

Profiting from the Future of the Poor

Lending and Indebtedness during the Hyper-Expansion of South Africa's Domestic
Credit Market

Submission to the

United Nations Human Rights Commission

Thematic Report on Private Debt and Human Rights

Malcolm Rees

Independent Research Consultant

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Rees.malc@gmail.com

1.1. The Birth of a New Credit Market

Over the decade to 2018, South Africa experienced a globally unprecedented explosion in the extension of unsecured forms of credit to households. This period, referred to as the 'unsecured boom', is characterised by three distinct phases (described in Table 1). The first phase, referred to as the 'peak boom', occurred between the beginning of 2009 and the end of 2012. During this phase, the quarterly value of unsecured credit granted to consumers showed phenomenal growth, increasing from just over R7,6bn to over R30bn, a near 300% increase (National Credit Regulator, 2018a).

This initial hyper-expansionary period was then followed by a mild contraction in 2013 and 2014, alongside the collapse of the then largest unsecured lender, African Bank. Still, the quarterly rates of unsecured credit extension during this period, referred to as the 'unsecured dip', remained at least twice as high compared to pre-boom periods, 'dipping' to lows of R20bn in Q3 2014. By 2015 a clear resurgence in the rates of unsecured credit extended into the economy was evident during the 'unsecured bounce'. By Q1 2018 the value of unsecured credit extended had once again reached the 'peak boom' highs at R31bn before tapering slightly to R28bn in Q1 2019.

Consequently, in the blink of a macro-economic eye, the levels of net outstanding unsecured credit in the economy had grown from marginal beginnings to represent over 10% of all outstanding domestic credit in the economy. The phenomenon resulted in the birth of an entirely new credit market which has grown by 570% in the decade to 2019 to be valued at over R200bn.

The Unsecured Lending Boom						
	“Peak Boom”		“Unsecured Dip”		“Unsecured Bounce”	
Period (strt/end)	Q1 2009	Q4 2012	Q4 2012	Q1 2015	Q1 2015	Q1 2018
Quarterly Values bn (strt/end)	7.68	30.78	30.78	19.94	19.94	26.45
Percentage Change	300.78%		-35.22%		32.65%	

Table 1: The three phases of the unsecured lending boom

1.2. Transformation of the Credit Landscape

The birth of the unsecured lending market coincided with a substantial contraction in mortgage lending which would fundamentally transform the South African domestic credit landscape. Unsecured credit is defined in the National Credit Act of 2005 (NCA) as any credit transaction which is not supported by a form of personal security such as property or suretyship. It is distinct from short term credit which, while unsecured in nature, is defined in the NCA as being of a value below R8000 and repayable over a period not exceeding six months (Banking Association of South Africa, 2018; DTI, 2004).

Figure 1 illustrates the rapid growth in the extension of unsecured forms of credit (unsecured +), which is calculated to include short-term credit. This is illustrated by both absolute quarterly values (left axis/line) and percentage increase from the base period of Q1 2008 (right axis/bar). In comparison with the base period, the rates of growth in the extension of mortgage finance remained negative throughout the decade. Consequently, while levels of outstanding unsecured credit in the economy more than tripled between 2008 and 2013, and remained roughly consistent at those levels through to 2018, outstanding mortgage finance sharply declined (National Credit Regulator, 2018a). In Q4 2007, mortgage finance represented 65% of all outstanding credit in the domestic market. By Q1 2019, it represented 50% of outstanding credit. Over the same period, unsecured credit had grown from 3% of net, to 11%. The growth in the

value of unsecured credit as a percentage of net outstanding credit was roughly equivalent to the respective decline in mortgage finance, thus illustrating a structural transformation of the market. As unsecured credit is dramatically more expensive than mortgage finance, which is secured against a borrower’s property, this transformation would have critical consequences for households and the economy.

