A CREDIT PROVIDER’S COMPLETE DEFENCE AGAINST A CONSUMER’S ALLEGATION OF RECKLESS LENDING

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Introduction

- In South Africa ("SA") credit supplied to consumers are strictly regulated by the National Credit Act of 2005 ("NCA") – fully operational since 1 June 2007.
- Act applies, with only a few exclusions, to all consumer credit agreements concluded between parties dealing at arm’s length & made, or having an effect within, SA.
- NCA aims to encourage responsible borrowing & avoid over-indebtedness and reckless lending.
- ‘Reckless lending’ as a general concept is well known in countries like Australia, the UK, and the USA. Before the NCA this concept was unknown in SA.
- The global financial crisis clearly illustrates that a wrong appreciation of the lending risks and a wrong assessment of a borrower’s ability to pay back a loan can start a chain reaction and endanger economic growth in a large part of the world.
- Provisions in the NCA preventing reckless lending & over-indebtedness are controversial.
- It is these rigorous provisions that have had the unintended consequence of closing access to credit for many & have ‘strangled a burgeoning property market’; but these are also the provisions that have cushioned SA from the current world-wide credit crunch/financial crisis which has shaken most of the developed world to its core.
Over-Indebtedness and Reckless Credit

• Creditor wanting to conclude an agreement with a prospective consumer must first do a compulsory pre-assessment of the consumer’s situation (eg, assessing his affordability, debt repayment history, & general understanding of the risks and obligations of the agreement).

• Provisions of over-indebtedness & reckless credit do not apply where consumer is a company, cc, partnership or certain trusts - apply only to natural persons, stokvels & certain types of trusts.

• Provisions of reckless credit do not apply to certain loans:
  – school, student, emergency loans;
  – public interest credit agreement;
  – incidental credit agreement;
  – temporary increase in credit limit under a credit facility; or
  – a pawn transaction.

• Consumer must fully and truthfully answer ANY REQUEST FOR INFORMATION MADE BY CREDIT PROVIDER when application for a credit agreement is made (express duty of consumer).
When is a consumer over-indebted?

• If the preponderance of available info at the time the determination is made indicates that the consumer is/will be unable to satisfy in a timely manner all the obligations under all his credit agreements, having regard to:
  – financial means, prospects and obligations (ie, any income/financial obligations/income from other family members in household); and
  – probable tendency to satisfy in a timely manner all the obligations under his credit agreements, as indicated by his history of debt repayment.

• Person making determination must apply above criteria as they existed at the time the determination is made.
Reckless credit

Agreement was reckless if, at the time the agreement was made:

- **Creditor provider failed to take reasonable steps to assess:**
  - the proposed consumer’s:
    - general understanding/appreciation of risks & costs of credit, rights and obligations;
    - debt re-payment history under credit agreements;
    - existing financial means, prospects & obligations; and
    - whether there is a reasonable basis to conclude that any commercial purpose may be successful, if the consumer has such a purpose for applying for credit.

- **Or creditor provider made such assessment and entered into agreement, despite the fact that:**
  - consumer did not understand/appreciate risks, costs or obligations; or
  - entering into it would make consumer over-indebted.
Reckless Credit (cont…)

• Person making the determination must apply above criteria as they existed at the time agreement was made.

• Complete defence for creditor to an allegation of reckless credit if:
  – creditor establishes that consumer failed to fully & truthfully answer any request for info made by creditor as part of the compulsory assessment; and
  – a court or National Consumer Tribunal determines consumer’s failure materially affected creditor provider to make proper assessment.

(Thus onus on creditor to prove it has a valid defence and not every failure by consumer to fully & truthfully answer any request for info will necessarily entitle the creditor to this defence.)
Reckless Credit (cont…)

Court may suspend reckless credit agreement in any court proceedings in which a credit agreement is being considered.

- If declared reckless:
  - setting aside all/part of obligations; or
  - suspend the force and effect of agreement.

- When court declares reckless, it must also consider whether consumer is over-indebted. If over-indebted:
  - suspend force & effect of agreement; and
  - restructure consumer’s obligations into NCA.

