).

who needs to buy a uniform for his or her child but who could not afford the entire amount in one go.²⁴⁴ Such a parent may not have a bank account but because of the income he or she was earning could easily be able to pay the price over a period of a few months. Such a parent would however be unable to open a clothing account because he or she would not be able to produce bank statements.

The court ruled in favour of the applicants and set regulation 23A (4) aside. The NCR was however not satisfied with this judgment because it argues that consumers who are employed and are able to provide payslips and bank statements will not be required to do so. It also argued that the purpose of having this regulation in place was to help eradicate reckless credit lending by ensuring that credit providers only lend to consumers on the basis of verified incomes. However, Lee Soobrathi (Senior Manager in the Department at the Credit Ombud) pointed out that if a consumer can justify their income through some other means (i.e because they do not have a bank account) and the credit provider can justify their decision, the agreement will not be reckless. The court was merely addressing a situation where a consumer does not receive a payslip or have a bank account.²⁴⁵

Initially, the NCR said that it would appeal against the ruling of the Western Cape High court, but now it has said that it will amend the regulations to deal with the problems identified by the court. These amendments will possibly be incorporated into new amendments which are, at the time of this research, under consideration.

3.3.3 Consumers obligations when applying for credit

The NCA contains specific measures for the purpose of preventing reckless credit, and it places obligations on both credit providers and consumers.²⁴⁶

The consumer is obliged to answer completely and honestly all questions provided by the credit provider.²⁴⁷ Any information that is required by the credit provider must be submitted when applying for credit so that the application can be considered by the

²⁴⁴ *Truworths* para 46.

²⁴⁵ *Ibid.*

²⁴⁶ Van Heerden CM Boraine A 'The money or the box: Perspectives on reckless credit in terms of the National Credit Act 34 of 2005' (2011) 44 (2) *De Jure* 392-415.

²⁴⁷ *Ibid.*

credit provider.²⁴⁸ Accuracy is essential when considering affordability assessments, as it gives both consumers and credit providers' precise information in establishing whether or not the consumer can afford to repay the loan under the loan agreement. If the consumer fails to answer truthfully and honestly, then this is able to serve as a defence for the credit providers.²⁴⁹

Credit providers and consumers will benefit from these requirements because they are intended to ensure that consumers do not become over-indebted. The practice of reckless lending prejudices the consumer due to the conduct of credit providers. Therefore, there is a need for remedies to rectify this problem.

3.4 Remedies for reckless lending

The Act sets out the remedies which a court or the NCT can grant to a consumer who is a victim in the case of reckless lending practices.²⁵⁰ When the Act was amended in 2015, the amendments provided that the NCT could also deal with reckless lending. Previously under the original Act, only a court could grant remedies to a consumer when it was found that there had been reckless lending. It is acknowledged that with the new amendment, the NCT has wide discretionary powers. This means that when a credit agreement is considered to be reckless, the consequences that credit providers should suffer will be determined by the NCT. Thus, the wide powers of the NCT allow them to determine what kind of penalties should be pinned on the credit provider.

In terms of the Act, it is stated that if there are any proceedings which involve debt, and the NCT or a court determines that the credit agreement was granted recklessly, they *must* make one of the orders in section 83 pertaining to the reckless credit remedies.²⁵¹ These options include:

²⁴⁸ Nortje A 'Reckless credit: obligations of the credit provider and the consumer' (2016) available at <https://www.schoeman.co.za/reckless-credit-obligations-credit-provider-consumer/> (accessed on 22 December 2018).

²⁴⁹ Goodwin-Groen RP (2006) The National Credit Act and its regulations in the context of access to finance in South Africa - Prepared for FinMark Trust, South Africa November (2006) 41.

²⁵⁰ Brits R 'The National Credit Act's Remedies for Reckless Credit in the Mortgage context' (2008) 21 *PER/PELJ* 1.

²⁵¹ *Ibid.*

- a. Setting aside the rights and obligations of the consumer flowing from such an agreement ²⁵² or
- b. Suspending the force and effect of the agreement.²⁵³

(a) *Setting aside the rights and obligations flowing from the agreement*

Regarding the setting aside remedy, the NCA merely states that it can be done in part or full and, importantly, that the order must be just and reasonable in the circumstances.²⁵⁴ In the case of *Taxi Securitisation v Mbatha*,²⁵⁵ the court indicated that if the consumer has a valid complaint that, but for the recklessness of the credit provider, the consumer would never have become involved in the credit transaction, it might be just and reasonable to set aside the agreement. Furthermore, the court stated that the setting aside remedy comprises of setting aside the agreement itself and thus that 'the agreement would be null and void, and as if it has never been.'²⁵⁶ As a result, the credit provider, who remains the owner of the vehicle which was financed in this specific instance, would become entitled to restoration thereof. On the other hand, the consumer, who no longer has any obligations under the agreement that has been aside, would be relieved of any further indebtedness or deficiency claim under the agreement.²⁵⁷

In *Standard Bank v Kelly*²⁵⁸ the court advised that

the decision will in general be informed by the statute's policy of promoting equity in the credit market and by consideration of assisting the consumer to fully repay responsibly undertaken debt at the expense, if necessary and appropriate, of subordinating the rights of reckless creditors.

It is important to note that the NCA fails to mention the rights and obligations of the credit provider but the reciprocal nature of the contract implies that, if the rights and

²⁵² S 83 (1) (a).

²⁵³ S 83 (1) (b).

²⁵⁴ Brits R (2008) *PER/PELJ* 9.

²⁵⁵ 2011 1 SA 310 (GSP).

²⁵⁶ *Mbatha* para 47.

²⁵⁷ *Ibid.*

²⁵⁸ 2016 ZAGPPHC 26.

obligations of the consumer are set aside, the countervailing rights and obligations of the credit provider must reasonably fall away.²⁵⁹

(b) Suspending the force and effect of the credit agreement

The NCA stipulates that during the period of suspension the court may order the following:

- a. The consumer is not required to make any payment under the credit agreement;
- b. Fees and interests may not be charged retrospectively to the consumer by the credit provider;
- c. The rights of the credit provider under the credit agreement become unenforceable for the period of suspension.²⁶⁰

Therefore, the credit provider's penalty consists of not receiving any payment from the consumer and it will forfeit any further interest accrued under the agreement whilst the agreement is suspended. The rationale of the suspension remedy is to assist the consumer to repay in due course the debt owed to the credit provider.²⁶¹ It is important to note that even though the agreement is suspended, consumers are still indebted towards the credit providers.²⁶² As mentioned, the Act states that credit providers are not allowed to charge further fees and interest to consumers that could not be charged during the suspension period.²⁶³ Although, once the credit agreement is revived, the credit provider is allowed to charge all the fees and interest that is appropriate to the agreement.²⁶⁴

It was argued by Van Heerden and Boraine that when it comes to movable property, the credit provider would be permitted to acquire an interim attachment order to secure the protection of the movable financed item during the suspension period.²⁶⁵ However, it will become more difficult if it is immovable security as the inconvenience and cost

²⁵⁹ Boraine and van Heerden 2010 THRHR 653.

²⁶⁰ S 84 (1) (a)-(b); *Mbatha* para 48.

²⁶¹ Boraine and van Heerden 2010 THRHR 654.

²⁶² *Ibid.*

²⁶³ *Ibid.*

²⁶⁴ S 84 (2).

