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Pre-contractual assessments in mortgage loans: Promoting responsible lending or exacerbating financial exclusion?

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A comparative study of the South African National Credit Act and the European Mortgage Credit Directive

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I hereby declare that I have read and understood the regulations governing the submission of LLM research papers, including those relating to length and plagiarism, as contained in the rules of this University, and that this research paper conforms to those regulations.

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Chapter 1: Introduction

1.1 General Introduction

The instrument of credit has been described as a 'double edged sword': 'Whilst credit allows access to products or services that cannot 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] It is a general governmental aim to level the playing field in the area of conflict between the accessibility to credit on the one hand and the prevention of over-indebtedness on the other. In this context, the terms 'responsible lending' and 'responsible credit regime' have become core ideas for international regulatory reforms in the consumer credit market. They have particularly gained new ground in the wake of the global financial crisis that shook the world economy ever since 2007.[2] It is now widely accepted that regulation of the financial sector must be 'responsible' in the sense that it includes protection against over-indebtedness of consumers.[3] Furthermore, the financial crisis changed the view on the impact of over-indebtedness in the sense that over-indebtedness is no longer seen only as an individual problem, but rather considered as a serious threat for the stability of the financial market. In particular, a responsible lending regime and the protection of consumers is crucial in the mortgage credit market, where over-indebtedness can have severe consequences for consumers, namely eviction and the loss of their home; and for the stability of the financial system as a whole.[4]

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[1] Department of Trade and Industry 'Making Credit Markets Work: A Policy Framework for Consumer Credit' (2004) 6, available at *https://www.ncr.org.za* (hereafter 'Policy Framework (2004)).

[2] V Mak 'What is Responsible Lending? The EU Consumer Mortgage Credit Directive in the UK and the Netherlands' (2015) 38 *Journal of Consumer Policy* 411.

[3] The World Bank 'Responsible lending: overview of regulatory tools' (2013), available at *http://documents.worldbank.org*.

[4] V Mak op cit note 2 at 411.

1.2 Scope of the study and limitations

The legislation and case law in South Africa and the European Union (hereafter 'EU'), that will be explored in detail in this study, deals with the objectives to create a responsible lending regime in the credit market as a whole and in the mortgage credit market in particular. The legislation aims at encouraging responsible borrowing, avoiding over-indebtedness and discouraging reckless lending.[5] A series of mechanisms were implemented specifically aimed at preventing consumers of credit agreements from becoming over-indebted in the first place.[6] The legislation in the consumer credit market in both South Africa and the EU ultimately aims at balancing the need of protection for consumers from reckless/irresponsible lending practices with the legitimate economic interests of credit lenders to make a fair profit. The legislation also intends to prevent over-indebtedness without creating insurmountable obstacles to access to credit. Striking a balance in the consumer credit legislation, which seeks to level the playing field between access to credit and preventing reckless/irresponsible lending, however, appears to be immensely hard to achieve. This study will examine whether the legislator in the two jurisdictions of South Africa and the EU has been able to close the loop in this regard.

The legislation which intends to create a responsible lending regime and safeguard the stability of the financial markets in the EU and South Africa covers a wide array of measures, including *inter alia* the promotion of financial education, responsible credit marketing and advertising, the disclosure of adequate information in order to enable the consumer to make an informed decision, and interest rate control.[7] The responsibility to take appropriate measures to promote responsible lending practices applies during all phases of the credit relationship.[8] Moreover, it includes prudential and regulatory measures in the financial sector.[9]

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[5] M Kelly-Louw *Consumer Credit Regulation in South Africa* (2012) 291.
[6] Ibid.
[7] S Renke 'Measures in South African consumer credit legislation aimed at the prevention of reckless lending and over-indebtedness: an overview against the background of recent developments in the European Union' (2011) 74 *Journal of Contemporary Roman-Dutch Law* 208 at 210 - 212.
[8] Ibid at 211.
[9] Notably, the South African Financial Sector Regulation Act (9 of 2017) which has recently been signed by President Jacob Zuma and was published in the Government Gazette on 22 August 2017 (*GG* Vol. 626 no 41060 of 22 August 2017). The Act introduces a so-called 'Twin Peaks' regulatory model: a Prudential Authority, which will supervise the safety and soundness of banks, insurance companies and other financial institutions, and a Financial Sector Conduct Authority, which will supervise how financial services firms conduct their business and treat customers (Republic of South Africa National Treasury 'TWIN PEAKS: Second draft of Financial Sector Regulation Bill and draft Market Conduct

However, it is important to note that this study is limited in its scope. First, it is beyond the scope of this study to consider all the measures that have been implemented in order to create a responsible lending regime, especially those that relate to the phase after the credit agreement has been concluded. Secondly, the study will not examine prudential and regulatory legislation such as the South African 'Twin Peaks' legislation[10] or the European Markets in Financial Instruments Directives ('MiFID I and II').[11] It will rather focus on the implementation of pre-contractual assessments in mortgage credit agreements, their content within the legal frameworks of the EU and South Africa, and their repercussions on the mortgage credit market.

The essential pieces of legislation related to the pre-contractual assessment in mortgage credit agreements are set out in the Mortgage Credit Directive (hereafter 'MCD')[12] of the EU and the South African National Credit Act (hereafter 'NCA')[13]. MCD and NCA cover a wide variety of regulations in the credit market. Unlike the MCD, however, the NCA is not confined to credit agreements relating to residential immovable property but covers a number of credit agreements, including direct personal loans, overdrawn cheque accounts, credit cards, the rendering of services, sale and lease of movable goods, and credit guarantees.[14]

1.3 Historical background

The transition from the Apartheid regime to a democracy in South Africa included a plurality of political and economic upheavals. Since 1994, it is the explicit governmental aim to redress the inequalities, imbalances, and discriminations of Apartheid by giving previously disadvantaged groups of South African citizens equal opportunities. As an essential part of this work towards transformation, South Africa has made diligent efforts to make the credit market accessible to the low-income and historically disadvantaged population.[15] Despite the fact that access to credit still

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Policy Framework discussion document published for comment' (2014) at 1-2, available at *http://www.treasury.gov.za)*.

[10] For a detailed overview of the Twin Peaks model see, *e.g.*, A Godwin & A Schmulow 'The Financial Sector Regulation Bill in South Africa: Lessons from Australia' (2015), available at *https://ssrn.com/abstract=2556544*.

[11] Directive 2004/39/EC and Directive 2014/65/EU.

[12] Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010.

[13] 34 of 2005.

[14] JM Otto & R-L Otto *The National Credit Act Explained* 4th ed. (2016) 17.

[15] M Ellyne & BM Jourdan 'Did the National Credit Act of 2005 Facilitate a Credit Boom and Bust in South Africa?' (2015) 4, available at *http://www.researchgate.net*.

remains a problem for certain parts of the population, thus hindering progress of the national economic transformation and development strategy[16], the sudden access to the credit market for parts of the population, who previously did not have access to credit, led to a vast growth of the South African retail credit market, resulting in a steep rise in household debt.[17]

The access to the credit market did not exclusively create desirable effects but also adversely affected the economy. It is estimated that the size of the South African consumer credit market was some R800 billion in 2007[18] and that the debt-to-disposable income ratio, used as an indicator for indebtedness, increased sharply from 2002 to an all-time high by the first quarter of 2008.[19] Even before, during the late 1990s and the early 2000s, the level of over-indebtedness in South Africa increased considerably.[20] In 2001, the South African Department of Trade and Industry (hereafter 'DTI'), responsible for consumer credit related issues, therefore decided to fully review the credit legislation that was in operation at the time, and to examine the problems that existed in the consumer credit market.[21] The DTI found that the operational system suffered a number of problems, *inter alia* fragmented and outdated legislation, ineffective consumer protection, particularly in relation to consumers in low-income groups, and reckless behaviour of market participants, in particular reckless lending by credit providers.[22] Notably, the practices of reckless lending (and ruthless collecting) became apparent in the South African micro-lending industry that provided credit to consumers particularly from the low-income group.[23] Hence, the DTI concluded that the operational consumer credit market was dysfunctional. Against this backdrop, it does not come as a surprise that South Africa witnessed the collapse of two large micro-lenders, the Saambou Bank Limited and the Unibank Limited, in

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[16] RP Goodwin-Groen & M Kelly-Louw 'The National Credit Act and its regulations in the context of access to finance in South Africa' (2008) 13, available at *http://www.finmark.org.za*.

[17] Exact figures on volumes of consumer credit extended in South Africa during the 1990s and early 2000s, however, are unreliable and incomplete due to the fact that different authorities such as the South African Reserve Bank, Statistics SA and the Micro Finance Regulatory Council dealt with bank and non-bank credit (M Kelly-Louw 'The Prevention and Alleviation of Consumer Over-indebtedness' (2008) 20 *SA Merc LJ* 200)

[18] National Credit Regulator's *Annual Report* (2007) 9, available at *http://www.ncr.org.za*.

[19] Industrial Development Corporation '*South African economy: An overview of key trends since 1994*' (2013) 12, available at *http://www.idc.co.za*.

[20] M Kelly-Louw op cit note 5 at 13.

[21] Ibid at 3.

[22] Department of Trade and Industry *Credit Law Review: Setting the Scene* (2004) 1, available at *http://www.ncr.org.za*.

[23] M Kelly-Louw op cit note 5 at 3.

2002, which highlighted underlying problems in the consumer credit market.[24] Consequently, the problem of over-indebtedness was no longer only considered a problem of the individual customer but also recognised as a systemic risk.[25] More generally, a link was drawn between the financial decisions taken and the overall well-being of national economies.[26]

Dysfunctional credit markets and high levels of over-indebtedness are admittedly not unique features of South Africa's financial sector. In the last part of the first decade of the twenty-first century, the devastating effects of the over-extension of credit[27] have been experienced on the global level with what is known as the global financial crisis. The global financial crisis took place in a context of largely liberalised credit markets and relaxed financial regulation.[28] The years before the crisis saw a flood of irresponsible mortgage lending, especially in the U.S. mortgage credit market, in an environment which enabled market conduct such as the spreading of risk through securitisation, including trading in residential mortgage-backed securities.[29] The global financial crisis not only led to massive bail-outs of financial institutions and an overall global economic downturn but also resulted in an increased number of credit defaults and forced sales of residential immovable property. The severe consequences of the financial crisis could also be felt in South Africa, where 2 million people experienced difficulties in meeting their financial commitments and more than 200,000 were in arrears on their mortgages.[30]

Many causes of the financial crisis have been suggested. Although the global financial crisis cannot be ascribed to any single factor – it was rather caused by a complex interplay of policies, market behaviour and other conditions – irresponsible behaviour by market participants was identified as one of the main causes that triggered the financial crisis. It is said that the worldwide economic meltdown during 2008 was the expensive price that credit providers and consumers had to pay for their

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[24] South African Reserve Bank – Bank Supervision Department *Annual Report* (2002) 8, available at *https://www.resbank.co.za*.
[25] Department of Trade and Industry *Credit Law Review August 2003: Summary of findings of the Technical Committee* (2003) 4, available at *http://www.ncr.org.za*.
[26] G Pearson G, PN Stoop & M Kelly-Louw 'Balancing Responsibilities – Financial Literacy' (2017) 20 *PER/PELJ* 3.
[27] JM Otto & R-L Otto op cit note 14 at 2.
[28] S Claessens & L Kodres 'The Regulatory Responses to the Global Financial Crisis: Some Uncomfortable Questions' (2014) 6, available at *https://www.imf.org*.
[29] T Wilson 'Credit and Over-indebtedness: Current Context, Regulatory Responses and Future Possibilities' in T Wilson (ed) *International responses to issues of credit and over-indebtedness in the wake of crisis* (2013) 3.
[30] G Davel 'Consumers the victims while credit regulator left headless' *Business Day* 18 July 2011 at 9.

irresponsible behaviour.[31] As pointed out above, the prevention of over-indebtedness and the creation of a responsible lending regime therefore became core points of the international responses in the wake of the crisis. Moreover, it was the financial crisis and the important role that the mortgage credit market played therein, that had the greatest impact on the awareness of the need for a common legal framework for mortgage credit agreements in the EU. The sub-prime lending disaster in the U.S. served as a reminder for the fact that there was a gap in EU-wide legislation applicable to mortgage credit agreements – despite accounting for the lion's share of the indebtedness of European households.[32]

1.4 Problem statement and research objective

'Responsible lending' and 'responsible credit regime' are policy terms that describe a whole range of regulatory measures or tools.[33] The agenda behind those terms is the need to balance several financial sector policy objectives: financial inclusion, stability and integrity of the financial sector, and consumer protection.[34] Within this framework, the pre-contractual (affordability) assessment plays a pivotal role in the creation of a responsible credit regime and in the prevention of irresponsible/reckless lending. It is safe to say that the legislative intent of creating a responsible mortgage credit regime and preventing reckless lending is of considerable importance for market participants (consumers, credit providers, and credit intermediaries) and regulators alike. Depending on the respective legal perspective, however, one can identify different approaches: The regulatory viewpoint would stress the importance of a responsible mortgage credit regime for the systemic integrity of the mortgage credit market and the financial market as a whole ('regulatory approach'). From the perspective of the consumer as an individual, on the other hand, the emphasis would be on the accessibility to credit and the protection against irresponsible market conduct of credit providers and intermediaries ('consumer protection approach'). The latter approach appears to be of particular importance in South Africa, bearing in mind that the South African Constitution[35], unlike other Constitutions, explicitly provides a

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[31] H Coetzee 'The impact of the National Credit Act on civil procedural aspects relating to debt enforcement' (2009) 1.
[32] H-J Dübel & M Rothemund 'A New Mortgage Credit Regime for Europe: Setting the Right Priorities' (2011) 1, *Center for European Policy Studies/European Credit Research Institute*, EPS Special Report, available at *http://www.ceps.eu/book/new-mortgage-credit-regime-europe-setting-right-priorities*.
[33] V Mak op cit note 2 at 413.
[34] World Bank 2013 op cit note 3 at 8.
[35] Constitution of the Republic of South Africa, 1996.

justiciable right of access to housing[36] and, more generally, pursues socially and politically transformative objectives, with a Preamble pointed towards the achievement of social justice.[37]

In light of the above, the research objective of the study is as follows: By means of comparative analysis, the dissertation firstly aims at providing an overview of the European and the South African responsible credit regime with a special emphasis on the pre-contractual assessment in mortgage credit agreements, and thereby legally defining the policy term of 'responsible credit' in the contexts of mortgage credit agreements in Europe and South Africa. The study will consider and duly compare the pre-contractual assessment provisions that have been implemented in order to create a responsible (mortgage) credit regime in South Africa and the EU. The purpose of the comparison is to reveal if it can be inferred from the NCA and the MCD that international best practices have emerged as regards pre-contractual assessments in the mortgage credit market and to identify potential shortcomings of the pre-contractual assessment in the two jurisdictions under consideration in this study.

On the basis of the comparative part, the study will secondly have a closer look at the actual or potential repercussions of the legislative attempt to create a responsible credit regime. In recent years, scholars have expressed the concern that a responsible credit regime in general and pre-contractual affordability assessments in particular necessarily lead to restrictive lending practices, especially in the mortgage credit market, which exacerbate financial exclusion.[38] Consumer protection imperatives, it is further argued, have 'to some extent been hijacked by a "financial stability" imperative, looking to the protection of markets rather than people'.[39] Furthermore, the current legal frameworks in South Africa and the EU as regards the responsible (mortgage) credit regime have been criticised for effectively focusing on irresponsible borrowing instead of irresponsible lending, holding the customer rather than the credit provider responsible for irresponsible market behaviour.[40] The legal frameworks in the EU and South Africa thus have been criticised for levelling the playing field of consumer protection and the access to credit on the one hand versus economic interests

[36] Section 26 of the Constitution.
[37] P de Vos '*Grootboom*, The right of Access to Housing and Substantive Equality as Contextual Fairness' (2001) 17 *SAJHR* 271. However, the focus of the minor dissertation is not on a constitutional examination of whether or not the provisions of the NCA might be inconsistent with the South African Constitution.
[38] T Wilson op cit note 29 at 8.
[39] Ibid.
[40] Ibid.

of credit providers and financial stability on the other to the detriment of the consumer. By contrast, pre-contractual assessments have been lauded for gaining traction over income benchmarks, giving more consumers access to credit. Drawing on the findings of the comparison between the MCD and the NCA, the study aims at scrutinising whether the provisions of the NCA and the MCD support the assumption that pre-contractual assessments in mortgage loans make credit more accessible or – conversely – exacerbate financial exclusion.

