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CENTRE FOR
SOCIAL SCIENCE RESEARCH

Relieving consumer over-indebtedness: the need for a 'fresh start' in South Africa

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CSSR Working Paper No. 369

January 2016



Published by the Centre for Social Science Research
University of Cape Town
2016

<http://www.cssr.uct.ac.za>

This Working Paper can be downloaded from:

<http://cssr.uct.ac.za/pub/wp/369/>

ISBN: 978-1-77011-356-5

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Abstract

Although the relative risks of consumer over-indebtedness can be identified, and to some extent prevented, the occurrence of unfortunate events beyond the market's control means that some consumers will find themselves financially over-extended and suddenly incapable of paying their debts. Modern credit societies have noted this, and devised legal measures to relieve such consumers of their debt distress by discharging them of their problematic debts in order to offer them an opportunity to reclaim their financial health (the fresh start). In a context like South Africa, where households are not only highly leveraged but also highly exposed to idiosyncratic risk yet inadequately insured, such measures have never been more relevant. However, the available measures are not up to the challenge of providing meaning relief and rehabilitation of consumers. This paper attempts to show why, and proposes the implementation a simple, straightforward mechanism for debt discharge akin to the 'fresh start'.

Introduction

With debt, rational consumers can successfully shift expenditure from a future period of their lives to the present, just as firms and governments do. While one cannot overstate the positive welfare effects of this innovation, there are immense risks involved. Although, under normal circumstance, consumers will make every effort to repay their debts, the possibility of default will remain inevitable even for tightly regulated credit markets due, in part, to factors that are sometimes beyond the control of both the consumers and the lenders. When consumers default, lenders have no choice but to pursue repayments either through litigation or seizure collateral (if there is any) whilst some might employ other heavy-handed debt collection approaches. Alternatively, they may simply write off the debt as a bad risk. Whatever the option, there are unwelcome costs to the credit system. Modern credit societies have recognised this and have devised legal means that not only prevent debt problems (as far as it is possible) without unnecessarily curbing the access to credit (Niemi-Kiesiläinen & Henrikson, 2005), but also alleviate and rehabilitate those for whom preventive measures failed to work.

In South Africa, the new consumer credit regulatory regime emphasises the prevention of consumer over-indebtedness. It introduced a range of relatively modern pre-contractual tools to enforce responsible market behaviours in addition to improving consumer decision-making (e.g., disclosure and information regulations). Nonetheless, while the legislation also provides for alleviative solutions to consumer indebtedness, these are a far cry from those on offer in other modern credit societies and fall short of modern standards. This inadequacy motivated the current analysis.

Alleviative solutions to consumer indebtedness entail post-contractual regulatory tools to allow over-indebtedness consumers to deal with the possible negative consequences of their over-indebtedness (i.e., consumer bankruptcy). Such tools allow natural persons to get relief from their over-indebtedness through a formal re-negotiation of the credit terms, thereby compelling creditors to compromise on repayment demands so as to enable the over-indebted debtor to rekindle his/her repayment capacity (to the extent possible) and consequently, to discharge the residual debt (Niemi-Kiesiläinen & Henrikson, 2005; Van Apeldoorn, 2008; Dickerson, 2008). The impetus behind such far-reaching regulatory interventions is the need to prevent the debtor and his/her family's welfare from utter devastation, with the hope that they achieve financial rehabilitation so as to become productive members of the economy again (Van Apeldoorn, 2008). Such is the American conception of the 'fresh start' consumer bankruptcy law, a legal novelty that has influenced consumer over-indebtedness alleviative regulations around the world in recent times.

Consumer bankruptcy laws are still new in the developing world. Where legislation exists, it often offers very modest relief to debtors, giving greater emphasis to the satisfaction of creditors' claims with stringent requirements and punitive implications for debtors (Tabb, 2005; Viimsalu, 2010). Political pressures to rein in the ever growing power imbalances between creditors (with the backing of big global finance) and powerless consumers (often low-income workers) have increased in such countries like South Africa in recent years, with the recognition that unfortunate events over which consumers have no control (e.g., job losses, illnesses, family breakdowns) play a big part in the accumulation of debts or the eventual inability to repay it. Consequently, calling for a more liberal consumer debt relief and rehabilitation system.

The South African National Credit Act 34 of 2005 (*hereinafter* NCA) introduced a legal mechanism to relieve debt problems of natural persons (§s 85–87).¹ This

¹ Solutions to alleviate debt already incurred are also provided under the provisions of the *in duplum* rule (§ 103(5)), settlement of the credit agreement (§ 125), early payments (§ 126) and surrender of goods (§ 127), but these mainly aim to prevent creditor losses.

entail a number of similar features with the contemporary consumer bankruptcy legislations in many of the financially developed markets, albeit more conservative, whilst beset by significant weakness and inconsistency which calls its capacity to provide meaningful relief from over-indebtedness into serious question. This paper analyses the South African approach to consumer debt relief under the NCA with the aim of providing an understanding of why it is still not equal to the task of providing comprehensive relief and rehabilitation of consumer over-indebtedness. This is done against a background of recent developments in the financially developed countries' approaches to debt discharge. Most narrowly, this contribution contends that the Act's objective of 'resolving over-indebtedness based on the principle of satisfaction by the consumer of all responsible financial obligations'² is overly conservative and likely to cause more hardship for unfortunate consumers who find themselves inundated with more debt than they can pay. While this contribution acknowledges that the debt review provisions of the NCA are a great improvement on their predecessors, it recommends that legislators need to take stock of developments in the 'fresh start' approach to consumer debt relief. This contention results from the realisation that given the increasing spread of consumer credit around the world which has given way to widening household income fragilities and consequently, increasing delinquency rates, finding new and universal denominators for dealing with consumer debt-related problems has never been more important. This analysis begins with the rationale for legal intervention to relieve consumer debt problems, followed by an overview of the legal approaches to consumer over-indebtedness in South Africa and an overview of the recent developments in the financially developed world – It should be noted that it is the purpose of this paper to provide an analytical and detailed comparison between the different legal systems. A discussion of the shortcomings of the South African approach and, consequently, policy recommendations follow. Throughout this paper, the terms insolvency and over-indebtedness are mutually interchangeable and in line with the NCA's definition of consumer over-indebtedness (i.e., a situation in which debtors' indebtedness has reached a level where they cannot continue paying their debts as they fall due or appear to have no reasonable prospect of being able to pay the debts when they fall due, without causing undue strain on their personal or family welfare).

