



MAKING CREDIT MARKETS WORK

A Policy Framework for Consumer Credit



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CHAPTER ONE

The case for a regulated consumer credit market

Introduction

- 1.1. The aim of this government is to build an economy that meets the needs of all the economic citizens of South Africa – its people and their enterprises. Much work has already been done towards the achievement of this aim. South Africa has in place strategies to transform the economy from one that served the wealthy and excluded the poor, to one that harnesses the full potential of all the country's people and resources.
- 1.2. Since coming into power in 1994, the approach of this government has been to play a leading and enabling role, providing the platform for all economic actors - public, private, enterprises and consumers - to work towards achieving the economic transformation that the country requires. Government has worked hard to promote private sector development, whilst ensuring that growth is not achieved at the expense of equity. Where industries require regulation, government's approach has been to put in place mechanisms that unlock the economic benefits of that industry while minimising social costs, and also address other social objectives, such as black economic empowerment and the development of social and economic infrastructure.
- 1.3. The consumer credit industry is one such industry. There are significant economic benefits to a credit market that works, helping individuals to accumulate assets and exploit economic opportunities and businesses to grow and create new jobs. However, it is an industry that needs to be regulated to ensure that potential consumer abuses are minimised.
- 1.4. This consumer credit framework seeks to provide policy direction in terms of the regulation of the consumer credit market. This is a market that is worth some R362 billion and provides credit to approximately 15 million people. It is important that this policy direction is discussed widely within government, national and provincial, with economic stakeholders at the National Economic Development and Labour Council (Nedlac), with the public and with Parliament.
- 1.5. This credit policy framework lays the basis for a regulated credit market that will contribute positively to unlocking the economic potential of the nation, whilst minimising social and economic costs and addressing the structural legacy that still results in discrimination against a large section of the population.

The role of credit in the economy

- 1.6. In a cash economy, or in a society structured on barter only, there would be no need for credit. Credit transactions are necessary where a person seeks to obtain a product or service for which the person cannot, or chooses not to pay in cash or by way of exchange in kind or barter. Credit enables people to have use of a product or service, at a cost represented by an interest rate, prior to their having paid for that product or service or, where an item cannot be afforded from a single month's salary, to spread the payments over a number of months.
- 1.7. Consumers would generally not be able to purchase items such as houses or cars if it were not possible to obtain finance. In acquiring such items, it is necessary to be able to spread the payments over a number of months. For a huge number of people the same is true in respect of the purchase of a fridge, bed, radio or television. It is also true in respect of the cost of a university education and even true for a great many South Africans in respect of the cost of items such as school fees and school uniforms, or the equipment or trading stock for a small business. Credit thus unlocks a diverse range of opportunities, some of which are economic, others educational and yet others simply improvement of 'standard of living'.

Credit - a double-edged sword

- 1.8. Whilst credit allows access to products or services that can not be acquired out of a single month's income, it can also be a dangerous instrument that can lead to high levels of debt and indebtedness.
- 1.9. The credit market is not a risk-free arena. There is a considerable imbalance of power between consumers

and credit providers, consumer education levels are frequently low, consumers are poorly informed about their rights and unable to enforce such rights through either negotiation or legal action. Commission-driven agents, deceptive marketing practices and weak disclosure can easily cause consumers to enter into unaffordable credit contracts.

- 1.10 It is quite easy for credit to lead to financial hardship and destroy a household's wealth. Taking on extra loans in order to pay back existing loans can lead people into a debt spiral out of which it may be difficult to escape. Over-indebtedness has a negative impact on families and has in some extreme cases even led to family suicides. Over-indebtedness further has an impact upon the workplace, can lead to de-motivation, absenteeism and even a propensity to commit theft.
- 1.11 For these reasons, most countries have a detailed and sometimes highly prescriptive legislative and regulatory approach to consumer credit. Consumer credit legislation is frequently more prescriptive and has a more extensive enforcement framework than what is usual in the regulation of other sections of the financial markets.

The need for balance

- 1.12 Because of the need for regulation, credit cannot be seen as a universal basic service to which access should be extended in the same way as access to water, healthcare and electricity. There is a greater need to balance access to credit with protection for consumers, especially the vulnerable.
- 1.13 Excessively onerous and costly compliance requirements, which increase the cost and risk for credit providers, is likely to lead to higher cost of credit for consumers and lower returns for providers. A legislative framework should therefore not introduce excessive or unpredictable risk, or introduce excessive or ill-defined compliance requirements. The framework should also not cause reputable credit providers to shun credit seekers, reduce access to finance and increase the cost of finance.
- 1.14 Banks, retailers and other credit providers have a need for a simple and transparent regulatory framework that is relatively easy to comply with. Effective debt recovery and enforcement are particularly important. Effective debt recovery procedures would assist credit providers by reducing bad debt write-offs, and assist consumers by ensuring that high bad debts of a minority of consumers do not feed through into higher interest rates for the rest. Effective enforcement would similarly be of value to both credit providers and consumers by ensuring that reckless credit providers do not increase the risk and cost to all parties.
- 1.15 It is therefore imperative that the new credit policy balance consumer protection measures with the regulatory burden it imposes on credit providers.

The context for the policy

- 1.16 This policy framework draws on several years of investigation into the credit industry, as well as policy documents of government dating back to the Reconstruction and Development Programme (RDP) of 1994. More recently, the Microeconomic Reform Strategy (MRS), which was outlined by President Mbeki at the beginning of 2002, sets out a clear work programme for addressing priority microeconomic interventions over

the next few years. This includes strategies to achieve greater social and economic equity and integration, and improved access to basic services and infrastructure for economic citizens. The envisaged policy on regulating the credit market fits into this Microeconomic Reform programme, both in terms of its potential contribution to economic growth and its contribution to addressing the current inequities in the system.

- 1.17 The Integrated Manufacturing Strategy (IMS) of **the dti** calls for an integrated approach to economic growth and emphasises the interconnected nature of different sectors and markets. The IMS implies that **the dti** will develop “broad-based programmes to promote market access, to create a fair and efficient regulatory environment, to incentivise investment, to improve access to finance, and to ensure policy coherence. This should apply in general, and not just in relation to specific prioritised sectors”. Introducing a new consumer credit policy enables government to ensure that the policy is in line with this approach to regulation, and reflects its commitment to policy coherence.
- 1.18 In March 2002, **the dti** established a task team to undertake a review of the legislation impacting on consumer credit and to make proposals for a new regulatory framework for consumer credit. The task team has produced a detailed report. The review drew on several other reports, including the 1992 SA Law Commission review of the Usury Act, the 1995 SA Law Commission report on debt collection, the 2001 investigation into SME finance by a task group of the Policy Board for Financial Services and Regulation and Ntsika’s 1999 National Small Business Regulatory Review.
- 1.19 The policy framework further supports the work done in Nedlac on financial sector transformation.