1.5 Structure of the minor dissertation

The structure of the minor dissertation is as follows. The study is divided into five chapters to meet the research objectives. Following the introduction, the study provides an outline of the NCA and MCD (chapter 2). Subsequently, the study will specifically compare the pre-contractual assessment in mortgage agreements under the NCA and the MCD, taking into account the prevention of irresponsible/reckless lending by means of pre-contractual assessments and the consequences and sanctions for reckless lending (chapter 3). Based on the findings in chapter 3, the study will examine some actual or alleged effects pertaining to pre-contractual assessments in South Africa and the EU at the crossroads between responsible lending and financial exclusion (chapter 4). The final chapter 5 contains the conclusions reached in this study.

Chapter 2: The National Credit Act and the Mortgage Credit Directive

1.1 History of the National Credit Act

As stated above, the DTI decided to fully review the operational credit consumer legislation in 2001 and to examine the problems that existed in the consumer credit market. Accordingly, the DTI initiated an in-depth legal-comparative research project in order to identify the problems that were being experienced in the credit market.[41] The research project ultimately resulted in the NCA, which came into full effective operation on 1 June 2007[42] and provides the regulatory framework for the South

[41] M Kelly-Louw op cit note 5 at 3.

[42] The NCA was assented to by the President on 10 March 2006 and came into effect incrementally on 1 June 2006, 1 September 2006 and 1 June 2007: See Proc 22 of 2006 in *Government Gazette* 28864 of May 2006. This piecemeal approach was chosen to give creditors an opportunity to get their financial

African credit market. In enacting the NCA, the South African legislature addressed a number of problems that have been identified in the *'Policy Framework for Consumer Credit'*[43] ('Policy Framework') in respect of the legislative framework that preceded the National Credit Act.[44] The drafters of the Policy Framework came to the conclusion that the consumer credit legislation current at the time[45] was ineffective, providing 'no effective protection against over-indebtedness'.[46] Over-indebtedness, in turn, was *inter alia* attributed to reckless lending and borrowing, low levels of awareness, and a lack of enforcement.[47] The Policy Framework therefore stated that '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'.[48]

The NCA brought about far-reaching changes in the South African consumer credit market and introduced new measures aimed at preventing 'reckless credit granting' and 'over-indebtedness'. Both terms were previously not addressed under the NCA's predecessors, the Usury Act[49] and the Credit Agreements Act[50] and were, thus, conceptually new to the South African consumer credit legislation.[51] In *Nedbank Ltd and Others v National Credit Regulator and Another*[52], Malan JA consequently pointed out that the NCA is not simply an amendment of the previous legislation[53] but rather represents a clean break and bears very little resemblance to its predecessors.[54]

Although the NCA has been described as more user-friendly and better worded than the previous legislation[55], the Act faced harsh criticism. Malan JA in *Nedbank Ltd v National Credit Regulator*[56] complained that '[n]umerous drafting errors, untidy

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systems, contract documents and other forms in place and to attend their registration as credit providers (JM Otto & R-L Otto op cit note 14 at 8).

[43] Policy Framework 2004 op cit note 1. The Policy Framework 2004 formed the basis upon which the NCA was drafted.

[44] C van Heerden & S Renke 'Perspectives on the South African Responsible Lending Regime and the Duty to Conduct Pre-agreement Assessment as a Responsible Lending Practice' (2015) 24 *INSOL* 67 at 71.

[45] As set out in the provisions of the Credit Agreements Act 75 of 1980, the Usury Act 73 of 1968 and the exemption notice in terms of the Usury Act.

[46] Policy Framework (2004) op cit note 1 at 30.

[47] Ibid at 31.

[48] Ibid.

[49] 73 of 1968.

[50] 75 of 1980.

[51] C van Heerden & S Renke op cit note 44 at 72.

[52] *Nedbank Ltd and Others v National Credit Regulator and Another* 2011 (3) SA 581 (SCA).

[53] Ibid para 1.

[54] JM Otto & R-L Otto op cit note 14 at 3.

[55] Ibid at 5.

[56] *Nedbank Ltd and Others v National Credit Regulator and Another* supra note 52 para 2.

expressions and inconsistencies make its[57] interpretation a particularly trying exercise.'[58] Following criticisms from the judicial and academic side and due to practical problems in the application of the NCA, the DTI published the draft National Credit Act Policy Review Framework and the draft National Credit Amendment Bill in the Government Gazette.[59]

Subsequently, the NCA was amended in 2014 by the National Credit Amendment Act (hereafter 'NCAA')[60] that rectified some of the NCA's shortcomings. On 19 May 2014, the NCAA was assented by the President, Mr Jacob Zuma.[61] The amendments subject to the NCAA became effective and operational on 13 March 2015.[62] The amendments included *inter alia* changes in certain definitions of credit agreements in the Act, in the field of application of the Act, as well as in the fields of reckless credit, unlawful agreements, debt review and debt enforcement.[63]

1.2 Main objectives of the National Credit Act

The NCA contains a number of purposes that are set out in Section 3 and are also reflected in the preamble to the Act. The purposes of the Act are 'to promote and advance the social and economic welfare of South Africans, promote a fair, transparent, competitive, sustainable, responsible, efficient, effective and accessible credit market and industry, and to protect consumers'.[64] Another one of its key objects is to create a single system of consumer credit regulation and a National Credit Regulator to administer the consumer credit industry.[65]

The Act aims to achieve its objectives *inter alia* by 'promoting the development of a credit market that is accessible to all South Africans, particularly to those who have historically been unable to access credit under sustainable market conditions'[66], 'promoting responsibility in the credit market by (i) encouraging responsible borrowing, fulfilment of financial obligations by consumers and avoidance of over-indebtedness; and (ii) discouraging reckless credit granting by credit providers, and

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[57] *i.e.* the NCA's.
[58] For more examples of those critics see JM Otto 'National Credit Act. *Vanwaar Gehási? Quo vadis lex?* And some reflections on the National Credit Amendment Act 2014 (part 1)' 2015 *TSAR* 585.
[59] *GG* Vol. 575 no 36504 & 36050 of 29 May 2013.
[60] 19 of 2014.
[61] *GG* Vol. 587 no 37665 of 20 May 2014.
[62] *Green Gazette* no 38557 of 13 March 2015.
[63] JM Otto op cit note 58 at 587.
[64] Section 3.
[65] M Kelly-Louw op cit note 5 at 20.
[66] Section 3(a) NCA. Section 2(6) provides who is considered to be a historically disadvantaged person in the context of the NCA.

contractual default by consumers'[67], and 'addressing and correcting imbalances in negotiating power between consumers and credit providers'[68].

The purposes of the Act as set out in section 3 are not of declaratory effect only. Section 2(1) of the NCA rather provides that each time the Act is interpreted it must be done in a way that gives effect to the purposes set out in section 3.[69]

Although the Act, in essence, aims to improve the protection offered to the consumers of credit, consumer protection is not the Act's sole or predominant purpose.[70] In *Standard Bank SA Ltd v Hales and Another*[71], the KwaZulu-Natal High Court, Durban, held that section 3 of the NCA lists a number of purposes without providing any prioritisation.[72] It can therefore be inferred that the protection of consumers cannot be the sole purpose of the NCA nor can be said that it is the Act's chief purpose. Likewise, Willis J said in *FirstRand Bank Ltd t/a First National Bank v Seyffert*[73] that 'it is clear from reading section 3 of the NCA, which sets out the purposes of the Act, that it pursues varied objectives which must be held in balance. Certainly, the NCA is designed to protect consumers, but it was not intended to make of South Africa a "debtor's paradise".'[74] In general, it can rather be said that the various purposes of the Act as set out in section 3 aim at striking a balance between consumer protection, financial stability of the credit market and the legitimate interests of credit providers.

1.3 Application and scope of the National Credit Act

As stated above, the NCA has a broad scope of application. The NCA generally regulates all kinds of consumer credit whether it is, *e.g.*, in the form of home loans, direct personal loans, vehicle and asset finance, study loans or clothing store accounts.[75] Section 8(1) of the NCA identifies four main types of credit agreements to which the Act applies. They are credit facilities[76], credit transactions[77], credit

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[67] Section 3(c) NCA.
[68] Section 3(e) NCA.
[69] M Kelly-Louw op cit note 5 at 23.
[70] M Kelly-Louw op cit note 5 at 20; *Rossouw and Another v FirstRand Bank Ltd* 2010 (6) SA 439 (SCA).
[71] *Standard Bank SA Ltd v Hales and Another* 2009 (3) SA 315 (D).
[72] Ibid para 13.
[73] *FirstRand Bank Ltd t/a First National Bank v Seyffert* 2010 (6) SA 429 (GSJ).
[74] Ibid para 10.
[75] M Kelly-Louw op cit note 5 at 28.
[76] Defined in section 8(3).
[77] Defined in section 8(4).

guarantees[78] and credit agreements that are a combination of the afore-mentioned types. The NCA further deals with developmental credit agreements and public interest credit agreements subject to sections 10 and 11 of the NCA.

Section 4(1) of the NCA provides that the Act applies to every credit agreement between parties dealing at arm's length and made within, or having an effect within, the Republic of South Africa. The definition of 'dealing at arm's length' is a negative one, *i.e*., the Act sets out arrangements in respect whereof it is considered that parties to a credit agreement are not dealing at arm's length (section 4(2)(*b*)), *e.g*., in case of a shareholder loan or a credit agreement between natural persons who are in a familial relationship and are co-dependent on each other or one is dependent upon the other.[79] However, the list provided in section 4(2)(*b*) is not exhaustive. Therefore, any arrangement of a type that has been held in law to be between parties who are not dealing at arm's length will not be an arm's length transaction for purposes of the NCA.[80]

The NCA does not apply to credit agreements in certain circumstances listed in section 4(1)(*a*) - (*d*) and is limited in its scope of application subject to section 5 and 6 of the NCA. It is beyond the scope of this study to consider each of the exclusions and limitations of the scope of application separately.[81] For the purposes of this study it is, however, important to note that 'a juristic person whose asset value or annual turnover, together with the combined asset value or annual turnover of all related juristic persons, at the time the agreement is made, equals or exceeds'[82] a certain threshold determined by the Minister[83] in terms of section 7(1) of the NCA, currently R1,000,000[84], will not come under the ambit of the NCA. Conversely, juristic persons whose asset value or annual turnover is below this threshold – commonly referred to as 'small' juristic persons or businesses – do, in general, enjoy the protection of the NCA.[85] Certain parts of the NCA, however, only apply to credit agreements where the consumer is an individual (a natural person). This is *inter alia* true for the provisions

[78] Defined in section 8(5).
[79] M Kelly-Louw op cit note 5 at 29.
[80] Ibid at 31.
[81] For further reading see M Kelly-Louw op cit note 5 at 32 et seq.
[82] Section 4(1)(*a*)(i) of the NCA.
[83] Minister meaning the member of the Cabinet responsible for consumer credit matters (section 1 of the NCA). Cabinet, in turn, means the Cabinet referred to in section 91 of the Constitution.
[84] See section 4(1)(*a*)(i) read with section 6 of the NCA and GenN 713 in *GG* Vol. 492 no 28893 of 1 June 2006 at 3.
[85] M Kelly-Louw op cit note 5 at 36.

of Chapter 4 Part D of the NCA dealing with over-indebtedness and reckless credit.[86] A juristic person is therefore barred from raising the issue of reckless credit or over-indebtedness.

In *Standard Bank of South Africa Ltd v Hunkydory Investments and Another 194 (Pty) Ltd (No 1)*[87], the question was raised whether the provisions of sections 4(1)(*a*) and 4(1)(*b*) of the NCA are unconstitutional insofar as they provide that the Act does not apply to a juristic person. The defendants argued that these provisions infringed their constitutional right to equality as found in section 9(1) of the Constitution.[88] The court pointed out that where the impugned provisions differentiate between people or categories of people, there must be, in the first place, a rational connection between the differentiation in question and the legitimate governmental purpose it is designed to further or achieve in order not to fall foul of the equality provisions of the Constitution.[89] In the given case, the court held that there was such a rational connection. It found that in essence, the NCA 'attempts to prevent the reckless provision of credit by institutions to persons who cannot afford the credit' and concluded that it was evident that there was 'a rational connection between the differentiation created by the relevant provisions of section 4 of the National Credit Act and the legitimate governmental purpose behind its enactment'.[90] Furthermore, the court found that the differentiation did not amount to unfair discrimination.[91]

1.4 Mortgage agreement under the National Credit Act

The NCA initially defined a mortgage agreement as a credit agreement that is 'secured by a pledge of immovable property'.[92] This definition was harshly criticised even before the NCA was enacted.[93] Taking into account that under common law rules only movable property can be pledged, one had to perforce interpret 'pledge of immovable property' as meaning 'registration of a bond over immovable property'.[94] The NCAA

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[86] Section 6(a) of the NCA. Other provisions that only apply to credit agreements where the consumer is a natural person include credit marketing practices, negative option marketing, debt-review or re-arrangement/restructuring, and rules regulating the interest rates and other costs of credit.
[87] *Standard Bank of South Africa Ltd v Hunkydory Investments and Another 194 (Pty) Ltd (No 1)* 2010 (1) SA 627 (C).
[88] Ibid para 18.
[89] Ibid para 22.
[90] Ibid para 20 and 25.
[91] Ibid para 25.
[92] Section 1 of the NCA.
[93] JM Otto referred to the definition of 'mortgage agreement' as a monstrosity (JM Otto & R-L Otto op cit note 14 at 22).
[94] JM Otto & R-L Otto op cit note 14 at 27.

of 2014 tried to address the inaccuracy as pointed out above. Pursuant to the NCAA, a mortgage is now defined as a 'mortgage bond registered by the registrar of deeds over immovable property that serves as continuing covering security for a mortgage agreement'.[95] However, JM Otto correctly points out that the wording 'continuing covering security' is misleading and unnecessary. This creates the impression that a mortgage for purposes of the NCA is a covering bond, that is to say a bond securing future debts. According to JM Otto, however, the courts should interpret the definition as including an 'ordinary' mortgage bond, that is a mortgage bond where the credit is in existence from day one.[96] A mortgage agreement is in turn defined as 'a credit agreement that is secured by the registration of a mortgage bond by the registrar of deeds over immovable property'.[97] A classic example of a mortgage agreement will be a housing loan.[98]

The NCA classifies credit agreements in three categories: Section 9(1) provides that for purposes of the Act, every credit agreement is characterised as a small, intermediate, or large agreement, as described in subsections (2) to (4) respectively. Pursuant to section 9(4), a mortgage agreement is regarded a large agreement, irrespective of the principle debt involved.[99] The categorisation is made in order to subdivide the consumer credit market by size and to facilitate effective regulation.[100] The type of category a specific credit agreement falls into has significance in different respects. Firstly, the different types of credit agreements require different pre-agreement disclosure statements and quotations that need to be made.[101] Secondly, the format in which credit agreements must be delivered to the consumer differs from category to category.[102] Thirdly, to exclude the application of the NCA where a juristic

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[95] Section 1(d) of the NCAA.
[96] JM Otto & R-L Otto op cit note 14 at 27.
[97] Section 1(e) of the NCAA.
[98] Section 1 of the Home Loan and Mortgage Disclosure Act 63 of 2000 defines a housing loan as a loan or advance by a financial institution to a person for purposes of constructing, purchasing, renovating or improving in any way such person's home with the security of a registered mortgage bond or any other form of accepted security (M Kelly-Louw op cit note 5 at 72).
[99] A credit agreement is a small agreement if it is pawn transaction or if a credit facility or credit transaction (excluding a mortgage agreement) if below the threshold of R15,000 (Section 9(2) read with *GN* 713 in *GG* Vol. 492 no 28893 of 1 June 2006 at 3). An intermediate credit agreement is a credit facility or credit transaction (excluding a pawn transaction or mortgage) of between R15,000 and R250,000 (Section 9(3) read with *GN* 713 in *GG* Vol. 492 no 28893 of 1 June 2006 at 3). Besides a mortgage agreement, a credit facility or credit transaction (excluding a pawn transaction) is considered a large agreement if the transaction value is equal to or more than R250,000 (Section 9(4) read with *GN* 713 in *GG* Vol. 492 no 28893 of 1 June 2006 at 3).
[100] M Kelly-Louw op cit note 5 at 93.
[101] Section 92 and regs 28 and 29 in GN R489 in *GG* Vol. 491 no 28864 of 31 May 2006 (see M Kelly-Louw op cit note 5 at 93).
[102] Ibid.