The rationale for consumer debt relief

Making it harder for over-indebted consumers to avoid repaying their debts is easily justifiable if purchases of iPods, plasma TVs, Hummers, or sable fur coats cause most consumer over-indebtedness. But empirical data collected by

² The NCA, Section 3(g).

prominent U.S. academics show this is not the case; medical debts, a divorce, or a job interruption cause most consumer bankruptcies... (Dickerson, 2008: 146).

Why would a 'market' economy (offering some social safety-nets) bother itself with debt relief when there are safe-guards in place to prevent irresponsible credit practices? The rationale for implementing legal provisions to relieve consumer debt distress speaks to the circumstances that lead to that situation in the first place, and the consequences thereof (Van Apeldoorn, 2008). Empirical investigations of these circumstances have suggested two distinctive factors: irresponsible market behaviours and unavoidable circumstances (e.g., Getter, 2003; Disney, Bridges & Gathergood, 2008; Grant, 2010; Gathergood, 2012). Regulatory efforts to stem irresponsible market practices have mainly focused on curbing and/or removing incentives for reckless lending and borrowing (Kelly-Louw, 2008; Renke, 2011; James, 2013). In this regard, regulation is primarily through information disclosures, consumer education, fairness in credit contracts, and sanctions for reckless lending (Reifner *et al.* 2003; Reifner & Herwig, 2003; Renke, Roestoff & Bekink, 2006; Renke, 2011). Such regulations contemplate that lenders will lend only to those who can afford repayments, while consumers will avoid overextending themselves by making informed borrowing choices as they will borrow in full view of all the necessary information – and the credit market will live happily ever after. However, this utopia ends the moment shocks come into the equation.

The possibility that consumers will experience shocks (often unanticipated) to their incomes means that regulating consumption levels might not be enough to eliminate consumer debt distress. Given the limits on state social welfare and the inadequacies of private insurance, the concurrence of shock means that some consumers will find themselves financially overstretched and unable to continue satisfying their obligations even when they borrowed within their means or even where lenders acted prudently (e.g., Getter, 2003, Van Apeldoorn, 2008; Grant, 2010). Such consumers will need a helping hand, not just because their predicament will have nothing to do with their borrowing behaviours, but also because leaving them to their own devices would be more damaging, to them, their dependants and the entire credit system.

Some consumers may even have accumulated some modest assets and might be earning relatively well, but they may still find themselves desperately over-indebted if hit by unanticipated negative shocks like job losses, business failures, divorce, illness, or even death. Current understanding is that people confront such misfortunes differently. Some might choose to borrow more if their credit ratings still permit (those with bad ratings might still borrow underground), others might liquidate valuables if any, or worse, resort to gratuitous behaviours such as crime or gambling. For such reasons, it becomes both a social and moral obligation of

the state to intervene and offer a legal mechanism to relieve such unfortunate consumers of their financial distress before the situation deteriorates irreversibly (Van Apeldoorn, 2008; Dickerson, 2008).

Besides the direct economic losses for lenders, over-indebtedness may erode economic productivity of the people concerned. Some may suffer serious socio-psychological problems, their living standards may become abject, including exclusion from the social settings (Van Apeldoorn, 2008; Münster *et al.* 2009; Lupica, 2009; Rueger *et al.* 2011). Leaving such consumers at the mercy of their creditor could potentially lead them to descend into lives of hopelessness with very little incentive to work more than they need for survival (Steiger, 2006; Niemi-Kiesiläinen & Henrikson, 2005) – which, affects the larger economy as well. Moreover, leaving consumers in a perpetual state of over-indebtedness will translate into loss of business for lenders as such consumers would be unable to participate in future borrowing.

In the nutshell, these outcomes and the unfortunate nature of over-indebtedness – in a sense that's it can results from situations beyond both the lender's and consumer's control – bring forth the necessity for the state to intervene and offer a legal framework to discharge unfortunate consumers of unmanageable debt in order to reclaim their financial health so they can continue to be productive members of society in addition to reclaiming their ability to participate in the credit market (Tabb, 2005; Niemi-Kiesiläinen & Henrikson, 2005).

Although empirical studies have shown that many of the causes and consequences of over-indebtedness are common to credit societies, there are manifest differences in terms of the social construction that underpin arguments on the best set of debt relief regulations enacted in each context. For a context like South Africa where idiosyncratic shocks play such an important role in the economic health of households (e.g., Collins & Leibbrandt, 2007), one qualified argument would be that consumer debt relief regulations akin to the 'fresh start' are more relevant here than in the U.S. or Europe where the fresh start is already an established law. A number of factors support this contention including the poverty situation here, the high unemployment rates (see, Chibba & Luiz, 2011; Magruder, 2012) and the lower levels of financial buffering (see, van den Heever, 2012). Moreover, the pressures to spend upon a background of insufficient incomes, large dependencies and the ever rising cost of living means that indebted households in South Africa will be in a weaker financial position compared to their American or European counterparts. Should they reach a point where they are unable to continue paying their debts, it becomes imperative that government steps in to offer a meaningful helping hand in terms of discharging their unmanageable debts.

