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The Regulation of Once-off Credit Agreements: Reflections on Government Gazette No 39981 Notice N513 through *Du Bruyn NO and Others v Karsten* (929/2017) [2018] ZASCA 143 (28 September 2018)

Herbert Kawadza
Associate Professor
School of Law University of the Witwatersrand

Abstract

This note seeks to discuss the new threshold pertaining to once-off credit agreements against the backdrop of Du Bruyn NO and Others v Karsten *and shows that the new regime is a crucial step towards the creation of an accountable credit market in the country, particularly the unregulated informal lending sector. It argues that the strict construal of the National Credit Act provides crucial clarifications on the regulatory regime and amounts to a commendable attempt at bringing certainty to the regulation of the unregistered lending sector. Furthermore, this note asserts that the new threshold is a step towards enhancing consumer protection in the South African credit market.*

Keywords: Credit, Debt, National Credit Act, Unregulated credit agreements, Once off credit agreements, social lending.

* PhD (Manchester) LLM (London) PGCE (Manchester) LLB Hons (Zimbabwe)

1 INTRODUCTION

The availability of credit has always played an important role in our lives in one way or another.[1] Much as "credit is an invaluable tool in our economy ... It must, however, be used wisely, ethically and responsibly."[2] Such an admonitory statement comes in the wake of shocking statistics that point to South Africans being among the most indebted in the world.[3] Several circumstances have combined to inexorably place borrowers in the grip of lenders, more than they have in some of the other settings. These include the historically low wages in South Africa and the proliferation of sources of credit.[4]

Scholars and the press have brought into sharp and painful focus the debt related vulnerabilities and the associated inadequacies of current models of regulating the credit market in the country.[5] Informed by such an environment the South African government has sought to intervene through legal instruments aimed at *inter alia*, stimulating fairer credit markets and protecting borrowers through ethical lending. However, the bulk of those efforts have been slanted towards the formal regulated credit sector such as banks, micro lenders, and the retail industries and not so much towards informal or social lending. The notable requirement that captured social lending was section 40 of the National Credit Act, 34 of 2005 (the NCA) which – when originally enacted – obliged a lender to register as a credit provider only if the amount to be loaned exceeded R500 000 or if that person was a credit provider under at least 100 credit agreements, other than incidental credit agreements. As such, section 40(1)(a) of the NCA did not require the registration of a credit provider if the transaction pertained to an incidental credit agreement.[6]

Unrelenting reports of unethical lending fostered by such flaws have made a compelling case for further legislative and judicial intervention particularly on the issue of once-off unregistered lending. As such, on 11 May 2016, *Government Gazette* No 39981 Notice N513 (hereafter GG3998") was published and its effect was the reduction of the threshold for credit provider registration from R500 000 to zero.

This note seeks to discuss that new threshold pertaining to once-off credit agreements against the backdrop of *Du Bruyn NO and Others v Karsten* (929/2017) [2018] ZASCA 143 (28 September 2018) (hereafter *De Bruyn v Karsten*) and shows that the new regime is a crucial step towards redesigning the unregulated informal lending sector with a view to crafting an accountable credit market in the country.

2 THE FACTS

In *De Bruyn v Karsten*, Mr and Mrs Du Bruyn (the appellants) offered to buy out Mr Karsten's interest in three business entities for a total of R2 000 000.[7] The sum was to be paid in instalments of R30 000 per month over a period of five years. A deposit of R500 000 was to be paid and

1 See e.g. Van der Walt "Bank Credit to the Private Sector" https://www.resbank.co.za/Lists/News%20and%20Publications/Attachments/4807/Article%20-%20Bank%20credit%20to%20the%20private%20sector.pdf (accessed 12-07-2020); Collins "Debt and Household Finance: Evidence from the Financial Diaries" 2008 *Development Southern Africa* 469.

2 *Kubyana v Standard Bank of South Africa Ltd* 2014 (3) SA 56 (CC) para 38.

3 National Credit Regulator "Consumer Credit Market Report - Third Quarter, September 2017" http://www.ncr.org.za/documents/CCMR/CCMR%20 2017Q3.pdf (accessed12-07-2020); The Banking Association of South Africa "Lenders and Regulators Need to Take Action" http://www.banking.org.za/news-media/association-news/lenders-and-regulators-need-to-take-action (accessed 12-07-2020) ; Kawadza "Remarks on Lending Reforms Ushered in by Regulation 23A of the Affordability Assessment Regulations" 2018 *De Jure* 163.

4 James "Deeper into a Hole? Borrowing and Lending in South Africa" 2014 *Current Anthropology* 17; Ardington, Leibbrandt and Levinsohn "Savings, Insurance and Debt over the Post-apartheid Period: A Review of Recent Research" 2004 *South African Journal of Economics* 604.