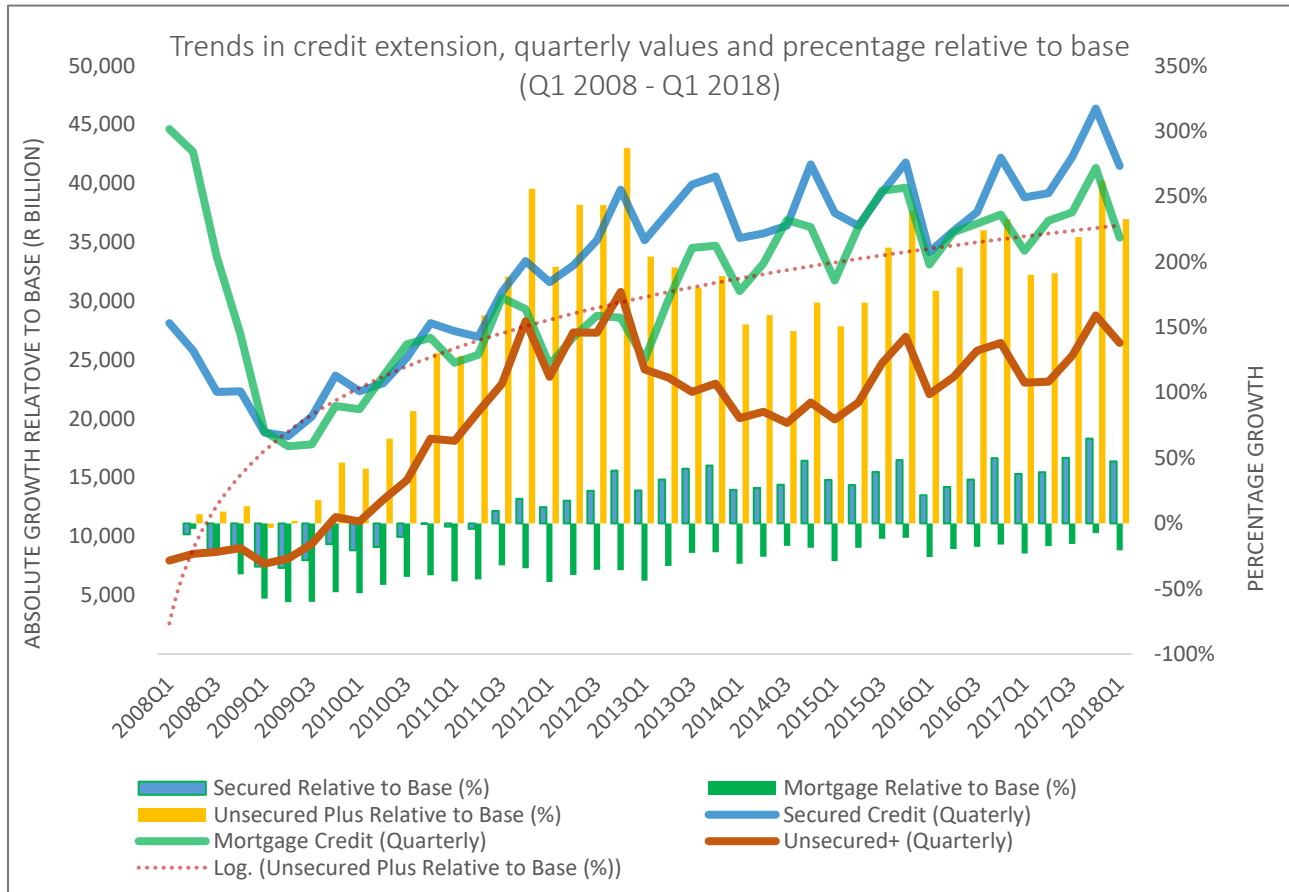


Figure 1: Trends in credit extension, quarterly values and percentage growth relative to base (NCR, 2018a)

1.3. A New Market for New Borrowers

Over the same period as the unsecured lending boom, eight million additional consumers were recorded as having an active credit account, representing a new market of first-time borrowers (NCR, 2018b). These new borrowers are the ‘previously unbanked’; a largely black, lower-income, majority citizenry which had been denied access to the formal credit markets through the

draconian 'credit-apartheid' legislation of the National Party (James, 2014). Expanding formal credit access to this population had been a specific intention of the NCA, inspired by the broad notion of 'financial inclusion' (Bateman, 2018; DTI, 2004; Mpahlwa, 2006). Promulgated in 2007, the NCA, is regarded as having catalysed the birth of the unsecured lending market (Ellyne & Jourdan, 2015). That the birth of the market coincided with the explosion in the number of first-time borrowers alongside a stagnation in the growth of other forms of credit indicates that the new market had, by-and-large, absorbed the new forms of unsecured credit inspired by the NCA. This assumption is supported by fact that unsecured credit extended during the peak boom phase of the wider, unsecured boom, was primarily issued to lower income borrowers (Ellyne & Jourdan, 2015; NCR, 2018a). By way of unsecured credit, therefore, the NCA had been remarkably successful in inspiring a dramatic expansion of access to the formal financial sector for a historically disenfranchised majority.

