

## **2. CEO's OVERVIEW**

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## CEO'S OVERVIEW OF THE YEAR

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**Gabriel Davel**

The year under review has been challenging. The global financial crisis has left no country or sector unscathed, with no clarity yet on how much worse it could get or how long before a real recovery would start. With subprime lending having triggered the crisis, the relevance of the regulatory measures contained in the National Credit Act (NCA) has been confirmed. The combination in the subprime market in the United States of 'teaser rates', miss-selling by agents and brokers and credit market practices which created perverse incentive structures, triggered a financial explosion which continues to impact. Through securitization, the originators gained access to limitless funding and through derivative instruments the risk was transmitted to financial institutions and investors all over the world.

The financial crisis has certainly impacted upon South Africa, evidenced by economic slowdown, increasing retrenchments and credit contraction. The impact has thus far been less severe than in many other parts of the world, having been protected from the full impact of the meltdown by several interrelated factors. These include: exchange controls, a monetary policy position which restrained the build-up of unsustainable debt levels while the resultant high interest rates may also have reduced the incentive for South African banks to seek higher yields off-shore; cautious bank regulators and their early introduction of Basle II and the National Credit Act. We must also recognise the role that South African banking community played, possibly reflecting a more cautious banking tradition.

There is little doubt that the NCA made a positive contribution. Although it is certainly true that the main damage had already been done well before the introduction of the NCA, the Act curtailed the tail-end of the credit boom. From the date of the introduction of the Act in parliament in 2004, the Act focused attention on the need to increase standards of loan origination. It is worth noting that the Micro Finance Regulatory Council (MFRC) had introduced a number of interventions in the lending area, well before the implementation of the

NCA. The MFRC's reckless lending rules (2002) and its establishment of the National Loans Register (2003) forced dramatic changes in lending standards in the low income market. These were the forerunners to the reckless lending provisions of the NCA.

Despite spectacular growth in commercial and residential property values, South African property valuations do not appear to be at the same inflated levels as in the US and UK. Although the growth in South African property valuations since 2000 has been spectacular, it was based on the highly depressed market conditions of the 90's. These factors cushioned South Africa from the effects of an economic crisis which is turning out to be the worst since the Great Depression of the 1930s.

### ***The role of debt counselling in dealing with the impact of the financial crisis***

Yet, the economic consequences of the crisis are having an increasing impact, feeding into debt stress and creating huge pressure on debt counselling. The NCA may, through debt counselling, have an important role to play in the resolution of this crisis. An important part of a debt counsellor's role is the engagement with the different credit providers. Consumers who apply for debt counseling have on average 10 credit agreements, many of which would already be in arrears, with legal action being threatened. Without the specialist assistance of a debt counsellor, most consumers would find it very difficult to conclude a feasible debt restructuring plan. The most critical and also most complex component of the debt restructuring process is the engagement with the different credit providers and achieving a restructuring plan which is acceptable to all parties. In many cases this also requires a hearing by the Magistrates' Court.

Debt restructuring also requires adjustment of a consumer's own expenditure, cutting back on luxury items and potentially the sale of assets. Without such adjustments the consumer cannot expect the credit providers to agree to a debt restructuring plan.

The inability to conclude the magistrates court hearings has proven to be the most significant obstacle to the effective implementation of debt counselling. It is only through the intervention of the magistrates court that unreasonable demands by either the credit providers or the consumer can be modified. Once these hearings start taking place on a more regular basis, it will set precedents which will guide the process, setting parameters for resolution of the competing interests of the different parties.

It is thus of great concern that magistrates court hearings have taken place for less than 3,000 of more than 50,000 applications for debt counselling. In an attempt to address this issue, the NCR applied for 'declaratory orders' by the High Court on certain aspects of the interpretation and application of the debt counselling provisions and of the NCA. The application also dealt with procedural aspects of the hearings, related to the Magistrates Court Act.

A submission has also been made to the Department of Trade and Industry (DTI) and to the Department of Justice and Constitutional Development in respect of these issues. DTI published draft regulations which could address certain of the problems which are delaying the magistrates court hearings.