Before court makes order of over-indebtedness it must consider certain aspects:

- current means and ability at time agreement was made; and
- expected date when obligations under agreement will be fully satisfied, assuming consumer makes all required payments in accordance with any proposed order.
What is the effect of suspension of a credit agreement?

• During:
  – not required to make any payment;
  – no interest, fee or other charge may be charged; and
  – creditor’s rights into agreement or any law unenforceable.

• After:
  – all rights and obligations revived, except if court provided otherwise;
  – no fees, charges or interest may be charged that were unable to be paid during suspension.
National Register of Credit Agreements

- Regulator must establish & maintain a single National Register of outstanding credit agreements based on info provided to it.
- Creditor must upon entering into, amending, settling, or terminating a credit agreement report certain info either directly to the National Register or to a credit bureau in the prescribed manner and form.
- Creditor must report transfer of an agreement to the National Register.
- Credit bureau must transmit any info reported to it by a creditor to the National Register.
- To contain minimum data to perform affordability assessments (loan and repayment status only (no “payment history”)).
- Delayed operation of the National Register.
Credit Bureaus

- Consumer has right to confidential treatment of his credit info.
- Credit Bureaus
  - Registration requirements and entry criteria.
  - Regulated (monitored by Regulator, could be prosecuted if not compliant).
  - Deals with the credit bureau info.
    - Defines “consumer credit information”.
    - Sets out duties of a credit bureau.
  - Free records & data correction requirement; data acceptance, verification, retention; uses of credit bureaus data.
- Right to access and challenge credit records and info held in National Register and by a credit bureau.
Case law - *Horwood v FirstRand Bank*

- Consumer applied to have 5 agreements declared reckless & for an order to set aside part of her obligations. Eg, concluded a mortgage agreement in 2005 for ZAR875 000 and in July 2007 borrowed an additional amount of ZAR200 000 secured by a 2nd mortgage.
- Argued that the 2nd mortgage constituted a new loan agreement & that the principal loan amount approved ito it was the sum of ZAR1 075 000.
- Argued that the reckless credit provisions applied to her “entire indebtedness” under consideration since “the greatest majority of withdrawals” was from August 2007 (ie, after the commencement of the provisions on 1 June 2007).
- Court disagreed – the relevant time for determining whether agreement is reckless is when the agreement was concluded/when the amount approved ito it was increased – the times of withdrawal of amounts not relevant to this determination.
- Consumer argued the 2nd mortgage was reckless credit as creditor had failed to conduct a proper assessment as required.
- Facts proved creditor did a proper assessment.
- Consumer
  - denied the correctness of all the info relating to her income & expenses upon which the creditor relied to approve credit;
  - denied that she had furnished incorrect info to the creditor, but neglected to adduce the relevant facts/evidence to refute the creditor’ allegations; and
  - stated the creditor was not entitled to only rely on info provided to it.
Case law - *Horwood v FirstRand Bank*

- Creditor then raised the complete defence (consumer failed to fully & truthfully supply requested info while it conducted the assessment).
- Court considered that:
  - consumer was existing client;
  - info supplied by consumer was similar to previous info supplied for other agreements;
  - no indications that would alert a creditor to contrary conclusion of the correctness of info supplied;
  - creditor did a proper assessment.

- Court concluded that:
  - creditor met its statutory prescribed assessment obligations;
  - creditor had taken reasonable steps to assess the consumer’s financial position & therefore the credit was not granted recklessly; and
  - unnecessary to deal with the complete defence raised by the creditor.

- Court pointed out that an important issue that was not raised/argued by the parties was what the test for materiality was, but decided to leave this issue open.
Case law - ABSA Bank v Coe Family Trust

- Trust entered into a mortgage loan agreement.
- Trust defaulted and creditor issued summons & applied for summary judgment against the trust & 2 sureties.
- Allegation of reckless credit – creditor did not assess the creditworthiness as required.
- Mortgage agreement contained clause 11 providing as follows:

‘The borrower states that . . . entering into this agreement will not cause him to become over-indebted as contemplated in the National Credit Act; . . . he has fully and truthfully answered all and any requests for information made of him by or on behalf of the bank leading up to the conclusion of this agreement.’