Of course, some might be sceptical as to whether a fresh start system is a viable option in a context in which shocks have longer-lasting effects. For example, in South Africa, it may take years for someone to find another job after losing one compared with the U.S. or Germany where it could be a matter of weeks or months, hence one might feel that attempts to rehabilitate such people may be a futile exercise. However, consider, a hypothetical debtor who is the sole bread-winner. He loses the job and stay unemployed for more than a year. He is obviously unable to continue paying his debts but his creditors start hounding him constantly. Then they send in the horrible debt collectors. There are no (or not enough) valuables for them to seize and no meaningful income prospects in the foreseeable future – naturally they resort to threats of violence against the debtor or his family. Consider the options left to such a debtor if no helping hand is forthcoming. On the cusp of becoming completely destitute, the possibilities might include, getting sucked into the loan sharks network, or even worse, turning to crime. A case in point, James (2013) has argued that the inability of current legislation to intervene appropriately and rescue over-indebted workers when lenders’ repayment demands exceed what they can genuinely satisfy might be responsible for some of the violent workers’ strikes ravaging the country in recent times. Such scenarios underpin the necessity of a tightly regulated framework for relief and rehabilitation of over-indebted consumers in the mould of the pure ‘fresh start’ approach to consumer protection while of course giving regard to the other social policy needs and local conditions.

The South African approach to consumer debt relief

The National Credit Act 34 (NCA) states its purpose to be the promotion of responsible borrowing, avoidance of over-indebtedness and fulfilment of financial obligations by consumers, and to discourage reckless credit granting by credit providers and contractual default by consumers. Perhaps the most important innovation of the Act is its post-contractual solutions to over-indebtedness. Under this, the Act states aims to address the problem of over-indebtedness³ of natural persons (*hereinafter* ‘debtors’ or ‘consumers’) by providing for a harmonised system of debt restructuring, enforcement and judgment ‘based on the principle of satisfaction by the consumer of all responsible financial obligations’.⁴ Prior to

³ NCA, § 79 (1) defines an over-indebted consumer in these terms, namely that a ‘consumer is over-indebted 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’.

⁴ NCA, § 3 (g) and (i).

the Act, the only legal remedies available to over-indebted consumers were sequestration and administration, which according to Roestoff & Renke (2005) provided no real relief but often left a large portion of over-burdened consumers worse-off.

Chapter 4 Part D of the NCA tackles consumer over-indebtedness.⁵ This part introduced the provisions of ‘debt review’ and ‘debt restructuring’ (§§ 86 & 87) which deal with the alleviation of over-indebtedness and rehabilitation of over-indebted debtors. Under these provisions, a debtor who is over-burdened with more debt than he/she can pay, may apply – in a prescribed manner and form – to a ‘debt counsellor’ to have him/her declared over-indebted,⁶ so that the ‘court’ may relieve him/her of his/her indebtedness. The court, a credit provider or the National Credit Regulator (NCR) may also refer an over-indebted debtor to the debt counsellor for the same purpose. There are essentially two intertwined processes with a common end: (1) the review is the initial process conducted by the debt counsellor and entail the evaluation of the case, fact finding and attempts at amicable solutions (§ 86) – this process is referred to under the Act as ‘debt counselling’, (2) debt re-arrangement which is conducted by the court based on the debt counsellor’s recommendation and involves the actual declaration of over-indebtedness and the subsequent restructuring of claims (§ 87) – Roestoff *et al.* (2009) note that the debt counsellor only evaluates whether there are grounds to declare the debtor over-indebted, but the actual declaration is a remit of the court.

The Act defines a debt counsellor as a ‘neutral person who is registered in terms of section 44 for the purpose of offering a debt counselling service’⁷ subject to specific registration requirements set forth in sections 44 and 45⁸ of the Act. Debt counselling (as defined under the Act) essentially means assisting the over-indebted consumer through the process of debt review. The roles of debt counsellors in the debt review processes are wide-ranging. They are tasked with explaining the nitty-gritty of the debt review, and the debtor’s rights and responsibilities during the process. Upon application, the debt counsellor shall

⁵ This part does not apply to credit agreements or proposed credit agreements in terms of which the consumer is a juristic person (NCA § 6(a)).

⁶ NCA, § 86(1) – pursuant to section 79(1) of the Act.

⁷ NCA Regulations, Regulation 1.

⁸ Read with NCA Regulations, Reg. 10: ‘The requirements include, inter alia, the provision that only natural persons may apply to be registered as Debt Counsellors; must adhere to certain minimum standards relating to education, experience and competence and must demonstrate an ability to manage their own finances’ (NCA Regulation 10(b)(aa)).

investigate the debtor's financial situation⁹ and make recommendations to court based on the results of this analysis.¹⁰

A debt counsellor who receives a petition for debt review shall notify all credit providers to whom the consumer is indebted and every registered credit bureau.¹¹ The law presumes that notifying these entities will prevent consumers from entering into further credit agreements while under the debt review process.¹² The debt counsellor shall have 30 business days from the date of the application for debt review to make a determination in terms of section 86(6) and another 30 business days to take action as contemplated in section 86(7)¹³ failing which, the creditor may proceed to enforce the credit agreement in question.

In terms of section 86 (7), it is expected that the debt counsellor's assessment of the consumer's financial situation should yield at least one of the following three scenarios:

1. The consumer is not over-indebted, in which case the debt counsellor must reject the application in a manner and form as prescribed by NCA Regulation 25.¹⁴
2. The consumer is over-indebted, in which case the debt counsellor shall make a recommendation to the Magistrate's Court to re-arrange one or more of the debtor's obligations.¹⁵ Also, under this scenario, the debt counsellor may recommend that the court declare one or more of the debts in question to be 'reckless',¹⁶ – if they are found to be so – pursuant to the provisions of section 80 and 81 of the NCA.¹⁷

⁹Giving regard to, inter alia, the debtor's financial assets, prospects and liabilities pursuant to section 79 and regulation 24(7) (NCA regulation 24 (1) provides a list of information and documents required to file a petition in respect of a debtor who wishes to be declared over-indebted).

¹⁰Roestoff et al. (2009) have suggested that the first task of the debt counsellor in the debt review process is to determine whether the consumer is indeed over-indebted, likely to become over-indebted, or not over-indebted at all.