Objectives of the new consumer credit policy framework

The new consumer credit policy framework will make credit markets work by:

- (1) Addressing South Africa’s historical legacy of systematic discrimination against the majority black population, which has been the unique challenge of all lawmaking since 1994. With respect to the credit market, this legacy sees the majority of South Africa’s credit seekers relegated to expensive credit, if they can get access to credit at all. Chapter three looks at ways to overcome this historical legacy by improving and increasing access to credit at reasonable rates from reputable credit providers, and increased availability of alternative finance at reasonable cost for SME and housing finance.
- (2) Making the credit market function more cost-effectively and competitively and promoting a fair, competitive and sustainable credit market. Chapter four analyses how weaknesses in the competition environment have led to the current discrepancies in terms of access to and cost of credit, and proposes new measures to promote more competitive credit markets.
- (3) Improving the understanding of the market and helping consumers make informed choices. Good information helps consumers make the best choices. The better consumers are informed about their choices, and the readier they are to complain, the more the industry will be under pressure to improve performance and customer service. The consumer credit market is notoriously opaque, and consumers frequently have no idea what they are signing up for. Chapter five examines the weaknesses in sales and advertising disclosure on the cost of credit, the ways in which the industry currently hides charges and the risks to the consumer of complicating and misleading contracting practices. It will propose new standards of disclosure, as well as consumer education at all levels.
- (4) This government continues to be concerned about the negative impact upon households of increasing levels of debt. This policy aims to ensure that increasing access to credit does not lead to “debt addiction”, and proposes several mechanisms to deal with debt, and especially to create a safety net for the highly indebted. This is covered in chapter six of the policy framework.

- (5) Even with competitive markets and well-informed consumers, transactions can go wrong. Moreover, the consumer credit market is one in which consumers are particularly vulnerable. Providing protection for consumers is imperative, as is securing redress for unacceptable practices and ensuring compliance with new regulatory requirements. Chapter seven sets out a regulatory framework consisting of a national consumer credit regulator, an incentive system to ensure industry compliance, and state funding for NGOs and CBOs, which will ensure that consumers are able to access the benefits of credit without suffering its potential negative impacts.
- (6) As indicated in the Microeconomic Reform Strategy and in the Integrated Manufacturing Strategy, government's approach to economic reform is to ensure that a coherent and integrated platform for sustainable development is created. Achieving this requires that government works with its partners in provincial governments, with industry, with protection agencies and with consumers, in order to build policy coherence through consultation and partnerships. This is further elaborated in chapter eight of the policy framework.





CHAPTER TWO

The need for reform

The credit market that developed over the past 40 years is inappropriate for the present and future political, economic and social context of South Africa. It is a market that both reflects, but also reinforces, the two economies of South Africa – one economy that is modern, globally integrated and producing most of the country's wealth; the other characterised by underdevelopment and structurally disconnected from the first and the global economy. It is furthermore a market that is characterised by a lack of transparency, limited competition, the high cost of credit and limited consumer protection. For all these reasons, a fundamental review of the credit market and its regulation is necessary.

Two economies – two credit markets

- 2.1. Research in the areas of consumer credit and SME financing reveals that financial markets are segmented into two markets – one market for low-income consumers (the majority of whom are historically disadvantaged) and SMEs, which is characterised by limited access to credit at a high cost; and another market serving primarily middle and high-income consumers (who are predominantly white) and large enterprises, with easy access to credit at preferential cost.
- 2.2. High-income groups (about 15% of the population) can obtain credit from a range of mainstream providers, including banks, at an interest rate limited by the Usury Act. Approximately R261 billion (72% of total credit extension) is extended to this income group. By contrast, only R21 billion (6% of total credit extension) is extended to the low-income population, which accounts for 67% of the total population. This divide reinforces the historical relationship between poverty and poor access to resources.
- 2.3. In addition, low-income groups generally have little access to conventional credit products such as mortgages, credit cards or overdraft facilities. They are relegated to non-bank credit, informal sector loans and other marginal providers. The products available to the lowest income groups consist mainly of micro-loans, store cards, hire purchase transactions and loans backed by provident or pension fund guarantees, which are generally available only at high cost, so that individuals in the poorest income category pay up to ten times the price paid by the wealthiest income groups.
- 2.4. The cost of credit varies from about 2% below prime for mortgages and loans secured against provident fund benefits, to 50-100% for furniture finance (on smaller items) and payroll deducted micro-loans and the extremes of one-month loans at 30% per month (360% per year). These interest rates, however, are only indicative, as, across the board, the cost of credit is frequently inflated by other costs such as credit life insurance, loan application fees, administration fees, club fees, irregular service charges and various bank charges. These additional charges are badly disclosed, and a survey of the cost of different products indicates that such charges can increase the cost of certain products by up to two or even three times the interest rate ceiling set under the Usury Act.
- 2.5. The situation in the consumer credit market is largely mirrored in the enterprise finance market, where there is a clear distinction between the volume and cost of credit made available to small businesses and that extended to medium-sized and large businesses.
- 2.6. This split in the market is largely created by the current regulatory framework for consumer credit. A comprehensive review of current regulation and institutions is therefore necessary to ensure that the underlying structural problems are addressed.

Access to credit versus over-indebtedness

- 2.7 The South African credit market is characterised by a lack of access to reasonably priced credit for the majority of the population. It is also characterised by an over-supply of credit to those considered creditworthy. As a result, a large number of consumers face a heavy debt burden and some consumers are so heavily indebted that it has a negative impact on their day-to-day lives.
- 2.8 While the high price of credit to poorer individuals often leads to heavy debt burdens in that income group, such levels of debt also extend through higher segments of the population. This is underscored by low savings levels, which increase the propensity to use (and abuse) credit.
- 2.9 The mechanisms currently in place are not adequate to promote the rehabilitation of consumers, or even to assist already over-indebted consumers to deal with their debt. A review of these mechanisms is therefore necessary.