- Creditor relied on clause 11 - argued it provided a complete defence against an allegation of reckless credit ito NCA.
- Based on papers - no indication that creditor had conducted a proper assessment.
- Court confirmed that NCA gave creditor a complete defence, but if no assessment was undertaken in the first place, then it was of no relevance.
- Creditor’s reliance on the standard terms to ascribe onerous statements (eg, clause 11) to the consumer could not be allowed unless brought particularly to the consumer’s attention.
A few comments and conclusions

- NCA seems to imply a duty on creditor to ask the correct info/questions.
- Consumer under no duty to supply any info not specifically asked. What if material info not supplied by consumer because it was not asked by creditor?
- No standardised guidelines as to how the assessment is to be done & what the correct questions/info are.
- Creditor determines his own assessment procedure/models – must be fair.
- Should be standardised – with minimum questions/requests for info. If standardised and the minimum guidelines are followed can it still be reckless credit in the court’s/tribunal’s view?
- Creditor allowed to accept the info supplied as correct without investigating it. Should creditor be under a duty to investigate all info supplied?
- Problems with materiality test – might differ from creditor to creditor. When will the incomplete/untrue info materially affect the creditor’s ability to make a proper assessment?
- Court/Tribunal must establish if incomplete or untrue info is material – difficulty with this.
- Should the type of clauses as found in the Coe Family Trust case be allowed, even if brought to the attention of the consumer?
A few comments and conclusions

- The National Credit Regulator ("NCR"), may publish non-binding guidelines proposing evaluative mechanisms, models and procedures to be used to determine whether credit is being granted recklessly in relation to credit agreements.

- During May 2013 the NCR issued a public notice stating that it intends to issue affordability assessment guidelines in terms of the NCA. The draft guidelines in the notice propose that:
  - Credit applicants prove their claimed discretionary income when it is above the norm for a person with their gross income and that such norms be determined as a percentage of gross income bands;
  - Credit providers consider all the credit applicant’s income, expenses and debt repayments when doing an affordability assessment;
  - Credit providers refrain from lending to the maximum of the consumers’ discretionary income and leave a margin of at least 25% of their discretionary income for adverse changes in the economy or the consumer’s circumstances;
  - That credit providers use the credit applicant’s current credit information as stored on one or more credit bureaux;
  - Credit providers process applications for credit within seven days from accessing an applicant’s credit information as stored on credit bureaux; and
  - Credit providers share credit application information on credit bureaus to allow for better affordability assessments to be made by other credit providers and to reduce credit application fraud.
A few comments and conclusions

• There is no magic number.
• Useful guidance may be found in Australia.
• The Australian National Consumer Credit Protection Act of 2009 imposes certain obligations on credit providers to ask questions and verify information.
• For example, in Australia credit providers have to make:
  – an assessment about whether a particular credit contract is unsuitable for the consumer;
  – reasonable inquiries about the consumer’s requirements and objectives in relation to the proposed credit contract;
  – reasonable inquiries about their financial situation; and
  – reasonable steps to verify the consumer’s financial situation.
• The Regulator, Australian Securities & Investments Commission (‘ASIC’) has published quite detailed guidelines about what the reasonable inquiries are and the reasonable steps that should be taken: see ASIC Regulatory Guide 209: Credit Licensing, responsible lending conduct available at http://www.asic.gov.au.
In *SA Taxi Securitisation (Pty) Ltd v Mbatha* Levenberg J said:

“While one purpose of the NCA is to discourage reckless credit, the Act is also designed to facilitate access to credit by borrowers who were previously denied such access. An overcritical armchair approach by the courts towards credit providers when evaluating reckless credit, or the imposition of excessive penalties upon lenders who have recklessly allowed credit, would significantly chill the availability of credit, especially to the less affluent members of our society.”