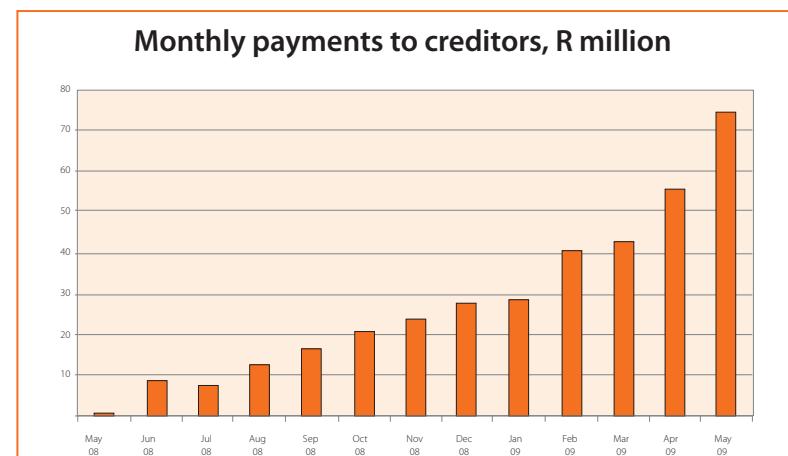
The resolution of these issues is a matter of priority. A total of 58,842 consumers had applied for debt counselling as at 31 March 2009 and this number has grown steadily in the interim. For the vast majority of these applications the magistrates court hearing is still outstanding, implying that the debt restructuring order cannot be finalised or implemented.

There is also encouraging news. The number of registered debt counsellors has steadily increased, reaching 834 by the end of the financial year. Payment distribution systems have been established and the gross monthly distributions had reached R42.6 million by the last month of the financial year. The NCR created a range of mechanisms aimed both at the monitoring of debt counselling and at the provision of support and training. These include a programme of regular on-site monitoring visits to debt counsellors, annual audits on payment distribution agents, regular capacity building workshops for debt counsellors, and dedicated staff to deal with both consumer complaints on debt counselling and debt counsellors' requests for assistance. Where required, formal compliance investigations have been conducted, followed by compliance notices and referrals to the Tribunal.

Despite all the challenges, a functional debt counselling system has been established. However, if the legal obstacles are not addressed and if the magistrates courts do not deal with the increasing backlog, there is a significant risk that debt counselling may not be as effective as intended and may not bring the intended protection, at a time when the financial crisis has made it more urgent than what could ever have been envisaged at the time of the introduction of the Act.

#### Debt Counselling, as at 31 March 2009

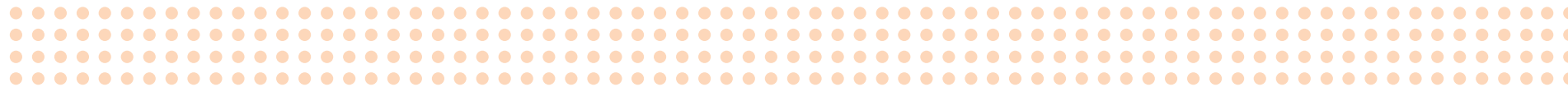
- 834 registered debt counsellors
- 58,842 applications for debt counselling
- R231 million distributed to creditors
- 209 on-site visits to debt counsellors
- 13 capacity building workshops, attended by 209 debt counsellors
- 2 audits on payment distributors
- 31 investigations into debt counselor compliance
- 1 compliance notice & 2 Tribunal cases related to debt counsellors



#### Consumer education and awareness

The profile of the NCA and the level of awareness of the protective measures in the Act continue to increase. Consumer journalists, provincial government and community groups have all contributed. The NCR strategy remained largely unchanged from the previous years, with regular 'capacity building workshops', continuous engagement through both national and community radio, ongoing exposure in print media and regular engagement with a range of different stakeholders.

Over the past year we tried to keep the public attention on the importance of 'responsible borrowing'. We managed a number of different media campaigns, each stressing a different aspect of responsible financial behaviour. Some of the themes were the dangers of over-indebtedness, financial planning, 'borrow wisely' and 'debt is not cool'. Messages related to savings behaviour are included throughout these campaigns.



This is an area in which the credit industry can play a much bigger role, particularly through non-branded and industry-based awareness campaigns. Unfortunately, there is still too much overlap between the product advertising and consumer protection messages of credit providers, which undermines the credibility of such campaigns.

### **Complaints, compliance & enforcement**

Compliance investigations continued. The main areas of focus were contraventions related to mortgage lending, debt counselling and micro-lending practices. Over the last two years, the NCR uncovered a number of cases where home owners who are in financial difficulty are targeted, often resulting in loss of home ownership through 'lending schemes' involving fraud and misrepresentation. Although we have been fairly successful in these interventions, it has been complex and time consuming.

Since the establishment of the NCR we have issued 24 Compliance Notices. Nine Compliance Certificates were issued to entities who have been found to be compliant in follow-up investigations. 7 Cases have been referred to the Tribunal for formal hearings.

### **Statistics and research**

Statistical monitoring is an important part of the NCR mandate, contributing to policy formulation whilst also providing information which will assist the credit industry in monitoring and managing credit risk. Based upon statistics submitted by registered credit bureaus, the NCR publishes a quarterly report with aggregated statistics on the credit profile of consumers. The NCR also publishes reports from returns which are submitted by credit providers, covering areas such as: statistics on the overall consumer credit market, including both bank and non-bank credit providers, the relative performance of the primary product categories, and a breakdown of access to credit based upon the income profile of consumers. The first report on credit provider statistics was released in March 2009.