person[103] with an asset value or annual turnover, at the time the agreement is made, below R1,000,000, concludes a large credit agreement.[104] The NCA therefore only protects (in a limited way) small juristic persons who enter into small or intermediate credit agreements.[105] Hence, a (small) juristic person cannot raise the defence of reckless credit or over-indebtedness as regards a mortgage agreement for two reasons: Firstly, because the provisions relating to reckless credit and over-indebtedness[106] will not apply in cases where the consumer is a juristic person.[107] Secondly, because a mortgage agreement is considered a large agreement irrespective of the principle debt involved and the NCA will not apply to a large credit agreement concluded by a (small) juristic person.[108]

2.1 History of the Mortgage Credit Directive

The consumer credit market has long been regulated in the EU, in particular by the Council Directive 87/102/EEC[109], and more recently by its successor, the Consumer Credit Directive 2008/48 ('CCD')[110]. Yet mortgage credit and high-value credit agreements were excluded from the CCD's scope[111], which led to a significant gap in EU consumer protection law applicable to mortgage credit agreements.[112] The MCD, published in the Official Journal of the Commission on 28 February 2014, with a transposition date of 21 March 2016[113], seeks to remedy this, pointing out that '[a]

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[103] See the definition in section 1 of the NCA.
[104] Section 4 (1)(*b*) read with s 7(1)(a) and *GN* 713 in *GG* Vol. 492 no 28893 of 1 June 2006 at 3. *FirstRand Bank Ltd v Carl Beck Estates (Pty) Ltd and Another* 2009 (3) SA 384 (T); *Structured Mezzanine Investments (Pty) Ltd v Davids and Others* 2010 (6) SA 622 (WCC).
[105] M Kelly-Louw op cit note 5 at 37.
[106] Sections 78 - 88 of the NCA.
[107] See chapter 2 para 1.3 above.
[108] Section 4(1)(*b*) of the NCA.
[109] Council Directive 87/102/EEC of 22 December 1986 for the approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit.
[110] Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC.
[111] Article 2(2)(a) and (c) of the CCD. Member States may, however, in accordance with the law of the EU, decide to apply the Directive to credit agreements not covered by its scope. A Member State could thereby maintain or introduce national legislation corresponding to the provisions of the Directive or certain of its provisions on credit agreements outside the scope of the Directive, for instance on mortgage credit agreements or high value credit agreements (see recital 10 of the CCD).
[112] This, however, does not mean that mortgage agreements and the mortgage credit market have not been regulated in the European Member States prior to the MCD. Rather, the Member States had 28 different frameworks for mortgages and mortgage credits that each functioned separately and independently (T Josipovic 'Consumer Protection in EU Residential Mortgage Markets: Common EU Rules on Mortgage Credit in the Mortgage Credit Directive' (2014) 16 *Cambridge Yearbook of European Legal Studies* 224).
[113] As the MCD is a European directive, the European Member States have to transpose it into national law.

series of problems have been identified in mortgage markets within the Union relating to irresponsible lending and borrowing'[114] and irresponsible behaviour by market participants 'can undermine the foundations of the financial system, leading to a lack of confidence among all parties, in particular consumers, and potentially severe social and economic consequences.'[115]

The MCD is the end of a long consultative and legislative journey.[116] As long ago as 1985, the European Commission drafted the first *Proposal for a Directive on the freedom of establishment and the free supply of services in the field of mortgage credit*.[117] The proposal, however, was not adopted at the time, and it was not until 2001 that the next step on the way towards a higher level of integration of mortgage credit markets within the European financial market was taken. In March 2001, the Commission published the *Commission Recommendation on pre-contractual information to be given to consumers by lenders offering home loans*[118], that resulted in the European agreement on a voluntary code on pre-contractual information for home loans.[119] The consultative process towards a common legal framework for mortgage credit agreements went further in March 2003 with the establishment of a Forum Group on mortgage credit.[120] In July 2005, the European Commission published a *Green Paper on Mortgage Credit in the EU*[121], following the recommendations of the Forum Group. The Green Paper examined the case for Commission action, looking at whether and how Commission action to develop the single market in mortgages could enhance efficiency and competitiveness and provide concrete benefits for EU consumers.[122] Subsequently, the Commission continued its analysis of the EU mortgage market and published the *White Paper on the Integration*

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[114] Recital 4 of the MCD.
[115] Recital 3 of the MCD.
[116] For a detailed chronology of events see the Commission Staff Working Paper Impact Assessment *Accompanying document to the Proposal for a Directive of the European Parliament and of the Council on credit agreements relating to residential property* COM(2011) 142 of 31 March 2011 at 51, available at *http://www.eur-lex.europa.eu*.
[117] EU Commission *Proposal for a Directive on the freedom of establishment and the free supply of services in the field of mortgage credit* COM(84) 730 of 7 February 1985, available at *http://aei.pitt.edu/8826/*.
[118] EU Commission *Commission Recommendation of 1 March 2001 on pre-contractual information to be given to consumers by lenders offering home loans* [2001] OJ L69/25.
[119] Agreement on the Code of Conduct and Register of Institutions adhering to the European Code are available at *http://www.ec.europa.eu*.
[120] A detailed chronology of events is displayed in the Commission Staff Working Paper Impact Assessment *Accompanying document to the Proposal for a Directive of the European Parliament and of the Council on credit agreements relating to residential property* op cit note 116 at 51.
[121] EU Commission *Green Paper on Mortgage Credit in the EU* COM(2005) 327 of 19 July 2005, available at *http://www.eur-lex.europa.eu*.
[122] Ibid.

of EU Mortgage Credit Markets[123] on 18 December 2007. The paper summarised the conclusions of a comprehensive review of European residential mortgage markets, and identified a package of proportionate measures designed to enhance the competitiveness and efficiency of EU mortgage markets.[124] The *White Paper* already referred to measures to protect consumers in mortgage credit markets at the time of the commencing global financial crisis.

The wording of the MCD itself is the result of several years of discussions on the *Proposal for a Directive on credit agreements relating to residential property*[125] of 2011.[126] However, in the course of the discussion in the European Parliament, almost every provision in the proposal was amended and expanded[127] and special emphasis was put on consumer protection in terms of protection against over-indebtedness and on the establishment of a system to create a responsible credit regime.[128]

As pointed out before, the MCD had to be transposed into national law before 21 March 2016. The European Commission closely monitors and enforces transposition. It verifies if transpositions are correct and complete, and takes action if necessary to ensure proper transposition.[129] The transposition status for the MCD, provided on the website of the Commission[130], shows that 26 Member States have communicated full transposition, while two Member States – Croatia and Spain – have still not transposed the MCD (by the end of September 2017). Furthermore, infringement proceedings are pending against 20 Member States due to the lack or delay of the notification of national transposition measures or their incompleteness.[131]

2.2 Main objectives of the Mortgage Credit Directive

The MCD first and foremost aims at consumer protection, particularly ensuring that all consumers who take out a mortgage to purchase a property are adequately informed

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[123] EU Commission *White Paper on the Integration of EU Mortgage Credit Markets* COM(2007) 807 of 18 December 2007, available at *http://www.eur-lex.europa.eu*.
[124] Ibid.
[125] EU Commission *Proposal for a Directive on credit agreements relating to residential property (text with EEA relevance)* COM(2011) 0142 of 31 March 2011, available at *http://www.eur-lex.europa.eu*.
[126] T Josipovic op cit note 112 at 235.
[127] See the EU Commission *Amendments adopted by the European Parliament on 10 September 2013 on the proposal for a directive of the European Parliament and of the Council on credit agreements relating to residential property* COM(2011) 0142 C7-0085/2011, available at *http://www.europarl.europa.eu*.
[128] T Josipovic op cit note 112 at 236.
[129] EU Commission *Monitoring of banking and finance directives*, available at *http://www.ec.europa.eu*.
[130] *http://www.ec.europa.eu*.
[131] See *https://ec.europa.eu/info/publications/mortgage-credit-directive-transposition-status_en.*

and protected against the risks. However, the objectives that form the basis of the MCD go beyond consumer protection. The MCD is also designed to provide for a more integrated internal European mortgage market[132] and aims at the promotion of stability in the financial market.

On a more detailed level, the main objectives of the MCD can be summarised as follows: (a) establishment of a high level of consumer protection; (b) creation of a responsible mortgage credit regime, including the prevention of irresponsible lending and borrowing, of unaffordable loans, and of defaults, foreclosures and eviction; (c) establishment of an efficient and competitive single market for the benefit of consumers, creditors, and credit intermediaries; (d) establishment of business and conduct principles, ensuring that creditors and credit intermediaries (*i.e.* persons or companies providing information and assistance to consumers looking for a mortgage loan) act honestly and transparently in the consumer's interests, and provide a high level of professionalism (ensuring that their staff have the necessary and latest knowledge on loan agreements and that customers are provided with all the necessary information before signing any agreement); (e) introduction of a passport regime of credit intermediaries[133]; (f) promotion of financial stability on the internal market.[134]

While the MCD does not create a certain order of priority between its different objectives, it is clear from the EU initiatives and the legislative procedure that the most significant emphasis is placed on improving consumer confidence, increasing consumer protection and facilitating mobility to establish a single mortgage credit market.[135] Importantly, the MCD does not aim at full harmonisation of the European mortgage credit market, 'taking into account the specificity of credit agreements relating to immovable property and differences in market developments and conditions in Member States, concerning in particular market structure and market participants, categories of products available and procedures involved in the credit granting process'.[136] Rather, the MCD requires minimum harmonisation, which does not generally restrict Member States from maintaining or introducing more stringent

[132] M Weinrich 'Europe: A shifting regulatory landscape – the Mortgage Credit Directive' 2016 *Housing Finance International* 11.
[133] Essentially, this means that in principle once authorised in one EU country, a credit intermediary is allowed to provide services throughout the EU, which, in turn, is linked to the Directive's objective of establishing a single European mortgage credit market.
[134] T Josipovic op cit note 112 at 237.
[135] Ibid at 234.
[136] Recital 7 of the MCD.

provisions in order to protect consumers.[137] The concept of minimum harmonisation therefore leaves it largely to the discretion of the member states how to transpose the requirements established by the MCD. However, there are two exceptions to this rule of minimum harmonisation pursuant to Article 2(2) MCD: (a) Member States shall not maintain or introduce in their national law provisions diverging from those laid down in Article 14(2) and Annex II Part A MCD with regard to standard pre-contractual information through a European Standardised Information Sheet (ESIS), which consumers have to receive before signing a credit agreement; and (b) the pre-contractual information has to include the so-called annual percentage rate of charge (APRC), which is an effective interest rate that is calculated according to a common, consistent EU standard as set out in Article 17(1) to (5), (7) and (8) and Annex I MCD.

2.3 Application and scope of the Mortgage Credit Directive

The material scope of application of the MCD is defined by Article 3(1) of the MCD. The MCD only applies (a) to credit agreements which are secured either by a mortgage or by another comparable security commonly used in a Member State on residential immovable property or secured by a right related to residential immovable property; and (b) credit agreements the purpose of which is to acquire or retain property rights in land or in an existing or projected building.[138] In this regard, the scope of application of the MCD is much narrower than the one of the NCA that applies to a variety of credit agreements in the consumer credit market.[139]

Regarding the personal scope of application, the MCD encompasses consumers. Article 1 of the MCD states that the Directive 'lays down a common framework for certain aspects of the laws, regulations and administrative provisions of the Member States concerning agreements covering credit for consumers secured by a mortgage or otherwise relating to residential immovable property'. Article 4(3) defines a credit agreement as 'an agreement whereby a creditor grants or promises to grant, to a consumer, a credit falling within the scope of Article 3 in the form of a deferred payment, loan or other similar financial accommodation'. Although the MCD itself does not contain any express limitation as regards juristic persons, it becomes clear from these provisions as well as Article 4(1) of the MCD that the Directive applies to natural persons only. Article 4(1) of the MCD provides that for the purposes of the

[137] Article 2(1) MCD.
[138] Article 3(1) MCD.
[139] See chapter 1 para 1.1 and chapter 2 para 1.3 above.

Directive, 'consumer' is defined as in Article 3(a) of the CCD. According to Article 3(a) of the CCD, a 'consumer' is considered to be a natural person who, in transactions covered by the Directive, is acting for the purposes which are outside his [or her] trade, business or profession.[140] Under the law of the EU, the notion of consumer does not extend to legal persons, even if they have a non-business character (e.g. non-profit associations).[141] Accordingly, the MCD limits its statutory protection to natural persons. The notion of 'consumer' therefore significantly differs from the understanding of the term in the context of the South African NCA, which, in general, encompasses both natural persons and small juristic persons or businesses.[142] Moreover, unlike the NCA, the MCD only applies to consumers 'acting for purposes which are outside his [or her] trade, business or profession'. However, in the case of dual purpose contracts, *i.e.* contracts that are concluded for purposes partly within and partly outside the person's trade, business or profession and the trade, business or professional purpose is so limited as not to be predominant in the overall context of the contract, that person should also be considered as a consumer.[143]

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[140] The notion of 'consumer' and 'consumer protection' is a key concept under the law of the EU. Article 38 of the Charter of Fundamental Rights of the EU (2002/C 326/391) states that the Union policies shall ensure a high level of consumer protection. The European treaties since the Single European Act (SEA) seek to guarantee a high level of consumer protection in the EU. It is also a general objective defined in Article 12 of the Treaty on the Functioning of the EU (Consolidated versions of the Treaty on European Union and the Treaty on the Functioning of the European Union 2012/C 326/01, hereafter 'TFEU').

Despite the fact that there is no consistent and uniform definition of consumer in EU law and there are also divergences amongst the Member States, the definition of 'consumer' as a natural person acting for the purposes which are outside his or her trade, business or profession is a common core under EU law (J Valant 'Consumer Protection in the EU – Policy overview' (2015) 4, available at *http://www.europarl.europa.eu*). It is applied in a variety of EU Directives and Regulations (such as the CCD or the Consumer Rights Directive (Directive 2011/83/EU of the European Parliament and of the Council of 25 October 2011 on consumer rights)) as well as the case law of the European Court of Justice (see, e.g., *Johann Gruber v Bay Wa AG* C-464/01 and *BKK Mobil Oil Körperschaft des öffentlichen Rechts v Zentrale zur Bekämpfung unlauteren Wettbewerbs eV* C-59/12C-59/12). There is, however, an ongoing discussion about whether or not the consumer protection law in the EU should be extended to 'small business persons'. The consumer protection rules in the EU are based on the notion that the asymmetry of information, where the seller or supplier knows more about the product or service in question than the consumer, is open to abuse and the weaker party needs protection in contracting in certain circumstances (E Hondius 'The Notion of Consumer: European Union versus Member States' (2006) 28 *Sydney Law Review* 89 at 96). This structural asymmetry, it is argued, applies to the same or at least a similar extent to a small business person that has no expertise on many commercial issues. However, the European legislator has so far abstained from including small businesses in the consumer protection legislation, mainly because of the difficulties where to draw the line between 'small' and 'big' businesses (Ibid at 96).

[141] R Manko 'The notion of "consumer" in EU law' (2013), available at *http://www.europarl.europa.eu*.

[142] See chapter 2 para 1.3 above.

[143] Recital 12 of the MCD. It does not come as a surprise that this may lead to serious difficulties in demarcation on whether a purpose is predominantly outside a person's trade, business or profession or not (see, *e.g.* the judgment of the European Court of Justice in *Johann Gruber v Bay Wa AG* C–464/01 on the issue of demarcation regarding the notion of consumer).

The MCD explicitly excludes certain agreements from its scope[144] such as credit agreements where the credit is granted free of interest and without any other charges except those that recover costs directly related to the securing of the credit[145] or credit agreements in the form of an overdraft facility where the credit has to be repaid within a month.[146] Moreover, the MCD leaves member states discretion to opt-out of certain provisions of the MCD and to exclude certain types of credit agreements from the scope of the MCD such as bridging loans.[147]

Lastly, regarding the temporal scope, the MCD shall not apply to credit agreements existing before 21 March 2016 according to Article 42(2) of the MCD.