5 See for example De Wet, Botha and Booyens "Measuring the effect of the National credit Act on Indebtedness in South Africa" 2015 *Journal of Economic and Financial Sciences* 83; Kreuser "The Application of Section 85 of the National Credit Act in an Application for Summary Judgment" 2012 *De Jure* 1.

6 Section 1 of the NCA states that such an agreement is one "in terms of which an account was tendered for goods or services that have been provided to the consumer, or goods or services that are to be provided to a consumer over a period of time and either or both of the following conditions apply 1. A fee, charge or interest became payable when payment of an amount charged in terms of that account was not made on or before a determined date, or2. Two prices were quoted for settlement of the account, the lower the price being applicable if the account is paid on or before a determined date, and the higher price being applicable due to the account not having been paid by that date."

7 Paragraphs 4-12

interest was to be levied on the deferred amount. Mr and Mrs Du Bruyn bound themselves as sureties and co-principal debtors for the agreements. They also agreed to register a covering bond over their immoveable property, within 60 days, which they guaranteed to be unencumbered. Throughout those transactions Karsten was not registered as a credit provider in terms of section 40 of the NCA.

The Du Bruyns subsequently defaulted on their repayments and in 2014 Karsten instituted breach of contract proceedings for R1 133 169.39 being the balance of the purchase price. In response, the Du Bruyns argued that the sale agreements were null and void due to Mr Karsten's failure to comply with the NCA. Furthermore, the Du Bruyns contended that what they solemnised were valid agreements of sale as per section 8 of the NCA and in accordance of which Karsten should have been registered as a credit provider at the time the agreements were concluded on 26 April 2013. They argued that failure to comply with sections 40(3) and 40(4) of the NCA rendered the agreements, the mortgage bond registration and the suretyship undertakings, unlawful and void. During the trial, Mr Karsten confirmed that he had to be registered as a credit provider in order to facilitate the registration of the covering bond.

Karsten had submitted that the sales agreements were not arms-length transactions and that as reiterated in *Friend v Sendal*[8] the NCA's requirement that the lender register as a credit provider was narrow; it was only meant for those in the credit market and not those engaging in a once-off transaction.[9] The Supreme Court of Appeal (SCA) identified that the issue before it centred on whether the NCA only applied to those trading in the credit industry to the exclusion of single transactions where credit was provided, notwithstanding the amount involved. Furthermore, the SCA noted that much as the approach in *Friend* was functional and sound, it was nonetheless incompatible with section 40 of the NCA which explicitly requires a person to register as a credit provider if the total debt exceeded what was then the prescribed threshold of R500 000.[10] The SCA went on to state that in so far as it was the threshold which triggered the obligation to register as a credit provider, the issue of whether a transaction was a single transaction was irrelevant.[11] It ruled that Karsten's subsequent registration was insufficient. Based on that, the SCA set aside the order of the High Court and ruled in favour of the Du Bruyns.

8 (2015) (1) SA 395 (GP).
9 Paragraph 13.
10 Paragraph 24–25
11 Paragraph 28.

3 REFLECTIONS

Government Gazette Notice 39981 and the SCA's judgment in *De Druyn v Karsten* are a welcomed and unequivocal acknowledgment of the devastating consequences of unfettered and unregulated credit transactions in South Africa. Such recognition comes in the face of an upsurge in statistics which show South African consumers as heavily indebted.[12] Furthermore, a shift towards regulating the credit market is backed by overwhelming evidence pointing to a close link between unsustainable debt and a wide range of health, family, and job woes.[13]

In the wake of the 2007–2009 global financial crisis , South African banks have become cautious lenders.[14] It is worth noting that the National Credit Amendment Act 19 of 2014 was crucial in this regard because it laid the foundation for the adoption of the affordability assessment regulations. On the basis of this an amendment to the NCA promulgated in 2015 brought in new regulatory requirements through which lenders need to conduct and assess affordability for every credit agreement they enter into.[15] These responses have had an unintended consequence of a "credit squeeze"; a contraction in the number of personal loans. In fact, according to the 2019 Consumer Credit Market Report unsecured credit agreements increased from R28.25 billion to R28.64 billion for June 2019.[16]

The lending shrinkage occasioned by stringent lending requirements in the regulated credit market has invariably resulted in a lending gap that the unsecured and unregulated credit market has been filling to satisfy the credit needs of those who are excluded from mainstream lenders. More specifically, while the main stream or formal lending sector has witnessed a drop in terms of the numbers of borrowers, the value of unsecured credit by unregulated lenders gained foothold, growing by 5,2% to R87.5 billion in 2017.[17] As such, it is clear that the wider the gap between borrowers and regulated lenders has become, the higher the figures of unsecured lending have become. This has exposed borrowers to what might turn out to be unsustainable debt obtained from unethical creditors.[18]