¹¹ NCA Regulations, Reg 24(5).

¹² NCA, § 88(4).

¹³ NCA Regulations, Reg 24(6). 130 Refer to Chapter 5, Part A or B and, or Chapter 6, Part A of the Act.

¹⁴NCA, §88(7)(a): The application may still be rejected even where the debt counsellor has concluded that a particular agreement was reckless at the time it was entered into.

¹⁵ NCA, § 86(7)(C) (ii).

¹⁶ Definition of 'reckless credit' see chapter 2 (subsection 2.5.4): i.e., credit agreements entered into without proper assessment of the applicant's creditworthiness by the credit provider or where the credit provider extends credit even when it is clear that the consumer could not afford or understand the terms of the credit (§. 80).

¹⁷ NCA, § 86(7)(C)(i).

3. The consumer is not over-indebted, but is nevertheless experiencing, or likely to experience difficulty satisfying all his/her obligations in a timely manner. The debt counsellor may then recommend that the consumer and his/her respective credit providers voluntarily consider and agree on a plan of debt re-arrangement.¹⁸ If the parties agree, the debt counsellor shall draft the agreement as a consent order in terms of section 138 of the Act and this will be binding as an order of the Tribunal or a Court.

If as a result of the evaluation, the debt counsellor rejects the application or the parties fail to consent to the debt counsellor's re-arrangement proposal, the consumer – with leave of the Magistrate's Court – may apply directly to Court,¹⁹ in the prescribed manner and form, for an involuntary debt restructuring.²⁰

Section 87 provides that upon receipt of the debt counsellor's referral, the Magistrate's Court must conduct a 'hearing' – based on its own discretion. Neither the NCA nor the Magistrates' Courts Act provide for a procedure in terms of which such a hearing should be conducted (Roestoff *et al.* 2009: 276). However, subsection 86(7)(c)(ii), states that, the Court – having regard to the debt counsellor's proposal and the consumer's financial means prospects and obligations – may re-arrange a consumer's obligations by, (a) extending the period of the agreement and reducing the amount of each payment due accordingly; (b) postponing during a specified period the dates on which payments are due under the agreement; (c) extending the period of the agreement and postponing during a specified period the dates on which payments are due under the agreement; or (d) recalculating the consumer's obligations because of contraventions in relation to unlawful credit practices.²¹

According to Roestoff *et al.* (2009) – based on section 129 of the NCA – there are no legal grounds to compel an over-indebted consumer to seek debt restructuring. Instead, a consumer may simply discontinue repayments and wait for a credit provider to enforce a credit agreement in respect of which he/she is in default, and then raise the issue of over-indebtedness in court. Under section 129, a creditor cannot commence legal actions against a defaulting debtor before drawing the

¹⁸ NCA, § 86(7)(b).

¹⁹For the definition of Court see Government Notice 288 of 2011, Government Gazette No.34281 (11 May 2011) 'court means Magistrates' Court established in terms of the Magistrates' Courts Act, 1944 (Act No. 32 of 1944), having jurisdiction over a consumer by virtue of such consumer's residence or place of business or the Debt Counselor carrying on business in the jurisdiction of such court irrespective of the monetary value of the credit agreements being considered by the court'.

²⁰NCA, § 86 (7)(b) & (c) and § 86(9).

²¹ Refer to Chapter 5, Part A or B and, or Chapter 6, Part A of the Act.

debtor's attention to that fact in writing²² and meeting the requirements set forth in section 130 including a referral to the debt counsellor.²³ The creditor shall also propose that the debtor refer the matter to an alternative dispute resolution agent, consumer court or ombudsman with jurisdiction.²⁴ Such a proposal is intended to avoid a protracted litigation process. While the extent to which lenders trust in the debt counselling process is unknown, anecdotal evidence suggests that many consumers only learn of the lenders' intentions to pursue repayment through court summonses pursuant to the provisions of other laws such as the 'Insolvency Act 24'.

Nonetheless, the Act provides that (in terms of section 85), if approached by a creditor, the court may exercise its discretion to refer the matter to a debt counsellor who will start over by evaluating the consumer's debt situation²⁵ and then making a recommendation to court in terms of section 86(7) to declare the debtor over-indebted and henceforth take steps to relieve the debtor of the over-indebtedness.²⁶ In practice, creditors can still petition court through other laws such as the Insolvency Act and may not have to contend with evaluation of the consumer's over-indebtedness, because the NCA does not limit or repeal the provisions of such laws (§ 2(7)).

The NCA does not prescribe the exact procedure the debt counsellor should follow to determine whether a consumer qualifies for debt re-arrangement or not. Based on the entirety of the situation, the debt counsellor will use discretion to make decisions in this regard. In order to streamline the debt counselling procedure, major credit providers in consultation with debt counsellors and the NCR, agreed to certain guidelines. However, Roestoff *et al.* (2009) note that such guidelines might not have legal standing, with voidable implications should they be tested in a court.

²²NCA, § 129(1)(a).

²³NCA, §130 (1): 'Subject to §§ (2), a credit provider may approach the court for an order to enforce a credit agreement only if, at that time, the consumer is in default and has been in default under that credit agreement for at least 20 business days and-

(a) at least 10 business days have elapsed since the credit provider delivered a notice to the consumer as contemplated in section 86(9), or section 129(1), as the case may be;

(b) in the case of a notice contemplated in section 129(1), the consumer has- (i) not responded to that notice; or (ii) responded to the notice by rejecting the credit provider's proposals; and

(c) in the case of an instalment agreement, secured loan, or lease, the consumer has not surrendered the relevant property to the credit provider as contemplated in section 127'.

²⁴ Note that the South African legal system tries to provide for out-of-court settlements in all sorts of disputes,

²⁵ NCA, § 85(a).

²⁶ Only a court can declare a consumer to be over-indebted. A debt counsellor's function in terms of section 86(6)(a) is merely to conduct a debt review in order to determine whether a consumer appears to be over-indebted or not, - based on available information.

