ombudsman for banking services
SOUTH AFRICA

Bulletin 5

Responsible Lending

Introduction

We receive complaints relating to the assessment of credit applications by the banks and the effect that this can have on complainants. The complaint is usually based on the following set of facts:

1. The complainant applies for credit from the bank.
2. The bank assesses his ability to repay and grants the credit.
3. Later, the complainant finds himself in financial difficulties and is unable to afford the repayments.
4. The bank starts legal proceedings against the complainant to try and recover the debt.
5. The complainant then approaches our office for assistance and claims that the credit was granted recklessly.

The National Credit Act,[1] which came into effect on 1 June 2007, provides the regulatory framework for the South African credit market. The NCA promotes responsible lending practices. Part D of Chapter 4 of the Act is aimed at preventing reckless credit- granting and over-indebtedness; it further provides debt relief measures to deal with consequences of reckless credit -granting and over-indebtedness.

Our office is only concerned with any maladministration that may have occurred in the process and not with the commercial decisions of the banks.

It must be noted that, both the credit provider and consumers are obliged to co-operate in the prevention of reckless credit: the credit provider by conducting a proper assessment as required by the Act prior to extending credit, and the consumer by answering fully and truthfully during the assessment.

When is credit granted recklessly?

To prevent credit being granted recklessly, the NCA imposes an obligation on a credit provider to conduct a pre-agreement assessment prior to extending credit. The purpose of the assessment is to establish whether a consumer can afford to repay the proposed credit on the terms and conditions as set out in the agreement. [2]

[1] Act 34 of 2005. Hereafter referred to as "NCA"
[2] See Scholtz, Otto, van Zyl, van Heerden and Campbell "Guide to the National Credit Act" (2017) for a more detailed discussion on reckless credit.

In terms of section 80 of the NCA, there are three situations in which reckless credit could be said to have been granted. A credit agreement is reckless if, at the time the agreement was made, or when the amount approved in terms of the agreement is increased, other than an increase in terms of section 119(4) –

(a) the credit provider failed to conduct an assessment as required by section 81(2), irrespective of what the outcome of such an assessment might have concluded at the time; or

(b) the credit provider, having conducted an assessment as required by section 81(2), entered into the credit agreement with the consumer despite the fact that the preponderance of information available to the credit provider indicated that –

(i) the consumer did not generally understand or appreciate his risks, costs or obligations under the proposed credit agreement; or
(ii) entering into that credit agreement would make the consumer over-indebted.

In respect of the first type of reckless credit noted above, a credit provider's failure to conduct a pre-agreement assessment before extending credit, makes the credit agreement per se reckless. Even if it is shown that the consumer would have been able to afford the credit and an assessment would merely have confirmed this, it would not change the fact that the credit was granted recklessly due to the credit provider's failure to conduct a compulsory section 81(2) assessment.

The second type of reckless credit is regarded as reckless because, even though the credit provider conducted a pre-agreement assessment, it disregarded the fact that the preponderance of available information indicated that the consumer was generally ignorant regarding the risks, costs and obligations under the credit agreement.

The third type of reckless credit is where even though a pre-agreement assessment was carried out, and indicated that the granting of credit under the specific agreement would render the consumer over-indebted, the credit provider disregarded such information and granted the credit.

It must be noted that a mere bare allegation by a consumer that credit was granted recklessly will not suffice. This approach has been confirmed by our courts.[3]

[3] See *Mercantile Bank v Hajat* 2013 ZAGPJHC 134, 134. See also *SA Taxi Securitisation (Pty) v Mbatha* 2011 (1) SA 310 (GSL).

The pre-agreement assessment requirement

The section 81 pre-agreement assessment requirement of the NCA is crucial in preventing credit being granted recklessly. It is clear from the reading of the section, that it not only relates to affordability but also to the consumer's ability to understand the consequences of obtaining credit and his/her credit repayment history.

The NCA not only prohibits reckless credit-granting, but also imposes peremptory pre-agreement assessment requirements to avoid this. Section 81(2)(a) of the Act prohibits a credit provider from entering into a credit agreement without first taking reasonable steps to assess the proposed consumer's general understanding and appreciation of the risks and costs of the proposed credit, of his rights and obligations under a credit agreement as well as his debt repayment history as a consumer under credit agreements and his existing financial means, prospects and obligations.

Essentially the credit provider must be able to show that it conducted a pre-agreement assessment and that the relevant considerations noted above were discussed and accepted / understood by the consumer.

It is important to note that prior to 13 September 2015, section 81(2) served as basic provision in the NCA against which a credit provider's compliance with the pre-agreement assessment obligation had to be tested. However, after 13 September 2015, a credit provider's compliance with the pre-agreement assessment obligation must be determined with reference to section 81(2) read with the Final Affordability Assessment Regulations as set out in paragraph 11.5.6(f). The Final Affordability Assessment Regulations lay down certain standard requirements, which such assessments will have to be met to pass the obligation of the credit provider to refrain from reckless credit granting.