1.4. Debt and Indebtedness

It is apparent that, closely corresponding to the boom period of unsecured credit, South Africa experienced a boom period of over-indebtedness. Already by 2010, two years ahead of the height of the unsecured boom, nearly half of all credit active consumer records were reflected as being 'impaired' (NCR, 2018a). Impaired records indicate that the consumer had begun defaulting on at least one loan; a reliable indicator of over-indebtedness. By 2018, nearly six million consumers had been recorded as having at least one account in default, an unsettling shift from an initial 2,44 million consumers a decade earlier. This represents an increase of nearly 130% (NCR, 2018a). Here 'default' is considered to occur when a consumer has failed to honour three consecutive loan repayments. Three failed repayments would compel a bank to write-off the loan from its balance sheet (Basel Committee on Banking Supervision, 2013) and is thus a stricter metric for over-indebtedness than an 'impaired loan' is.

Similarly, a sharp increase in the number of consumer applications at debt counselling firms was evident in Credit Bureau Monitor data (NCR, 2017b). This indicated that ever more consumers were being forced to seek help due to unbearable levels of indebtedness. As the rates of growth

in debt-stress indicators far outstripped the rates of growth in the number of credit active consumers, it is abundantly clear that the process of financial inclusion in South Africa had coincided with a dramatic deterioration in consumer financial health. Accordingly, the World Bank concluded in 2015, ahead of the 'unsecured bounce', that South Africa had become the most over-indebted country in the developing world (Bateman, 2018; Demirgüç-Kunt, Klapper, Singer, & Van Oudheusden, 2015).

The second major ambition of the NCA had been to promote consumer financial wellbeing by curbing the abuses and reckless lending that had come to characterise the micro-lending boom which had preceded the unsecured lending boom. That the rapid expansion of the unsecured market has coincided with a dramatic deterioration of consumer financial health suggests that the NCA failed in this key aspect.

Figure 2 describes the trends in debt penetration, consumer indebtedness and employment in terms of both the absolute growth (left index per million) and percentage increase (right index percentage) between Q1-2008 to Q1-2018 based on a cross-reference of Credit Bureau Monitor (CBM), Consumer Credit Market Report (CCMR) and Quarterly Labour Force Survey data (NCR, 2018a, 2018b; StatsSA, 2018). The strictest measure of indebtedness, that of consumers with accounts three months in arrears, was selected. The rate of growth recorded for consumers with an account at least three months in arrears, calculated as a percentage increase from the base period of Q1 2008, was more than double the rate of growth in the number of consumers recorded with a credit active account over the decade. Remarkably, these increases in the number of credit active consumers and those in default dramatically outstripped employment growth over the period, solidifying a view that much of the unsecured borrowing was motivated by consumer stress (Ellyne & Jourdan, 2015; P. Bond, personal communication, September, 2018). Proportions of loans three months in arrears had, by 2018, begun to approach levels seen prior to the decline of the unsecured lending market and subsequent collapse of African Bank in 2014.