An outdated and ineffective regulatory framework

- 2.10 The current regulatory framework is between 20 and 30 years old. No significant review of either the Usury Act, 1968 or Credit Agreements Act, 1980 has taken place since their initial introduction. The credit market has evolved significantly over the past 30 years, and the regulatory measures put in place have become outdated. There is thus a need to modernise the current consumer credit laws and to harmonise them with best practice international jurisdictions.
- 2.11 In addition to being dated, the current regulatory framework has been largely ineffective. It has distorted the credit market through its differential and unequal treatment of different credit products and credit providers. Importantly, it has also had the result of affording different consumers different levels of protection, with the poorest and most vulnerable having the least protection.
- 2.12 Through a lack of enforcement, the practices of less scrupulous providers have become the norm, and have stigmatised certain segments of the credit market. This in turn has discouraged reputable credit providers, in particular banks, from venturing into the low-income market and from providing more affordable finance to low-income earners.
- 2.13 A lack of consistency with other relevant legislation has further reinforced a lack of enforcement. This has resulted in practices such as abusive debt collection and the abuse of administrative orders by legal practitioners and others.
- 2.14 There is thus an urgent need to review the current regulatory framework, not just for consumer credit, but also for contract enforcement and debt collection.



CHAPTER THREE

Addressing the historical legacy

A review of South Africa's consumer credit policies is necessitated not only by outdated and fragmented legislation. The country's history of systematic discrimination against the majority of the population, and the stripping of their asset base, requires special measures to address the historical legacy of apartheid economic policies and of apartheid educational policies, which has placed black people at a fundamental disadvantage.

Lack of access to credit for capital accumulation

- 3.1 The current legislation that regulates the consumer credit market dates from the late 1960s and early 1980s, a time of limited access to credit by the black working class. A severe lack of access to credit for capital accumulation and productive use prevented investment in housing, education and economic opportunities generally.
- 3.2 In the late 1980s and early 90s, the availability of credit provided by furniture and clothing retailers to black South Africans increased. However, consumer options were limited and the finance provided was inappropriate for many of the most pressing needs, such as finance for business start-ups, for education and for many others. It also gave an advantage to the major retailers as most smaller entities (and black-owned businesses) could not provide credit facilities and were thus at a competitive disadvantage.
- 3.3 In 1992, the initial Exemption from the Usury Act meant that money-loans became increasingly available. This gave the consumer much more freedom in terms of the purpose for which the money could be utilised but a number of severe problems arose. The increase in the supply of money-loans, moreover, did not address the primary need for increased *enterprise finance*. Certain of the lending practices raised very serious consumer protection concerns. Furthermore, the loans being provided were of a very short-term nature and inappropriate to finance real asset accumulation by black households (e.g. housing loans remained inaccessible). The revised Exemption Notice of 1999 and creation of the Micro Finance Regulatory Council improved the consumer protection.

Collateral

- 3.4 Critical to the role of credit in capital accumulation is the availability and enforceability of collateral. Collateral reduces the risk to credit providers and therefore should, in a competitive credit market, increase the availability of reasonably priced credit to consumers.
- 3.5 Banks have historically refused to take the assets of black people as collateral, such as ownership transfer of rental housing and the government's housing programme. This legacy meant that many black people have assets, but cannot use them as collateral, and have been unable to gain access to any form of finance apart from unsecured short-term loans, at very high interest rates.
- 3.6 There appears to be a close relationship between having a mortgage on property and the cost of credit in general. Those consumers with a mortgage will generally have better access to credit (whether for car finance, credit card or any other finance), as well as access to cheaper credit. It is therefore important to understand the market for mortgages and residential property, in order to understand the functioning of the credit market.

- 3.7 For the vast majority of individuals, their home is the largest investment that they would make over the course of their lives. Furthermore, an individual's 'net worth' closely tracks the value of their home. The value of residential property, on its part, is dependent upon clarity of ownership, on there being a 'market' for such property, including the availability of buyers, the availability of finance for such buyers and the possibility of, transferring the ownership to the buyer.
- 3.8 Outside the prime housing areas (and in township areas in particular), the housing market is ineffective and mortgage finance is generally unavailable. Problems in housing registration and in the housing transfer process contribute substantially to this state of affairs. The impact of an inefficient housing market is that, of the estimated 2.3 million urban residential properties registered in the names of black South Africans, only between 5% and 10% have mortgages registered. At an estimated average property value of R50, 000, this implies that township residents have at least R115 billion of property that could potentially serve as collateral, but is currently a 'stranded asset'.
- 3.9 As a result, most historically disadvantaged South Africans are either (a) locked out from the opportunity to acquire property by their inability to access finance, or (b) have acquired property, but with the appreciation of the property value being undermined due to obstacles to property transfer and the lack of access to finance for the potential purchasers, are unable to realise the value of their underlying asset and leverage additional funds. In rural areas, barriers to land ownership similarly constrain asset and wealth accumulation. A large majority of the population can thus not gain the benefit of what should be their best security, their home, and therefore face generally high costs of finance.
- 3.10 The Usury Act has contributed to certain of these problems; both through the application of interest rate regulation and through inappropriate provisions on security provided against loans. These weaknesses will be addressed in the proposed legislative changes, but will require a review that extends to the modernisation and simplification of all legislation that deals with collateral. The feasibility of establishing a "Collateral Register" will be investigated. A similar mechanism made an important contribution to increasing the collateral-based lending in countries such as Canada.
- 3.11 In addition to these immediate challenges, government intends to continue giving attention to potential problems and obstacles in the township housing market (these efforts are led by the Department of Housing) and to pro-actively seek solutions.

Racial bias in credit allocation

- 3.12 There is immense frustration with credit bureaux and with credit bureaux information amongst black South Africans, and with the practice of so-called "blacklisting". Other alleged practices, such as "redlining" of certain areas by banks, have similarly been severely criticised.
- 3.13 Ideally, credit bureaux should improve the flow of information, creating a source of objective information for client selection and thus reducing the scope for discrimination in decisions about credit. Credible credit bureaux information could also provide a basis for a statistical analysis to detect potential racial bias in client selection by any particular credit provider. Credit bureaux could thus play a very important role in supporting more efficient financial markets, and more equitable credit allocation. However, credit bureaux are currently seen as reinforcing discrimination and inequalities, rather than relieving them.