²⁶⁵ Van Heerden and Boraine 2011 De Jure 407.

of demanding that the consumer vacate the property for the period of the suspension would be substantial.²⁶⁶

The suspension remedy is problematic in many situations. For example, the Act fails to stipulate the required time period for the suspension which could result in court orders suspending credit agreements over a substantial period of time.²⁶⁷

Brits pointed out that when the court grants one of the remedies to a consumer, it is important for the court to provide the right balance between the purpose of the remedy and the effects it has on the credit provider.²⁶⁸

An important case which dealt with this balance is *Absa v De Beer*.²⁶⁹ Briefly, the facts were as follows. An elderly couple decided to use their pension pay-outs upon retirement to buy a small holding and begin farming. They did not have sufficient resources, so the couple decided to obtain a loan from ABSA Bank. ABSA granted the couple three different loans. Eventually, the elderly couple was unable to repay these loans, and the bank attempted to institute legal action against them which involved selling their home. The High Court declared the mortgage agreement to be reckless and remedied the situation by ordering all of the consumers' obligations under the agreement to be set aside. An important element that was highlighted in this case was that to avoid credit being granted recklessly, a creditor not only has to conduct an assessment but also the results of the assessment need to be used.²⁷⁰

Brits further points out that when the courts use these remedies, they will act as a penalty which is why it is important for courts to cautiously examine all the effects the order will have so that the outcome that is reached is a just and reasonable one.²⁷¹

Although the remedies provided for in the Act seem to be relatively straightforward, there is still uncertainty surrounding them. Firstly, it is unclear as to how a court should exercise its discretion when it comes to choosing between the two remedies.

²⁶⁶ Van Heerden and Boraine 2011 *De Jure* 405.

²⁶⁷ *Ibid.*

²⁶⁸ Brits R (2008) 21 *PER/PELJ* 22.

²⁶⁹ 2016 (3) SA 432.

²⁷⁰ Debtfree Magazine 'ABSA v De Beer and Others' available at <https://debtfreedigi.co.za/absa-v-de-beer-others/> accessed on 23 January 2019.

²⁷¹ Brits R (2008) *PER/PELJ* 1.

Secondly, the remedies fail to distinguish between the circumstances where either or both of the parties have already performed in terms of the agreement.²⁷²

It is important to note that the preventing and remedying of reckless credit is critical as exorbitant loans can result in both social and financial damage for consumers, their families, as well as society.²⁷³ When the NCA came into effect and included these remedies, the principal purpose was to deter credit providers from entering into reckless credit agreements with consumers and encourage proper pre-agreement assessments. In addition, the Act aims to provide debt relief for consumers who have fallen victim to reckless credit agreements.²⁷⁴

Even though the NCA encompasses comprehensive credit regulation, the legislation is merely a framework which alone is insufficient. Hence, more vigorous enforcement is required. There is evidence which shows that the NCR is failing to take action against negligent credit providers.²⁷⁵ The lack of enforcement has led to predatory lenders evolving in the credit market especially in the four major South African banks.²⁷⁶ Thus, there was a need to amend the Act by the end of 2017, as records demonstrated that there were still millions of consumers who were struggling with over-indebtedness.²⁷⁷ The DTI intends to publish further amendments which are presently in the form of the National Credit Bill²⁷⁸ to deal with the large amount of debt consumers' face²⁷⁹ as the government felt that the practice of reckless lending needed to be amended and improved.

²⁷² Ibid.

²⁷³ Brits R (2008) *PER/PELJ* 21.

²⁷⁴ Ibid.

²⁷⁵ Arde A 'NCR in hot water over enforcement' (2016) available at <https://www.ioi.co.za/personal-finance/ncr-in-hot-water-over-enforcement-2044166> (accessed on 28 December 2018).

²⁷⁶ James D 'Deeper into a Hole? Borrowing and Lending in South Africa' (2014) 55 (9) *Current Anthropology* 20.

²⁷⁷ Steele P 'National Credit Amendment Bill 2018' (2018) available at www.fluxmans.com/national-credit-amendment-bill-2018-by-priscilla-steele/ (accessed on 16 November 2018).

²⁷⁸ National Credit Amendment Bill Government Gazette No 41274 of 24 November 2017('hereinafter the Bill').

²⁷⁹ Steele P 'National Credit Amendment Bill 2018' (2018) available at www.fluxmans.com/national-credit-amendment-bill-2018-by-priscilla-steele/ (accessed on 16 November 2018).

3.5 National Credit Amendment Bill (NCAB)

Unfortunately, after the NCA become effective, many difficulties with implementing the Act emerged which led to the Act being amended a number of times. The most recent Bill introduced on 24 November 2017 is presently under consideration.

3.5.1 Rationale for the latest amendments

In its submission regarding the amendment, the Banking Association of South Africa acknowledged that over-indebtedness is an economic and social challenge which has severe consequences.²⁸⁰ It is a standard norm for consumers to have debt in order to make monthly repayments which includes taking out loans to pay back other loans.²⁸¹ The South African government realised that something needed to be done due to the high levels of debt consumers face every day. It was acknowledged that both reckless lending and predatory lending practices had contributed to this problem as credit providers engaged in abusive practices which drove many over-indebted consumers into a vicious cycle of debt. Loopholes in the NCA were identified, which made it possible for credit providers to avoid provisions which were identified as mandatory.²⁸² On 24 November 2017, the *Government Gazette* published the National Credit Amendment Bill with the purpose of further eradicating over-indebtedness. The Bill includes new measures which include debt intervention and rehabilitation procedures for consumers who are mired in debt. Amendments which are relevant to the problems of reckless and predatory lending will be discussed to answer the research question.

These include the following:

- Report and investigation of reckless credit;
- Affordability assessments; and
- Application for debt intervention

²⁸⁰ 'National credit amendment bill' available at <https://www.banking.org.za/news-media/publications/presentations-submissions/draft-national-credit-amendment-bill-submission> (accessed on 28 November 2018).

²⁸¹ Drake Flemmer and Orsmond Attorneys 'National Credit Amendment Bill: No more reckless lending' available at <https://www.drakefo.co.za/NewsResources/NewsArticle.aspx?ArticleID=1124> (accessed on 28 November 2018).

²⁸² *Ibid.*

(a) Report and investigation of reckless credit²⁸³

The purpose of section 82A is to report any suspicion if there are reasonable grounds to believe that the credit agreement included in the assessment is a reckless credit agreement. The credit provider, upon request, is obliged to provide certain information to the NCR and, should they intentionally fail to do so they can be charged an administrative fine.

(b) Affordability assessments

The NCR conducted a policy review of the NCA in order to identify problems that have hampered the efficiency of the NCA. As a result, the NCAB has been drafted to curb reckless lending by creating a uniform affordability test for prospective credit providers.²⁸⁴ The difference between the NCAB and the NCA is that the Bill will provide the affordability assessment and not the credit providers. Previously, it was the credit providers who were given the discretion to create their own affordability assessments which resulted in many discrepancies in credit agreements, but presently, the Bill stipulates a specific affordability criteria which is to be adhered to by credit providers. In the *Truworths* case, the judge stated that credit providers are obliged to assess consumers' affordability and to avoid reckless credit by using their internal methods and requesting documents that will be easily obtained by the consumer depending on the category of the consumer.²⁸⁵ Therefore, all the other requirements for granting credit are still applicable, and the granting of reckless credit by the credit providers or submission of false information by the consumers, in order to qualify for credit, constitutes an offence.²⁸⁶

²⁸³ National Credit Amendment Bill GG No.41274 of 24 November 2017.

²⁸⁴ Drake Flemmer and Orsmond 'National Credit Amendment Bill: No more reckless lending' available at <https://www.drakefo.co.za/NewsResources/NewsArticle.aspx?ArticleID=1124> (accessed on 28 November 2018).

²⁸⁵ Strauss Daly 'Banking Law: Amendments to the NCA and the impact of the proof of income regulations' available at <https://www.straussdaly.co.za/2018/10/02/banking-law-amendments-nca-impact-proof-income-regulations/> (accessed on 18 March 2019).