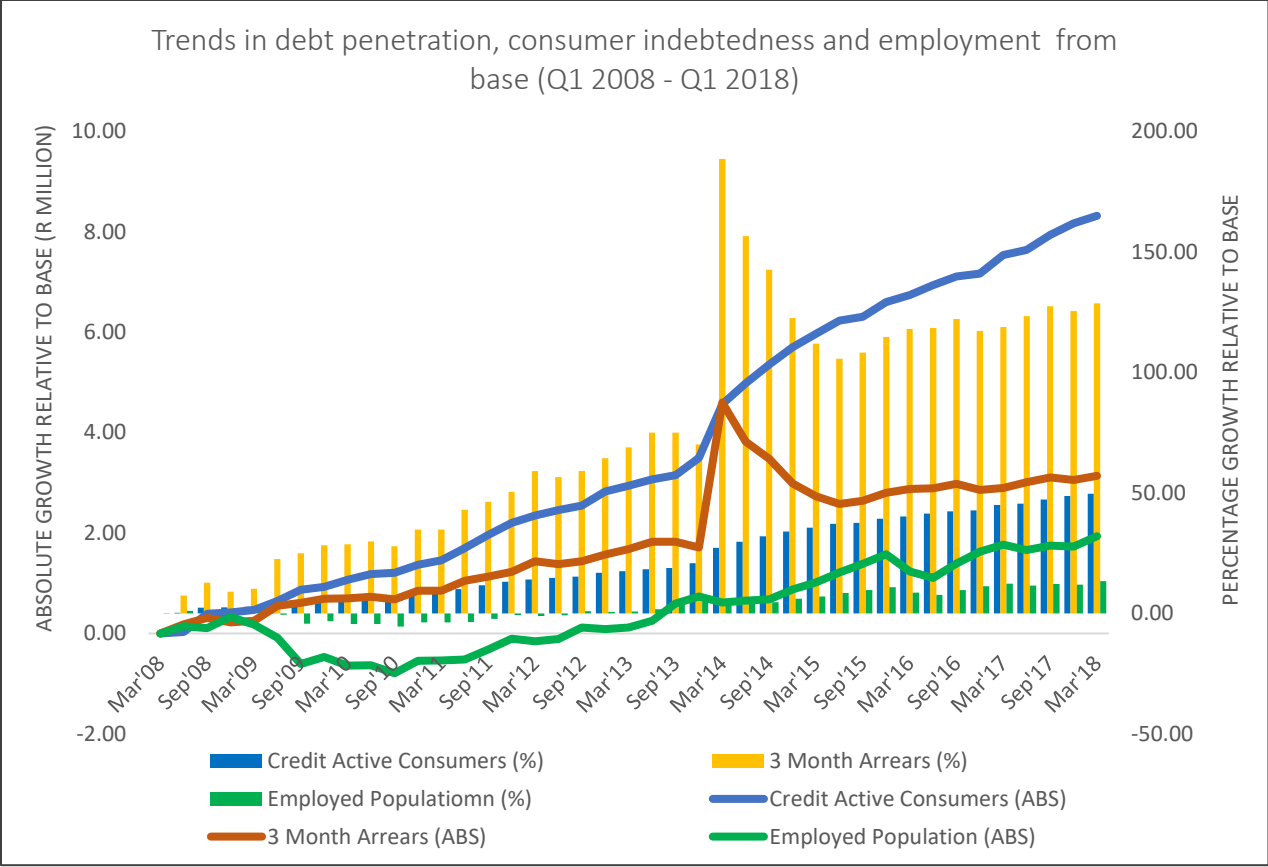


Figure 2: Trends in credit penetration, indebtedness and employment (NCR, 2018a)

1.5. Financial Inclusion or Financial Enslavement?

At a first glance the rapid expansion of ‘innovative’ credit products designed specifically to address the ‘needs’ of a largely lower income and structurally disenfranchised population might be seen to tick some of the boxes axiomatically described in developmental and social innovation theories. The NCA was inspired by an “imperative to drive social change” (Martin & Osberg, 2007, p. 1) as it sought to address the structural imbalances of ‘credit apartheid’. The unsecured boom undoubtedly inspired dramatic and rapid change, thus marking a ‘bifurcation’ or splitting in the structural and causal trajectory of the market (Max-Neef, 2009; Mulgan, 2006). This brought an end to ‘financial exclusion’ because of innovation in the design of products tailored for the ‘base of the pyramid’ population (Prahalad, 2006). The unsecured market is also loosely synonymous with, and had been partially inspired by, the once wildly popular micro-credit models. These had been espoused as a means to address poverty by unleashing the entrepreneurial spirit of the

poor (Bateman, 2018; Otero & Rhyne, 1994; Robinson, 2001; Yunus, Moingeon, & Lehmann-Ortega, 2010).