- 3.14 The envisaged consumer credit legislation will provide for the regulation of credit information, but primarily with a view to ensuring the integrity and accuracy of information held by credit bureaux and to giving consumers rights to have incorrect information rectified or removed. It is recognized that there is a need for the much more extensive regulation of credit bureaux. However, the Department of Justice, through the Law Commission, has initiated a process to draft new privacy legislation, which will also capture the regulation of credit bureaux and credit information. In order to minimise potential duplication and regulatory conflict, the more extensive regulation of these institutions will be left to privacy regulation. It is further envisaged that provisions concerning credit bureaux in new credit legislation will eventually be taken over in new privacy law.
- 3.15 In order to further promote transparency in the allocation of credit, it will be necessary to introduce in new credit legislation a general prohibition on discrimination in credit allocation (with a possible exception for positive discrimination for targeted groups) and also to provide consumers with reasons for the refusal of credit on request. These provisions should also be applicable to small businesses, where concerns about racial bias and discrimination are prevalent.

Black economic empowerment

- 3.16 There are significant empowerment opportunities in the growing market of credit provision. Government has been and will continue to investigate strategies in support of wider ownership within the broader financial service provider industry, as well as other mechanisms for black economic empowerment, as envisaged in the Black Economic Empowerment Act, 2003.
- 3.17 These initiatives will build on the recent successes with the Financial Services Charter. It will also be necessary to consider the impact on small credit providers, so as not to impose too onerous requirements.

Alternative financing mechanisms and savings

- 3.18 This policy document focuses on the consumer credit market, and in particular on modernising and improving the regulation of consumer credit. However, the consumer credit market is linked with the other financial markets. The structural legacy of South Africa results in low-income consumers and small and micro enterprises being denied access to bank credit and savings facilities.
- 3.19 When people are unable to save, it increases their dependence on short-term credit to deal with emergencies. South Africa has traditionally had low savings levels. Low-income consumers tend not to save in formal mechanisms, but rather through informal mechanisms such as stokvels and burial societies.
- 3.20 In addition to helping to smooth consumption over time, savings are critical to our start-up enterprises, especially small enterprises. A number of different studies in South Africa have shown that in excess of 75% of start-up enterprises raise finance from their own savings, loans from family or friends, or retrenchment packages. Constraints to saving thus do not only undermine individual wealth creation and exacerbate household vulnerability, but are also a major inhibitor of SME start-up and growth.

- 3.21 Despite the importance of savings in preventing excessive debt and in facilitating enterprise, a surprising number of disincentives to formal savings exist. About 40% of South African adults do not have access to any formal financial services (including savings, transmission, credit and insurance facilities), while in excess of 50% are excluded from saving accounts. It is the lower income groups who are most negatively affected. In addition, a very poor return on savings is offered, especially for small amounts and entry-level savings facilities. In fact, in a survey conducted recently, it was found that fees are taken into account, entry level savings accounts of five major banks as well as the Post Bank, offer negative returns to low-income consumers, some of a significant magnitude (-20%).
- 3.22 This lack of access to financial services is reinforced by the geographical location of bank branches and rationalisation in banking infrastructure, largely as a result of economic factors. The effect is that black South Africans are consistently relegated to non-bank and marginal credit providers, whether to finance business, education, housing or other items.
- 3.23 Current initiatives within **the dti** and other government departments to establish and fund alternative financing institutions will be accelerated. One particular initiative includes the establishment of a Pro-Poor Apex, which will seek to develop and provide financial and savings services to the poor.
- 3.24 Furthermore, low cost savings vehicles will be promoted, especially as a safety net for emergency situations. Initiatives by the National Treasury to promote second and third tier banking services are critical in this regard and will be accelerated.

CHAPTER FOUR

A fair, competitive and sustainable credit market

The credit market at present is a dysfunctional market that under-serves the historically disadvantaged and is characterised by a lack of effective competition, inadequate transparency and the high cost of credit. In order to address the structural discrimination in the credit market, it is necessary to develop an integrated solution that can address the underlying structural problems. This chapter sets out the key issues that government intends to address to promote a credit market that is equitable, competitive and transparent, and that fosters sustainable and socially responsible credit provision in an environment where consumers have rights and can access effective redress.

Current regulation of consumer credit

- 4.1 Presently, the Usury Act, 1968 applies to leasing, credit and money lending transactions. It is limited to money lending transactions below R500 000 and lease agreements that do not exceed R100 000 in value. The Credit Agreements Act, 1980 applies to specified credit agreements relating to movable goods. There is a lack of uniformity in the transactions that are protected, with the Usury Act, 1968 being more comprehensive. The Credit Agreements Act, 1980, applies only to items that have been listed by the Minister of Trade and Industry in a Government Notice. Credit agreements in respect of items that are not listed are not covered by the Act. This inconsistency in the statutes creates a legal problem in that some items are regulated in terms of either the one Act or the other, some are regulated by both statutes and yet others may not be regulated by either Act.
- 4.2 The 1999 Exemption Notice to the Usury Act exempted transactions below R10 000 (this replaced and modified a previous exemption that was introduced in 1992). The Exemption Notice required a “regulatory body” to be established, whose purpose was to provide consumer protection to the clients operating in this unrestricted interest rate window. The Micro Finance Regulatory Council has been approved as such a regulatory body.
- 4.3 The regulatory structure has created a number of inconsistencies, with different and inconsistent regulatory requirements applying to financial transactions that are inherently very similar. There are thus significant differences in the compliance standards, registration costs and compliance costs that apply to:-
- (a) money-lending (including bank loans) that fall under the Usury Act,
 - (b) money-lending (including bank loans) falling under the Exemption Notice,
 - (c) credit for the purchase of items listed in the Credit Agreements Act, and,
 - (d) credit related to items that are not listed and which may potentially not be governed by either law.
- 4.4 Not only does the current regulatory framework create different regulatory standards, it also creates incentives for regulatory arbitrage and circumvention. For example, to purchase a fridge in terms of a hire purchase agreement, a deposit is required. However, the same fridge could be purchased with a credit card or with a money loan, under which circumstances no deposit is required. While there are differences in the transactions in that the asset does not belong to the consumer in terms of a hire purchase agreement until such time as the transaction is fully paid up, from the consumer’s perspective, there may in fact be little difference.
- 4.5 Further distortions are introduced into the market by the different application of interest rate regulation. For example, money-lending transactions below R10 000 are exempted from the provisions of the Usury Act,

in particular from the imposition of an interest rate ceiling. This exemption has skewed the market in favour of money-lending transactions and has resulted in a limited set of products being offered to low-income consumers. In addition, it has limited competition between different types of products and market segments and, as a result, has limited innovation.