Thus, GG39981 has ushered a laudable feature which conveniently captures informal once off loans or short-term unsecured finance from family, friends or neighbours which as shown above, is gaining popularity mainly due to its convenience and the regulatory-induced shrinkage in the mainstream credit market.[19] For instance, a South African research conducted by Wonga Ltd

> suggests that mashonisas [loan sharks] are a far more widespread phenomenon than is often thought … Based on a physical count …, researchers conservatively estimated that there could be at least 40 000 mashonisas operating in South Africa. In fact, the qualitative evidence collected suggest this is likely to be a low estimate …Mashonisas offer quick and easy access to small, short-term (less than one month) cash loans that are utilised by borrowers to manage their monthly cash flows. They are typically used to finance immediate needs such as food, transport, cell phone airtime and pre-paid electricity, and less commonly used to finance

12 See SA Consumer Credit Index Q1 2018 https://www.transunion.co.za/resources/transunion-za/doc/campaign/CCI/INT-AF-18-265801-CCI-Q1-2018/TU-CCI-Report-Q1-2018.pdf (accessed 5-08-2020; Kawadza 2018 De Jure 163.

13 Seedat *et al* "Life Stress and Mental Disorders in the South African Stress and Health Study" 2009 SAMJ 375; Corrigall *et al* "Decreasing the Burden of Mental Illness" Western Cape Burden of Disease Reduction Project, Final Report 2007; Smith and Green "Water Service Delivery in Pietermaritzburg: A Community Perspective" 2005 Water SA 435.

14 See for instance Baxter "The Global Economic Crisis and its Impact on South Africa and the Country's Mining Industry" https://www.resbank.co.za/Lists/News%20and%20Publications/Attachments/51/Roger+Baxter.pdf (accessed 5-08-2020).

15 Department of Trade and Industry "National Credit Regulations Including Affordability Assessment Regulations" *Government Gazette*, 13 March 2015 http://www.creditombud.org.za/wp-content/uploads/2015/11/NATIONAL-CREDIT-REGULATIONS-INCLUDINGAFFORDALITY.pdf (accessed 7-08-2020).

16 Consumer Credit Market Report, Second Quarter June 2019 https://www.ncr.org.za/documents/CCMR/CCMR%202019Q2.pdf (accessed 7-08-2020).

17 Wonga.

18 See for instance Mashigo "The Lending Practices of Township Micro-lenders and their Impact on the Low-income Households in South Africa: A Case Study for Mamelodi Township" (2012) http://dspace.nwu.ac.za/bitstream/handle/10394/8260/No_65%282012%29_Mashigo_P.pdf?sequence=1&isAllowed=y (accessed 27-01-2019).

19 Morduch, Rutherford and Ruthven Portfolios of the Poor. How the World's Poor Live on $2 a Day (2009); FinMark Trust and Save Act "Impact Evaluation of Savings Groups and Stokvels in South Africa" 2018 http://saveact.org.za/wp-content/uploads/2018/11/FMT_Stokvels-and-SGs-Report_10-October-2018_final.pdf (accessed 17-08-2020).

unexpected once-off expenses such as funerals.[20]

The utility of such lending – convenience and accessibility of such loan sharks – seems to have legitimatised the activities of informal lenders.[21] Besides its accessibility, there are other benefits that characterise this form of financing. To begin with, there is the element of proximity or personal knowledge between lenders and borrowers. Loans are worked out on a mutually agreed formula and granted on a face-to-face basis. Close acquaintance between the parties generally means that no collateral and intricate paperwork are needed. This cuts administration and information asymmetry. Less bureaucracy invariably means that credit is accessible when it is most needed and within the shortest possible time.[22]

Much as the availability of credit has assisted in softening the economic adversities of the low-income earners, it is the characteristic lending practices, especially during collections that are a cause for concern.[23] It is reported that other than reckless lending, collections are effected through verbal and at times physical harassment, social shaming and shockingly high interest rates.[24]

Since unregulated lending will always be part of the economy, there is need to ensure that the unsecured lending sector be subjected to some form of regulation. Left to itself in an unregulated environment the sector will only serve to perpetuate some of its adverse features on borrowers. As such, GG39981 should be commended as an attempt at absorbing the informal into the formal lending sector through legalisation and institutionalisation. Regulatory intrusion is arguably a result of the recognition that "the informal sector by itself plays a beneficial role in overall economic growth, and therefore the two sectors should in fact be linked and should complement each other."[25] As has been noted, "informal credit markets existing side by side with the formal sector play a vital role in the mobilisation and allocation of capital as they complement the resources supplied by formal financial intermediaries."[26] As has been argued above, this is also reflective of the South African context.