As such, the clear association between the rise of the unsecured market and rampant consumer indebtedness has provided fertile ground for critiques of such models, which have come under substantial criticism elsewhere in the world (Banerjee & Duflo, 2011; Guerin, Labie, & Servet, 2015). Perhaps most notably Milford Bateman, a leading international critic of the micro-credit model, has often zeroed in on South Africa as a most egregious case that typifies the failure of the micro-credit model (Bateman, 2010, 2012, 2014, 2018). Nonetheless, the model adopted by South Africa's lending institutions would appear to be distinct from the classical micro-credit model in one important aspect: it had been affected at an institutional level by a drive for profit, rather than by an 'imperative to drive (positive) social change'. This is perhaps most clearly exemplified by the meteoric rise and enormous profitability of South Africa's now largest unsecured lender, Capitec Bank (Capitec, 2018). Bateman describes the local unsecured markets as a case study that typifies the failure and potential catastrophic consequences of micro-credit. In his most recent work on the local market (Bateman, 2018), he sees this as 'hi-jacking' of the developmental micro-credit model by a 'white minority elite' seeking purely to enrich themselves. In discussion Bateman has also confirmed that the costs of unsecured credit, described in this report, far exceed even the most extreme cases of micro-credit markets elsewhere in the world. This distinction implies, at least in part, a need for deeper consideration when seeking to understand the causes of consumer over-indebtedness in South Africa during the hyper-expansion of the unsecured market. One cannot simply transfer assumptions regarding the inherent problems of micro-credit models globally to the local context, or visa-versa.

1.6. New Data, New Insight.

To explore the relationship between consumer over-indebtedness and unsecured credit a unique dataset has been constructed which provides for a nuanced analysis of the types of loans and types of lenders which had extended these loans to respective consumers. The dataset for

analysis was constructed by combining a 'skeleton' dataset built from data obtained from a firm operating in the unsecured lending markets with data developed through exhaustive secondary research and calculation. The datasets for analysis contained records for 85 877 loans pertaining to 15 874 consumers and classed over 1000 separate lenders and dozens of loan types. Due to an inherent sampling bias, the dataset represented a portion of the South African borrowing population which can be described as severely over-indebted.

Two major findings have emerged through exploration of the data and identified for consideration. The first is a clear association between unsecured forms of lending and unsecured lenders and the sample of 'severely overindebted' consumers. The second is a clear tendency for short-term forms of credit to be issued to consumers described as 'chronically' over-indebted and for those forms of credit to primarily be issued by large, private networks of lenders not including traditional banks. A surprising volume of short-term credit appears to be systematically issued to consumers whose' levels of indebtedness breach affordability thresholds legally prescribed by the NCA. This finding is suggestive of a widespread failure among short-term lenders to adhere to the legal provisions of the NCA designed to prevent reckless lending.

No longitudinal analysis could be performed on the data to prove a causal link between unsecured lending and consumer-over indebtedness, or on short-term lending and consumer over-indebtedness. Yet the clear relationship between these forms of lending and chronic consumer over-indebtedness is alarming. The scale of the phenomenon and the profound effect that it may have on borrowers and the economy warrants further, urgent, research to examine causality and interrogate the methods and motives of lenders and borrowers and the outcomes of those dynamics.

1.7. Finding: Unsecured Credit in a Severely Indebted Sample.

From a total of 85 877 loans, in the analysis sample, 54 378 loans (63,32%) fell into the category 'Unsecured'. This is compared to credit card loans with a total representativeness of 27,65% of

the number of loans and total outstanding value of 24.92%. Analysis of CCMR data revealed that mortgage finance represented 51% of the gross outstanding debtors' book and secured credit represented 23% as at Q1 2018. As 'secured' credit in the analysis sample data is described as both mortgage finance and other forms of secured credit, this would equate to a net of 74% of all outstanding credit.