Nonetheless, the Act requires debtors and creditors to participate in good faith and to act responsibly during the review and in any negotiations designed to result in a debt re-arrangement and will comply with any ‘reasonable’ request by the debt counsellor for information necessary to evaluate the consumer’s financial position.²⁷ For instance, the Act mandates the debt counsellor to propose a voluntary re-arrangement agreement between the parties which can be ratified by the court as a binding consent order without the court’s interference the process or outcomes.

The debt review process presents some important effects on the rights of debtors and creditors alike. Notably, the commencement of debt review proceedings will have the effect that any form of enforcement of the credit agreements in question (including any rights or security) will be stayed until the review or re-arrangement is terminated.²⁸ The Act also debars the debtor from entering into any further credit agreements (other than consolidation agreements) until the review or re-arrangement process is terminated (which naturally means: until the debtor fulfils all the repayment obligations).²⁹ A credit provider who enters into a credit agreement with such a debtor, risks sanctions for reckless lending, while the agreements entered will be void.³⁰

While the Act and regulations do not set out specific grounds for termination of the debt review (Van Heerden & Coetzee, 2011), the debtor or the debt counsellor may withdraw from the process at any time at least 60 business days after the commencement of the debt review. A credit provider may withdraw from the debt review process on grounds that the debt counsellor failed to arrive at an agreeable debt re-arrangement proposal within the mandatory 60 days. A debt counsellor may also withdraw from the debt review as a result of the consumer not acting in good faith or being uncooperative.

Termination of the debt review (due to non-compliance by debtor) has the consequence that the debtor will forfeit the right to debt relief in terms of the Act and the creditor may proceed with legal actions to pursue the debtor for all payments due. Moreover, the credit bureaux with record this fact for a period of six months. However, the court hearing the case may on its own authority or upon

²⁷ NCA, § 86(5).

²⁸ NCA, § 88(3).

²⁹ NCA, § 88(1): Section 88(2) provides that if a consumer fulfils obligations by way of a consolidation agreement he/she will still be barred from incurring more debt until he/she fulfils all of the obligations under the consolidation agreement, unless he/she again fulfils the obligations by way of a consolidation agreement.

³⁰ NCA, § 83(2) & (3).

petition by the debtor, order that the debt review resume on any conditions that the court considers to be just under the circumstances.

If the debtor satisfies all the obligations as re-arranged, the debt counsellor must issue a clearance certificate in a prescribed form.³¹ The credit bureaux and the NCR must then expunge from their records the facts of the case and any information relating to the default that led to the proceedings in question.³²

Perhaps the most important departure of the NCA from contemporary consumer debt relief and rehabilitation regimes is that the NCA only permits the court to re-arrange the consumer's obligations and does not provide for a discharge (§ 86(7)(c)(ii)). The court would only discharge outright, debts resulting from reckless credit agreements and without proof of over-indebtedness, even these shall be binding. Furthermore, the NCA does not regulate the contents and the length of the period of the repayment plan under the re-arrangement order.

In practice, the debt review process (locally referred to as debt counselling) is simply a process where an over-indebted debtor applies to have his/her debts restructured, so that he/she is able to meet household expenses and still keep up with monthly debt repayment. It primarily entails reducing monthly payments and extending the period of payment.³³ A debtor applies to a debt counsellor who in turn notifies the respective creditors. Meetings are arranged and repayment proposals are presented to creditors and if agreed to, the debt counsellor will collect a court order (consent order) from the clerk of the court and deliver it within five working days to the affected consumer and each credit provider – not always the case, sometimes it takes longer. As such all debt counselling applications will end in court. From then on, the debtor will commence repaying the re-structured obligations in a manner ordered by the court. Insolvent accounts for which legal action has been commenced before entering the process cannot be restructured, as such, creditors often take the opportunity to initiate legal action in time before a debtor applies for debt counselling. Creditors do not often agree to debtors' proposals and this necessitates an application to court to consider the debtors' financial situation and then compel creditors to lower their demands.

During the repayment period, the debt counsellor will provide aftercare service whilst, the debtor will pay a 5% monthly aftercare fee capped at R400. In addition, creditors cannot take any legal actions against the debtor and the debtor cannot take new debt. Because the law gives debt counsellors a lot of room to manoeuvre,

31 NCA, § 71 (read with Regulation 27).

32 NCA, § 71(5); read with NCA Regulation 17(1) as amended.

³³ “6 drawbacks of debt counselling. Available”: <http://www.women24.com/CareersAndMoney/Money/6-Drawbacks-of-Debt-counselling-20120606> [20 May 2014].

a number of complaints have emerged (according to the regulator – the NCR), including that many have designed their own processes and even neglected some regulations. Reports also claim that some debt counsellors often place debtors under debt review without debtors’ consent or even before signing the mandatory form, some debt counsellors do not perform aftercare while others apply for, collect and deliver consent order arbitrarily.³⁴

Developments in some financially developed states

Japan

Just like the South African NCA, the current Japanese regulatory regime for dealing with debt problems of natural persons was introduced as a response to long-standing deficiencies in existing laws, including the fact that the consumer insolvency law was a dislocated set of procedures developed according to historical circumstances (Steele, 2000). The legislation is set forth in two separate codes: the Bankruptcy Act No. 75 (*Hasan-ho*) of June 2, 2004 (as amended by Act No.109 of December 15, 2006) and the Civil Rehabilitation Act No. 225 (*Minjisaisei-ho*) of December, 1999 (as amended by Act No. 87 of 2005) – collectively referred to as the “insolvency laws”³⁵ – with the former largely intended to realise a debtor’s non-exempt assets so as to prepare the way for relief and rehabilitation (if necessary) and the latter for the actual rehabilitation. Under the Japanese law an over-indebted consumer may choose to commence either liquidation or rehabilitation proceedings. Legislation defines an over-indebted debtor as one ‘unable to pay’ his/her debts as they fall due³⁶ or when he/she suspends debt repayment.³⁷

In practice, the Japanese system offers two conduits to the fresh start for over-indebted consumers, either through ‘sell-out’ proceedings or ‘pay-out’

³⁴ NCR’s Circular NO.8 (September 2013) “The industry trends, practices and developments”. Available: [http://www.ncr.org.za/publications/circula_sep/Circular%20\(No.08ofSep-2013\).pdf](http://www.ncr.org.za/publications/circula_sep/Circular%20(No.08ofSep-2013).pdf) [20 May 2014].