2.4 Mortgage agreement under the Mortgage Credit Directive

Unlike the NCA, the MCD does not contain a definition of 'mortgage', 'mortgage agreement', or 'mortgage credit agreement'. The understanding of a mortgage (credit) agreement under the MCD is rather determined by its scope. According to Article 1 of the MCD, the subject matter of the Directive relates to 'agreements covering credit for consumers secured by a mortgage or otherwise relating to residential immovable property'. As stated above, the MCD shall apply to (a) agreements which are secured either by a mortgage or by another comparable security commonly used in a Member State on residential immovable property[148] or secured by a right related to residential immovable property; and (b) credit agreements the purpose of which is to acquire or retain property rights in land or in an existing or projected building. When the MCD speaks of 'credit agreement', 'mortgage credit agreement' or 'mortgage credit', it

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[144] See Article 3(2) of the MCD.
[145] Article 3(2)(c) of the MCD.
[146] Article 3(2)(d) of the MCD.
[147] See Article 3(3) of the MCD.
[148] This wording takes into account the extensive conceptual differences in the types of security rights on immovables (mortgage, hypothec, fiduciary transfer of ownership, retention of title, etc.) in the EU member states. Conceptual differences in individual security rights on immovables mostly derive from the fact that some are typical of common law systems, i.e. mortgage, and some of civil (continental) law systems, i.e. hypothec. Moreover, some of the security rights are accessory rights, some are largely non-accessory in nature like the German *Grundschuld* or the Swiss *Schuldbrief* (land charge), i.e. their establishment and existence is not conditioned by the existence of a valid claim secured by it (T Josipovic op cit note 112 at 225). Initiatives to unify or harmonise the European capital market on security rights on immovables exist since 1966 (see '*The Development of a European Capital Market'* Report of a Group of experts appointed by the EEC Commission, Brussels, November, 1966 (Segré Report), available at *http://ec.europa.eu)*, most notably the model of the so-called *Euromortgage* or *Eurohypothek*, a security right on immovable property governed by separate rules uniformly applied in all member states. However, the member states failed to achieve any consensus on unifying or harmonising the security rights on immovables, so that the question of introducing the *Euromortgage* or *Eurohypothec* as a model for the integration of mortgage credit markets remains open (T Josipovic op cit note 112 at 233).

always refers to 'an agreement whereby a creditor grants or promises to grant, to a consumer, a credit falling within the scope of Article 3'.[149] As can be seen in Articles 1 and 3, the MCD applies only to consumer credit agreements that relate to residential immovable property. Other consumer credit agreements that relate to immovable property without any residential purpose are outside the scope of the MCD.[150] If the credit agreement falls under the ambit of the MCD as described above, the MCD applies irrespective of whether cross-border or domestic credit agreements are at issue.[151]

3. Conclusion

The overall assessment of the history and objectives, the scope of application of the NCA and MCD and the term 'mortgage agreement' under NCA and MCD leads to the following findings:

(1) Both the NCA and the MCD are comprehensive pieces of legislation. They are – broadly speaking – aimed at balancing several financial sector policy objectives: consumer protection, financial inclusion, and stability and integrity of the financial markets. While consumer protection might be the bedrock principle of both statutes, it is neither under the NCA nor the MCD the sole or predominant legislative purpose.

The main objectives of NCA and MCD appear to be substantially similar.[152] However, the NCA has a stronger emphasis on socially transformative objectives with section 3 explicitly pointed towards the promotion and advancement of economic and social welfare, *inter alia* by making the credit markets accessible for all South Africans, 'in particular to those who have historically been unable to access credit under sustainable market conditions' (section 3(a) NCA). Moreover, it can be inferred from the legislative procedure that the legislator was looking at the protection of individuals against over-indebtedness and reckless lending rather than focusing on the underlying systemic risks that can be caused by such scenarios. The MCD, on the other hand, seems to have a stronger focus on the stability of the credit market as a whole. Consumer protection and the promotion of responsible lending and borrowing are strongly considered in the light of the financial crisis (see for example recital 3 of the Directive) and consequently considered a systemic risk to the financial market.

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[149] Article 4(3) of the MCD.
[150] T Josipovic op cit note 112 at 238.
[151] Ibid.
[152] Except, of course, for the MCD's objective of harmonisation of the internal market which derives from the EU's structure as a supranational organisation.

The different weightings of the statutory objectives derive to a great extent from the historical contexts under which NCA and MCD were drafted. Although the drafting process of the MCD originated in 1985[153], the final steps in the legislative process took place in the years after the financial crisis. The Directive was therefore greatly influenced by the lessons that were drawn from the crisis. The NCA, on the other hand, came into full effective operation on 1 June 2007. The drafting process thus took place before the financial crisis had its devastating effect on the world economy. When drafting the legal provisions, the legislator was consequently looking on the developments of the domestic consumer credit market and how to overcome its shortcomings instead of focussing on an international regulatory perspective.

(2) Both NCA and MCD aim at guaranteeing a high level of consumer protection. On the face of it, NCA and MCD thus seem to have a similar personal scope applying to 'consumers'. However, NCA and MCD apply a different notion of 'consumer' insofar as, in general, both natural and small juristic persons enjoy the protection of the NCA, whilst the MCD applies to natural persons only.

Despite the different notion of 'consumer', the personal scope of application as regards pre-contractual assessments in (mortgage) credit agreements in terms of Chapter 4 Part D of the NCA[154] and Articles 18 and 20(1) of the MCD appears to be substantially the same as the NCA excludes any juristic person from the scope of Chapter 4 Part D.[155] In this regard, both NCA and MCD apply to natural persons only. However, the scope of application still remains distinct. Chapter 4 Part D of the NCA applies irrespective of whether the natural person seeks a credit for a private or commercial purpose[156], while the MCD only applies to consumers acting for purposes which are outside his trade, business or profession.

(3) The credit agreements that fall within the scope of the MCD are not congruent to the definition of 'mortgage agreement' under the NCA. Unlike the definition of 'mortgage agreement' under the NCA, Article 3 of the MCD embraces agreements regardless of whether they are secured by a real security right on

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[153] See chapter 2 para 2.1 above.

[154] In the context of the NCA, the pre-contractual assessment is considered a part of the concept of 'reckless credit' (See chapter 3 below).

[155] Section 78(1) read with section 6(a) of the NCA.

[156] This can be inferred from two circumstances: First, the NCA does not limit the scope of application of Chapter 4 Part D to instances, where the natural person seeks the credit for purposes that are outside his trade, business or profession. Secondly, section 81(2)(*b*) expressly mentions 'commercial purposes' as part of the compulsory pre-contractual assessment to be conducted by the credit provider (see chapter 3 below).

immovable property (so-called 'home-loans').[157] The definition of mortgage agreement under the NCA is narrower in this regard as it only applies to 'a credit agreement that is secured by the registration of a mortgage bond'.[158] This, however, does not mean that consumer credit agreements that are not secured by the registration of a mortgage bond are excluded from the scope of the NCA, since its scope is by no means confined to mortgage agreements.[159] On the other hand, the NCA applies a broader definition in the sense that a 'mortgage agreement' – unlike under the provisions of the MCD – does not necessarily need to relate to residential immovable property.

In this chapter, an overview was given of the NCA and the MCD, their similarities and dissimilarities. Chapter 3 will specifically look at the pre-contractual assessment in mortgage credit agreements that have been introduced to the legal frameworks of South Africa and the EU in order to prevent reckless lending.

Chapter 3: Pre-contractual assessment in mortgage credit agreements under the National Credit Act and the Mortgage Credit Directive

1. National Credit Act

1.1 Introduction

Chapter 4 Part D of the NCA[160] deals with the concepts of 'over-indebtedness' and 'reckless credit' that have been introduced into South African consumer credit law by virtue of the NCA.[161] As has been pointed out already, this part of the NCA does not apply to credit agreements in respect of which the consumer is a juristic person.[162]

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[157] T Josipovic op cit note 112 at 238.
[158] Section 1(e) of the NCAA.
[159] See chapter 1 para 1.1 above.
[160] Sections 78 - 88.
[161] See chapter 2 para 1.1 above.
[162] Section 78(1) read with section 6(a) of the NCA. The provisions of the NCA relating to over-indebtedness and reckless credit do, however, apply to stokvels – the stokvel is a peculiar feature of the South African credit market and defined in section 1 of the NCA as a formal or informal rotating financial scheme with entertainment, social or economic objectives (for a full discussion of stokvels see WG Schulze 'The Origin and Legal Nature of the Stokvel' (1997) 9 *SA Merc LJ* 18 and (1997) *SA Merc LJ* 153) – as stokvels are excluded from the definition of a juristic person pursuant to section 1 of the NCA, which is why stokvels enjoy the full protection of the NCA just as natural persons do when they borrow money from banks (M Kelly-Louw op cit note 5 at 292). However, the provisions pertaining to over-indebtedness and reckless credit as set out in Chapter 4 Part D of the NCA do not apply to a transaction between a stokvel and a member of that stokvel in accordance with the rules of that stokvel because such a transaction is not classified as a credit agreement pursuant to section 8(2)(*c*) of the NCA.

The pre-contractual assessment in credit agreements is indivisibly linked to the concepts of 'reckless credit' and 'over-indebtedness' as can be seen particularly in sections 80(1) and 81 of the NCA.

The NCAA and the amended National Credit Regulations brought about significant changes in the affordability assessment procedure as part of the pre-contractual assessment. On 13 March 2013, the DTI published the amended National Credit Regulations including Affordability Assessment Regulations (hereafter 'AARs') in addition to the NCAA.[163]

This part of chapter 3 will address the question how to determine if a credit agreement is 'reckless'. In this regard, a special emphasis will be on the assessment mechanisms and procedures used by credit providers to prevent entering into reckless credit agreements. Moreover, this part of the study will look at the requirements of the AARs and examine the question of whether there are any specific requirements or standards relating to the pre-contractual assessment in mortgage credit agreements. Lastly, the consequences of reckless credit and the powers of the court with regard to reckless credit will be examined.

1.2 Reckless credit

To determine when a credit agreement is reckless, one must turn to section 80(1) of the NCA.[164] Section 80(1) of the NCA envisages two types of reckless credit agreements.[165] The section provides as follows:

> A credit agreement is reckless if, at the time that the agreement was made, or when the amount improved in terms of the agreement is increased other than an increase in terms of section 119(4)
> (a) the credit provider failed to conduct an assessment as required by section 81(2), irrespective of what the outcome of such an assessment might have concluded at the time; or
> (b) the credit provider, having conducted an assessment as required by section 81(2), entered into the credit agreement with the consumer

[163] *GG* no 38557 of 13 March 2015. See also *National Credit Regulator v Standard Bank of South Africa Limited* [2017] ZANCT 118 para 78.4.
[164] *Desert Star Trading 145 (pty) Ltd and Another v No 11 Flamboyant Edleen CC and Another* 2011 (2) SA 266 (SCA) para 14.
[165] JW Scholtz *Guide to the National Credit Act* (2008) para 11.4.3

> despite the fact that the preponderance of information available to the credit provider indicated that
>
> (i) the consumer did not generally understand or appreciate the consumer's risks, costs or obligations under the proposed credit agreement[166]; or
>
> (ii) entering into that credit agreement would make the consumer over-indebted[167].

It follows that a credit granting is reckless if the credit provider falls foul of the requirement to undertake a proper pre-contractual assessment in terms of section 81(2) of the NCA.

Although the NCA gives some guidance on when a credit agreement is recklessly granted, it remains the task of the courts to decide this issue on a case-by-case basis. In respect of the approach to be taken by a court when addressing this matter, the South Gauteng High Court in *SA Taxi Securitisation (Pty) Ltd v Mbatha*[168] held:

> While one of the purposes of the NCA is to discourage reckless credit, the Act is also designed to facilitate access to credit by borrowers who were previously denied such access. An over-critical armchair approach by the court towards credit providers when evaluating reckless credit, or the imposition of excessive penalties upon lenders who have recklessly allowed credit, would significantly chill the availability of credit especially to the less affluent members of our society.[169]

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[166] It has been submitted that that this type of reckless credit does not only refer to the requirement to 'assess' the consumer's general understanding or appreciation but, more accurately, implies that the credit provider has a duty to inform the consumer of his or her risks, costs or obligations (Ibid para 11.4.3).

[167] A consumer is over-indebted according to section 79 of the NCA, 'if the preponderance of available information at the time a determination is made indicates that the particular consumer is or will be unable to satisfy in a timely manner all the obligations under all the credit agreements to which the consumer is a party, having regard to that consumer's

(a) financial means, prospects and obligations; and

(b) probable propensity to satisfy in a timely manner all the obligations under all the credit agreements to which the consumer is a party, as indicated by the consumer's history of debt repayment.'

[168] *SA Taxi Securitisation (Pty) Ltd v Mbatha* 2011 (1) SA 310 (GSJ).

[169] Ibid para 36.

The court thus explicitly took into account the NCA's objective of 'promoting the development of a credit market that is accessible to all South Africans'[170] when evaluating reckless credit. However, it remains unclear what the impact of this objective on the test of reckless credit really is on a practical level.

In *Absa Bank Limited v Kganakga*[171], the court stated that section 80 of the NCA refers to whether a credit agreement is reckless or not. 'It deals with no other interactions whether they be offers to purchase, agreements of sale, lease agreements, subdivision agreements and resulting applications, partnership agreements, company memoranda or shareholders agreements, deeds of trusts.'[172] Consequently, section 80 of the NCA only looks at the credit agreement between the credit provider and the consumer and is not concerned with other commercial engagements between persons or entities. Put differently, the NCA is not about the risk in the value of that which is acquired with credit. It is concerned with the risk in the ability to pay back the credit itself.[173]

1.3 Assessment mechanisms and procedures

It is clear from the above that section 80(1) of the NCA dealing with reckless credit largely relates to the assessment as required by section 81 of the NCA. According to section 81(2), credit providers may not enter into a credit agreement with a prospective consumer (a natural person) without conducting a comprehensive pre-assessment of the consumer, including

(a) his or her general understanding and appreciation of the risks and costs of the proposed credit, and of the rights and obligations in connection with the agreement;
(b) the consumer's debt re-payment history; and
(c) an assessment of whether the consumer can afford the transaction by virtue of his or her existing financial means, prospects and obligations.[174]

From the matters that the credit provider is required to address when conducting an assessment subject to section 81(2) of the NCA as listed above, it is clear that the

[170] See section 3(a) of the NCA and the discussion in chapter 2 para 1.2 of this study.
[171] *Absa Bank Limited v Kganakga* 2016 JDR 0664 (GJ).
[172] Ibid para 21.
[173] Ibid para 72.
[174] Section 78(3) provides a definition of 'financial means, prospects and obligations' in this context.

assessment is more comprehensive than a mere affordability assessment.[175] In general, the pre-contractual assessment shall ensure that both the consumer and the credit provider make informed and responsible decisions on whether they enter into a credit agreement or not.

As regards the consumer's obligation to cooperate during the pre-contractual assessment, section 81(1) requires the consumer to fully and truthfully answer any requests for information made by the credit provider as part of the required assessment when applying for a credit agreement, and while that application is being considered by the credit provider. A credit provider is entitled to accept the veracity of information provided to it by or on behalf of the customer, unless there are indications that would reasonably alert the credit provider to the contrary.[176] It is a complete defence to an allegation that a credit agreement is reckless if the credit provider establishes that the consumer failed to fully and truthfully answer any requests in the course of an assessment subject to section 81(2) of the NCA.[177] Therefore, the NCA does not only place obligations on the credit provider but also holds the consumer responsible for preventing reckless lending.

Although section 81(2) of the NCA requires the credit provider to take reasonable steps to conduct a pre-contractual assessment, it does not specify what these reasonable steps are and how exactly the assessment must be done.[178] Apart from obliging the credit provider to have regard to the broad considerations indicated in section 81(2) of the NCA and imposing a duty on the consumer to answer fully and truthfully during the assessment in terms of section 81(2), initially no standard format for the assessment was prescribed in the NCA.[179] It was thus left to the courts to give some guidance as to whether or not a credit provider has taken the required steps to meet its assessment obligations in terms of section 81(2) of the NCA.

In *Horwood v FirstRand Bank Ltd*[180], the court held that, in light of the wording of sections 81(2) and 82(1), it had to be determined objectively on the facts and circumstances of the given case if the credit provider has taken the reasonable steps to meet its assessment obligations.[181] The case *Absa Bank Limited v De Beer and*

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[175] C van Heerden & A Boraine 'The money or the box: Perspectives on reckless credit in terms of the National Credit Act 34 of 2005' (2011) 44 *De Jure* 392 at 397.
[176] Ibid para 14.
[177] C van Heerden & A Boraine op cit note 175 at 400.
[178] JW Scholtz op cit note 165 para 11.4.2.
[179] C van Heerden & S Renke op cit note 44 at 76.
[180] *Horwood v FirstRand Bank Ltd* unreported case no 36853/2010 21 September 2011 (GSJ).
[181] Ibid para 5.