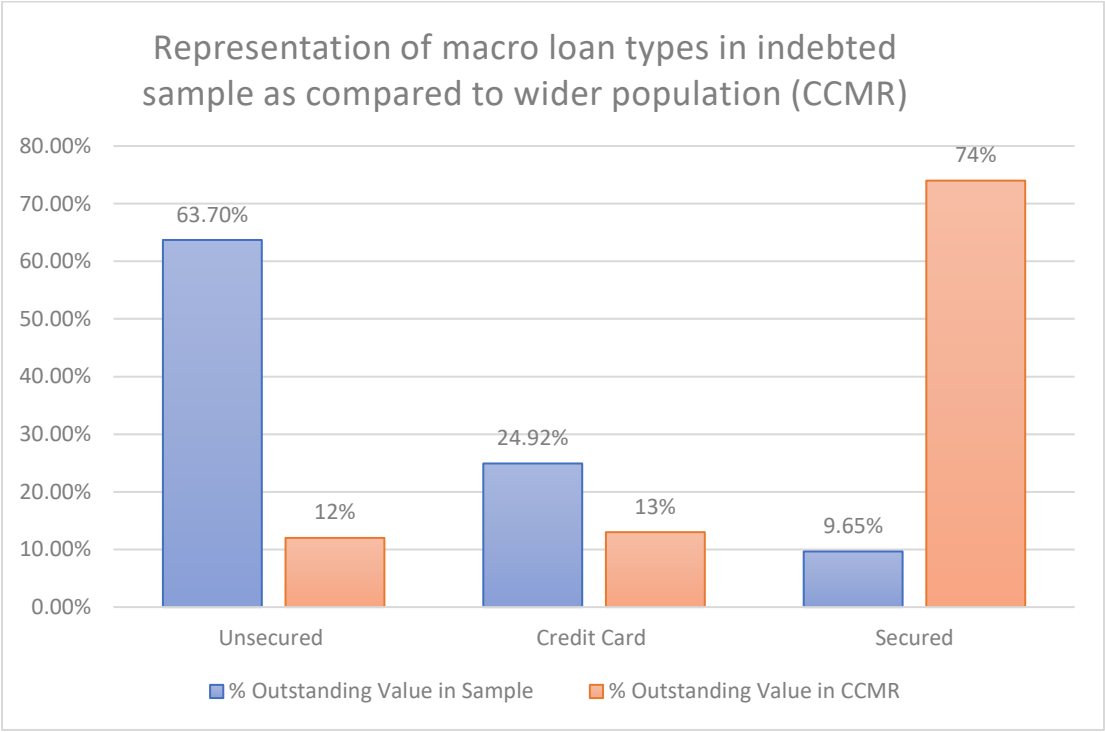


Figure 3: Representation of macro loan types in indebted sample as compared to wider population.

The severe levels of indebtedness in the sample are evident through analysis of the most recent loans obtained by each consumer in the final dataset, representing some 15,874 (from nearly 35777) consumers. Of these loans, 56% had been granted to consumers with a maximum disposable income to monthly debt instalment ratio (PctMaxDis) > 60%. An alarming 27.76% of the loans had been granted to consumers with a PctMaxDis ratio above 90%. Comparatively, just 18.18% of the value of loan instalments had been granted to consumers with levels of indebtedness below 40% of their maximum disposable income.

1.8 Finding: Short-term credit and Chronic Over-indebtedness

Analysis of the most recent loans issued to consumers found that short-term forms of credit were far more likely to be issued to consumers who were in the most extreme states of over-indebtedness as compared with other forms of credit, including unsecured credit. In a final sample of some 15 874 consumers; 4803, or 30%, had been issued short term credit as the most recent loan recorded on their profile. Of these, 40% had been issued to consumers who had a debt to maximum disposable income ratio (DI) of 90%, a further 35,1% had been issued between a DI ratio of 75% and 90% and 32.72% at a DI ratio of between 60 and 75%.

PctMaxDisCat	CREDITCARD	RETAIL	SECURED	SERVICES	SHORTTERM	UNSECURED	Total
1: < 10%	28.99%	32.10%	0.74%	11.09%	5.62%	19.82%	676
2: 10% - 25%	23.44%	11.83%	3.77%	3.84%	14.92%	42.05%	1327
3: 25% - 40%	15.44%	7.88%	6.43%	3.02%	20.30%	46.27%	1852
4: 40% - 60%	14.82%	7.38%	5.29%	2.28%	28.71%	41.42%	3117
5: 60% - 75%	14.15%	6.89%	5.59%	1.22%	32.72%	39.06%	2381
6: 75% - 90%	13.03%	6.58%	5.45%	1.47%	35.10%	38.23%	2111
7: >90%	12.93%	7.10%	6.13%	1.29%	40.28%	31.93%	4407
Total	15.35%	8.61%	5.40%	2.33%	30.26%	37.71%	15874

1.9 Cause for concern.

While this analysis does not prove a causation in the progression to states of worsening indebtedness by consumers of unsecured and short-term credit products, the clear association between the shocking states of consumer-indebtedness and these loan products is cause for concern. The results provide strong evidence in support of a hypothesis that the coincidence of the unsecured lending boom and starkly worsening consumer indebtedness is not coincidental. Worryingly, the unsecured credit market has been following an expansionary trend while the short-term credit market is in a boom cycle by Q1 2018. This is illustrated in Figure 4 which

describes the quarterly values of short-term credit extension per income category (NCR, 2018a). The boom cycle continued through 2018, yet Q1 2019 data shows a relative retraction.