²⁸⁶ *Ibid.*

(c) Application for debt intervention

The DTI conducted research and observed that debt review is not considered to be cost-effective for debt counsellors when it came to consumers who have an income that was less than R7500 per month. Therefore, many debt counsellors started to avoid these consumers. The Amendment Bill, for this purpose, states that a debt intervention applicant must be a South African citizen who, on the date of submission of the application is a consumer who has no realisable assets.²⁸⁷

By amending and inserting new sections into the NCA through the Amendment Act, the government is trying to fix the loopholes set out in the NCA which is still responsible for consumers becoming over-indebted. The new and improved sections are seen to impose stricter measures to be taken against credit providers who are in contravention of the Bill. In terms of the amendment, it is stated that section 87 is hereby amended to include giving the NCT the power along with the Magistrates Court to re-arrange consumer's obligations. In relation to the NCR, it was stated that the NCR is being given the power to set aside or annul a credit agreement that is found to be reckless.²⁸⁸ The Tribunal, however, has the power to compel a credit provider to refund a consumer the interest that was paid on a loan, impose administrative fines to guilty credit providers,²⁸⁹ and make just and equitable orders if it is concluded that a reckless agreement has been granted.²⁹⁰ It is possible that this can act as a deterrent to the credit provider and can be seen as an affordable choice where a consumer can lodge the allegation of reckless lending. When it comes to affordability assessments, it is mandatory that extra caution be taken so that the purpose of the Act, which is to allow access to credit for all consumers, is not defeated.

During late October 2018, provincial briefings occurred. Public hearings also commenced at the end of October and continued until the beginning of November with final mandates being handled on 5 December.²⁹¹

²⁸⁷ SS 88A of the National Credit Amendment Bill.

²⁸⁸ Arde A 'Amnesty or not, become debt free' (2016) available at <https://www.iol.co.za/personal-finance/amnesty-or-not-become-debt-free-2027388> (accessed on 17 March 2019).

²⁸⁹ Ibid.

²⁹⁰ S 87 1A (b) of the Amendment Act.

²⁹¹ National Credit Amendment Bill [B30-2018]: briefing available at: <https://pmg.org.za/committee-meeting/27173> (accessed on 29 December 2018).

3.6 Predatory Lending

The practice of predatory lending is a common social issue worldwide. The Act does not specifically deal with predatory lending as a specific concept as there is no definition of predatory lending in the Act. However, there are many practices which are prohibited in the Act and which are regarded generally as being predatory. Hence, it can be argued that the Act tackles predatory practices especially by prohibiting misleading and unfair marketing and selling practices.²⁹² Provisions which have been identified as targeting predatory lending include the following:

- Negative option marketing
- Marketing and sales of credit at work or home
- Advertising practices
- Unlawful credit agreements
- Unlawful provisions in credit agreements
- Prohibited charges

(a) Negative option marketing

Negative option marketing is a marketing practice in terms of which the consumer agrees that the agreement will come into existence automatically unless the consumer specifically turns down the offer. This practice is regarded as a predatory practice because it often results in consumers being charged for products or services they never intended to purchase.²⁹³ It is vital that consumers are informed and should not be automatically forced into agreements because they did not opt out. An example of a negative option marketing practice often employed in the credit market is an automatic annual increase in consumers' credit limits.²⁹⁴ This option is problematic because it gives consumers access to credit which they may not be able to repay. The Act provides (in section 74) that when consumers wish to conclude credit agreements, credit providers are obliged to give them certain options. These are as follows:

- a. The option to decline pre-approved annual credit limit increases;

²⁹² Schmulow Woker Van Heerden (2019) *Journal of Business Law* 3.

²⁹³ Huffman M 'Negative option: when no means yes' available at https://www.consumeraffairs.com/news04/2005/negative_option.html (accessed on 26 December 2018).

²⁹⁴ Ibid.

- b. The option to be excluded from any telemarketing campaign of the credit provider;
- c. The option to be excluded from any marketing or customer lists that may be sold or distributed by the credit provider; and
- d. The option to be excluded from any mass distributions of emails or SMS's.²⁹⁵

The Act indicates that, should products be sold, or services rendered by way of negative option marketing, the transaction would be declared unlawful and will have no force and effect.²⁹⁶ The purpose of having this section in place is to ensure that consumers are offered the choice to opt out of marketing activities which allows them the opportunity to decline any offers that may make consumers further indebted.²⁹⁷ The onus is on the credit provider to ensure that the consumer is permitted these options.²⁹⁸

(b) Marketing and sales of credit at work or home

The Act, stipulates explicitly that credit providers are prohibited from harassing consumers at home or work so that they can be persuaded to enter into a credit agreement or apply for credit.²⁹⁹ If a credit provider wishes to approach a consumer's workplace, they must be invited by the consumer's employer and have the consent of the consumer.³⁰⁰ Credit providers are, however, permitted to enter into a credit agreement at a private dwelling provided the visit has been pre-arranged by the consumer for that purpose or if the credit provider visited the private dwelling for the purpose of offering goods or services for sale and incidentally offered to provide or arrange credit.³⁰¹

²⁹⁵ S 74 (6) read with 'Marketing Practices' *Personal Finance* 8 February 2008 available at <https://www.iol.co.za/personal-finance/4-marketing-practices-997268> (accessed on 23 February 2019).

²⁹⁶ Ibid.

²⁹⁷ Paragraph 14 *National Credit Regulator v Hirst* (NCT/22133/2015/57(1)) [2015] ZANCT 18.

²⁹⁸ Ibid.

²⁹⁹ South African Law Centre 'Marketing of credit' available at www.salawcentre.org.za/marketing-of-credit/ accessed on (28 December 2018).

³⁰⁰ Compuscan Keep your marketing practices in line with the NCA' available at <https://compuscan.global/newsroom/keep-your-marketing-practices-in-line-with-the-nca/> (accessed on 28 December 2018).

³⁰¹ Ibid.

(c) Advertising practices

Section 76 deals with advertising practices which are often regarded as predatory practices. In terms of section 76, it is essential to note that advertisements should not deceive consumers to obtain credit that they are unable to afford.³⁰² Credit providers are prohibited from using phrases such as 'no credit check required', 'blacklisted consumers welcome' or 'free credit' when advertising for credit. Moreover, the terms 'cheap', 'affordable' 'low-cost' credit may only be used if there is a clear indication that fees are included.

Advertising, sales and marketing materials are regulated to include standard minimum costs of credit.³⁰³ It must be ensured that when there are credit advertisements, certain information specified in the Act must be included. This information includes applicable interest rates and cost of credit which will be discussed below. The purpose of credit advertisements is that it must give equal emphasis to the costs involved and should not be hidden by the use of small font instead it should be indicated clearly in the same average font size.³⁰⁴ The NCA seeks to ensure that all misleading advertisements are prohibited.³⁰⁵

(d) Unlawful credit agreements

The Act provides that in certain situations the entire credit agreement is unlawful.³⁰⁶ Such contracts are void from the day they were entered into.³⁰⁷ According to section 89 of the Act, the agreement is unlawful if:

- a. The agreement is entered into with an unemancipated minor or who is unassisted by a guardian;
- b. The agreement is part of negative option marketing;
- c. It is a supplementary agreement or document prohibited by section 91 (a);

³⁰² Ibid.

³⁰³ DTI 'Making Credit Markets Work, A policy framework for consumer credit' available at www.ncr.org.za/publications/Background_NCA_docs/CreditLawReview.pdf (accessed on 15 November 2018).

³⁰⁴ Ibid.

³⁰⁵ South African Law Centre 'Marketing of credit' available at www.salawcentre.org.za/marketing-of-credit/ (accessed on 28 December 2018).

³⁰⁶ Misrole A 'Unlawful credit agreements- section 89' (2016) available at <https://www.exonerate.co.za/unlawful-credit-agreements-section-89/> (accessed on 15 May 2019).

³⁰⁷ Ibid.