- 4.6 Finally, the enforcement of the Usury Act and Credit Agreements Act has largely been ineffective, in part due to unequal treatment of different products and providers. Through lack of enforcement, the practices of less scrupulous providers have become the norm, and this has stigmatised certain segments of the credit market. This in turn has discouraged reputable credit providers, in particular banks, from venturing into the low-income market and from providing more affordable finance to low-income earners.

A single law that treats transactions equivalently

- 4.7 South Africa needs a single piece of legislation to replace the current Usury Act, Credit Agreements Act and Usury Exemption Notice. The proposed Credit Act will apply equally to all consumer credit transactions irrespective of their form, and to all credit providers. It will ensure a consistent approach to interest rate regulation, minimising arbitrage and circumvention:
- 4.8 The new credit legislation will apply equally to all credit transactions, and to all credit providers. However, any regulation of the credit market must recognise that there are differences between a pawn transaction, a mortgage and a credit card or overdraft facility. These differences relate primarily to disclosure, the treatment of accounts and contracts. Thus, the new law will provide for differential treatment to accommodate differences in products and in costs associated with smaller transactions, but overall will introduce a common regulatory scheme.
- 4.9 This policy framework further proposes the standardisation of charges across all service providers into three categories, being loan origination fees, monthly service fees and interest. The new Bill will provide for the Minister of Trade and Industry to introduce, if deemed necessary, limitations for all three categories of fees. The discretion of the Minister in setting these fees will be limited and must be based on recommendations from the National Credit Regulator after research has been conducted to minimise the distorting effect of finance charge regulation.
- 4.10 To further enhance consistency and transparency, it is necessary that credit insurance be treated consistently with other finance charges. Current legislation allows for considerable scope where credit insurance is concerned, and as a result credit insurance has become a major area of growth for credit providers and insurers. While the intention of this policy and the new credit legislation is not to regulate the insurance market, it will seek to regulate the relationship between credit products and insurance products, especially where there is the potential for over-selling or over-insuring to the detriment of the consumer and where consumers will be limited in their choice of insurance product.

Leveling the playing field

- 4.11 Certain mechanisms for repayment undermine competition in the consumer credit market by creating unjustified competitive advantages for certain credit providers. Mechanisms such as payroll deductions and collection through 'preferred debit orders' allow microlenders and banks to secure the client's repayment directly from his or her payroll, or from the bank account into which the salary is paid. Although this does reduce the cost and risk for the credit provider, it also creates incentives for excluded credit providers to resort to undesirable practices, such as the retention of bankcards and pin numbers, or to jump the queue by obtaining garnishee orders. Payment preferences thus increase the risk in the credit market overall and exacerbate the bias against new entrants and innovation.
- 4.12 New credit legislation will therefore need to introduce provisions to regulate such practices. However, **the dti** is cognisant of potential regulatory overlap and has been engaging with the South African Reserve Bank and the National Treasury on payment systems and related issues.

Reducing risk and uncertainty

- 4.13 Investors and financial service providers perceive the low-income personal finance market and SME market to be high risk with high levels of uncertainty. These perceptions are reinforced by a number of factors:
- 4.13.1 Contract enforcement is costly and time consuming, with a high level of uncertainty about the likelihood of success.
- 4.13.2 The current Usury Act Exemption Notice, through which the lower-income market segment is regulated, creates a high degree of uncertainty for investors, as it is perceived that unfavourable regulatory changes can be effected fairly quickly with limited consultation and oversight.
- 4.13.3 Weaknesses in consumer protection, in compliance monitoring and in regulatory enforcement exacerbate perceptions of risk and uncertainty. These weaknesses create the perception of an undesirable market characterised by predatory practices in the lower income market and concerns about arbitrary and ad hoc government intervention.
- 4.14 In addressing these concerns and in creating more certainty in the market place, thus stimulating investment and innovation, while encouraging credit providers to take a longer-term view on their products and services, it will be necessary for new credit legislation to address where possible the concerns outlined. It will further require a more extensive review of legislation regarding contract enforcement.

CHAPTER FIVE

Helping consumers make informed choices

The credit market inherently lacks transparency, as information asymmetries are particularly pronounced. Due to weak disclosure of the full cost of credit and the financial complexities of some products, it is difficult for consumers to understand the risks and make informed choices. Standard information in a simple, comparable form is essential if consumers are to make informed choices.

Disclosure

- 5.1. Very few consumers are aware of the total cost, including the fees, charges and 'add-ons', of an item bought on credit. The disclosure requirements in the current legislation are outdated and ineffective.
- 5.2. Apart from the lack of disclosure, what is disclosed is often in the "small print" and consumers have difficulty in understanding what it is saying. In most cases, consumers do not even attempt to read credit contracts before signing, as their eagerness to obtain the finance overrides concerns about the terms and conditions.
- 5.3. In addition, the regulation of credit advertising and sales is inadequate, allowing for incomplete or even misleading disclosure of the cost of credit and the terms under which credit may be obtained. For example, 'no deposit' advertising is pervasive in certain market segments. This type of advertising often leads consumers to believe that they are entering into a hire purchase agreement with no deposit requirement, when in fact it is a money-lending transaction.
- 5.4. Under a new consumer credit policy, credit providers and lenders would be required to disclose costs in a standard manner, with prescriptions around the cost that may be charged. Advertising, sales and marketing material will also be regulated to include standard minimum indicators of the total cost of credit in such documentation.
- 5.5. Legislation will also introduce pre-contractual disclosure in the form of a compulsory, written quote, which would be binding on the credit provider for a minimum period. This will allow consumers the time and provide them with the information needed to enable them to shop around. It will help consumers to make better choices between cash and credit purchases and between different credit providers.

Standard contracts

- 5.6. It is not sufficient to ensure that there is full disclosure, while leaving it up to the consumer to struggle with unfamiliar contractual language and information that makes little sense to them. Consumers' rights are frequently undermined by the inclusion of complex and compromising clauses into contracts. Credit providers also commonly attempt to reduce the consumer's common law rights through certain contractual clauses.
- 5.7. The consumer is frequently intimidated by the language and presentation of the information, and consumers have indicated that sales staff and intermediaries are generally unwilling or unable to explain the meaning of the contractual clauses.
- 5.8. Irregular contract clauses can undermine the court's ability to protect consumers' rights in the case of legal action following late payments or defaults.