The far-reaching financial implications of GG39981 and *De Bruyn v Karsten* will be felt by all the parties in once-off credit transactions. While borrowers are likely to be afforded legal protection arising from the NCA's stipulation of fees charged on loans, for the once-off lender it means more costs in the form of *inter alia*, registration, compliance and annual licensing fees. Borrowers will also feel the effect especially in instances of an emergency where they need money urgently but where the lender cannot disburse pending registration in terms of the NCA. Lenders might have to consider other ways of avoiding the registration requirements by not charging loan fees and interest.

For the new threshold to be administratively effective, the acceleration of the creditor registration process by the National Credit Regulator (NCR) would be a must. As shown in *De Bruyn v Karsten* the process takes a long time and that negatively impacts on those who would want to offer someone a loan, pending registration. The NCR has always faced funding challenges and has been ill-equipped to monitor the vast credit industry.[27] Unfortunately, the widened net or blanket registration obligation under *Government Gazette* Notice 39981 has added even more credit providers (both persons and institutions) to its portfolio and it is inevitable that more supervisory and enforcement resources be added to its armoury for the regulator to effectively execute the mandate of the NCA. It is unlikely that even with resources, expecting the regulator to efficiently monitor the large volumes of credit providers in the

20 Wonga "Informal Lending Report" (2018) 5 https://www.wonga.co.za/media/1066/wonga-mashonisas-brochure-2018-web.pdf.
21 See Reynolds "Predatory Loan Sharks Offer Lifeline to Many" *IOL* 24 May 2018.
22 Srinivas and Igel "The Co-option of Low-income Borrowers by Informal Credit Suppliers" 1996 *Third World Planning Review* 287.
23 Bahre *Money and Violence: Financial Self-help Groups in a South African Township* (2007); Crankshaw "Class, Race and Residence in Black Johannesburg, 1923–1970" 2005 *Journal of Historical Sociology* 353.
24 Benjamin "Garnishee Abuse is Order of the Day" *Mail & Guardian* (25 October 2013) https://mg.co. za/article/2013-10-25-00-garnishee-abuse-is-order-of-the-day (accessed 21-08-2020)
25 Germidis, Kessler and Meghir "Financial Systems and Development: What Role for the Formal and Informal Financial Sectors?" *Development Centre Studies* (1991) 1.
26 Srinivas and Igel *Third World Planning Review* 287 287.
27 See for example National Credit Regulator Annual Report 2017/18; National Debt Advisers "Consumer Protection Bodies Join Forces!" (2016) https://nationaldebtadvisors.co.za/consumer-protection-bodies-join-forces/ (accessed 28-08-2020).

country would be idealistic.

It can reasonably be argued that a corollary of the enlarged numbers of registered credit providers would be an upsurge in unlawful credit agreements. It is also likely to trigger an increase in lawsuits emanating from noncompliance with the regulatory requirements In fact, cases such as *Collotype Labels RSA (Pty) Ltd v Prinspark CC and Others*[28] and *Maepi v Abrahams*[29] which dealt with similar issues could be a manifestation of this. Whether the NCR is fully equipped to deal with such an environment remains to be seen.

Government Gazette Notice 39981 and *De Bruyn v Karsten* might be misinterpreted to mean that the once-off borrowers from an unregistered credit provider do not have to repay the debt. However, in *National Credit Regulator vs Opperman and Others*[30] the Constitutional Court ruled that the credit provider would still have a right to recover the capital loan amount on the ground of unjustified enrichment. However, the credit provider would not be able to recover any interest or other charges in terms of the agreement.

4 CONCLUSION

It is worth noting that in its own admission, the Supreme Court of Appeal stressed that it was handing down the judgment with reservations; the ruling was an "imperfect solution but whose consequences… arefor the legislature to remedy."[31] Notwithstanding that, in so far as it has sought to interpret *Government Gazette* Notice 39981 through the context of social lending, *De Bruyn v Karsten* is undeniably path-breaking. Its strict construal of the NCA provides crucial clarifications on the regulatory regime and amounts to a commendable attempt at bringing certainty to the regulation of the unregistered lending sector. This note asserts that the new threshold is a step towards enhancing consumer protection in the South African credit market. Likewise, *De Bruyn v Karsten* provides a compelling illustration of legislative efforts towards bringing sanity in the credit sector.

28 (6722/2016) [2016] ZAWCHC 159 (9 November 2016).
29 (43355/15) [2015] ZAGPPHC 885 (21 August 2015).
30 2013 2 SA 1 (CC) (10 December 2012).
31 Paragraph 28