³⁵ While these procedures are available to both natural and legal persons, there is a reorganization process provided for under the Commercial Code (*Kaisha Seiri*) which only applies to business corporations.

³⁶ The Bankruptcy Act, Art. 15(1), § 1: The application for admission to proceedings can be made not only by the debtor but also by creditors against the debtor. Also a court can subject a debtor to these proceedings.

³⁷ The Bankruptcy Act, Art. 15(2), § 1.

proceedings in order ensure a quick exit from debt distress (Matsushita, 2006). In that way, debtors with some non-exempt assets who are willing to give them up (for the benefit of their creditors) can be admitted to a bankruptcy proceeding (sell-out) so they may be free of their over-indebtedness immediately. Alternatively, a debtor can agree (or be subjected) to a rehabilitation procedure in which he/she keeps all assets in exchange for promising to pay off debts from future income over a period of time according to the rehabilitation plan (pay-out). While, based on the situation, both options seem positive for consumers, creditors and legislators have often expressed some discontent with each. For the ‘sell-out’ option, some felt that, if creditors should lose the opportunity to recuperate a bigger share of their claims from the debtor’s future incomes it might damage their interests while on the ‘pay-out’ option the counter-argument (mainly from legislators) was that sifting through all debtors’ disposable income statements to ascertain their abilities to pay would be very time-consuming and not cost-effective (*ibid.*: 270). Consequently, a recent innovation has given over-indebted debtors the right to choose between either bankruptcy proceedings or rehabilitation proceedings, regardless of the amount of expected disposable income.

The American approach

Historically, the U.S. system has given over-indebted consumers a fresh start that allowed them to discharge their debts and become productive members of the economy again (Dickerson, 2008). The social, moral and practical reasoning underpinning this generosity is that over-indebtedness is a social problem that can result from misfortunes over which people have no control, thereby necessitating state intervention to prevent an overall deterioration of their economic situations (Van Apeldoorn, 2008).

The U.S. Bankruptcy Act³⁸ (as amended by the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA).³⁹ on April 20, 2005) enables over-indebted consumers to seek formal financial relief by obtaining a discharge from some or all of their existing debts. Before this amendment, relief from over-indebtedness was open to everybody and debtors had the right to decide whether they wanted to attempt to pay some of their debts over a three-to-five-year period under a “Chapter 13” repayment plan or seek a quick discharge in a “Chapter 7” proceeding by turning over part of their non-exempt wealth for liquidation but

³⁸ The US Code, Title 11- Bankruptcy of 1978, Pub. L. 95–598, Title I, § 101, 92 Stat. 2549 [hereafter 11 U.S.C].

³⁹ Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (codified as amended in scattered sections of 11 U.S.C.) [Hereinafter BAPCPA].

keep complete control of their future incomes (White, 2007). Debtors filing under Chapter 13, were obliged to repay only from non-exempt earnings. Under both procedures most unsecured debt was dischargeable (White, 2007; Gerhardt, 2009).

The new developments under the BAPCPA, however, seek to limit access to a quick discharge (offered under Chapter 7) by forcing more consumers into Chapter 13 debt repayment plans instead. This entailed the introduction of a ‘means-test’ which requires consumers to pass an elaborate quantitative test⁴⁰ in order to ‘earn’ the right to a fast track to discharge under Chapter 7 where they can pay off a fraction of their debts using available resources (if any), while keeping all their future incomes. Debtors who fail the means-test may file a Chapter 13 case under which they get to keep a greater share of their properties but pay a bigger fraction of the debt using future incomes over a period of three to five years after which, they can be discharged from their remaining debts. The main impetus for these innovations was the complaint that consumers who could afford to repay their debts were walking away from these obligations far too easily (Dickerson, 2006; White, 2007). Thus the consumer’s duty to behave responsibly and good faith became imperative etiquettes of the American system (Dickerson, 2008: 144).

The European approach

The fresh start approach to consumer debt relief is relatively new to most of Europe. Until recently most European countries specified a policy of life-long liability for debt (Livshits, MacGee & Tertilt, 2007; Viimsalu, 2010). Over the last two decades, many countries have adopted the American idea of the fresh start, albeit with stricter terms for discharge and requiring consumers to make considerable effort – usually in form of a more demanding repayment plan (Niemi-Kiesiläinen & Henrikson, 2005; Van Apeldoorn, 2008; Viimsalu, 2010) – the requirements vary greatly. Recent reforms in this area have seen attempts to a convergence towards the American system (Van Apeldoorn, 2008; Gerhardt, 2009). Notable innovations in this respect have been the decrease in the duration of the repayment plan and attempts to reduce other constraints to access to proceedings while extending the scale of discharge to involves as many types of debts as possible (Niemi-Kiesiläinen & Henrikson, 2005; Van Apeldoorn, 2008).

The duration of the plan varies from 12 months (the U.K.) to three years (the Netherlands) to five years (Belgium, Denmark, Finland and Sweden), to six or

⁴⁰ 11 U.S.C. § 707 (b) (2) (A): Such a test would take into account a consumer’s income (adjusted for family size), monthly expenses and monthly expenditure on secured debt repayment.

seven years (France, Austria and Germany). The longest is for Ireland (twelve years under certain circumstances – with a minimum of five years) (Gerhardt, 2009). Plans usually contain some form of payment, although a few states (e.g., France and the Netherlands) are able to grant discharge without any payment at all – citing hardship cases.⁴¹ Then again, there is Austria, which requires a minimum payment of 10 per cent, thereby excluding the really poor debtors from the process (Van Apeldoorn, 2008).