- 5.9 The legislation will therefore introduce the outright prohibition of certain undesirable contract clauses and contractual practices, and define certain standard protective clauses that will be included (or deemed to be included) in all consumer credit contracts.
- 5.10 Contracts should be written in plain language, and be available in writing, before any transaction is concluded.

Consumer education

- 5.11 Ensuring that the information is disclosed, and in a standard format, is not by itself sufficient to ensure that people are going to be able to convert this information into effective knowledge. Basic literacy and numeracy skills are prerequisites. South Africa faces a tremendous challenge in this regard, and new consumer credit policy must address consumer education at both the adult education and school learner levels. This is critical in terms of the President's vision of an integrated economy with equal participation of all citizens, given that commercial life (including consumer credit) is becoming increasingly complex and a certain level of knowledge is required to understand and participate fully.
- 5.12 More discerning and knowledgeable consumers will also in itself increase competition in the industry and raise quality of supply.
- 5.13 Currently, the balance of power between the credit provider and the credit seeker is heavily skewed toward the credit provider. However, higher skills levels and greater awareness of the consumer's rights in respect of credit transactions will build the confidence to demand better levels of service from business. Consumer organisations and consumer journalists also play a critical role in informing and warning the consumer about high-risk products.
- 5.14 The legislative and regulatory framework should therefore make specific provision for consumer education, and provide institutional and financial support for implementation.
- 5.15 Consumer education should be incorporated in the mandate of the consumer credit regulator and in the mandates of the provincial consumer protection agencies. These bodies should be required to report on the achievement of consumer education targets. Employers and trade unions can also play a big part in helping to raise consumer awareness levels in the workplace, and government would endeavor to create appropriate incentives and support to enable these parties to play a greater role.
- 5.16 It is further proposed that industry make contributions to consumer education programmes, whether that is in terms of the Banking Charter or through other contributions made by industry. A mechanism must therefore be developed that will allow for joint contributions by government and industry and provide for the joint determination and development of education campaigns.



CHAPTER SIX

Dealing with Debt

South African law provides no effective protection against over-indebtedness and insufficient rehabilitation mechanisms to assist people who have become over-indebted. A debt spiral generally results when a consumer becomes increasingly indebted, to the extent that the debt becomes unserviceable.

Reckless behaviour

There is mounting evidence of reckless behaviour by credit providers, and of exploitation of consumers by micro-lenders, intermediaries, debt administrators and debt collectors.

- 6.2 Weaknesses in personal insolvency legislation, which does not enable effective rehabilitation of over-indebted low and middle-income consumers, exacerbate the problem.
- 6.3 Furthermore, the requirements for the granting of court orders (e.g. garnishee orders or emolument attachment orders) do not take into account whether the credit grantor might have been reckless in granting the credit, thus creating an incentive for reckless credit provision.
- 6.4 At the same time, the current environment, in which consumers cannot escape excessive debt burdens due to weaknesses in insolvency law, encourages reckless behaviour by consumers. Often, consumers incur new debts at a high cost to pay off old debts. To access further credit, consumers do not always disclose the full extent of their liabilities, or simply try to escape their debts by moving to a new location. This type of conduct increases the uncertainty and risk in the credit market and raises the overall cost of credit.
- 6.5 It is therefore necessary to review the legislation relating to debt collection and court orders to ensure that penalties are introduced to curb reckless lending and credit provision. New credit legislation will introduce a requirement on courts to obtain a report from a debt counsellor before making a final decision in respect of an administration order or in issuing a judgment against a debtor.

Addressing unsolicited credit

- 6.6 In recent research, consumers indicated that unsolicited credit offers cause them to take on more debt than they believe they should. First-time credit users and middle-income consumers who may be living beyond their means are most at risk. Ever increasing credit card limits, increasing limits on store cards, unsolicited mail offerings for loans and credit, misleading advertising, coercive sales techniques and aggressive agents and brokers each play a role.
- 6.7 New credit legislation will impose limitations on certain types of marketing strategies, door-to-door sales will be curbed, tougher regulations will be introduced on agents and brokers while unsolicited solicitation and harassment of consumers by commission-driven agents will be prohibited. The relationship between a credit provider and intermediaries will be more tightly regulated, with the principals being held responsible for the actions of the intermediary, and intermediaries prohibited from receiving any fees from the credit receivers. Care will be taken to ensure that these measures are consistent with existing legislation, including the Financial Advisors and Intermediary Services (FAIS) Act.

Indebtedness and over-indebtedness

- 6.8 Over-indebtedness results from reckless lending and borrowing, low levels of awareness, and a lack of enforcement. Over-indebtedness occurs when a borrower can no longer service all of his/her debts or where the level of debt servicing is depleting the household income and consumption.
- 6.9 This will be addressed through the following measures:
- 6.9.1 Reckless credit extension will be curbed by introducing a general requirement that all credit providers should do affordability assessments prior to approving any credit facility. Credit providers' compliance with these responsible credit standards will be monitored, and will be subject to significant penalties if they are found guilty of reckless credit provision. The ultimate penalty will be the suspension of the credit agreement.
- 6.9.2 In order to improve the ability of credit providers to do affordability assessments, measures will be taken to improve and integrate the credit information infrastructure. In particular, it is proposed that a National Loans Register be established, which will be maintained by the National Credit Regulator. All credit transactions will have to be registered with the National Loans Register. It will be critical that such infrastructure is efficient, up to date and accurate, as it will impact significantly on both consumers and credit providers.

Debt counselling

- 6.10 To whom does a consumer turn when he/she is unable to escape from a debt spiral? Introduction of appropriate mechanisms to prevent and penalise reckless lending should reduce further credit being offered to consumers who are already over-indebted. However, there is still a need to make provision for some form of relief, other than more extreme measures such as debt administration, for those who are unable to repay their debts.
- 6.11 This policy framework envisages that a national network of regulated debt counsellors will be created, and that appropriate enabling legislation will be introduced. This framework will enable debt counsellors to renegotiate debt commitments on behalf of consumers in order to provide relief in cases where clients are over-indebted. Debt counselling should accommodate mechanisms to enable rescheduling of debt as well as debt reduction. These mechanisms will be applied in accordance with specified criteria and a prescribed approach, so as not to introduce an unacceptable level of uncertainty into the consumer credit market. In addition, it is important that debt counsellors fulfil these functions in a non-profit environment, so that predatory practices can be prevented.
- 6.12 While all debt counsellors will be required to be registered and will have to meet certain criteria, it is not envisaged that unrealistic entry requirements will be imposed. It is important that the experience of those who have already been fulfilling these functions for some time is recognized. However, minimum professional qualifications, such as an accredited professional examination, will be explored.
- 6.13 It is further important that funding is made available to provide these services to consumers on a large scale. While funding mechanisms must still be developed, a significant role for government and the National Credit Regulator is envisaged. Contributions by industry can be channeled through the National Credit Regulator.