These statistics provided a powerful indicator of the impact of the financial crisis. It indicated a significant contraction of credit granted, a 42% decline in quarterly consumer credit granted over the period from March 2008 to March 2009. Mortgages and motor vehicle finance contracted most sharply, while there has been significantly less contraction in unsecured lending (a contraction of 5%) and a growth of 12% in short term lending (i.e., loans of less than R8,000, extended for terms shorter than 6 months). It appears that the repayment performance of credit extended to low and middle income groups is gradually improving, probably indicating shorter term agreements being settled and consumers being cautious in taking on new credit. The repayment performance statistics indicate a high level of stress among mortgage holders.

The NCR statistics cover a fairly short time frame, which limits their predictive value. Over time, these statistics will establish a powerful tool to monitor trends in the credit market, such as changes in the profile of access to credit, debt stress and repayment performance. This would add value both to public policy formulation and to the credit industry's ability to benchmark its own performance and trends.

The NCR's research projects included the following:

- An assessment of the status of credit information sharing in South Africa and the role that the Credit Register could play in expanding SMME access to finance;
- An analysis of indebtedness levels across different income groups;
- An assessment of the operational progress and challenges in respect of debt counselling;
- A review of the developments and changes since the implementation of the NCA, with reference to the cost of finance and access to consumer credit, and
- An in-depth assessment of the potential impact of the financial crisis and the economic downturn on the consumer credit market in South Africa, and its implications given the profile of indebtedness and debt stress across different segments of the consumer credit market.

### **National Credit Register**

The feasibility study and technical specifications for the establishment of the National Credit Register are nearing completion. Apart from its role in combating over-indebtedness, the Register will also play an important role in monitoring the trends in the credit market in some of the risk areas as highlighted by the financial crisis – such as levels of debt stress; loan-to-value ratios for mortgage lending and changes in housing valuations over time. It is likely that other regulators and public institutions may also benefit from the establishment of the Register, with statistics that could assist in monitoring the stability of the financial sector and in monitoring residential mortgage lending, as required in terms of the Home Loan & Mortgage Disclosure Act.

It is a major project and the Register would require the capacity to manage data related to an estimated 17 million consumers and 36 million credit agreements, involving 3,600 credit providers. There is a high level of support in the credit industry for the creation of the Register and a willingness by the private sector to contribute to the cost of its establishment.

### **Financial management, human resources & operational control**

The performance of our financial department has once again been outstanding, with another unqualified audit report, following the unqualified audit report of the last year. The level of commitment which this required from a relatively small financial team should not be underestimated, given the demands which are made by the Public Finance Management Act of 1999 (PFMA) and government reporting requirements. The NCR's total operational expenditure for the past year was R52.8 million.

Despite various recruitment campaigns, we have still not been able to fill all positions, which made substantial demands on the NCR staff. This will remain a priority and we envisage further staff growth over the next years, given the demands of the current economic environment. Yet, staff commitment and operational performance have remained at a very high level. The NCR's staff complement at the close of the financial year stood at 66 permanent staff members, with an additional 20 people on temporary or fixed term contracts.

The operational and management systems which have been implemented since the NCR's establishment have performed admirably and established a solid base for the future. We will perform a full assessment of all aspects of our information technology requirements and shortfalls over the coming year, potentially to develop and implement a specialised and integrated IT support system. However, we remain committed to the principle that our expertise lies in our staff and staff capacity, rather than in the sophistication of our computers.

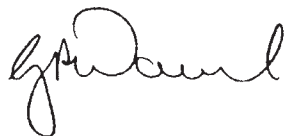
### **Areas of focus for the next year**

The impact of the financial crisis and the economic downturn on consumers and credit providers will undoubtedly be the overriding priority in the coming year. Our primary challenge is to address the obstacles which are impeding the effective implementation of debt counselling. This will require legal and regulatory changes. Without these changes, debt counselling would not provide the protection which was intended and is likely to result in increasing housing repossession and escalating write-offs by credit providers, impacting most severely on mortgage banks.

In consumer awareness, investigations and research, the focus will similarly be on topics related to the financial crisis and its impact upon consumers and credit providers. Consumer awareness is of primary importance, in order to assist consumers in responding to the impact of the crisis. We believe that consumers would get value from information on personal options and strategies which could lessen their financial vulnerability.

### **Conclusion**

The commitment and passion of the staff of the NCR made an incalculable contribution to our ability to get through a year marked by unprecedented international crises. The frequency at which managers and staff work through lunches, attend training sessions over week-ends or come in over a week-end to catch up on back-logs do not go unnoticed! This commitment gives me confidence in facing the challenges which the unfolding impact of the global crisis will bring.



**Gabriel Davel**

Chief Executive Officer