A few countries have attempted to regulate initial out-of-court settlement. This requires that the debtor shall attempt to reach an amicable settlement with the creditors before going to court (e.g., Germany, the Netherlands, Finland, Austria, France and Luxembourg) – for Germany, it is a prerequisite for the opening judicial proceedings. A demonstration of good faith is also an important aspect of the European approach. In a nutshell, while, the material aspects of laws differ, the general European approach to debtor relief and rehabilitation is manifested in the principles of partial payment of the debts, appropriate counselling and enforcement of behaviour, and consequential discharge.

Common aspects of contemporary legislation

Insofar as consumer protection legislation carries welfare and moral undertones, contemporary consumer bankruptcy laws (in advanced credit societies) will amalgamate a certain set of functional values. While the material aspects of these laws are considerably different, a few common characteristics are identifiable. Notably, these speak to: the need to protect consumers who suffer misfortunes; the dangers of staying in debt distress for an extended period of time; and the necessity of eliminating abuse and opportunism by consumers (Niemi-Kiesiläinen & Henrikson, 2005; Dickerson, 2008).

Ease of entry and right to relief

In advanced credit societies, access to relief has become both a right and a favour (Van Apeldoorn, 2008). As a result, impediments to entry have in most cases been lowered as long as available information proves the consumer is over-indebted. In other cases (e.g., Japan), general cessation of payment by the consumer can be enough grounds to infer over-indebtedness and eligibility for

⁴¹ For example, where there is a reason to conclude that the debtor is permanently incapable of payment and where debtors face longer periods of unemployment.

protection⁴² while in the United States, even those who fail the means test can still get relief under Chapter 13. In addition, the idea of a moratorium is also tied in with right to relief. A moratorium is a temporary court order that suspends creditors' actions and right to receive payment upon commencement of proceedings. This is crucial as it creates a regulated environment for the debtor to get momentary relief from financial distress which, in turn, gives the debtor a better chance of recovery (Feibelman, 2009; McBryde, Flessner & Kortmann, 2003).

Good faith

The principle of good faith is an important aspect of contemporary consumer debt relief processes as it debars consumers from using debt relieve procedures a ticket to freeload or as a solution of first resort. The issue of good faith is quite broad and subject to definition in different jurisdiction. Nonetheless, common aspects include a requirement for over-indebted debtors to behave responsibly for instance, by not electing to disadvantage their creditors and not to knowingly aggravate their indebtedness by consuming more debt while under the debt relief procedures. This principle also contemplates that the consumer will make an effort to pay at least some – if not all – of his/her debts if he/she is to benefit from the legal protection.

Repayment plan

A 'repayment plan' is the staple of contemporary debt relief legislation insofar as discharge is conditional upon fulfilment of the plan. In some jurisdictions (especially Europe), it is closely regulated while in others, it can be a result of negotiations between the debtor and his/her creditors. While the level of regulation on this aspect and the outcomes differ, the repayment plans largely entail, inter alia, setting aside a portion of the debtor's assets for his/her creditors' benefit; re-structuring of payments; and modification of creditors' and debtors' rights under the agreements in question. There is a particular importance attached to the length of time a debtor must remain under the constraints of the repayment plan or period of good conduct (as it is commonly known in Europe and the U.S.). This period and the corresponding repayment plan are not only intended to give creditors an opportunity to recuperate some payments, but also – equally important – to give consumers an incentive to adjust their spending behaviours and possibly learn to spend more shrewdly. The argument in this respect is that

⁴²Japan (Bankruptcy Act, Art. 15 § 2, Civil Rehabilitation Act, Art. 21(2)); South Africa (NCA, § 130, read with §129 & §85).

the idea is to have a plan that does not run too long as not to be a punishment for unfortunate debtors and not too short as not to allow meaningful recuperation of claims or encourage opportunistic behaviours (Gerhardt, 2009).

A shorter period, is meant to afford expedited rehabilitation for debtors so that they can be able to get on with normal life quickly and not be constrained for a long period. Contrariwise, a long plan has the risk that it may aggravate debtors' financial distress by handicapping them with the requirements of the process especially the inability to access new credit during the period. In other cases, some debtors may use the process as a means to hide from their obligations whilst creditors may not be able to recoup any meaningful value from the small payments that take forever.

Discharge

For contemporary legislation, discharge (fresh start) is the implicit purpose of admission to consumer insolvency proceedings. Under the Japanese⁴³ and U.S. laws, and much of Europe (except Ireland where the High Court reserves the discretion for discharge – but a debtor is relieved after 12 years), debtors are presumed to apply for discharge upon application for commencement of proceedings – subject to a defined period of good conduct.

The process leading up to discharge is closely regulated in most of these systems to the extent that the outcomes are more predictable at the onset and this is primarily depends on the debtor's available or expected wealth. Those with little or no assets may qualify for an expedient discharge. For instance the U.S. (under Chapter 7) and Japanese liquidation procedure, once the available non-exempt assets have been sold, the debtor will be discharged from any other dischargeable debts. However, those with good future income prospects maybe subjected to a relatively longer period of good conduct before discharge. The U.S.'s Chapter 13 and the Japanese rehabilitation procedure, require the period of good conduct to run for three to five years; after which the debtor will be discharged of all unpaid dischargeable debts. For most of Europe this period runs between seven years for the more restrictive systems to as little as 12 months for the more liberal like the U.K.