Responsibilities of the consumer

Section 81(1) provides that when applying for credit, and while the application is being considered by the credit provider, the prospective consumer must fully and truthfully answer any requests for information made by the credit provider as part of the assessment. Essentially the section also places an obligation on the consumer to prevent the granting of reckless credit.

In terms of section 81(4) of the NCA, it is a complete defence to an allegation of reckless credit if the credit provider can show that the consumer failed to answer fully and truthfully any such request for information made by the credit provider and if a court or

the Tribunal establishes that the consumer's failure to do so materially affected the ability of the credit provider to make a proper assessment.

It must be noted however, that this defence is only available to a credit provider if the credit provider took reasonable steps to conduct the assessment in accordance with the matters that should be considered for purposes of section 81(2) of the Act and now, with the Final Affordability Assessment Regulations.

Powers of the court and Tribunal when reckless credit has made the consumer over-indebted

In terms of section 83(1) of the Act, a court (and now also the Tribunal) can declare a credit agreement reckless.

If it is found by a court or Tribunal that a credit agreement is reckless because entering into that specific agreement made the consumer over-indebted, the court and Tribunal must consider the consumer's state of over-indebtedness both at the moment of entering into the agreement and at the time that the court or the Tribunal declares the agreement reckless.

The wording of section 83(3)(a) and (b) indicates that although a credit agreement may be declared reckless because it resulted in over-indebtedness, the court or Tribunal will be able to exercise its powers in terms of section 83(3) only if the consumer is still over-indebted when the court or Tribunal makes the declaration of over-indebtedness. If the consumer is still over-indebted, the court or the Tribunal has a discretion to suspend the force and effect of the reckless agreement in accordance with provision 84 and to restructure any other obligation under any other credit agreement entered into by the over-indebted consumer.

It is important to note that once the consumer's other credit agreements have been restructured by the court or Tribunal, the consumer may not incur any further charges under a credit facility or enter into any further credit agreement other than a consolidated agreement, and the credit provider may not exercise or enforce by litigation or other judicial process, any right or security under that credit agreement.[4]

[4] (n 1) – S88

The Code of Banking Practice

Clause 8 of the *Code of Banking Practice* deals with Credit.

Section 8(1) specifically states:

8.1 Provision of Credit

8.1.1 We will extend credit to you in a manner that is responsible and that matches your borrowing requirements and financial capability, so as to ensure as far as possible that you are not extended beyond your financial means. You are also responsible for ensuring that you do not extend yourself beyond your financial means.

8.1.2 Our ability to do so is heavily dependent on your co-operation and the full disclosure of your financial obligations. You must provide complete and accurate information to your bank as part of the credit application process.

Before extending credit, we will

8.1.3 assess your general understanding and appreciation of the risks and costs of the proposed credit and your rights and obligations under the credit agreement. We will make available to you educational information on how to manage debt and how to manage specific products, such as your mortgage, where appropriate, as outlined in more detail below;

8.1.4 assess your ability to afford and willingness to repay the credit you applied for. This credit assessment may take into account a range of factors, such as:

- *i. your income and expenses and statement of assets and liabilities;*
- *ii how you handled your financial affairs in the past;*
- *iii. how you have conducted your previous and existing accounts with us;*
- *iv. information obtained from credit risk management services and related services, and other appropriate parties, for example, employers, other lenders and landlords; and*
- *v. any security or collateral provided.*

8.1.5 provide you with the costs and Terms and Conditions of the credit you applied for, prior to signing the credit agreement.

8.1.6 If we decline your application for credit and you request the reason/s, we will provide you with the main reason/s, in writing, which could include:

- *i. the overall credit score;*
- *ii. information obtained from credit risk management services;*
- *iii. the outcome of the credit assessment;*
- *iv. over-indebtedness; or*
- *v. a specific policy of the bank.*

With automated credit scoring systems these reasons may not be explicit, in which case only general reasons may be provided.

Clause 8 of the *Code of Banking Practice* details the bank's obligations as contained in the relevant sections of the NCA discussed above.

Conclusion

The NCA obliges a credit provider to take reasonable steps to conduct a proper assessment of a consumer's affordability at the time of the application to avoid reckless credit granting.

Although the obligations imposed on credit providers by far outweigh the obligations placed on consumers, it is important to note that consumers have a duty to ensure that they fully and truthfully answer any requests for information made by the credit provider as part of the assessment. Failure to do so, afford the credit provider a complete defence to any allegation of reckless lending.

As noted above, when investigating complaints of this nature, our office is concerned with any maladministration that may have occurred in the process and not with the commercial decisions of the banks.

When investigating these complaints, we adopt an inquisitorial approach and obtain all the information that is considered relevant to the assessment of whether there has been any maladministration. Our office will consider whether the complainant acted with bone fides at all times in its dealings with the bank and that they freely, openly and honestly appraised the bank of all pertinent financial and circumstantial facts surrounding their application for facilities, to facilitate correct lending decisions. A 'both sides of the story' approach must be followed.

Once all this information has been obtained, an assessment of whether the duty of care has been complied with or breached can be made.

The Ombudsman for Banking
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