- d. At the time the credit agreement was entered into, the credit provider was not registered.³⁰⁸

In the case of *De Bruyn v Karsten*³⁰⁹ which dealt with section 89 (2) (d), Du Bruyn made an offer to purchase Karsten's interest in three business entities for the sum of R 2 000 000 to be paid in instalments. In addition, De Bruyn undertook to register a covering bond over their immovable property, within 60 days. However, Karsten was not registered as a credit provider in terms of the NCA at the date of conclusion of the sale agreement. Du Bruyn defaulted on his instalments and Karsten instituted proceedings for the balance of the purchase price. Du Bruyn then argued that the agreement was null and void because Karsten was not a registered credit provider. The Supreme Court of Appeal stated that section 40 makes it obligatory for a person to register as a credit provider irrespective of whether it was a single transaction or not.³¹⁰ The Court therefore upheld De Bruyn's argument. It must be noted that this judgment sends out a strong warning to anyone who intends to lend money to another and that the argument regarding what constitutes an arm's length transaction will have to be carefully considered in the future. Karsten argued that this was not an agreement which was subject to the NCA because it was not an arm's length transaction. The parties had been business partners. The court however found that because the relationship between the parties had broken down, and the dealings were conducted at arm's length, the agreement was an arm's length transaction and therefore the NCA applied.³¹¹

(e) Unlawful provisions in a credit agreement

The Act contains a list of clauses which are outlawed when it comes to credit agreements. These are stated in section 90 of the Act. The purpose of having these provisions in place is to help consumers who have been deceived.³¹² The section stipulates that if the provisions of the Act authorise the credit provider to engage in any unlawful activities or deprives a consumer of a right that is set out in the NCA, the

³⁰⁸ S 89 (2) (a) – (e).

³⁰⁹ 2019 (1) SA 403 (SCA).

³¹⁰ *De Bruyn* para 18.

³¹¹ *De Bruyn* para 14.

³¹² S 90 (ii)-(iii).

provision is considered to be unlawful. Thus, the rationale behind implementing this section is to enhance consumer protection and act as a barrier against predatory lending practices.

(f) Prohibited charges

Predatory practices are commonly identified when credit providers charge consumers exorbitant interest rates and fees and conceal important terms in credit agreements. Thus, in order to eradicate this practice, section 100 of the NCA provides a list of charges that prohibits credit providers from charging fees that are recognised to be unlawful and inconsistent with the Act. In addition, the NCA has incorporated a section which displays the list of charges that credit providers are entitled to include in their credit agreement.³¹³ This section is intended to clarify the financial implications of the credit agreement for consumers. It is included in the agreement, so credit providers do not take advantage of consumers by adding extra unlawful fees to benefit themselves.

3.6.1 Remedies for predatory lending

When the NCA was introduced, it was proposed by the Department of Trade and Industry that a key focus of the Act should be on regulating predatory lending practices that contribute to consumer over-indebtedness.³¹⁴

3.6.1.1 Remedies for consumers

If there are agreements that are being granted to the detriment of the consumers, it is only fair to have remedies to help balance out the wrong done.

It is acknowledged that negative option marketing is a prohibited practice which is why the NCA indicates that if a credit agreement is entered into as a result of an offer or proposal none which is consented by the consumer, the agreement would be deemed

³¹³ S 101.

³¹⁴ Van Heerden CM Steenot R 'Pre-Agreement Assessment as a responsible lending tool in South Africa, the EU and Belgium: Part 1' (2018) 21 *PER/PELJ* 8.

to be void to the extent provided for in section 89. In addition, a provision which has been entered into as a result of an offer or proposal is considered to be unlawful and void to the extent provided for in section 90.

Deceptive advertising often leads to consumers making uninformed decisions.³¹⁵ If advertisements perceive particular goods or services as something that they are not, it is likely that consumers will become wedged in a financial situation they did not ask for.³¹⁶ Predatory lending arises in situations where credit providers provide misleading and false information in advertisements.³¹⁷ Therefore, the NCA seeks to outlaw deceptive advertisements by allowing agreements to be declared void if the credit lender is found guilty of participating in this practice. The rationale behind the implementation of strict advertising principles is designed primarily to combat the practice of predatory lending engaged in by unscrupulous credit providers.

In *National Credit Regulator v Opperman and Others*³¹⁸ the Constitutional Court declared that section 89 (5) was unconstitutional and that it constitutes the deprivation of property which is therefore inconsistent with section 25 of the Constitution regarding it invalid. Section 89 (5) (a)-(c) previously stated that in the event of an unlawful agreement the court must order that the credit agreement is void from the date that it was entered into, that the credit provider must refund the borrower all monies paid under the unlawful credit agreement and that all the purported rights of the credit provider to recover any money paid on behalf of the consumer were either cancelled or forfeited to the State.

Section 89 (5) was amended when the National Credit Act came into operation on 13 March 2015. The amended section now states that if a credit agreement is unlawful in terms of this section, a court must make a just and equitable order including but not limited to an order that the credit agreement is void as from the date the agreement was entered into.

From the above, it can be deduced that it is important for credit grantors to ensure that credit agreements do not contain unlawful provisions. If a credit agreement does

³¹⁵ Ray L 'What is the worst thing about deceptive advertising' (2018) available at <https://yourbusiness.azcentral.com/worst-thing-deceptive-advertising-10156.html> (accessed on 01 March 2019).

³¹⁶ Ibid.

³¹⁷ S 76.

³¹⁸ [2012] ZACC 2; 2013 (2) BCLR 170 (CC).

contain unlawful provisions, the court has the option of either declaring the provision unlawful and deleting it from the agreement or ordering the term to be amended in a way that renders it lawful.³¹⁹

When credit providers are found guilty of overcharging consumers on interest and fees the credit agreement is not void, but the Act does allow for aggrieved consumers to reclaim the extra fees and interest.³²⁰ Credit providers may be referred by the NCR to the NCT for a hearing regarding the prohibited conduct and if the credit lender is found guilty, the Tribunal, in terms of section 150 of the Act, may the order that the credit providers recompense consumers for those extra fees and interest.³²¹

3.7 Consequences for credit providers

Section 1 defines prohibited conduct as an 'act or omission in contravention...' of the NCA by, for example, a credit provider. Thus, when credit providers engage in prohibited conduct a number of consequences may follow including the following:

- The NCR may issue a compliance notice;
- The NCR may refer the matter to the NCT for a hearing into prohibited conduct;
- The NCR may apply for the credit provider to be deregistered as a credit provider.

(a) Compliance notices

Section 55 of the Act states that the NCR may issue a compliance notice in the prescribe form to-

- (a) a person or association of persons whom the NCR on reasonable grounds believes-
 - (i) has failed to comply with a provision of this Act; or

³¹⁹ Misrole A 'Unlawful credit agreements- section 89' (2016) available at <https://www.exonerate.co.za/unlawful-credit-agreements-section-89/> (accessed on 15 March 2019).

³²⁰ Peterson R 'Credit providers who over-charge may have to repay consumers' available at <https://www.financialinstitutionslegalsnapshot.com/2015/02/credit-providers-who-overcharge-may-have-to-repay-consumers/> (accessed on 15 December 2018).

³²¹ *National Credit Regulator v Shoprite Investments Ltd* (NCT/32946/2015/140(1)) [2017] ZANCT 98 (5 September 2017).

- (ii) is engaging in an activity in a manner that is inconsistent with this Act; or
- (b) a registrant whom the NCR believes has failed to comply with a condition of its registration.

The above section was confirmed in the case of *Barko Financial Services (Pty) Ltd v National Credit Regulator and Another*.³²² The court stated that with regards to section 55 (1) (a) and (3) of the Act, Barko failed to adhere with the provisions of the Act in that he required consumers to enter into agreements which consisted of charging fees that were not permissible and fees that exceeded the minimum amount under the Act.³²³ Thus, the Supreme Court of Appeal (SCA) held that the abovementioned section empowers the NCR to issue a compliance notice when the NCR reasonably believes that there has been non-compliance with the provisions of the Act or a party is participating in an activity that is inconsistent with the NCA.³²⁴

It is worth noting that should a credit provider fail to obey the notice, the matter can be referred to the NCR for an appropriate order such as the imposition of administrative fees.

(b) Referral matters

When credit providers engage in prohibited conduct they can be referred by the NCR to the NCT for a hearing relating to that conduct. If they are found to have contravened the Act, section 150 gives the Tribunal the power to make certain orders including imposing an administrative fine on the credit provider.

In order for an administrative fine to be imposed, the NCA sets out a list of factors, that the NCT must take into account when determining the appropriate fine:

- The nature, duration, gravity and extent of the contravention;
- Any loss or damage suffered as a result of the contravention;
- The behaviour of the respondent
- The market circumstances in which the contravention took place;

³²² (415/13) [2014] ZASCA 114 (18 September 2014). The matter was initially dealt with by the National Consumer Tribunal. Barko took the decision on appeal to the High Court and then to the SCA.