Others[182] concerned the consolidation and extension of earlier loan agreements by a further loan which was secured by a mortgage bond and by third parties' standing surety. The court held that the assessment in terms of section 81 of the NCA must be done reasonably, *i.e.* not irrationally. In this regard, it found that it is clearly irrational of the credit provider to have taken the surety's income into account in reaching the conclusion that the 'existing financial means'[183] existed to pay the instalments, considering that a surety is secondary in nature in the sense that it remains totally out of the picture until the principal debtors have failed to comply with their obligations under the credit agreement.[184] In *Absa Bank Limited v Kganakga*[185], the court stated that the assessment as required by section 81 of the NCA must be situate in context, taking into account, *e.g*., the consumers background and experience in matters of credit and finance.[186] In respect of the obligation to take reasonable steps, the court summarised as follows:

> In sum, the credit granter must take reasonable steps to assess that the proposed consumer understands and appreciates what she is getting herself into, what it means to have entered into certain obligations and what rights she has in relation to the credit granter, what the risks are of borrowing too much or failing to pay full or any instalments; the credit granter must do the arithmetic on income and expenses, other assets, prospective income and expenses; the credit granter must see whether or not the prospective consumer is a good or bad risk insofar as previous borrowings and repayments are concerned.[187]

In light of the consequences of a credit provider falling foul of the requirement to conduct an assessment in terms of section 81 of the NCA[188], it does not come as a surprise that credit providers commonly try to protect themselves by making use of

[182] *Absa Bank Limited v De Beer and Others* 2016 (3) SA 432 (GP).
[183] See section 82(1)(*a*)(iii) of the NCA.
[184] *Absa Bank Limited v De Beer and Others* supra note 174 para 60 - 61.
[185] Supra note 171.
[186] Ibid para 73.
[187] Ibid para 28.
[188] See chapter 3 para 1.2 below.

standard form 'compliance clauses'.[189] In *Absa Bank v COE Family Trust and Others*[190], the clause in a mortgage loan agreement reads as follows:

> The borrower states that
>
> 11.1 he undertakes his risks and costs, as well as his rights and obligations under this agreement;
>
> 11.2 entering into this agreement will not cause him to become over-indebted as contemplated in the National Credit Act;
>
> 11.3 he has fully and truthfully answered all and any requests for information made of him by or on behalf of the bank leading up to the conclusion of this agreement;
>
> 11.4 the bank has given the borrower a pre-agreement statement and quotation.[191]

The defendants raised the defence of reckless credit *inter alia* because they did not understand the inherent risks of the contract. The plaintiff, on the other hand, argued that that the defendants cannot raise this defence, because they had entered into a contract which had specifically made provision for these issues. The plaintiff's submission was that section 81(2) of the NCA was not of application when clauses 11.1 - 11.4 of the agreement so concluded, confirmed the veracity of the answers given by defendants.[192] The court, however, dismissed the application for summary judgment *inter alia* because it appeared that no assessment as required by section 81(2) of the NCA was conducted. The court thus found that section 81(2) of the NCA governs the dispute, notwithstanding the terms of the contract.[193] It can therefore be concluded that a standard form 'compliance clause' in itself is not sufficient to show that the credit provider has met its obligations to conduct a proper assessment in terms of section 81 of the NCA.

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[189] It has been suggested that, as a prudent approach, credit providers should insert such a clause into the credit application indicating that the risk and costs of the credit and the consumer's rights and obligations under the credit agreement have been explained to him by the credit provider and that the consumer expressly acknowledges that he or she understands and appreciates his or her rights and obligations as a consumer (C van Heerden & A Boraine op cit note 175 at 398).
[190] *Absa Bank v COE Family Trust and Others* 2012 (3) SA 184 (WCC).
[191] Ibid para 6.
[192] Ibid para 7.
[193] Ibid para 12.

Originally, section 82(1) of the NCA merely stated that it is in the discretion of the respective credit provider to determine for itself the evaluative mechanisms or models and procedures to be used in meeting its assessment obligation under section 81(2) of the NCA, provided that any such mechanism, model or procedure results in a fair and objective assessment.[194] Prior to the enactment of the AARs, section 82(2)(*a*) read with section 82(3) of the NCA provided that the National Credit Regulator may have published non-binding guidelines proposing evaluative mechanisms, models and procedures to be used to determine whether credit is being granted recklessly in relation to credit agreements generally (other than for developmental credit agreements). It was further provided that if a credit provider repeatedly failed to meet its obligations under section 81(2) of the NCA or customarily used evaluative mechanisms, models or procedures that do not result in a fair and objective assessment, the National Credit Regulator could have applied to the Tribunal[195] for an order in terms of section 82(4) of the NCA to require that the credit provider applies any guidelines published by the National Credit Regulator in terms of Section 82(2)(*b*) or any alternative guidelines consistent with prevalent industry practice, as determined by the Tribunal.

However, until the first quarter of 2013 no guidelines for the assessment in terms of section 81 of the NCA were published by the National Credit Regulator with the effect that no matters relating to non-compliant assessment models were brought before the Tribunal and very few cases were reported relating to reckless credit granting.[196] As a result, the control mechanisms set out in the NCA relating to the evaluative mechanisms or models and procedures being used by credit providers were effectively meaningless. Credit providers were obligated to conduct pre-contractual assessments in terms of section 81(2) of the NCA without any guidance. Hence, they had a very wide discretion how to structure and conduct the pre-contractual assessment in terms of section 81(2) of the NCA.[197]

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[194] Section 82(1) had to be read with section 61(5) of the NCA, which provides that a credit provider may determine for itself any scoring or other evaluative mechanism or model to be used in managing, underwriting and pricing credit risk, provided that any such mechanism or model is not founded or structured upon a statistical or other analysis in which the basis of risk categorisation, differentiation or assessment is a ground of unfair discrimination, prohibited in Section 9(3) of the Constitution (C van Heerden & S Renke op cit note 175 at 397).

[195] According to section 1 of the NCA, Tribunal means the National Consumer Tribunal established by section 26 of the NCA.

[196] C van Heerden & S Renke op cit note 44 at 77.

[197] Ibid.

In May 2013, the National Credit Regulator issued a public notice in which certain draft affordability guidelines were proposed. These were followed by the much more comprehensive 'Affordability Assessment Guidelines', published by the National Credit Regulator in September 2013.[198] It was laid down that the Affordability Assessment Guidelines should be read with the 'Credit Provider's Code of Conduct to Combat Over-Indebtedness', also dated September 2013.[199] The process of giving statutory guidance by way of standardising and unifying the assessment in terms of section 81 of the NCA – specifically the regulation of the affordability assessment as required by section 81(2)(*a*)(iii) – that commenced with a joint media statement issued by the Minister of Finance and the Chairperson of the Banking Association of South Africa (BASA) in November 2012 entitled 'Ensuring Responsible Market Conduct for Bank Lending'[200] eventually resulted in the NCAA introducing significant amendments to the assessment mechanisms and procedures set out in section 82 of the NCA. Section 48 of the NCA was amended so that it provided for the Minister to prescribe criteria and measures to determine the outcome of affordability assessments.[201] Section 24(a) of the NCAA set out that the Minister of the DTI must, on recommendation of the National Credit Regulator, make affordability assessment regulations. These are binding in nature to the effect that evaluative mechanisms or models and procedures to be used by a credit provider in meeting its assessment obligations under section 81 must be in line with the affordability assessment regulation according to the amended section 82(2)(*a*) and (3) of the NCA.[202]

1.4 Affordability Assessment Regulations

The AARs were published on 13 March 2015 as part of the amended National Credit Regulations.[203] Chapter 3 of the National Credit Regulations in force until that date

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[198] Or the 'September 2013 Draft Guidelines', available at www.ncr.org.za. C van Heerden & S Renke op cit note 44 at 79.
[199] Ibid at 82.
[200] Joint Statement 'Ensuring Responsible Market Conduct for Bank Lending' (November 2012), *available at http://www.treasury.gov.za/comm_media/press/2012/2012110101.pdf*.
[201] See section 15(*c*) of the NCAA. It has been rightly pointed out that the Minister cannot prescribe the outcome but merely the content affordability assessments (C van Heerden & S Renke op cit note 44 at 82).
[202] For a detailed overview of the legislative developments see C van Heerden & S Renke op cit note 44 at 78 - 88.
[203] *GG* no 38557 of 13 March 2015.

was amended by the insertion of Regulation 23A headed 'Criteria to Conduct Affordability Assessment'. These provisions are referred to as the AARs.

The AARs provide a benchmark against which a credit provider's compliance with its pre-contractual assessment obligations in terms of section 81 of the NCA is measured.[204] It is important to note that the AARs lay down minimum standard requirements that the credit provider has to comply with in order to pass its obligation to refrain from reckless credit granting.[205] Moreover, it has been submitted that the assessment required in terms of section 81(2) of the NCA goes beyond a mere affordability assessment. As the name indicates, the AARs only relate to affordability assessments which is why their scope does not cover the whole range of assessment measures as required by section 81(2) of the NCA. It is therefore not sufficient for a credit provider to merely rely on and comply with the AARs in order to pass the assessment requirements in terms of section 81 of the NCA.

In order to achieve a parallelism in the scope of application with Chapter 4 Part D of the NCA, the AARs apply to natural persons only and exclude juristic persons from their ambit.[206] In regard of existing 'financial means and prospects', the AARs stipulate that '[a] credit provider must take practicable steps to assess the consumer or joint consumer's discretionary income to determine whether the consumer has the financial means and prospects to pay the proposed credit instalments.'[207] Regulation 23A(4) further elaborates on this requirement. It provides that a credit provider is required to validate the consumer's gross income. Depending on the respective type of occupation (employed, self-employed, informally employed or employed in a way through which the consumer does not receive a payslip or proof of income), the consumer has to hand in the latest three payslips or latest bank statements showing the latest three salary deposits, the latest three documented proofs of incomes, or the latest financial statements.

In line with the consumer's requirement in terms of section 81(1) of the NCA to fully and truthfully answer any requests for information made by the credit provider, the consumer must provide authentic documentation and accurately disclose all financial obligations to enable the credit provider to conduct the affordability assessment.[208]

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[204] C van Heerden & S Renke op cit note 44 at 83.
[205] JW Scholtz op cit note 165 para 11.4.2.
[206] Regulation 23A(2). See also chapter 2 para 1.3 above.
[207] Regulation 23A(3).
[208] Regulation 23A(6) and (7).

According to Regulation 23A(8), '[a] credit provider must make a calculation of the consumer's existing financial means, prospects and obligations as envisaged in sections 78(3) and 81(2)(*a*)(iii)' of the NCA. The methodology to be used in this regard must comply with sections 23A(9) and (10) of the Regulations. Table 1 to the Regulations sets out the minimum expense norms that the credit provider, in general, must utilise instead of verifying the consumer's living expenses.[209] However, the credit provider may, in exceptional cases, accept the consumer's declared necessary expenses which are lower than those set out in Table 1 to the Regulations provided the questionnaire set out in Annexure A to the Regulations ('Declaration of Consumer's Necessary Expense Questionnaire') is completed by the consumer or joint consumers.[210]

The AARs introduce a new right for the consumer regarding the outcome of an affordability assessment[211]: a consumer who is aggrieved by the outcome of the affordability assessment may at any time lodge a complaint in terms of section 134 or 136 of the NCA with the credit provider for dispute resolution.[212] The credit provider must then attempt to resolve the complaint within 14 days.[213] If the grievance is not or not in a timely manner addressed by the credit provider, the consumer can, according to Regulation 23A(18), approach the National Credit Regulator.

1.5 Pre-contractual assessment in mortgage credit agreements

The NCA does not provide for specific rules regarding the issues of pre-contractual assessment, reckless credit and over-indebtedness in mortgage credit agreements. Moreover, Chapter 4 Part D of the NCA does not differentiate between small, intermediate and large credit agreements.[214] The provisions regarding reckless credit and over-indebtedness thus apply irrespective of whether the credit agreement entered into is a mortgage credit agreement or another form of credit agreement falling under the ambit of the NCA. Section 80(3) of the NCA sets out some of the factors that must be considered in determining whether there has been reckless credit. These include a determination of the value of any credit facility available to the borrower at the time

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[209] Regulation 23A(9).
[210] Regulation 23A(11).
[211] C van Heerden & S Renke op cit note 44 at 86.
[212] Regulation 23A(16).
[213] Regulation 23A(17).
[214] See chapter 2 para 1.4 above.

that the credit was granted and the amount of any pre-existing credit guarantees.[215] However, section 80(3) of the NCA does not distinguish between different kinds of agreements. Consequently, no specific provision is made for mortgage credit agreements.

Likewise, the AARs do not provide for any distinct provisions regarding mortgage credit. The affordability assessment pursuant to the AARs takes place irrespective of the type of credit agreement that the consumer wishes to obtain.

Whether or not the credit in question is a mortgage credit agreement may, however, be relevant insofar as inherent risks are at issue that relate to the specific type of credit agreement. The customer must understand and appreciate the risks that specifically relate to mortgage credit agreements as part of the assessment in terms of section 81(2)(*a*)(i) of the NCA. If the credit agreement in question is secured by a mortgage bond, the immovable property may be at risk if the instalments are not paid. The credit provider must therefore see that the prospective customer understands what is meant by and how and when the mortgage is used in relation to the credit agreement.[216] In this regard, the customer's prior experience and knowledge of obtaining credit secured by a mortgage bond over property must be taken into account.[217]

1.6 Consequences of reckless credit and powers of the court with regard to reckless credit

Section 83(1) of the NCA sets out that despite any provision of law to the contrary, in any court or the Tribunal proceedings in which a credit agreement is being considered, the court or the Tribunal, as the case may be, may declare that the credit agreement is reckless.[218] If a court or the Tribunal declares a credit agreement reckless in terms of section 80(1)(*a*) because no pre-contractual assessment was done or in terms of section 80(1)(*b*)(i) because, although an assessment was done, the consumer did not generally understand or appreciate the risks, costs or obligations under the proposed credit agreement, the court may

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[215] *SA Taxi Securitisation (Pty) Ltd v Mbatha* supra note 168 para 40.
[216] *Absa Bank Limited v Kganakga* supra note 164 para 25.
[217] Ibid para 38.
[218] Section 83 of the NCA was amended by section 25 of the NCAA insofar as the National Consumer Tribunal, established in terms of section 26 of the NCA, now also has the power to declare that reckless credit has been extended (JW Scholtz op cit note 165 para 11.4.5 and 11.4.5.3.

(a) set aside all or part of the consumer's rights and obligations flowing from such an agreement, as the court determines just and reasonable in the circumstances of the given case or

(b) suspend its force and effect.[219]

If the consumer, to the satisfaction of the court, invokes that he or she would have never become involved in the credit transaction if it wasn't for the recklessness of the credit provider, it might be 'just and reasonable' to set aside the credit agreement.[220] In this case, the agreement would be null and void and treated as if it had never existed.[221] If, on the other hand, the credit agreement is merely suspended, section 84 of the NCA sets out the effect of the suspension. During the period for which the force and effect of a credit agreement is suspended in terms of the NCA,

(a) the consumer is not obliged to make any payment required under that agreement;[222]

(b) no interest, fee or other charge under that agreement may be charged to the consumer;[223] and

(c) the credit provider's rights under the agreement, or under any law in respect of that agreement, are unenforceable, despite any law to the contrary.[224]

Importantly, both in the case of setting aside or suspension of a reckless credit agreement, the consumer is not entitled to further retain possession and utilise the credit provider's security.[225] In *SA Taxi Securitisation (Pty) Ltd v Mbatha*, a case in which the credit provider's security at issue was a motor vehicle, the court put it this way:

> It seems unlikely that the legislature ever intended that the consumer could keep the 'money and the box'. If the consumer obtained possession and use of a motor vehicle in circumstances in which no credit should have been extended to the consumer, it would be fundamentally unfair and counterproductive for the consumer to continue to use the vehicle while at the same time not making any payments under the agreement.[226]

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[219] Section 83(2) read with section 83(3)(*b*)(i) of the NCA.
[220] *SA Taxi Securitisation (Pty) Ltd v Mbatha* supra note 168 para 47.
[221] Ibid.
[222] Section 84(1)(*a*) of the NCA.
[223] Section 84(1)(*b*) of the NCA.
[224] Section 84(1)(*c*) of the NCA.
[225] M Kelly-Louw op cit note 5 at 310.
[226] *SA Taxi Securitisation (Pty) Ltd v Mbatha* supra note 168 para 46.

