Executive summary

The cost of credit, access to credit & associated market practices

Date completed: 2011

1 Key words

Consumer Credit; National Credit Regulator; National Credit Act; Mystery Shopping; Market Practices; Mortgage; Asset Finance; Overdraft; Revolving Credit Plan; Service Fee; Annual Percentage Rate; Credit Card; Store Card; Repo Rate

2 Commissioned and supported by

The evaluation was commissioned by the National Credit Regulator (NCR).

The contact details for the NCR are as follows: Ms Lebogang Selibi; Tel: +27 (0)11 554 2722; Email: lselibi@ncr.org.za.

3 Conducted by

The evaluation was conducted by Feasibility (Pty) Ltd. Contact person: Dr Penelope Hawkins; Tel: 0116464708; Cell: 0833271059; Email: research@feasibility.co.za.

4 Background to evaluation

Prior to the introduction of the National Credit Act (NCA) on the 1st June 2007, aggregate credit extended to households rose by 24% per annum between June 2005 and May 2007. Although exchange controls and financial regulation served to insulate SA from the direct effects of the financial turmoil after September 2008, export sales declined dramatically and more than a million jobs were lost.

Prior to the NCA, credit extension data was obtained almost exclusively from the banking sector - through their DI900/BA900 returns to the SA Reserve Bank (SARB). All registered providers are now required to submit returns regularly. SARB data incorporates responses by all monetary institutions. NCR data include returns from all institutions extending credit to the household sector and juristic persons as defined in the NCA.

During the period 1994 to 2010, the value of credit extension to SA's domestic private sector increased from R230 billion to R2.1 trillion. Mortgage advances were the dominant form (53.7% in 2010) of credit extension to the domestic private sector and during the period, there was a sharp increase in the relative share of mortgage advances, and declines in leasing finance, instalment sale credit and other loans and advances.

5 Overall purpose of the evaluation

To assist the NCR to meet its annual market research reporting requirements in terms of the NCA and to gain an in-depth understanding of consumer credit products available to consumers.

6 Scope of the evaluation

The evaluation was nationally representative in scope.

7 Evaluation questions

The NCR specified the need to examine market practices with a view to probing the consumer experience in obtaining and repaying credit. The different life-cycle stages of the credit relationship – beginning with advertising and ending with the termination of the contract – were of particular interest.

8 Evaluation methodology

8.1 Type of evaluation

The evaluation was both diagnostic and economic in nature.

8.2 Methodology

Six research tools were employed for the research into cost, distribution and practices related to credit:

- Market practices interviews with consumer experts, journalists and ombudsmen;
- Focus groups discussions with indebted consumers (particularly over-indebted or debt-stressed consumers);
- Mystery shopping for a range of consumer credit types;
- Analysis of a range of different types of credit agreements – from different providers;
- Quantitative survey of credit providers – focusing on pricing and operational details; and
- In-depth interviews with credit providers on trends in the market.

8.3 Data collection

The views of stakeholders were collected by interviews, focus groups, mystery shopping and evaluations of credit agreements.

9 Findings

Consumer credit market practices

Social aspirations were a key motivator behind applications to obtain credit. In many cases, the participants incurred debt through spontaneous credit purchases, without much consideration. People who accessed credit for education purposes, or to start businesses were less likely to be over-indebted than those who accessed other forms of credit. Most had their first taste of credit by taking up offerings of store cards at retail outlets for conspicuous personal consumption purposes. Most participants felt competent neither in their ability to understand financial transactions, nor to manage their budget constraints. They called for more financial education in schools, as well as for awareness campaigns for adults. Because most of the focus group participants were debt stressed and under debt review, it is not surprising that most of them regretted the credit choices that they had made earlier in their lives. Most still had very limited knowledge and understanding of current credit regulation and legislation.

Post-NCA, providers had been compliant regarding visible or public material. Nevertheless, much reference was made by consumers to unsolicited SMS marketing or misleading adverts. They felt that most adverts for vehicle finance were not compliant in terms of interest rates and deal structure. Attractive terms were offered to only a minority of customers. Market practice interviewees felt that such adverts contravened sections 76(4)*c*(iii) and 75(1) of the NCA.

One of the aims of the NCA is to enable consumers to shop around for the best credit available for their needs. The research showed that consumers do not shop around for quotations, except in the case of mortgages. Many consumers made decisions based on unsolicited offers of credit, often telephonic. Incentives for providers to expand their book (via bonuses), and incentives for consumers to qualify for credit tend to nullify regulatory attempts to prevent reckless lending.

Analysis of agreements suggested that the degree of attention to the detailed requirements of the NCA varies between suppliers, with respect to pricing, disclosure during the process, and readability of contracts. Although most agreements met the minimum standards of compliance, some also included the consequences of default and how it would be calculated, while others simply stated that there are costs to default. Several accused providers of not fully informing them of implications of the small print in credit agreements that they had signed.