³²³ *Barko* para 2.

³²⁴ *Ibid.*

- The level of profit derived from the contravention;
- The degree to which a respondent has co-operated with the National Credit Regulator and the Tribunal; and
- Whether the respondent has previously been found in contravention of the NCA.³²⁵

In the case of *National Credit Regulator v Self Discovery Cash and Marketing CC*³²⁶ the respondent was found to have repeatedly contravened numerous provisions of the Act.³²⁷ As a result, the Tribunal was asked to impose certain penalties on the respondent such as deregistering the respondent and imposing an administrative fine on the respondent. After taking into account all the relevant evidence, the Tribunal had to consider the factors for imposing an administrative fine. The Tribunal found that the conduct of the respondent was extremely serious because that conduct went to the heart of the business. The respondent had been charging excessive interest rates and conducted no proper assessments prior to the granting of loans leading to many consumers becoming over-indebted. Moreover, the respondent failed to co-operate in the investigation and even ignored the NCA by engaging in practices that were common before the Act was introduced and which had been outlawed by the Act. Lastly, it could be seen that overcharging consumers led to the respondent deriving a significant profit for itself.

The Tribunal's final order consisted of the respondent's registration being cancelled with immediate effect due to the severity of the prohibited conduct. Furthermore, the respondent was liable to pay an administrative fine of R100 000.00 into the National Revenue Fund. An important element demonstrated was that this case acts as a warning to all credit providers that even small businesses cannot escape the peremptory provisions of the NCA.³²⁸

³²⁵ S 151 (3) (a)-(g).

³²⁶ NCT/71714/2016/140(1).

³²⁷ *Self Discovery Cash & Marketing* para 1.

³²⁸ *Self Discovery Cash & Marketing* para 110.

(c) Cancellation of registration

The NCA permits the NCR to apply for credit providers to be deregistered if they are found guilty of contravening the Act. This means that once credit providers become deregistered, they can no longer engage in being a credit provider.

According to section 57 of the NCA, a registration in terms of this Act may be cancelled by the Tribunal if the registrant repeatedly-

- (a) Fails to comply with any condition of its registration³²⁹;
- (b) Fails to meet a commitment contemplated in section 48 (1)³³⁰;
- (c) Contravenes this Act.³³¹

In the case of *National Credit Regulator v Vaidro 178 CC t/a Vuleka Cash Loans*,³³² the NCR applied for the cancellation of the respondents' registration with reference to section 57 (1). The NCR claimed that the respondent had contravened various provisions of the Act; namely, by using prohibited collection methods by retaining consumers' bank cards and identity documents, failing to conduct affordability assessments prior to the granting of credit leading to reckless lending and charging excessive fees. The respondent failed to oppose the application therefore, the Tribunal found in favour of the NCR. The Tribunal held that the respondent had engaged in prohibited conduct and declared that the respondent's registration was cancelled as per section 150 (g) of the NCA.

Another case which demonstrated deregistration is *National Credit Regulator v Piet Cash Loans*.³³³ The NCR requested that the Tribunal cancel the respondent's registration as a credit provider and declare the conduct of the respondent to be prohibited under the Act. The respondent had been found in possession of consumers' bank cards and required consumers to reveal their bank pins to him. The respondent failed to conduct pre-agreement assessments, did not keep proper records and induced consumers to enter into unlawful agreements with him. The Tribunal stated that due to the severity of the respondent's contraventions and because consumers

³²⁹ S 57 (1) (a).

³³⁰ S 57 (1) (b).

³³¹ S 57 (1) (c).

³³² NCT /7321/2013/57 (1) (P).

³³³ NCT/654/2010/57(1)(a)(c)(P) [2011] ZANCT (15 February 2011).

were severely prejudiced the respondent's registration was cancelled with immediate effect.

It can be seen from the above cases that when credit providers engage in prohibited conduct large administrative fines can be imposed or their registration can be cancelled. The purpose of having these sections implemented is to demonstrate to credit providers that if they are caught engaging in prohibited conduct that contravenes the Act it can result in severe consequences. Furthermore, the sections are in place to ensure that credit providers are responsible when it comes to credit lending. Not only do the consequences cause financial hardship for the particular credit provider they can also affect the reputation of the credit provider.

3.8 Conclusion

The DTI's primary purpose in introducing the NCA was to ensure that consumers are treated both fairly and equally in the credit marketplace. Reckless lending and predatory lending are concepts that are new to the South African credit industry. Globally, these terms are well-known, as, in the USA, predatory lending is common in the mortgage lending field. Credit providers use predatory tactics that result in house owners losing their homes to foreclosure.³³⁴

The NCA provides severe consequences for credit providers who fail to adhere to the regulations. There is now a greater onus placed on credit providers to ensure that when credit is being granted, it is done responsibly. Particularly, credit providers must complete a comprehensive background check to ensure that a consumer is creditworthy and able to repay the debt.³³⁵

The next chapter will discuss the laws of other jurisdictions that have been introduced to prevent these types of practices from occurring. It will further provide a comparative analysis as to how these lending practices are being regulated in order to establish whether there are any lessons which South Africa can learn from these other jurisdictions.

³³⁴ McCoy PA 'A behavioural analysis of predatory lending' (2015) 38 (4) *Akron Law Review* 726.

³³⁵ Vessio, M.L (2009) 22 (2) *TSAR* 288.

CHAPTER 4

A COMPARATIVE STUDY OF THE CONCEPTS OF RECKLESS AND PREDATORY LENDING

4.1 Introduction

The practices of reckless and predatory lending have become the subject of concern in many jurisdictions. This chapter examines laws in operation in Canada, the USA and the UK which seek to regulate these practices in order to see if there are any lessons which can be learnt for South Africa.

4.2 Canada

4.2.1 Introduction

The Canadian credit market is regulated by the Banks Act (1991 c.46) and the Consumer Protection Act.³³⁶ Canada also has a wide range of federal and provincial laws in place which aims to protect consumers in the credit industry. The laws seek to promote access to credit facilities³³⁷ and contain guidelines for consumer complaints and redress.³³⁸ Business standards, especially in the credit industry, are overseen by the National Standards System (NSS). The purpose of the NSS is to regulate and shape business practices in Canada.³³⁹

³³⁶ Global legal insights 'Banking regulation 2018' available at www.globallegalinsights.com/practice-areas/banking-and-finance-laws-and-regulations/canada#chaptercontent1 (accessed on 19 November 2018).

³³⁷ Protecting vulnerable credit consumers- the National Credit Act and the experiences in Canada and the USA. (Discussion paper submitted at the Southern African Catholic Bishops Conference) (August 2007).

³³⁸ Ibid.

³³⁹ Protecting vulnerable credit consumers- the National Credit Act and the experiences in Canada and the USA (Discussion paper presented at the Southern African Catholic Bishops Conference) (August 2007).

4.2.2 Reckless Lending

The Banks Act is prominent consumer protection legislation in Canada. The Banks Act³⁴⁰ is federal legislation that governs how banks operate in Canada.³⁴¹ The Act is reviewed regularly to ensure that it is in line with the rapidly progressing marketplace while simultaneously benefitting the Canadian economy.³⁴²

In 2016, when the Banks Act was updated, there were a number of changes which included a new cooling-off period for most products and services, express consent requirements and minimum disclosure requirements for all products and services.³⁴³

Although the revised Banks Act has been successful in achieving its purpose, it has to be amended, due to the evolving credit market. The next review of the Bank Act is planned to take place in late 2019, but the first round of consultations has already been conducted. Some of the priorities that have been submitted include³⁴⁴

- a. Aiming strike a better balance between efficiency and stability in the financial sector;
- b. Further protecting and enhancing the jurisdiction of the regulatory system and role in financial services regulation;
- c. Aiming to balance the financial innovation needs with a framework that protects consumers;
- d. Reforming the existing framework to allow financial institutions to participate in technological activities that promote further innovation;
- e. Ensuring that financial regulations are updated to keep up with innovations in the financial sectors.