A court is empowered to invoke the provisions regarding reckless credit even without an allegation of reckless credit. Accordingly, a court can *suo motu* raise and investigate the issue of reckless credit.[227] Of course a consumer may also raise the issue of reckless credit in defence of a claim[228] or in a direct application to a court to have his or her credit declared recklessly granted.[229] If, however, an allegation of reckless credit is made, the consumer who alleges that reckless credit has been extended bears the onus of proving it.[230] Detailed information must be provided by the consumer in respect of the credit agreement in question; a bald allegation that there was 'reckless credit' or there is 'over-indebtedness' will not suffice.[231]

2. Mortgage Credit Directive

2.1 Introduction

According to the MCD, consumer protection in the pre-contractual phase is based on various measures, including the provision of clear and general information on the credit granting process (Article 6 of the MCD) – most notably, by means of the European Standardised Information Sheet ('ESIS') as set out in Article 14 of the MCD – and the standardisation of the method of calculating the annual percentage of charge (APRC).[232] The common aim of these measures is to provide the consumer with the information needed to compare the credits available on the market, assess their implications and make an informed decision on whether to conclude a mortgage credit agreement or not.[233] Moreover, the pre-contractual measures aim at preventing consumers from assuming unaffordable credit obligations which at the end of the day may lead to residential immovable property foreclosures.[234] The MCD stresses the importance of these pre-contractual measures given the significance of the financial commitments of the consumer for credit agreements relating to residential immovable

[227] JW Scholtz op cit note 165 para 11.4.5.
[228] M Kelly-Louw op cit note 5 at 306.
[229] See, e.g., *Horwood v FirstRand Bank Ltd* supra note 174.
[230] Ibid; M Kelly-Louw 'A credit provider's complete defence against a consumer's allegation of reckless lending' 2014 *SA Merc LJ* 24 at 43.
[231] *SA Taxi Securitisation (Pty) Ltd v Mbatha* supra note 168 para 56.
[232] Article 17 of the MCD read with the mathematical formula set out in Annex I to the MCD.
[233] Article 14(1) of the MCD.
[234] T Josipovic op cit note 112 at 240.

property[235] and taking into account that taking out a mortgage is still a once-in-a-lifetime decision in many markets.[236]

Furthermore, when the promotion of a responsible lending regime is at issue, a central place in the pre-contractual phase is given to the assessment of the creditworthiness of the consumer as set out in Articles 18 - 20 of the MCD. The assessment of creditworthiness shall not only prevent the consumer from becoming over-indebted but is also designed to enhance the credit provider's ability to make an informed decision. The assessment of creditworthiness shall enable the credit provider to establish, in the pre-contractual phase, the consumer's real capacity to regularly meet his or her commitments under the mortgage credit agreement, *i.e.*, to be able to pay the credit instalments.[237]

Despite the fact that, strictly speaking, the provisions governing the ESIS are not part of the pre-contractual assessment of the consumer, they play a central role in the promotion of a responsible credit regime and will therefore be examined in greater detail in this part of the study. Subsequently, the pre-contractual assessment of creditworthiness in terms of the MCD will be scrutinised.

2.1 European Standardised Information Sheet ('ESIS')

The ESIS is not an invention of the MCD. It has its origin in the 2001 European Agreement on a Voluntary Code of Conduct on Pre-contractual Information for Home Loans (hereafter 'Code' or 'Code of Conduct')[238] which was negotiated and adopted by European associations of consumers and the European Credit Sector Associations offering home loans.[239] The Code of Conduct entitled consumers to receive a personalised European Standard Information Sheet which was intended to facilitate consumers' access to comprehensive and understandable information on the mortgage product at issue, and thereby facilitate comparability of the credits available on the market.[240] The voluntary nature of the Code of Conduct, however, resulted in considerable disparities regarding adherence to the Code. Data provided by the European Commission and the European Banking Industry Committee's (EBIC) in a

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[235] See, *e.g.*, recital 21 and 67 of the MCD.
[236] H-J Dübel & M Rothemund op cit note 32 at 42.
[237] T Josipovic op cit note 112 at 240.
[238] The 'European Agreement on a Voluntary Code of Conduct on Pre-contractual Information for Home Loans', available at *http://ec.europa.eu/internal_market/finservices-retail/docs/home-loans/agreement_en.pdf.*
[239] Ibid at 1.
[240] H-J Dübel & M Rothemund op cit note 32 at 37.

progress report on the implementation of the code published in April 2009[241] showed that adherence to the Code was unsatisfactory for several countries. While Germany, Malta, and the UK showed a compliance rate of 100 per cent, the level of adhesion and implementation in France and Cyprus was below 60 per cent.[242] Accordingly, the European Commission identified *inter alia* a lack of EU wide comparability due to an insufficient adherence to the Code of Conduct, divergences in the timing and application of providing pre-contractual information in the form of the European Standardised Information Sheet, and a lack of credible monitoring and enforcement mechanisms in the *White Paper on the Integration of EU Mortgage Credit Markets*.[243] The assessment of the problems in regard of the provision of pre-contractual information on mortgage credit in the EU eventually resulted in the provision of the ESIS as set out in the MCD.

The ESIS is a standardised pre-contractual disclosure document. A model is provided in Annex II Part A of the MCD. This model must be followed by the Member States.[244] Comprehensive instructions are given in Annex II Part B on how the ESIS must be completed. The ESIS contains *inter alia* information on the main features of the loan, interest rate and other costs, frequency and number of payments, the amount of each instalment and early repayment. Unlike most of the provisions in the MCD that merely aim at minimum harmonisation, Member States are bound to transpose the rules on the ESIS (Article 14(2), Annex II of the MCD) into their national legislation without any variations (maximum harmonisation as stipulated in Article 2(2) of the MCD).[245] The obligation of maximum harmonisation, however, refers only to the rules on the use of a standard form.[246] Other rules on personalised pre-contractual information are subject to either minimum or optional harmonisation.[247]

The ESIS must be handed out to the consumer 'in good time before the consumer is bound by any credit agreement or offer.'[248] If explanations have been given to consumers before the credit provider has assessed their financial situation and

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[241] European Banking Industry Committee 'European Agreement on a Voluntary Code of Conduct on Pre-contractual information for Home Loans: Third Progress Report on Implementation in the European Union' of 8 April 2009, available at *http://www.ebic.org*.
[242] Ibid at 2 and 3; H-J Dübel & M Rothemund op cit note 32 at 38.
[243] EU Commission *White Paper on the Integration of EU Mortgage Credit Markets* op cit note 123 at 6.
[244] Article 14(2) read with Article 2(2) of the MCD.
[245] T Josipovic op cit note 112 at 241.
[246] Ibid.
[247] Ibid.
[248] Article 14(1)(b) of the MCD.

creditworthiness[249] – whether in the form of the ESIS or in any other form – these explanations will need to be adapted before the credit agreement is concluded, albeit no separate document needs to be drawn up.[250]

2.2 Obligation to assess the creditworthiness of the consumer

2.2.1 Historical development

Comparable to the development of the ESIS, the development of the creditworthiness assessment was not revolutionary, but evolutionary. The assessment pertaining to the creditworthiness of the consumer is not a newly created feature of the MCD. Prior to the enactment of the MCD and its transposition into the domestic law of the Member States, credit providers have already undertaken assessments on the financial background of potential borrowers either as an obligation under general national banking laws in the respective Member State or as an integral part of their business conduct.[251] Specific legal requirements encouraging mortgage credit providers to conduct a creditworthiness assessment prior to granting a credit (or industry guidelines/recommendations) have been in place in most of the Member States. Only in eight Member States[252], no such legal requirements, guidelines or recommendations were provided.[253] Moreover, some countries opted to apply Article 8 of the CCD headed 'Obligation to assess the creditworthiness of the consumer' to mortgage credit agreements despite the fact that the CCD excluded mortgage credit agreements from its scope.[254] It was the MCD that introduced a common legal framework regarding the obligation to assess the creditworthiness of the consumer in mortgage credit agreements across the EU.

While originally the assessment of creditworthiness was seen as serving public interest only, it is now also perceived as a means of individual consumer protection which aims at preventing the consumer from concluding commitments he or she cannot fulfil and thus protecting consumers against the risk of over-indebtedness and bankruptcy.[255] This shift in paradigm is attributed to the decision of the European

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[249] See chapter 3 para 2.2 below.
[250] *CA Consumer Finance SA v Bakkaus and Bonato* C-449/13 para 45-47; V Mak op cit note 2 at 425.
[251] H-J Dübel & M Rothemund op cit note 32 at 53.
[252] Namely Austria, Denmark, France, Luxembourg, Portugal, Slovakia, Slovenia, and Spain.
[253] H-J Dübel & M Rothemund op cit note 32 at 54.
[254] H-J Dübel & M Rothemund op cit note 32 at 54. See also footnote 106 in chapter 2 para 2.1 above. It has been pointed out already that the exclusion from the scope of the Directive does not hinder Member States from transposing the Directive into national law in such a manner that the Directive applies to credit agreements not covered by its scope.
[255] A Rank & M Schmidt-Kessel 'Mortgage credit in Germany' 2017 *EuCML* 176 at 177.

Court of Justice ('ECJ') in *LCL Le Crédit Lyonnais v Fesih Kalhan*.[256] The judgment was induced by the French '*tribunal d'instance d'Orléans*' requesting a preliminary ruling of the ECJ under Article 267 TFEU. The request concerned the interpretation of Article 8 and 23 of the CCD that set out the creditworthiness assessment and the sanctions in case of a defective or non-existing creditworthiness assessment in the context of the CCD. The court held that the assessment of creditworthiness is not only a prudential requirement but a pre-contractual obligation of the credit provider, intended to protect consumers against over-indebtedness.[257]

The changed perception of the creditworthiness assessment is more than a dogmatic classification. It had practical implications insofar as it caused legislators, for instance the German legislator, to transform the obligation to assess the creditworthiness from a matter of purely prudential, *i.e.* public law, to also a matter of private law.[258] Despite the fact that recital 83 of the MCD leaves it to the discretion of the Member States to transpose the creditworthiness assessment in national law by prudential or civil law, the German legislator felt obliged to lay it down as a matter of private law according to the explanatory memorandum to the German Act on the implementation of the MCD.[259] Following *inter alia* the decision of the ECJ in the case *Le Crédit Lyonnais*[260], the German legislator considered it insufficient to lay down only a prudential sanction in case of a defective creditworthiness assessment.[261] As a result, a customer may now assert individual rights[262] if the credit provider commits a breach of its duty to conduct a proper assessment of creditworthiness. The creditworthiness assessment does no longer only provide obligations of the credit provider vis-à-vis the national regulatory authority.[263]

2.2.2 Content of the obligation to assess the creditworthiness of the consumer

Article 18 of the MCD requires that, before concluding a credit agreement, the creditor makes a thorough assessment of the consumer's creditworthiness and takes into

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[256] *LCL Le Crédit Lyonnais v Fesih Kalhan* C-565/12.
[257] Ibid para 42.
[258] A Rank & M Schmidt-Kessel op cit note 253 at 177.
[259] Entwurf eines Gesetzes zur Umsetzung der Wohnimmobilienkreditrichtlinie BT-Drucks. 18/5922 at 62, available at *https://dip21.bundestag.de/dip21/btd/18/059/1805922.pdf*.
[260] Supra note 256.
[261] V Stamenkovic & R-R Michel 'Die geplante Neuregelung zum Inhalt und zur Durchsetzung der Kreditwürdigkeitsprüfung im deutschen Recht' (2016) 4 *VuR* 132 at 134.
[262] See chapter 3 para 2.3 below.
[263] In the case of Germany, the Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht – 'BaFin')

appropriate account factors relevant to assess (and verify)[264] the ability of the consumer to meet his or her obligations under the credit agreement. The brief wording of Article 18 of the MCD is supplemented by recital 55 of the MCD that gives some guidance on the factors to be taken into account in the assessment procedure. Recital 55 stipulates that the assessment of creditworthiness should take into consideration all necessary and relevant factors that could influence a consumer's ability to repay the credit over its lifetime, for instance a consumer's income, savings and assets. On the other side of the coin, regular expenditure, debts and other financial commitments of the consumer must be taken into account. Moreover, the assessment should include consideration of future payments or payment increases and reasonable allowance should be made for future events during the term of the proposed credit agreement such as a reduction in income where the credit term lasts into retirement.[265] Thus it appears that the guidelines given in Article 18 and recital 55 of the MCD are very broad in terms of the income and more specific in terms of the expenditures to be taken into account in the course of the creditworthiness assessment. The MCD largely focusses on potential risks regarding the financial position of the consumer.[266]

A consistent implementation and application of the creditworthiness assessment across the EU shall be ensured by the 'Guidelines on creditworthiness assessment'[267] issued by the European Banking Authority (hereafter 'EBA').[268]

The assessment of creditworthiness may include the use of loan-to-value, loan-to-income, debt-to-income or similar ratios to assess the ability of a consumer to pay back the credit amount or set out minimum levels below which no credit would be deemed acceptable.[269] However, the MCD itself does not provide for such ratios or minimum levels. It is left to the discretion of the Member States to issue additional guidance in this regard or to implement the Financial Stability Board's Principles for Sound Residential Mortgage Underwriting Practices.[270]

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[264] V Mak op cit note 2 at 426.
[265] Recital 55 of the MCD.
[266] J Braspenning 'Mortgage credit in the Netherlands' (2017) *EuCML* 180 at 183.
[267] European Banking Authority 'Guidelines on creditworthiness assessment' (2015), available at *https://www.eba.europa.eu*.
[268] The EBA is a supervisory body established by virtue of Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC.
[269] Recital 3 of the MCD.
[270] Recital 55 of the MCD. The Financial Stability Board (hereafter 'FSB') is an international body that monitors and makes recommendations about the global financial system. The FSB is made up of representatives, from finance ministries, central banks and surveillance authorities, as well as international financial institutions of the G20 (see *http://www.fsb.org)*. The FSB 'Principles for Sound

The assessment of creditworthiness shall not rely predominantly on the value of the residential immovable property exceeding the amount of the credit or the assumption that the residential immovable property will increase in value (Article 18 (3) of the MCD). The possibility of value increases of the property is therefore not the determinative element in the decision of granting a mortgage credit. The main focus is on the ability of the consumer to repay the credit.[271] Consequently, market conduct known as 'pure asset lending', which can be defined as lending money without regard to the ability of the borrower to repay by instalments under the contract, in the knowledge that adequate security is available in the event of default, will be curbed.[272]

Compared to the provisions of the CCD, the MCD requires a higher degree of due diligence in the assessment of creditworthiness. While the CCD merely requires conducting an assessment of creditworthiness, the MCD calls for a 'thorough' assessment and therefore applies a stricter standard in respect of the assessment of creditworthiness. In light of the MCD's objectives, the European legislator consequently assumes that the credit agreements covered by the MCD pose a greater risk to the financial stability of the market and the financial soundness of the individual consumer due to the comparatively higher amounts of credit amounts and concomitant long-term commitments under the credit agreement.

In order to conduct an effective creditworthiness assessment, the credit provider must gather all information relevant to the assessment.[273] The credit provider may obtain information from internal and external sources, including the information provided to the credit provider by the consumer, an intermediary, or appointed representative.[274] They may also be obtained from public and private databases used in all Member States for the assessment of creditworthiness, and each Member State shall ensure that access for all creditors from all Member States is guaranteed.[275] The information so gathered must not only be assessed but also appropriately verified, including through reference to independently verifiable documentation when necessary.[276]

Residential Mortgage Underwriting Practices', published in April 2012 and available at *http://www.fsb.org*, aim at providing a framework for jurisdictions to set minimum acceptable underwriting standards relating to residential mortgage agreements.

[271] Recital 55 of the MCD.

[272] J Tuffin 'Responsible Lending Laws: Essential Development or Overreaction' (2009) 9 *QUTLJJ* 280 at 285.

[273] T Josipovic op cit note 112 at 244.

[274] Article 20(1) of the MCD.

[275] Articles 20 and 21 of the MCD.

[276] Article 20(1) and recital 58 of the MCD.

The assessment results determine the credit provider's decision with regard to the credit application.[277] Clearly, the creditor's decision as to whether to grant the credit should be consistent with the outcome of the assessment of creditworthiness (recital 57 of the MCD).[278] While a positive creditworthiness assessment should not constitute an obligation for the creditor to provide credit, Member States shall ensure that the credit provider only makes the credit available where the result of the assessment indicates that the obligations of the consumer under the mortgage credit agreement are likely to be met.[279] In other words, the credit application must be rejected in case of a negative outcome of the creditworthiness assessment.[280]

Unlike the NCA (read with the AARs), the MCD does not provide for any specific complaint mechanism regarding the outcome of an affordability assessment.