Some market practice interviewees said many complaints were received about pre-NCA contracts were in respect of ‘bubble’ payments on cars at the end of leases. Many consumers were unaware of the penalties of being in arrears. Nevertheless, most commentators acknowledged improvement since the pre-NCA days, with improved clarity in contracts and greater awareness of consumer rights.

Trends in consumer credit market

Macroeconomic data shows evidence of a credit crunch in the mortgage market. The growth of mortgage extension from an annual average of R28 billion in 2001 to R160 billion in 2007, was followed by a decline to only R37 billion in 2010. Providers indicated that their margins on mortgages had been eroded by a slump in the property market; bond originators; the high value of arrears; and the cost of realising the security of the housing asset.

The growth of the unsecured loan book (7.8% of new lending in the 4th quarter of 2007, to 17.8% in the 3rd quarter of 2010) is illustrative of the importance of this category of credit. Unsecured loans in excess of R150,000 – over as much as seven years - are now offered especially by African Bank and Capitec primarily for the purposes of consolidating other loans; incremental housing or renovations; and deposits for mortgages; and often to state employees. This was attributable to an undermining of mortgage provision, as a consequence of the debt review process.

Credit life insurance is typically offered to cover the obligation on the client in the event of death, disability or retrenchment. The terms of such credit life insurance is variable and it is clear that this has been a profitable service for credit providers.

The repo rate, upon which the maxima interest rate caps are set, was at its lowest level for 30 years. Several commentators felt that the repo rate had been reduced too far and too fast, but the cost of funds has not fallen commensurately.

Because the credit card facility allowed one to enter into a long-term relationship with the consumer – and that it was a cheaper option for many clients than a personal loan, it should become more readily available as a source of household credit. However, at prevailing rates, it was not sustainable to offer a credit card or store card – to lower income consumers.

Consumer credit market analysis

Over and above the capital amount borrowed, the NCA allows credit providers to charge interest; an initiation fee; and monthly service fee. The maximum prescribed interest rate on mortgage agreements declined from 31.4% in 2008 to 17.1% in 2011, with similar trends on all other credit products.

Reduced mortgage lending preceded the Global Economic Crisis and subsequent recovery coincided with the end of the crisis, raising the question of what has driven developments in mortgage loan markets. Respondents (85% of SA household mortgages) declared an aggregate book of R682.5 billion in 2010, 7% more than in June 2008. The value of mortgages less than R300,000 declined from R104 billion to R94 billion, while that of mortgages of R300,000 to R1,000,000 increased by R30 billion, with mortgages between R1,000,000 and R3,000,000 increasing by R24 billion. Mortgage loans with values above R3,000,000 rose by just over R1 billion. The proportion of SA households with an outstanding mortgage declined from 14.3% to 13.7% and the aggregate value of loans in arrears grew from R74 billion to R106 billion, declining to R97 billion by the end of 2010. Arrear rates for lower value loans were lower than for higher value loans.

In addition, 13.3% of households had a financed motor vehicle or other asset in mid-2010. More than half were valued at R100,000 to R300,000, and 466,000 were for assets valued from R60,000 to R100,000. Most of such deals were sourced from dealerships, which received commissions of up to 2.8% of the deal value.

The value of personal loans increased from R36 billion (2008) to R72 billion (2010). While there was a drop of 5% in loans up to six months for R8,000 or less, there was 288% growth in loans of less than R8,000. One third of loans had original values of R8,000 to R25,000; and a third of R25,000 to R100,000, but this category increased by more than 300%. Loans above R100,000 increased by 1136%. The aggregate default ratio changed from 22% (2008) to 29% (2009) to 20.4% (2010).

Clients were required to repay a set monthly minimum (5% to 7.5%) of the outstanding balance on credit cards. There was a ten-fold increase in the nominal value of aggregate credit card purchases between January 1995 and December 2008, followed by a sharp drop and subsequent recovery. The average value of transactions increased from R133 per transaction in 1995 to R527 in 2010, mostly attributable to inflation. However, the number of electronic fund transfer transactions increased by 312% during the period 1995-2010, while that of credit card transactions increased by only 162%.

Providers of furniture loans are perceived to derive greater profit margins from their lending activities than from sale of furniture. Nominal value of household spending on furniture and household appliances increased from R8 billion (1995) to R25 billion (2010). The most significant growth (306%) was for loans of more than R15,000. The value of loan arrears increased from R0.9 billion to more than R2 billion. It was highest (45%) for loans valued less than R2,500 by the end of 2010.