Canada's Bank Act is legislation which offers consumers effective protection and ensures that the financial system is effective. The need to continue to amend and

³⁴⁰ The Banks Act 1991.

³⁴¹ Canadian Bankers Association 'Canada's Bank Act Review. Learn more about the legislation governing how banks operate in Canada' available at <https://www.cba.ca/canada-bank-act-review> accessed on (23 November 2018).

³⁴² Ibid.

³⁴³ Eilyn S 'Bank Act financial consumer protection framework passes third reading in the house of commons' (2016) available at <https://www.regulationtomorrow.com/ca/banking-ca/bank-act-financial-consumer-protection-framework-passes-third-reading-in-house-of-commons/> (accessed on 23 November 2018).

³⁴⁴ 'Canadian Bankers Association 'Canada's Bank Act Review. Learn more about the legislation governing how banks operate in Canada' available at <https://www.cba.ca/canada-bank-act-review> (accessed on 23 November 2018).

develop the Act demonstrates the intention of ensuring that consumer protection will always be improved to suit consumers in a rapid credit market.

4.2.3 Predatory Lending

In Canada, predatory lending affects Canadians of all financial backgrounds. Although payday loans are predominantly used by consumers from low-income backgrounds well-earning consumers also access them. Most of the time, when it comes to payday lending, consumers are aware of the high rates, but often they do not have any other options available to them and so they proceed to take out such loans regardless of the cost involved.³⁴⁵

In 2016, the government of Alberta, Western Canada, introduced its Act to End Predatory Lending.³⁴⁶ The purpose of this Act was to strengthen consumer protection and create fair rules when it came to payday lending and end predatory lending practices that cause consumers to end up in a cycle of debt.³⁴⁷ The legislation strives to ensure that consumers are permitted to repay loans in instalments rather than all at once, prohibit direct solicitation and forbidding credit providers from granting loans to consumers who already have existing outstanding payday loans.³⁴⁸ Since payday loans consist of high interest rates there is a legislation in Canada that governs interest rates. For instance, interest rates in Canada are governed by section 347 of the Criminal Code. This section provides that interest rates which exceed 60 per cent per annum, will be regarded as criminal rates of interests.³⁴⁹

In the Canadian case of *Caisse populaire Desjardins d'Aylmer v Roy*³⁵⁰ the Quebec court dismissed a claim by a company that sought to remedy a credit agreement that

³⁴⁵ Craig-Bourden M 'High interest loans: Why Canadian borrowers are still taking on the steep commitment' (2018) available at <https://www.cpacanada.ca/en/news/canada/2018-08-13-high-interest-loans-why-canadian-borrowers-are-still-on-the-steep-commitment> (accessed on 19 November 2018).

³⁴⁶ Ebner D 'Payday lenders squeezed by new regulations' (2017) available at <https://www.theglobeandmail.com/report-on-business/small-business/payday-lenders-squeezed-by-new-regulations/article37361268/> (accessed on 19 November 2018).

³⁴⁷ Government introduces legislation to end predatory lending (2016) available at <https://www.alberta.ca/release.cfm?xID=41741840F017D-BA4D-A70A-741F47E98B7F6C4> (accessed on 19 November 2018).

³⁴⁸ Ibid.

³⁴⁹ Robinson S VanderMuelen M 'Canadian interest rate rules' (2013) available at <https://mcmillian.ca/mobile/show-publication-aspx?show=100312> accessed on (20 November 2018).

³⁵⁰ 2012 QCCQ 2012.

erroneously failed to include an interest rate. After realising their mistake, the financial institution unilaterally modified the loan agreement to include the interest rate and increased the number of monthly payments required to repay the loan so that the interest would be recovered. The parties were told to live with the mistake and the company was prohibited from unilaterally altering the credit agreement to include an interest rate that had been specified in the credit applications. The court ordered the company to pay damages for having registered a notice of default, thereby negatively affecting the credit rating and financial reputation of the debtor.³⁵¹ This judgment was seen to act as a warning to all financial institutions to ensure that all credit applications include the applicable rates.

The purpose of having the above provisions in place is to help demonstrate to credit providers and consumers that when conducting a credit agreement, the parties should be attentive and obey the rules included in the Canadian legislation that governs credit transactions and interest rates.³⁵²

4.3 The United Kingdom

4.3.1 Introduction

The consumer credit industry is substantial and diverse.³⁵³ In the UK, the credit industry is regulated by the Consumer Credit Act (CCA)³⁵⁴ which was the first law in the UK to regulate consumer credit under one distinctive regulatory framework.³⁵⁵ The purpose of the CCA was to ensure that there was a comprehensive code which regulated consumer credit.³⁵⁶

³⁵¹ Robinson S VanderMuelen M 'Canadian interest rate rules' (2013) available at <https://mcmillian.ca/mobile/show-publication.aspx?show=100312> (accessed on 20 November 2018).

³⁵² Ibid.

³⁵³ Edmonds T 'Consumer Credit Regulation' (2014) *House of Commons Library Briefing Paper No 06842*.

³⁵⁴ Act 39 of 1974.

³⁵⁵ The UK'S consumer credit act 1974: New evidence of its economic benefits (2016) available at www.ehs.org.uk/press/the-uk-s-consumer-credit-act-1974-new-evidence-of-its-economic-benefits (accessed on 01 December 2018).

³⁵⁶ Goode A *consumer credit Act: A guide for students* (1979) 37.

4.3.2 Reckless Lending

The main objective of having the CCA implemented was to ensure that small individual consumers were provided with the protection they needed without creating any barriers between one sort of credit and another.³⁵⁷ The CCA sought to regulate all aspects of individual credit³⁵⁸ and even contained basic requirements with regards to credit assessments and determining consumer creditworthiness. In terms of section 55B, creditors are obliged to conduct assessments before entering into a credit agreement with consumers.³⁵⁹ Furthermore, it is mandatory that credit agreements are explained thoroughly prior to the entering of agreements with consumers. The explanations must include the cost of credit and the consequences for consumers should they fail to make payments in terms of their credit agreements. The reason being it can help consumers make a choice as to whether they are financially capable of entering into the agreement.³⁶⁰

The Act requires strict compliance, particularly with regard to credit transactions. Non-compliance therewith will result in a penalty or harsh consequences for the credit provider. These penalties include the creditors' license being suspended or revoked and it's even possible for the creditor to receive a £50,000 penalty.³⁶¹

A key feature that was implemented in the legislation is the requirement that credit grantors have to be registered by the Office of Fair Trading (OFT) before they can grant credit. The rationale behind this requirement is that it gives the OFT control with respect to its regulation so that if there is non-compliance, the OFT can put the firms out of business.³⁶²

In July 1999, the government stated in the White Paper *Modern Markets: Confident* that it intended amending consumer credit legislation so that consumer protection could be afforded in a more suitable way. On 1 July 2001, the UK'S Department of

³⁵⁷ Edmonds T 'Consumer Credit Regulation' (2014) *House of Commons Library Briefing Paper No 06842*.

³⁵⁸ Ibid.

³⁵⁹ S 55 B (1) & 2.

³⁶⁰ Which 'Consumer Credit Act' available at <https://www.which.co.uk/consumer-rights/regulation/consumer-credit-act> (accessed on 01 December 2018).

³⁶¹ Conway L 'The Consumer Credit Bill' (Research paper presented to the House of Commons Library) (January 2005).

³⁶² Edmonds T 'Consumer Credit Regulation' (2014) *House of Commons Library Briefing Paper No 06842*.

Trade and Industry published a consultation document in which they sought to obtain views on the effectiveness of the current legislation³⁶³ because there was a vast increase in consumers who continued to struggle with their debt repayments.³⁶⁴

In 2006, the 1974 Act was revised and enacted with the intention of reforming the CCA. The changes that were implemented had the purpose of:³⁶⁵

- a. Enhancing consumer rights;
- b. Strengthening the regulation of consumer credit businesses;
- c. Extending regulation to all different consumers; and
- d. Providing debtors with new post-contractual information.