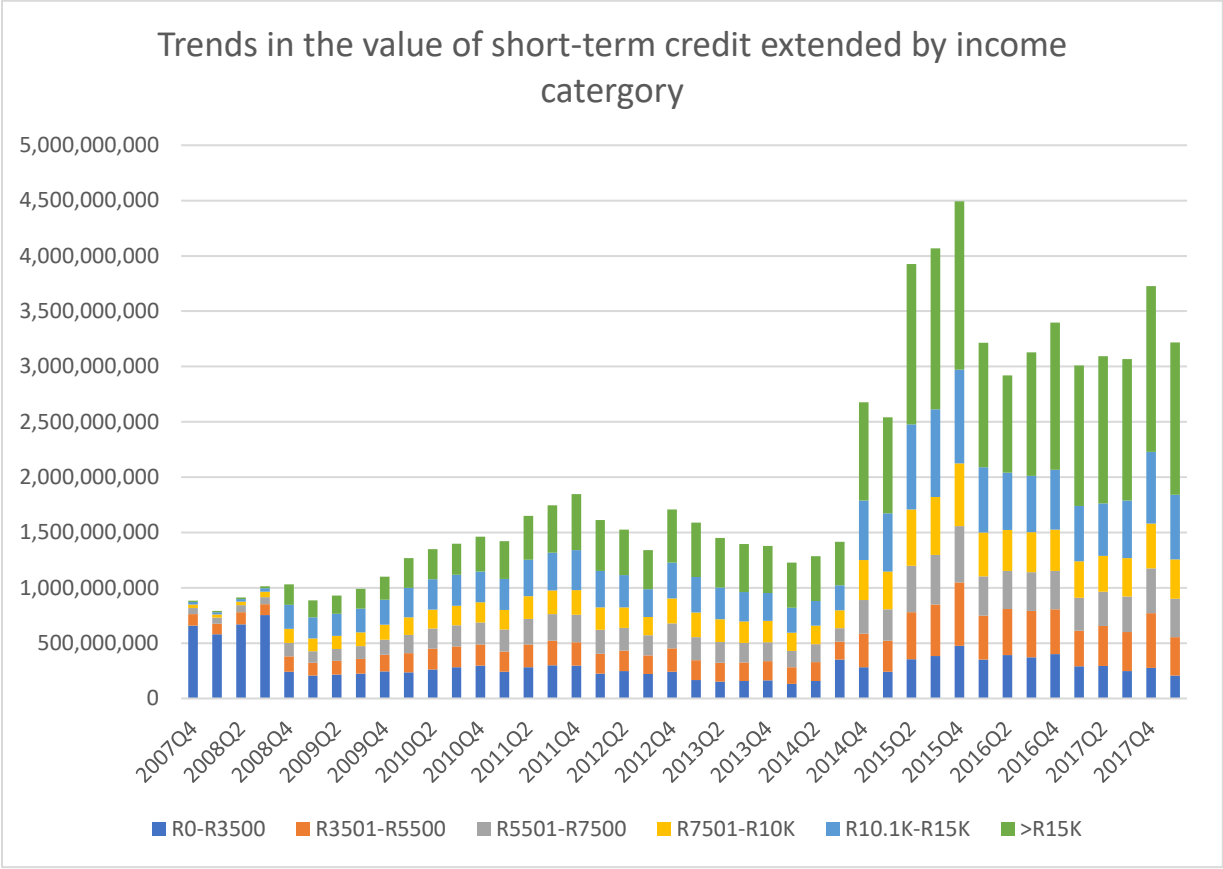


Figure 4: Spike in short-term credit (NCR, 2018a)

The strong association between these forms of credit and severe consumer indebtedness can in no way be interpreted positively at a time of market expansion. At best it describes a catalyst for worsening financial inequality and an increasingly desperate borrowing population. At its worst it may precipitate yet another credit delinquency crisis.

1.8. References

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