2.3 Sanctions applicable to infringements of the obligation to assess the creditworthiness of the consumer

The question arises as to the sanctions and consequences if the credit provider falls foul of its obligation to assess the creditworthiness of the consumer. According to Article 39 of the MCD, Member States should lay down rules on sanctions applicable to infringements of the MCD as transposed into national law. The MCD merely states that the sanctions provided for should be effective, proportionate and dissuasive.[281] In *Le Crédit Lyonnais*[282], the ECJ reiterated its approach according to which 'the severity of penalties must be commensurate with the seriousness of the infringements for which they are imposed, in particular by ensuring a genuinely dissuasive effect, while respecting the general principle of proportionality.'[283] However, within the wide limits of 'effectiveness, proportionality and dissuasiveness', the choice of sanctions remains

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[277] T Josipovic op cit note 112 at 245.
[278] Recital 57 further illustrates that 'the capacity for the creditor to transfer part of the credit risk to a third party should not lead him to ignore the conclusions of the creditworthiness assessment by making a credit agreement available to a consumer who is likely not to be able to repay it.' This constitutes a response to market conduct such as the securitisation of sub-prime mortgages into mortgage-backed-securities, which was a major contributing factor in the sub-prime mortgage crisis (see chapter 1 para 1.3 above and A Ashcraft & T Schuermann 'Federal Reserve Bank of New York Staff Reports: Understanding the Securitization of Subprime Mortgage Credit' (2008) at 1, available at *https://www.newyorkfed.org*).
[279] Article 18(5)(a) of the MCD.
[280] V Mak op cit note 2 at 426; T Josipovic op cit note 112 at 245.
[281] Article 39 and recital 76 of the MCD.
[282] Supra note 256.
[283] *LCL Le Crédit Lyonnais v Fesih Kalhan* supra note 254 para 45; *Texdata Software GmbH* C-418/11 para 51.

within the discretion of the Member States.[284] It follows that the sanctions of a failure to conduct a proper creditworthiness assessment vary amongst the Member States. It is beyond the scope of this study to examine all of the different regimes of sanctions as set out in the national law of the Member States. However, the study will outline the regime of sanctions in some of the Member States, namely Germany, Greece, France, Austria and Ireland, for illustrative purposes without going into detail.

All of these jurisdictions have in common that the sole breach of the obligation to assess the creditworthiness of the consumer does not turn the agreement into a 'reckless' or 'unfair' credit relationship.[285] The mortgage credit agreement remains valid and, unlike in the regime of sanctions provided for under the NCA[286], is not set aside or suspended.[287]

According to the German Civil Code (Bürgerliches Gesetzbuch – hereafter 'BGB'), the sanctions for a faulty or non-existent creditworthiness assessment will be as follows: First of all, the interest rate payable under the credit agreement will be reduced.[288] A fixed interest rate will be replaced by the customary interest rate for German mortgage-backed bonds.[289] A flexible interest rate will be replaced by the customary interbank rate.[290] If, however, this interest rate is higher than the interest rate agreed upon, it will not be replaced.[291] The reduction is retroactive so that the consumer may claim any overpaid interest.[292] Secondly, the consumer has a right to terminate the credit agreement without any prepayment penalty becoming due.[293] Thirdly, the credit provider is barred from claiming damages under certain circumstances if the consumer is not able to fulfil his or her contractual obligations.[294] Lastly, the credit provider may not terminate or alter the credit agreement solely based on the fact that the creditworthiness assessment was conducted in an insufficient way.[295]

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[284] Recital 76 of the MCD.
[285] European Parliament Directorate-General for Internal Policies 'Implementation of the Consumer Credit Directive' (2012) at 56, available at *http://www.europarl.europa.eu*. The paper deals with the implementation to the CCD. However, the same applies to the MCD.
[286] See chapter 3 para 1.6.
[287] A Rank & M Schmidt-Kessel op cit note 253 at 178.
[288] Section 505d(1) of the BGB.
[289] Section 505d(1)1. of the BGB; A Rank & M Schmidt-Kessel op cit note 253 at 178.
[290] Ibid.
[291] A Rank & M Schmidt-Kessel op cit note 253 at 178.
[292] Ibid.
[293] Section 505d(1) of the BGB.
[294] Section 505d(2) of the BGB.
[295] Section 499(3) of the BGB.

In Greece, non-compliance with the rules regarding the assessment of creditworthiness results in the consumer being discharged from the total cost of the credit, including the rates.[296] The consumer will only be obliged to make restitution of the capital received according to the modalities under the credit agreement.[297]

Unlike in Germany and Greece, the creditworthiness assessment remains a matter of purely prudential law in France and Austria.[298] Also in Ireland, it seems like the creditworthiness assessment is still a matter of prudential law only. The MCD is transposed into the national law of Ireland by the EU (Consumer Mortgage Credit Agreements) Regulations 2016.[299] Where a credit provider contravenes a provision under Regulation 19 dealing with the obligation to assess the creditworthiness of the consumer, that lender commits an offence.[300] The Central Bank can issue sanctions in respect of this offence.[301] However, it is unclear if the individual consumer can derive any claims from a misconduct of the credit provider regarding the creditworthiness assessment.[302]

This short overview already shows that the legal framework as regards the sanctions for a defective creditworthiness assessment is still very fragmented across the Member States of the EU.

3. Conclusion

The aim of this chapter was to examine and compare the measures in South Africa and the EU regarding the pre-contractual assessment in mortgage credit agreements. The findings can be summarised as follows:

(1) In recent years, pre-contractual affordability or creditworthiness assessments have made their way up the priority ladder for legislators, especially in the wake of the global financial crisis. International institutions such as the World Bank promote pre-contractual (affordability) assessments as a key regulatory tool in the prevention of reckless or predatory lending.[303] In line with these recommendations, the legislators in South Africa and the EU developed rules on pre-contractual assessments in consumer

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[296] European Parliament Directorate-General for Internal Policies op cit note 285 at 56.
[297] Ibid.
[298] C König 'Neue Anforderungen an die zivilrechtlichen Kreditwürdigkeitspflichten' (2017) 6 *WM* 269 at 272.
[299] S.I. No. 142/2016.
[300] M Jordan 'The impact of the Mortgage Credit Directive 2014/17 in the Republic of Ireland' (2017) at 24, available at *http://diposit.ub.edu*.
[301] Ibid.
[302] Ibid.
[303] The World Bank op cit note 3 at 35.

credit agreements including mortgage credit agreements. In South Africa, pre-contractual assessments were introduced as part of the concept of 'reckless lending' with the NCA coming into full force in 2007. The AARs, published in 2015, specifically elaborated on the affordability assessment requirements as part of the pre-contractual assessment in terms of section 81 of the NCA. Clearly, the AARs aim at standardising and formalising the affordability assessment procedures in South Africa. In the EU, the rules on pre-contractual assessment have undergone an evolution from voluntary codes of conduct[304] and national laws or voluntary business conducts[305] to the binding rules of the MCD that had to be transposed into the national laws of the Member States across the EU. The MCD aims *inter alia* at setting standards for the pre-contractual assessment in mortgage loans and strives towards harmonisation across the EU.

It follows that the legislative measures in both South Africa and the EU show a clear trend towards standardisation, unification and formalisation of the rules on pre-contractual assessments. In both South Africa and the EU, the rules in regard of pre-contractual assessments have moved away from non-binding guidelines towards a comprehensive set of binding regulations, particularly as regards the regulations on affordability assessments. The legislative approach has thus clearly become more interventionist.[306]

(2) Despite the trend to standardise and formalise, and to provide guidelines as to how a credit provider shall assess the creditworthiness of the consumer, the legal frameworks still contain a number of indeterminate legal terms such as 'thorough' assessment, taking 'appropriate account' (Article 18 of the MCD), and taking 'reasonable steps' (section 81(2) of the NCA). Especially in case of the 'thorough' assessment as required by Article 18 of the MCD, it remains to be seen how this term will be received and applied in the case law of the national courts of the Member States and the ECJ and what its impact on the practice of handing out mortgage credits will be.[307]

(3) On the face of it, the NCA and MCD apply similar standards by looking at and verifying the consumer's income, expenses and credit history in order to assess whether the consumer will be able to repay the mortgage credit. Moreover, both

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[304] *i.e.* the Code of Conduct on Pre-contractual Information for Home Loans (op cit note 240).
[305] See chapter 3 para 2.2.1 above.
[306] C van Heerden & S Renke op cit note 44 at 89.
[307] A Rank & M Schmidt-Kessel op cit note 253 at 179.

jurisdictions prescribe the disclosure of pre-contractual information in a standardised manner to enable the consumer to make an informed decision. There are, however, some differences between the legal frameworks. First of all, the legal framework in the EU sets out differential rules on mortgage credit agreements. Compared to the assessment in consumer credit agreements falling under the ambit of the CCD, the creditworthiness assessment under the MCD lays down a stricter standard for the assessment ('thorough' assessment). The South African NCA, on the other hand, does not differentiate between mortgage credit and other consumer credit agreements as regards the pre-contractual assessment. The rules on pre-contractual assessments apply irrespective of whether the credit agreement in question is a mortgage credit agreement or another kind of credit agreement falling under the ambit of the NCA. Accordingly, the MCD contains specific provisions relating to mortgage credit agreement, such as Article 18(3) of the MCD according to which the pre-contractual assessment may not rely predominantly on the value of the residential immovable property exceeding the amount of the credit or the assumption that the residential immovable property will increase in value, while the NCA and/or the AARs do not entail any such provision.

Secondly, and most importantly, the consequences and sanctions if the credit provider fails to do a proper creditworthiness assessment significantly differ. The NCA provides that a court may set aside or suspend the consumer's rights and obligations under a credit agreement if the agreement is deemed reckless. Under the MCD, on the other hand, the choice of sanctions remains within the discretion of the Member States with the effect that the rules vary amongst the Member States. However, the jurisdictions of the Member States considered in this study[308] have in common that, unlike under the NCA, the credit agreement may neither be set aside nor suspended but remains valid. The sanctions will either be purely prudential (as in case of France and Austria), or will be limited to a reduction of interest and costs (Germany and Greece) or a right of the consumer to terminate the mortgage credit agreement (Germany).

(4) Overall, the jurisdictions in South Africa and the EU apply a similar procedure of pre-contractual assessments in consumer credit agreements, including mortgage credit agreements, despite the differences that have been identified in this study. Moreover, they serve very similar statutory purposes, namely the prevention of over-indebtedness and reckless lending. The mechanisms and procedures of pre-

[308] Namely France, Germany, Greece, Austria and Ireland.

contractual assessments, however, have not been transplanted from the European jurisdiction to the South African jurisdiction or vice versa. They have rather developed independently in the context of global and domestic developments in the consumer credit market. It may be inferred that affordability or creditworthiness assessments have emerged as an international best practice in the aim of creating a responsible credit regime.

Chapter 4: Pre-contractual assessments at the crossroads between responsible lending and financial exclusion

1. Introduction

Since the global financial crises at the latest, it is largely uncontested that the consumer credit market in general and the residential mortgage credit market in particular is not self-correcting but needs regulatory intervention.[309] The regulatory intervention in terms of the South African NCA and the European MCD aims at creating a responsible (mortgage) credit regime. In her book 'International responses to issues of credit and over-indebtedness in the wake of crisis'[310], Therese Wilson commented on the legislative framework pertaining to responsible lending *inter alia* in South Africa and the EU. She argues that an effective responsible lending regime should include certain common criteria against which the efficiency of the lending regime may be benchmarked.[311] In her view, a responsible lending regime should

> (1) focus on responsible lending, rather than responsible borrowing, in order to avoid over-indebtedness; (2) focus on consumer credit in general, not limited to residential mortgage loans; (3) encourage flexible, individualized credit assessment practices; and (4) involve a regulatory agency charged with enforcement, which is adequately resourced to properly monitor and enforce compliance with market conduct regulation, including responsible lending obligations.[312]

[309] H-J Dübel & M Rothemund op cit note 32 at 28.
[310] Op cit note 29.
[311] Ibid.
[312] T Wilson 'The Responsible Lending Response' in T Wilson (ed) *International responses to issues of credit and over-indebtedness in the wake of crisis* (2013) 128.

Building on these criteria, Wilson blames the South African and European consumer credit regime for being ineffective insofar as both jurisdictions, so she argues, focus on responsible borrowing instead of responsible lending.[313] Moreover, she contends that pre-contractual assessments in general and inflexible credit assessment methods in particular bear the risk of being interpreted in such a way that it leads to restrictive lending practices, which exacerbate financial exclusion.[314] Similar concerns have been raised within the EU pertaining to the MCD in particular. These critiques also fear financial exclusion through the instrument of pre-contractual affordability assessments, though with a slightly different line of argumentation.[315]

Against the backdrop of these criticisms and concerns, and based on the findings in the previous chapters, the study explores whether the critique of pre-contractual assessments is well founded. The study examines (a) whether the responsible credit regime as set out in the provisions of the NCA and MCD actually focuses on responsible borrowing instead of responsible lending or if it can be considered effective, benchmarked against the above-mentioned criteria developed by Wilson, and (b) whether the responsible credit regime leads to restrictive lending practices that exacerbate financial exclusion, and if so, whether this is justifiable against the background of the objectives of the NCA and the MCD.

2.1 Effectiveness of the responsible credit regime in South Africa and the EU

2.1.1 South Africa

As stated above, the NCA places an obligation upon consumers to answer fully and truthfully during a pre-contractual assessment in terms of section 81 of the NCA.[316] It is a complete defence to an allegation that a credit agreement is reckless if the credit provider establishes that the consumer failed to fully and truthfully answer any requests of the credit provider.[317] In the light of the foregoing, Wilson concludes that the South African consumer credit regime includes an 'unfortunate focus on responsible borrowing'.[318] This conclusion, however, gives a distorted picture of the pre-contractual assessment under the NCA. Van Heerden and Renke correctly point out that the South African reckless lending regime imposes an onerous pre-assessment

[313] Ibid at 126.
[314] Ibid.
[315] A Rank & M Schmidt-Kessel op cit note 253 at 179.
[316] See chapter 3 para 1.3 above.
[317] Ibid.
[318] T Wilson op cit note 311 at 128.

obligation on a credit provider.[319] The credit provider must *inter alia* verify the consumer's debt re-payment history and make sure that the consumer gets a general understanding and appreciation of the risks and costs of the proposed credit.[320] The obligation for a consumer to cooperate in the course of a pre-contractual assessment by answering fully and truthfully is merely one piece of a much larger puzzle. In this context, it has to be taken into consideration that the credit provider must be able to rely on the peculiar knowledge that the consumer has about his or her own financial situation.[321] Where the pre-contractual assessment is based on inaccurate or falsified information, the assessment's purpose to prevent the granting of unaffordable loans may effectively be defeated, especially if the accurate information would have led to a negative outcome of the assessment. It therefore seems reasonable that the NCA applies sanctions to consumers who deliberately provide inaccurate or falsified information or intentionally did not provide information that would have led to a negative outcome of the assessment.

The obligation of the consumer to cooperate in the assessment is also in line with the objectives of the NCA as set out in section 3 and how these are perceived in the case law. As has been said before, the NCA is designed to protect consumers, but consumer protection is not its sole or predominant purpose. The NCA was not intended to make South Africa a 'debtor's paradise'.[322]

In conclusion, it can be established that there is no such 'unfortunate focus on responsible borrowing' in the South African responsible lending regime as indicated by Wilson.

Measured against the other criteria Wilson uses to benchmark the likely effectiveness of a responsible credit regime, the following can be observed: First, the NCA is not limited to residential mortgage loans but focuses on consumer credit in general. Secondly, the responsible credit regime involves a regulatory agency in the form of the National Credit Regulator that monitors the consumer credit market and has the duty to enforce the NCA including the provisions pertaining to reckless lending.[323] It is, however, questionable whether the NCA and the AARs encourage flexible and individualised credit assessment practices. As concluded in chapter 3 of this study, the development of the rules on pre-contractual assessments show a trend

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[319] C van Heerden & S Renke op cit note 44 at 93.
[320] See chapter 3 para 1.3 above.
[321] C van Heerden & S Renke op cit note 44 at 93.
[322] *FirstRand Bank Ltd t/a First National Bank v Seyffert* supra note 73 para 13.
[323] M Kelly-Louw op cit note 5 at 112.

towards standardisation and formalisation. It is conceded that this trend poses a potential threat to the flexibility of the assessment procedures, and may thus also have a negative impact on the accessibility to credit and the effectiveness of the responsible lending regime if benchmarked against the criteria developed by Wilson.