The reasoning behind the strengthened consumer protection was for consumers to be protected against irresponsible lending. This was done by ensuring that the terms and conditions of credit agreements supported consumers when they experienced difficulties repaying their loans.

In order to try and curb irresponsible lending, the Responsible Lending Index (RLI) was introduced. The RLI is an index which permits credit providers to measure themselves according to the degree of responsibility in the corporate industry.³⁶⁶ In various newspaper articles, the UK had advised consumers to be more responsible when borrowing.³⁶⁷ It was agreed upon by the UK government that consumers should contemplate affordability requirements when borrowing and ought to avoid consciously over-indebting themselves. Consumers were further advised not to engage in major risks that can result in a debt cycle.³⁶⁸

³⁶³ Conway L 'The Consumer Credit Bill' (Research paper presented to the House of Commons Library) (January 2005).

³⁶⁴ Richards et al 'Irresponsible lending?' A case study of a UK credit industry reform initiative (2008) *Journal of Business Ethics* 502.

³⁶⁵ Edmonds T 'Consumer Credit Regulation' (2014) *House of Commons Library Briefing Paper No 06842*.

³⁶⁶ Richards et al 'Irresponsible lending?' A case study of a UK credit industry reform initiative (2008) *Journal of Business Ethics* 504.

³⁶⁷ Davey E 'New Consumer credit rules herald responsible lending culture' available at <https://www.guardian.com/money/blog/2011/feb/01/consumer-credit-rules-responsible-lending-culture> (accessed on 23 November 2018).

³⁶⁸ Seeking Alpha 'UK consumer debt: A cause for alarm?' available at <https://seekingalpha.com/article/4195621-u-k-consumer-debt-causes-alarm> (accessed on 23 November 2018).

The Consumer Credit Act is regarded as comprehensive credit legislation which provides greater consumer protection against unscrupulous credit providers.³⁶⁹ Furthermore, there has been a development in the credit market which strives to be more fair and competitive.³⁷⁰

4.4 The United States of America

4.4.1 Introduction

The practice of predatory lending in American law is often associated with overpriced and risky home loans and subprime loans.³⁷¹ It was in the 1990s that the practice began to evolve. Research showed that a substantial number of consumers were receiving loans at prices lower than the cost and that there was a major increase in relation to foreclosure rates.³⁷² The consumers who generally suffer the consequence of foreclosures are the African American, Latino, and low-to-moderate-income households who, to begin with, have little financial resources. The elderly consumers have also been targeted where predatory lenders obtain high prices by disguising them through up-front fees and high-risk loans.³⁷³ Predatory lenders in the USA frequently use clever marketing distractions to divert the focus of many consumers by coercing them to sign abusive agreements that will cause a catastrophe in their financial lives.³⁷⁴

4.4.2 Predatory Lending

Predatory lending is a prevalent issue of concern in the USA. Current laws which include disclosure laws are seen to be adequate to eradicate this issue, but a problem that lies with this law is that it needs to be enforced more vigorously.³⁷⁵ This is the

³⁶⁹ Vaughan E 'Consumer Protection- A guide to the consumer credit act 2006' (2006) available at www.glovers.co.uk/news_article205.html accessed on (28 November 2018).

³⁷⁰ Ibid.

³⁷¹ Wallis LE Decision making and the Limits of Disclosure: The Problem of Predatory Lending: Price' (2002) 65 (3) *Maryland Law Review* 713.

³⁷² Ibid.

³⁷³ Ibid.

³⁷⁴ McCoy P (2015) *Akron L. Rev* 726.

³⁷⁵ Wallis LE (2002) *Md. L Rev.* 739.

reason why there are anti-predatory laws to assist, particularly when it comes to vulnerable consumers. The anti-predatory laws include:

- a. Home Ownership and Equity Protection Act (HOEPA),
- b. The Truth in Lending Act (TILA), and
- c. Real Estate Settlement Procedures Act (RESPA).

The HOEPA legislation was introduced to ensure that there would not be any:

- a. unfavourable terms in credit agreements,
- b. increasing interest rates due to consumer default, and
- c. balloons on loans shorter than five years.³⁷⁶

Many states lack strong anti-predatory lending laws. The result of this is that there is an absence of meaningful due diligence and predatory loans become more prominent.³⁷⁷ Even though there are other federal and state laws which regulate predatory lending generally, these have failed in preventing several cases of predatory lending abuses. Unfortunately, today there are still many cases of lending abuses which are considered lawful under state and federal law. When it comes to due diligence, there should be actual compliance with anti-predatory lending criteria which can be done by thoroughly reviewing all individual loans. The two methods of verifying actual compliance are by way of automated compliance and manual inspection. Both methods have benefits and disadvantages. Automated compliance systems have only just been adopted and consist of checking all loans for compliance with state and federal anti-predatory laws, disclosure regulations, and measures that are selected by credit providers or investors.³⁷⁸

Automated compliance systems and manual due diligence are conducted with the purpose of verifying whether there has been acquiescence with federal, state and local consumer protection laws, including anti-predatory lending laws. However, the existing work of the federal, state and local laws still results in many cases of lending abuses being unregulated.³⁷⁹

³⁷⁶ Ibid.

³⁷⁷ Engel KC McCoy PA 'Turning a Blind Eye: Wall Street Finance of Predatory Lending' (2007) 75 *Fordham Law Review* 131.

³⁷⁸ Ibid.

³⁷⁹ Ibid.

All of the deceptive practices in this classification are violations of current laws, such as state fraud statutes, consumer protection laws and federal disclosure statutes such as TILA or the RESPA.³⁸⁰ Fraud, in the context of home lending practices, contains deception which is aimed at consumers. These include deceitful disclosures, failure to disclose information and home-repair scams. There are reports which indicate how credit providers finance fees without the knowledge of the consumer or even deliberately concealing loans on consumers' homes.³⁸¹

TILA, along with RESPA, entitles consumers to be given full price disclosures. TILA requires credit providers to disclose two key things. Firstly, to disclose the finance charge and secondly to disclose the annual percentage rate (APR).³⁸² In terms of RESPA, the legislation aims to provide consumers with sufficient disclosures about the costs for mortgages and obliges credit providers to provide consumers with different disclosure statements.

Credit providers lure consumers by promising to refinance loans at lower rates. In addition, a lending officer may encourage an innocent, impoverished consumer to sign a blank loan application only for the credit provider to then falsify and paint a good picture of the consumer so that the loan can easily be granted. Similarly, unscrupulous credit providers may do the same to justify a higher principal amount. Evidently making the consumers unaware of the fraud and victims.³⁸³

In 2003, the Office of Thrift Supervision (OTS) removed both prepayment rules and late fee rules from the list of its regulations that pre-empt state law under the Parity Act. The OTS had stated that 'the application of its late fee and prepayment penalty regulations to housing creditors might be contributing to predatory lending practices in the subprime mortgage market.'³⁸⁴ The need for change was to combat predatory lending. However, state consumer protection measures aimed at combating the predatory lending problem resulted in being pre-empted.³⁸⁵

The regulation further prohibits national banks from granting credit without properly assessing the consumer's capability to repay the debt. The regulation also outlaws

³⁸⁰ Engel KC McCoy PA (2002) *Tex. L. Rev.* 1267.

³⁸¹ *Ibid.*

³⁸² *Ibid.*

³⁸³ Engel KC McCoy PA (2002) *Tex. L. Rev.* 1268.

³⁸⁴ *Ibid.*

³⁸⁵ Forrester JP (2006) *U. Cin. L. Rev.* 50.

practices that would be considered misleading or deceptive.³⁸⁶ The purpose of having these pieces of legislations is to address abusive practices by credit providers and ensure that consumers are protected against these abuses.