The value of outstanding overdraft balance rose from R12.4 billion (June 2008) to R17.1 billion (June 2009), then oscillated between R15 and R17 billion for 18 months. Revolving Credit Plan balance values increased simultaneously from just under R8 billion to over R10 billion. The average balance of outstanding overdrafts rose from R7,000 (June 2008) to R9,500 (June 2009), then declined to R7,800 by the end of 2010. Overdraft arrears rose from R1.3 billion to almost R3.6 billion, and then to R2.4 billion. By the end of 2010, 7.6% of RCP accounts were in arrears.

Pension-and policy-backed loans increased between June 2008 and December 2009 from R4.5 billion to R5.2 billion, and to R7.8 billion by the end of 2010. The number of these loans advanced rose by more than 31% from June 2008 to December 2010. There was a 19% contraction in the number of loans valued at less than R10,000, and a 28% to 130% increase in those in the higher value categories.

The value of developmental housing finance increased from R109 million (June 2008) to R554 million (end of 2010). While loans of less than R15,000 initially made up almost the entire combined book, loans in the R15,000 to R25,000 and above R25,000 increased substantially faster after since mid-2008. The arrears ratio for loans initially valued at less than R15,000 was consistently above 50%.

The value of outstanding education loans (predominantly over R20,000) stood at between R1.6 and R1.7 billion. The aggregate number of such loans declined from 111,000 in June 2009, to over 93,000 at the end of 2010.

Small business loan providers that responded to the survey included the major commercial banks and two development finance institutions. The value of loans increased from R1,3 billion in mid-2008 to R2,4 billion at the end of 2010. There was a decline in loans of R50,000 to R100,000 of more than a third; and substantial increases in loans under R10,000 and above R100,000. Arrears ratios ranged from less than 3% for loans of less than R10,000 to more than 55% for loans valued from R10,000 to R50,000.

Comparisons with the 2008 survey

In 2008, the aggregate value of the surveyed book was R1076.4 billion (R1058.5 billion in December 2010, i.e. 1.7% growth). The share of mortgages diminished from 69% to 63% and the value of overdraft facilities from 4% to 2%.

10 Conclusions and recommendations

Recommendations in respect of market trends were:

(i) The formula for interest caps should remain intact, but an absolute minimum or maximum should be imposed for the repo rate within the formula.

(ii) The extent that the debt review process has unintentionally undermined repayment of mortgage obligations should be addressed.

(iii) Disclosure of an inclusive APR should be required in relation to loans where credit life insurance is a requirement of the loan.

(iv) The NCR should review inflationary pressures on fee limits set by regulations.

Recommendations relating to market practices

(i) The regulator should consider providing guidance notes or declaratory statements which set clear boundaries for certain market practices, in particular, the *in duplum* rule, reckless lending and extended warranties.

(ii) The expense side of the consumers' balance sheet should be more rigorously evaluated by providers. The NCR should undertake further mystery shopping.

(iii) Where consumers declare very low levels of expenditure relative to income, the provider should substitute a benchmark figure related to the consumer's social circumstances, to protect the consumer against reckless borrowing.

(iv) There should be a requirement for audio recordings of the disclosure provided at the point of sale where the consumer is illiterate.

(v) Total cost of credit should be clearly set out for agreements of *all* sizes, to facilitate comparison of prices for intermediate and larger agreements.

(vi) The NCR should consider requirements for the NCA stipulations to be grouped. Other contractual terms relating to the provider's own conditions should be kept separate. The use of Form 20.1 needs to be enforced.

(vii) Where credit life or property insurance is a condition or option for a credit transaction, details of the cost, commission, other fees and coverage should be provided in the pre-agreement quotation and the credit agreement.

(viii) The NCR should require providers to frame and prominently display an example of a compliant pre-agreement quotation in their branches.

(ix) The NCR should intensify education drives targeted at specific rights that can empower the consumer.

(x) The NCR should enhance its own resources to conduct inspections of advertising material at providers' premises; and provide explicit guidelines for acceptable market practice.

11 Evidence of use

The mandate of the NCR is to monitor the implementation of the NCA on a continuous basis. It is therefore incumbent upon the NCR to evaluate and implement recommendations that are deemed appropriate, from each of its regularly commissioned research reports of which this report is one. It is evident that the provisions of the NCA are becoming more known in the public domain as a consequence of drives for transparency, honesty and awareness creation.

12 Note on quality of report

The overall quality of this report has been rated a 3.81 out of 5 on the scale applied to assess the quality of government evaluations [EQAT].

It is a high quality report comprising thorough analysis of each area of credit provision on the basis of primary empirical research as well as data published regularly by the SA Reserve Bank. The reader is fully informed of the extent and types of credit that has been extended to South African consumers and of the degree to which they are or are not able to keep up with their repayment agreements.