2.1.2 European Union

According to the MCD, the pre-contractual assessment must be based on accurate information. While it would not be appropriate to apply sanctions to consumers for not being in a position to provide certain information[324], Article 20(4) of the MCD provides that Member States shall have measures in place to ensure that consumers are aware of the need to provide correct information upon request of the credit provider. Despite the fact that the MCD thus acknowledges the need for cooperation of the consumer in the assessment, the credit provider clearly bears the brunt of carrying out a proper pre-contractual assessment. It is *inter alia* the credit provider's obligation to gather the information by specifying in a clear and straightforward way at the pre-contractual phase the necessary information and independently verifiable evidence that the consumer needs to provide and the timeframe within which the consumer needs to provide the information.[325] Moreover, it is first and foremost the credit provider who faces sanctions if the creditworthiness assessment falls foul of the requirements of the MCD as transposed into the national law of the Member States.[326] In conclusion, the MCD has – just as the NCA and contrary to Wilson's point of view – a strong focus on responsible borrowing.

Regarding the other criteria developed by Wilson, one can observe that the responsible credit regime in the EU is not limited to residential mortgage loans despite the fact that the MCD sets out differential rules on residential immovable property. Prior to the enactment of the MCD, the CCD has already implemented a responsible credit regime on consumer credit contracts other than credit agreements for consumers relating to residential immovable property.[327] In terms of flexible and individualised credit assessment practices, the MCD shows the same trend towards standardisation and formalisation as the NCA.[328] Therefore, it cannot be assumed that the MCD promotes a flexible and individualised assessment procedure.

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[324] Recital 58 of the MCD.
[325] Article 20(3) of the MCD.
[326] See chapter 3 para 2.3 above.
[327] See chapter 2 para 2.1 above.
[328] See chapter 3 para 3 above.

Lastly, regarding the criteria of a regulatory agency charged with enforcement, the European legal framework shows a complex coexistence of a European regulatory authority, namely the EBA[329], and national regulatory banking authorities. It is beyond the scope of this study to elaborate on the interplay between the European and national regulatory agencies. For the purposes of this study, it is sufficient to note that the enforcement of the MCD is safeguarded and monitored either by the EBA or the national regulatory authorities of the Member States.

2.1.3 Other criteria influencing the effectiveness of the responsible credit regime

In addition to the criteria developed by Wilson, there might also be other factors that critically influence the effectiveness of the responsible credit regime. In this regard, attention has to be drawn especially to the sanctions and consequences of a defective or non-existent pre-contractual assessment. They are likely to have an impact on the effectiveness of the responsible credit regime insofar as they could deter credit providers from irresponsible lending and might enable the consumer to enforce or exercise individual rights in case of irresponsible/reckless lending.

It has been shown that the legal consequences significantly differ in the jurisdiction of South Africa and the EU.[330] Under South African law, reckless credit in terms of section 80(1) of the NCA may either be pursued as a cause of action, or invoked as a defence against the lawsuit of a credit provider.[331] A credit agreement being recklessly granted may be suspended or set aside.[332] In the light of the statutory objective to prevent and curb over-indebtedness, such a remedy seems far more appropriate compared to the sanctions as set out in the jurisdictions of the European Member States of France, Germany, Greece, Austria and Ireland.[333] As indicated earlier, these sanctions will either be purely prudential (as in case of France and Austria), or will be limited to a reduction of interest and costs (Germany and Greece) or a right of the consumer to terminate the mortgage credit agreement (Germany). In all of these instances, the legislator disregards the fact that the consumer, in all probability, will not be able to repay the credit amount. A reduction of costs or interest will not safe the consumer from becoming over-indebted in the first place. It follows that the South African remedies of setting aside or suspending the credit agreement are

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[329] See footnote no 266.
[330] See chapter 3 para 3 above.
[331] C van Heerden & S Renke op cit note 44 at 94.
[332] See chapter 3 para 1.6 above.
[333] Ibid.

far more in line with the statutory objective of curbing over-indebtedness. In this regard, the South African responsible credit regime may be regarded as more effective compared to European law in general and jurisdictions of France, Germany, Greece, Austria and Ireland in particular.

While the sanctions for reckless lending under the NCA compare favourably with those of the EU, *i.e.* some of its Member States, they might have a shortcoming considered in the light of the right of access to housing provided in section 26(1) and (3) of the Constitution. A credit agreement may be suspended or set aside as a result of reckless lending. It has also been noted, however, that the consumer is not entitled to further retain possession and utilise the credit provider's security.[334] While this is an equitable result in case of movable property[335], the situation is different if the credit provider's security is immovable property. It is not only the inconvenience and immense cost of requiring the consumer to vacate the immovable property, *e.g.* for the period of suspension.[336] The remedies also need to be considered in the light of the constitutional right of access to housing in terms of section 26(1) and (3) of the Constitution, which calls for differential rules if immovable residential property is at stake. Notwithstanding that it is very difficult to get a sale in execution of immovable property in South Africa and the right to housing is considered before granting a mortgage foreclosure[337], evictions should be prevented if the credit was being granted recklessly. This differentiation between movable and immovable residential property should be reflected in section 84 of the NCA. [338]

2.1.3 Concluding remarks

The analysis of the likely effectiveness of the South African and European responsible credit regime as measured against the criteria developed by Wilson shows ambiguous results. While some of the criteria are fulfilled, namely the focus on responsible lending instead of responsible borrowing and the focus on consumer credit in general, not limited to residential mortgage loans, it cannot be assumed that the credit regimes

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[334] M Kelly Louw op cit note 5 at 310.
[335] *SA Taxi Securitisation (Pty) Ltd v Mbatha* supra note 168 para 56.
[336] C van Heerden & A Boraine op cit note 175 at 407.
[337] See, *e.g.*, the Constitutional Court's judgment in *Gundwana v Steko Development* 2011 (3) SA 608 (CC) and rule 46 of the Uniform Rules of Court. For further information on this point see R Brits 'The National Credit Act and the Bill of Rights: Towards a constitutional view of consumer credit regulation' 2017 TSAR 470.
[338] Notwithstanding also that such a differentiation might give rise to a claim of infringement of the right to equality (see C van Heerden & A Boraine op cit note 175 at 407).

as set out in the NCA and the MCD encourage a flexible and individualised pre-contractual assessment due to the trend of standardising and formalising the assessment procedure. However, contrary to Wilson's assumption, it is debatable whether a flexible and individualised assessment procedure actually contributes to the effectiveness of the responsible credit regime. In fact, individualised and flexible assessments might actually thwart the objectives of pre-contractual assessments. If no binding guidelines for the assessment procedure are provided, credit providers might apply their own fragmented standards. This could either result in uncertainty on the side of the credit provider pertaining to the legal requirements of conducting a proper pre-contractual assessment, and uncertainty, in turn, could lead to restrictive lending practices that obstructs access to credit. Or else, credit providers could apply relaxed standards in terms of affordability assessments that lead to the granting of unaffordable loans. Either way, the objective of creating a responsible lending regime might be contradicted. It is therefore reasonable to apply binding standardised and formalised guidelines on the assessment procedure. These guidelines secure the unity in the application of the law and make the assessment procedure transparent to consumers. Consequently, flexible, individualised assessment practices as opposed to standardised and formalised assessments cannot be considered a suitable indicator for the effectiveness of a responsible lending regime.

2.2 Responsible lending versus financial exclusion

As this study shows, pre-contractual assessments are a key regulatory tool in South Africa and the EU in the aim of creating a responsible lending regime.[339] They will prevent the granting of credit to those who cannot afford to repay them. Thereby, pre-contractual assessments shall contribute in achieving one of the main objectives in the efforts to create a responsible lending regime, namely the prevention of over-indebtedness. [340] While it is beyond dispute that the prevention of over-indebtedness is a laudable intention, pre-contractual assessments have been criticised for exacerbating financial exclusion. In the following section, these criticisms pertaining to the South African mortgage credit market and the European MCD will be looked at in turn.

[339] See chapter 3 para 3 above.
[340] See chapter 2 para 1.2 and 2.2 above.

2.2.1 Financial exclusion in the South African mortgage credit market

Wilson has expressed the concern that a responsible credit regime in general and pre-contractual affordability assessments in particular necessarily lead to restrictive lending practices, especially in the mortgage credit market, which exacerbate financial exclusion.[341] What remains to be seen is whether this assumption supported by the developments in the mortgage credit market as monitored by the National Credit Regulator and illustrated in the *Consumer Credit Market Report*.[342]

Table 1 below shows the development of the mortgage agreements granted by size on a year-on-year basis from 2009 to 2016. The year-on-year development shows an overall increase in the mortgages granted. However, the majority of the agreements were granted in favour of larger-sized credit agreements. Mortgage agreements of up to R150,000 show significant declines.

Table 1: Mortgages granted – size of agreements[343]

Agreements	2009 % Change (Y/Y)	2010 % Change (Y/Y)	2011 % Change (Y/Y)	2012 % Change (Y/Y)	2013 % Change (Y/Y)	2014 % Change (Y/Y)	2015 % Change (Y/Y)	2016 % Change (Y/Y)
R0-R50k	-25.42	-24.11	-14.26	-19.79	8.10	-27.52	-20.41	-40.89
R51K-R100K	-31.15	-17.17	-12.55	-15.00	-8.40	-18.99	-2.86	-12.47
R101K-R150K	-36.35	-5.54	-11.87	-10.45	3.49	-17.63	-4.35	-9.18
R151K-R350K	-33.62	14.51	3.87	-18.12	-0.58	-12.26	-10.02	-16.75
R351K-R700K	-31.16	26.05	15.78	-9.59	17.54	-2.37	-0.83	-7.62
>=R700K	-14.61	32.52	17.31	-1.26	25.25	8.31	13.43	-4.73
Total	**-22.46**	**27.44**	**14.95**	**-5.00**	**21.37**	**4.50**	**9.26**	**-5.79**

According to table 2, an overall increase in the value of the mortgage agreements granted from R20,682,139 in 2009 to R37,342,883 in 2016 is recorded. As indicated in the table, the vast majority of mortgages granted is in favour of individuals with a gross monthly income of greater than R15,000. This income category accounted for 98.16 per cent of the rand value of the mortgages granted at the end of 2016 (as compared to 92.21 per cent at the end of 2009). At the same time, the percentage share

[341] T Wilson op cit note 311 at 126.
[342] The *Consumer Credit Market Report*, available at *https://www.ncr.org.za*, is published quarterly and represents the disclosure and analysis of data on the South African credit market in terms of the NCA.
[343] The figures are based on the '*Consumer Credit Market Reports*' December 2009-2011 and 2013-2016, as well as *Consumer Credit Market Report* September 2012 due to the fact the report for December 2012 is not available at available at *https://www.ncr.org.za*.

of mortgage credit granted in the lower income bracket of up to R10,000 decreased from 2.37 per cent to 0.35 per cent.

Table 2: Mortgages granted – gross monthly income of individuals (rand value)[344]

Level of income	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
<=R10K	489,963	524,507	561,907	303,004	242,376	207,796	142,431	130,372
% share of credit granted	2.37 %	1.97 %	1.88 %	1.06 %	0.71 %	0.57 %	0.36 %	0.35 %
R10.1K-R15K	1,120,491	1,459,625	1,737,170	1,277,787	1,171,389	992,010	837,291	556,567
% share of credit granted	5.42 %	5.48 %	5.80 %	4.48 %	3.41 %	2.73 %	2.11 %	1.49 %
>R15K	19,071,686	24,663,044	27,666,652	26,949,257	32,935,414	35,074,571	38,658,695	36,655,944
% share of credit granted	92.21 %	92.55 %	92.33 %	94.46 %	95.88 %	96.69 %	97.53 %	98.16 %
Total value of mortgages	**20,682,139**	**26,647,176**	**29,965,728**	**28,530,048**	**34,349,179**	**36,274,377**	**39,638,417**	**37,342,883**

While it may not be possible to establish a direct link between pre-contractual assessments and the developments in the mortgage credit market as presented above[345], the following can be inferred from table 1 and 2 in respect of financial exclusion in the South African mortgage credit market: First, the enactment of the NCA including the provisions on pre-contractual assessments did not lead to restrictive lending practices in general. In fact, the total value of mortgages granted significantly increased from 2009 to 2016. This result, however, can be attributed solely to the increase in mortgages granted to individuals with a gross monthly income of greater than R15,000. Secondly, therefore, the assessment shows that individuals in the low-income bracket are increasingly cut off from the mortgage credit supply and thus financially excluded. In this respect, the developments in the mortgage credit market are contrary to the statutory aim of making the credit market accessible to the low-income and historically disadvantaged population. [346]

[344] Ibid.
[345] Clearly, the mortgage credit market is not solely dependent on the regulatory framework of the NCA but is influenced by a number of factors including the overall market conditions.
[346] See chapter 2 para 1.3 above.

To sum up, the developments in the mortgage credit market suggest that pre-contractual (affordability) assessments may be an appropriate tool to curb over-indebtedness. However, they do not contribute in improving the access to mortgage credit for low-income individuals. Further governmental action will therefore be required to improve the access to mortgage credit and/or housing especially for the low-income and historically disadvantaged population, and to meet the statutory objective of making the (mortgage) credit market more accessible especially to these individuals. The solution for this problem cannot be found solely on the regulatory level of pre-contractual assessments in terms of the NCA.

2.2.2 Financial exclusion in the European mortgage credit market

Regarding the MCD, no such empirical as provided in the Consumer Credit Market Reports pertaining to the South African mortgage credit market is yet available. It remains to be seen what the impact of the MCD on the practice of handing out mortgage credits will actually be on an economic level. However, critiques have already expressed the concern that the MCD exacerbates financial exclusion by practically excluding the value of the acquired property from the creditworthiness assessment.[347] It is feared that certain groups of people, particularly young families and older people, are effectively cut off from the mortgage credit supply.[348] Despite the fact that that this is a valid concern, it still seems reasonable to focus on the ability of the consumer to repay the mortgage credit instead of relying on the value of the acquired property, taking into account the MCD's objective to prevent the granting of unaffordable loans, and the prevention of defaults, foreclosures and eviction.[349] The credit instalments need to be paid out of the consumer's disposable income, whereas the value of the property is the decisive element only insofar as to whether the credit provider gets full reimbursement of the outstanding credit amount or lowers its losses in case of default of the borrower and immovable property foreclosures.

[347] See chapter 3 para 2.2.2 above.
[348] A Rank & M Schmidt-Kessel op cit note 253 at 179.
[349] See chapter 2 para 2.2 above.

Chapter 5: Conclusion

As indicated in this study, the South African NCA and the European MCD both aim at implementing a responsible (mortgage) credit regime. They are alike in the sense that they seek to level different policy objectives, including the prevention of irresponsible lending and over-indebtedness, as well as the stability of the (mortgage) credit market as a whole. This justifies the implementation of a similar regulatory tool to prevent the granting of unaffordable loans, namely pre-contractual (affordability) assessments. Pre-contractual assessments as set out in the South African NCA and the European MCD are an adequate tool to prevent and curb over-indebtedness related to the granting of unaffordable mortgage credits. The trend of standardising and formalising the assessment procedure helps in securing the unity in the application of the law and makes the assessment procedure transparent to consumers. On that note, pre-contractual assessments contribute in implementing a responsible mortgage credit regime.

Clearly, however, pre-contractual assessments are not the panacea for all the challenges in the mortgage credit market. They will particularly not be able to square the circle by both preventing over-indebtedness and facilitating access to credit at the same time. While access to credit might not be at the centre of importance in the European Union, the situation significantly differs in the South African jurisdiction. In the light of the developments in the mortgage credit market, the constitutional right of access to housing, and the objectives of the NCA, it is important to facilitate the access to credit. The statistics and figures presented in chapter 4 para 2.2.1 of this study illustrate this need especially for the low-income and historically disadvantaged South African population. In this respect, the South African jurisdiction needs an approach that is different from the legal framework in the European Union. Further governmental and/or legislative action will therefore be required in order to facilitate access to mortgage credits in South Africa. This might be achieved by providing *e.g.* government subsidies or sureties as collaterals for mortgage credit agreements. In this context, the South African mortgage credit regime needs to be flexible in the sense that it allows for credits to be granted in exceptional cases irrespective of the outcome of an affordability assessment.

The study thus concludes that despite the fact that pre-contractual assessments have emerged as best practices in the consumer credit regulation, there is not a ‘one-

size-fits-all' approach. On the contrary, unique historical, social and economic backgrounds of each country require tailored solutions.

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