Insolvency Law Review

- 6.14 The Credit Law Review highlighted serious weaknesses in the insolvency legislation and particularly in terms of the mechanisms for personal insolvency of consumers who are over-indebted. This is consistent with the findings of the Boraine Commission, which was established by the Department of Justice.
- 6.15 Government recognises that there are weaknesses in the insolvency law and that measures must be implemented to rectify these weaknesses in order to create effective mechanisms for personal insolvency and debt rehabilitation. This forms part of a holistic strategy for dealing with the problems resulting from over-indebtedness.

In Duplum Rule

- 6.16 The "*In Duplum Rule*" is a common law rule that limits the interest that a creditor can charge on an account that is in arrears. It thus provides protection against the exploitation of consumers that cannot service their debt commitments.
- 6.17 This policy proposes that legislation should be introduced to clarify and codify the *In Duplum Rule*.

Monitoring indebtedness

- 6.18 It is critical for the public sector to have accurate statistics on the national position with respect to the levels of debt and the number of people who find themselves in an over-indebted position. This would enable government to monitor the position, and to introduce further protective measures if required.
- 6.19 The National Credit Regulator will be tasked with conducting regular surveys on the levels of indebtedness, so that the trends can be monitored and the adequacy of the protective measures can be reviewed from time to time.

CHAPTER SEVEN

Securing compliance and access to redress

Consumer perceptions of the service received from credit providers, whether these be banks, retailers or micro-lenders, generally reflect a feeling of disempowerment and helplessness. The credit industry is seen as an industry where the consumer is at the mercy of the credit provider. This policy makes far-reaching proposals for improvements in the regulatory infrastructure in the consumer credit market in order to improve access to redress for consumers and ensure compliance by credit providers.

The need for more effective redress and enforcement

- 7.1 To provide effective consumer protection and effective access to redress, without undue interference in the relationship between the credit providers and their customers and without excessive regulatory and compliance costs, requires cooperation between the different stakeholders involved in the consumer credit market. National government, provincial government, industry, Non-Governmental Organisations (NGOs), Community Based Organisations (CBOs) and consumers each have a role to play.
- 7.2 Increasing numbers of people, even at relatively low income levels, use credit. It is imperative to provide effective protection and effective access to redress. Effective enforcement and the quick resolution of complaints are also beneficial to the industry. Reputable credit providers require assurance that their competitors play by the same rules. Low levels of compliance, high levels of reckless behaviour and a lack of responsiveness to consumer complaints are negative for the consumer, but also for the growth of a stable and sustainable credit industry.

The role of the National Credit Regulator

- 7.3 To ensure enforcement and promote access to redress, it is necessary that a suitably empowered statutory regulator be created to regulate the credit industry and to provide consumers with effective recourse. The establishment of a National Credit Regulator is envisaged.
- 7.4 The National Credit Regulator will be required to register consumer credit providers, to perform inspections and to generally monitor compliance with the Credit Act. The regulator will be expected to resolve complaints against credit providers, refer matters to appropriate institutions, but most importantly, to pro-actively investigate systemic market conduct problems and violations of consumer rights. This function is particularly important if one considers the fundamental inequality between consumers and credit providers in the credit market and the inability of consumers, especially low-income consumers, to negotiate. For this reason, the regulator will be mandated to take up matters on behalf of consumers.
- 7.5 In addition, the regulator will be tasked with promoting consumer education and establishing a network of accredited debt counsellors. It will require not only the registration and accreditation of debt counsellors, but also the accreditation of training programmes. While the responsibility for consumer education and debt counselling will be shared with provincial government, NGOs and CBOs, it is important that significant resources be allocated to these functions at a national level. Finally, the regulator will encourage and approve industry codes and guidelines for the resolution of complaints, and monitor the enforcement of such codes and guidelines.
- 7.6 The National Credit Regulator will be governed by a Board of Directors, consisting of members nominated by the Ministers of Finance and Social Development, as well as individuals with specific expertise in the area of credit extension and consumer protection. The regulator will be accountable to Parliament through the offices of **the dti**.
- 7.7 In recognition of the unique experience and expertise gathered by the Micro Finance Regulatory Council (MFRC) over the five years of its operation, it is proposed that the National Credit Regulator will absorb the MFRC, but also the national Usury Act inspection function within **the dti**. The National Credit Regulator will be jointly funded from credit provider registration fees and levies, and an annual transfer from national government.

The role of the Consumer Tribunal

- 7.8 Due to the volume of complaints and investigations anticipated in this regulated market, as well as the need to ensure quick and effective redress for consumers, it is proposed that a Consumer Tribunal be established. The Tribunal will adjudicate contraventions of new credit legislation and have the power to impose administrative penalties and issue orders. The role of courts in matters of breach of contracts, unfair contracts and other contractual matters, including debt administration, will remain unchanged.
- 7.9 To promote quick decision-making and reduce costs, the proceedings before the Tribunal will be of a more informal nature and allow for greater participation.
- 7.10 In order to ensure that the proposed regulatory framework is cost-efficient and does not result in duplication of functions, it is further proposed that the function of the Tribunal be expanded to other areas of consumer protection. It is therefore envisaged that the Tribunal will also hear matters in respect of contraventions of general consumer law as well as other areas of consumer protection.