4.5 Conclusion

It is evident as discussed above, that reckless and predatory lending practices are practices which are prevalent in many other jurisdictions. This is not just a problem faced in South Africa. It can be seen that it is often vulnerable consumers who are targeted; consumers who do not understand things like interest rates and additional fees and who are therefore unaware that a relatively small or manageable loan can balloon into a huge problem thereby creating a life time of debt. In order to deal with these problems legislation in many jurisdictions have been introduced. An examination of this legislation indicates that in order to deal with reckless and predatory lending the following is required:

- In Canada, the main source of credit legislation is the Banks Act. The Banks Act includes express consent provisions and minimum disclosure requirements to help consumers make informed decisions and for reckless credit granting to be eradicated.
- Payday lending is a prominent predatory practice that affects millions of people. Alberta, Western Canada has introduced the Act to end Predatory Lending which allows consumers to pay in instalments and regulates the credit industry by ensuring that credit providers do not grant loans to consumers who already have existing loans.
- The CCA regulates the UK's credit industry. It obliges credit providers to conduct credit assessments prior to granting credit and makes it mandatory for credit providers to disclose to consumers the cost of credit and consequences of failing to make payment so that consumers are informed as to whether they are financially capable of becoming indebted.
- The three main legislations in the USA deals with the many different aspects of predatory lending. HOEPA protects consumers against unfavourable terms in

³⁸⁶ Ibid.

credit agreements and unjustly interest rates and TILA and RESPA deal respectively with the prevalent issue of fraud by enforcing strong disclosure requirements. These laws were put into place to ensure credit providers perform credit transactions wisely and help consumers make educated financial decisions.

- It is important to note that South Africa has a very similar position in respect to the other jurisdictions as the NCA incorporates most of the provisions stated above. For instance, the NCA ensures that interest rates included in credit agreements do not exceed what is stated in the Act and that it is mandatory for disclosures to be made to consumers prior to entering into agreements. Furthermore, it has specific provisions which set out the consequences for credit providers who are fraudulent, predatory and reckless. The legislations above may be named differently, but the intention is the same and that is to eradicate practices that cause harm to consumers and the economy.

CHAPTER 5:

CONCLUSIONS AND RECOMMENDATIONS

5.1 Conclusion

Reckless lending and predatory lending constitute prohibited conduct under South African law. According to the NCA, it is prohibited to grant loans to consumers who lack the means to repay these loans.³⁸⁷ As indicated in the previous chapters, these practices have a serious impact on consumers and has a domino effect on the economy.³⁸⁸ The problems of these practices have been discussed in this dissertation and even indicates how other countries deal with this conduct.

The evolution of the credit market requires that as the industry progresses, so does the need for updated legislation. Previously, credit legislation was characterised by a lack of access to reasonably priced credit for the majority of the population.³⁸⁹ When the National Credit Act was implemented, it was shown that the Act had a positive impact on the South African economy.

The purpose of this legislation is to ensure that credit is been granted righteously and in a justifiable manner. The NCA seeks to eradicate practices such as reckless and predatory lending and simply provides requirements that are just and equitable and applicable to every consumer. The NCA consists of a broad framework that set out regulations for consumers and credit providers in the credit industry and sets out severe penalties for non-compliance.

The main purpose of this research was to analyse and explain the practice of reckless lending and predatory lending in South Africa and the consequences for credit providers who are guilty in engaging in such practices. It was important to include a comparative study to indicate how other jurisdictions deal with these practices. Upon

³⁸⁷ Information regarding this can be found on the reckless lending website 'Reckless lending in South Africa' available at reckless-lending.co.za/reckless-lending-south-africa/ (accessed on 27 December 2018).

³⁸⁸ Information regarding this can be found on the reckless lending website 'Effects of over-indebtedness' available at reckless-lending.co.za/effect-of-over-indebtedness/ (accessed on 27 December 2018).

³⁸⁹ DTI 'Making Credit Markets Work, A policy framework for consumer credit' available at www.ncr.org.za/publications/Background_NCA_docs/CreditLawReview.pdf (accessed on 15 November 2018).

comparing South Africa's NCA with other jurisdictions, it was found that the NCA and the amendment bill, which is yet to be properly enacted, is on the right path to solving credit discrepancies. Each country discussed has executed different credit legislation, but they all promote the same purpose, which is to prevent and provide solutions for practices such as reckless and predatory lending.

In this dissertation, it was found that when credit legislation is being enacted, it is mandatory that there is a correct and appropriate balance between the credit provider and the consumer. The DTI had the right intention when the NCA was enacted, but the problem lies in the fact that over time, credit providers went back to their old routine which involved participating in reckless and predatory lending.

The government decided to draft and submit an amendment bill which includes new affordability assessments and demonstrates how the credit industry can be properly monitored. In turn, this provides an advantage for both consumers and credit providers as the practice of reckless lending can be slowly eradicated.

5.2 Recommendations

The following recommendations are proposed:

- As indicated previously, South Africa has a significant number of consumers who are financially illiterate. To be financially illiterate means that consumers have the required resources of sufficient income and assets but they desire a more lavish lifestyle which results in higher credit use. Hence, the government should implement more short courses and workshops to help consumers improve their planning, budgeting and saving plans. The result of this is that consumers can efficiently manage the controlling of credit and have enough money to make ends meet at the end of the month instead of applying for more loans to pay off debts.
- South Africa has one of the most progressive credit legislations in the world which can be seen above as it incorporates many aspects that are included in first world jurisdictions. The problem faced in South Africa is the factor of proper enforcement. For example, consumers who have obtained their loans from unregistered credit providers. The NCA must be properly applied and those

provisions which relate to unlawful loans must be applied. At the moment, the NCA allows the court or Tribunal to make any order which is just and equitable in the circumstances when it comes to prohibited conduct by credit providers which even includes declaring the agreement to be void. The issue however, is that someone has to approach the court to do this as an agreement cannot automatically be void. Thus, there should be more pressure on credit officials such as debt counsellors to ensure that over-indebted consumers as a result of prohibited conduct should refer the matter to the court or the Tribunal so that loans can be written off.

- It is acknowledged that although the NCA caters for predatory practices, it fails to have a specific section for predatory lending. It is suggested that South Africa enforce more vigorous anti-predatory laws as there are still many consumers who are being abused in the money lending business and many credit providers who use deceptive methods to persuade consumers into entering credit agreements. There are many predatory practices as seen above. Thus, having these new legislations which focusses primarily on predatory practices would enhance consumer protection and will impose more severe penalties for credit providers guilty of engaging in the practice.

The NCA proves to be an effective credit legislation aimed at helping many consumers in the credit market. Although, there are many criticisms, the Act is seen to be progressive in comparison to the prior Acts. The new credit Amendment Act which is currently undergoing amendments to the main Act is hoped to decrease the amount of over-indebtedness in South Africa and create a credit market which completely eliminates the practice of reckless and predatory lending. Furthermore, if there is vigorous enforcement, it would provide enhanced consumer protection and ensure that the practices of reckless and predatory lending are handled in a way which promotes the objectives of access to credit.

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3 September 2018

Miss Ovayshea Govender 214539011
School of Law
Howard College Campus

Dear Miss Govender

Protocol reference number: HSS/1413/018M

Project title: A critical examination of reckless and predatory lending and how the National Credit Act seeks to prevent these practices

FULL APPROVAL – No Risk/Exemption Application

In response to your application received 2 August 2018, the Humanities & Social Sciences Research Ethics Committee has considered the abovementioned application and the protocol has been granted **FULL APPROVAL**.

Any alteration/s to the approved research protocol i.e. Questionnaire/Interview Schedule, Informed Consent Form, Title of the Project, Location of the Study, Research Approach and Methods must be reviewed and approved through the amendment /modification prior to its implementation. In case you have further queries, please quote the above reference number.

PLEASE NOTE: Research data should be securely stored in the discipline/department for a period of 5 years.

The ethical clearance certificate is only valid for a period of 3 years from the date of issue. Thereafter Recertification must be applied for on an annual basis.

I take this opportunity of wishing you everything of the best with your study.

Yours faithfully



.....
Professor Shenuka Singh (Chair)
Humanities & Social Sciences Research Ethics Committee

/pm

cc Supervisor: Professor TA Woker
cc. Academic Leader Research: Dr Shannon Bosch
cc. School Administrator: Ms Robynne Louw/ Mr P Ramsewak

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