Partnership between national and provincial government

- 7.11 Provision of effective consumer protection and access to redress in the credit market will only be possible if national and provincial governments are successful in working together to achieve these aims. In terms of the Constitution, consumer protection is an area of concurrent responsibility between national and provincial government. The regulation of the credit market is primarily concerned with providing protection to consumers. For this reason, the regulation of the credit market can be considered to fall within the ambit of consumer protection.
- 7.12 At present, provinces have some responsibility for consumer credit in their respective jurisdictions. Provinces deal with complaints regarding credit and in some cases also have responsibility for the enforcement of the Credit Agreements Act. However, the Usury Act is enforced only at a national level. In order to provide each consumer, wherever located, with advice, assistance or protection, it is necessary that national and provincial resources are combined and that complementary roles for the respective tiers of government are established.
- 7.13 This policy framework therefore proposes that national government and the National Credit Regulator are responsible for the enforcement of systemic practices and the regulation of credit providers with national reach or which operate across provincial boundaries, as well as the conduct of credit bureaux and the registration of debt counsellors. Where there is no provincial capacity to register or regulate credit providers, the National Credit Regulator will retain responsibility. It is further envisaged that new credit law will allow for the delegation of certain functions to provincial regulators, in the event of provinces not having passed provincial credit laws.
- 7.14 In addition, the responsibility for consumer education should be shared among the different tiers of government, industry and the non-governmental sector.

The role of the National Consumer Credit Council

- 7.15 The exercise of concurrent jurisdiction between national and provincial government in the area of consumer protection, and consumer credit in particular, will require consultation between the respective spheres of government, as well as the harmonisation of activities. For this reason, the establishment of a National Consumer Credit Council is proposed, which will consist of the Minister of Trade and Industry, as well as the relevant Ministers of Executive Council from each province. National and provincial regulators will also be represented on the Council.

The role of a National Consumer Credit Advisory Committee

- 7.16 To promote discussion and debate on consumer protection measures and its implementation, it is further proposed that a National Consumer Credit Advisory Committee be established. The role of the Advisory Committee will be to make recommendations in respect of consumer education, provide independent advice on policy proposals by the National Credit Regulator and **the dti**, and to generally advise the Minister on any matter referred to the Committee.
- 7.17 The Council will consist of representatives of industry and consumer organisations.

The role of industry in complaints resolution and redress

- 7.18 Responsible complaints resolution through interaction between the credit provider and the client is likely to provide the most efficient remedy to the consumer. It would also be the most cost-effective mechanism to address consumer problems and could avoid government intervention in the relationships between credit providers and millions of clients. Responsible complaints resolution mechanisms that are managed by industry members would allow government and national and provincial regulatory bodies to limit their involvement to those cases that are not solved in this manner, to serious cases and to cases of systematic breach of the legislative provisions.
- 7.19 Industry-based self-regulatory mechanisms, such as the Banking Adjudicator and the Credit Information Ombuds, have an important role to play. They provide access to redress for consumers who cannot obtain such redress from the credit provider. Any industry-based mechanisms established should remain in place and continue to perform their current functions. Government would welcome the establishment of other adjudicators, whether for non-bank credit providers or any other sub-sector of the consumer credit market. It is important, however, that provision be made for the approval of Codes of Conduct and the establishment and workings of an ombudsman and that information and statistics on complaints received and resolved be made public and available to the National Credit Regulator. New credit legislation will provide for a formal mechanism to effect these.

The role of NGOs and CBOs in counselling and legal advice

- 7.20 There are a number of NGOs, CBOs and Legal Advice Offices at universities that currently play a valuable role in the provision of consumer education, debt counselling services, facilitating complaints resolution and advocacy. These include entities such as Black Sash, the National Community Based Paralegal Association, as well as a host of other organisations. Such institutions are ideally placed to provide objective advice and support, given their existing relationships with consumers.
- 7.21 The government's intention is to make specific provision to support the continuation and expansion of a role for the NGOs and CBOs. We will investigate mechanisms through which sustainable finance can be provided to cover the cost of NGO and CBO activities in this area. We will also investigate the need for government or another entity to perform a co-ordination and support function in respect of the NGO and CBO activities.

CHAPTER EIGHT

Consultation and partnerships

This consumer credit framework seeks to provide policy direction on the regulation of the consumer credit market. The consumer credit market involves a broad range of industry members and millions of consumers. The latter include some of the lowest income earners as well as the very highest earners. Given the diversity of consumer and business interests affected by the consumer credit policy, it is important that the policy direction is discussed widely within national and provincial government, with economic stakeholders at Nedlac, with the general public and with Parliament.

Consultation within government

- 8.1. Within national government, it will be important to consult a number of departments whose mandates relate to the field of consumer credit. The Department of Justice has jurisdiction over the Magistrates Courts Act, and the Insolvency Act, both of which would require amendment in order to implement the proposals of the consumer credit policy. National Treasury is affected as it has been leading the Nedlac negotiations on the transformation of the financial sector, monitors the levels of household debt and savings and is the department that oversees bank supervision. Interaction is similarly required with the departments of Housing and Education, on certain aspects that are covered in the policy proposals.
- 8.2. Provincial government has a critical role to play in a number of the areas covered in this policy. On certain of the areas that are covered in the proposed policy, discussions have already taken place at a number of different platforms and joint working groups. Further consultation will take place on the specific proposals that are made in this document, both through the general consultation platforms that already exist, and through multi-lateral discussion sessions.

Consultation with economic stakeholders

- 8.3. **the dti** will lead the consultation with stakeholders from labour, business and community representatives, which will include bilateral discussions and discussions at Nedlac.
- 8.4. The policy document and the supporting research that inform it will be published and all stakeholders will be provided with the opportunity to submit public comment.

Drafting legislation

- 8.5. The feedback that is received on the policy document will be integrated into the draft legislation that will be presented to Parliament and the Parliamentary committees.

International benchmarks

- 8.4. The policy proposals were informed by the consumer protection standards and regulatory approaches in countries that are amongst the leaders in this area of regulation.
- 8.5. Prior to finalisation of the envisaged consumer credit legislation and its presentation to Parliament, government intends to gather an international reference group to consider and comment on its merits and weaknesses.
- 8.6. Through this process, government intends for South Africa to introduce consumer credit legislation and establish a regulatory framework that is modern and meets international consumer protection norms, but that is adapted to the needs of the South African population. Government intends to ensure that effective consumer protection is provided without setting standards that are inappropriate for South Africa, and that does not undermine the objective of increased access to finance and increased credit market efficiency.
- 8.7. In this manner, government intends to introduce a regulatory model that will make the consumer credit market work for the majority of its citizens.

THE DEPARTMENT OF TRADE AND INDUSTRY

Mapungubwe - **the dti** Group Campus
77 Meintjies Street
Sunnyside

Private Bag X84
Pretoria
0001

the dti Customer Contact Centre:
0861 843 384 (Local)
+27 12 394 9500 (International)