43 Bankruptcy Act, Art. 248.

Treatment of secured creditors

Secured credit usually excluded from the insolvency plan not only because it is naturally bulky and would greatly inflate the repayment plan thereby making harder for the over-indebted to satisfy, but also because creditors often have collateral to hold on to. It might become tricky though, if the value of the collateral is too low relative to the principal debt. Both the Japanese and U.S. laws (including Europe) provide for the right of separation, thus allowing secured creditors to exercise their security rights outside the insolvency process – the requirements are profoundly variable. In the case of Japan, even the temporary stay (moratorium) or the commencement of proceedings cannot extinguish these security rights.⁴⁴ However, secured claims for which payment cannot be covered by the collateral at hand may be exercised as insolvency claims (i.e., where the total amount of debts outstanding exceeds the value of collateral).⁴⁵ The U.S. system offers an insolvency debtor with secured obligations three choices: to surrender the property that secures the debt; reaffirmation of the debt; or redemption. However, Chapter 13 gives debtors an option to pay the secured debt within the repayment plan, albeit under different conditions. In most of Europe secured debts like mortgages are left out of the process completely, and the principal debt cannot be included in the repayment plan.

Exemptions

Exemption refers to the wealth (physical and/or liquid) the debtor is allowed to keep in the insolvency procedure so that he/she may continue to earn a living. The list of such items is often listed in greater details and usually include the normal household items, the tools of one's trade, and a portion of future income not exceeding a certain threshold. While some jurisdictions like the U.S. (where exemption laws are regulated both at the state and federal level) allow for homestead exemption, such that debtors can keep a share or all of their principal residence (Gerhardt, 2009; Cornwell & Xu, 2014), in others like most of Europe, homeowners will have their homes liquidated – except for some countries (e.g., France, Denmark, Sweden) where special policies apply on a case-by-case basis, usually based on the value to the property (Van Apeldoorn, 2008).

44 Civil rehabilitation Act, Art. 53; the Bankruptcy Act, Art. 65, § 1.

45 Civil Rehabilitation Act, Art. 88.

Discussion

As noted earlier, consumer bankruptcy legislation is a relatively new territory in the general realm of consumer protection. While differences in the material aspects of the debt relief regulations across states should be expected (and indeed do exist), contemporary approaches identify with the goal of providing a safety net for families whose financial positions have been damaged by unfortunate circumstances. The idea (strongly supported by empirical studies) that the causes and consequences of consumer debt problems are more similar across countries than they are different calls for a concerted effort in finding common approaches to solving these problems.

The South African approach to debt relief under the NCA is quite different to those pursued in advanced credit societies which have embraced the ‘fresh start’ approach. Certainly, the path dependence of institutions and/or the political influence of interest groups (e.g., COSATU, SACP) might explain these difference. Notwithstanding, one cannot overlook issues like the level of development of the markets, the general level of economic development and standards of living while, others might argue along the lines of cultural differences. But one needs to be especially sceptical with the cultural difference argument when dealing with consumer debt problems because as markets grow, consumer behaviour, consumption trends and influences tends to homogenise. Issues such as conspicuous consumption and other excesses are common to all credit societies, but it is highly unlikely that any government will implement such far-reaching safety nets to aid people who encounter financial problems because they bought gold watches or diamond earrings.

To reiterate, modern states implement legal consumer debt relief measures to protect consumers because they realise that consumer debt problems often result from unfortunate events over which many consumers have no control (e.g., job losses, business failure, illness, divorces), or which are not of their own making (e.g., rising interest rates, falling property valuation). Furthermore, they realise that if a person who has lost the capacity to repay his debts and has no immediate prospects of paying those debts in the foreseeable future were to be left at the mercy of debtors, it would lead to far worse outcomes for himself and his family. It is also useful to draw attention to the fact that, individual consumers and credit providers may also be complicit in causing over-indebtedness by acting irresponsibly. In this respect, regulatory intervention will speak to preventive (pre-contractual) measures that attempt to rein in irresponsible lending and borrowing behaviours. As such, contemporary consumer credit legislation has two facets: the preventive and the alleviative. The subject of the current discussion is entirely on interventions ‘after the fact’ (alleviative). The preventive aspect has

been left out of the discussion deliberately. This point belaboured because quite often people from different academic lives fail to distinguish between these consumer protection solutions.

Having clarified these issues, now, fast-forward to the South African approach to alleviating consumer debt problems. The NCA was introduced with great fanfare as sure proof tool for protecting consumers and providing redress to those 'exploited' by lenders. Much like the entire legislation, the provisions on debt review and debt restructuring are a great improvement on any other similar laws (past and present) in the context of consumer protect.

Currently, a person who finds him/herself with more debt than he/she can manage to pay or one who fears that he/she will not be able to pay future debts can seek legal protection from his/her creditors. In doing so, such a person will petition court – with the help of a debt counsellor – to allow him/her pay off these problematic debts on manageable terms as deemed fit by the court. In turn, the court will proceed to relieve this indebtedness by rearranging the problematic obligations, reducing the instalments payable or extending the terms of payment – while the court may absolve the debtor completely of debts that resulted from reckless lending. The issue of deserts for relief is an important aspect of this undertaking as relief is only reserved for 'over-indebted' consumers or those facing a prospect of becoming over-indebted in the near future, giving regard to available information about the debtor's obligations, resources and prospects.

Overall, the idea behind the South African system is that consumers have a duty to satisfy their obligations but due to some misfortunes and other market imperfections, they are unable to do so and therefore it becomes a duty of the state to help them revive their repayment capabilities rather than subjecting them to punitive actions. This idea is not unique in itself, but it is as modern as it is moral and practical. Having said that, however, questions linger as whether measures in the NCA are up to the challenge of providing meaningful debt relief and rehabilitation for consumers facing unmanageable debt.

Is the debt review process up to its task?

In making the case for a new credit legislation, the Department of Trade and Industry's (DTI) policy document that preceded the NCA stated in no uncertain terms that the mechanisms that were in place were not adequate to promote the rehabilitation of consumers, or even to assist already over-indebted consumers to deal with their debt, in which case, it called for a review of those mechanisms (Department of Trade and Industry, 2004a: 13). This was in reference to the

insolvency law of 1936 in general and sequestration in particular, including certain provisions of the Magistrates Court Act of 1944. However, it seems that the new legislation, focuses more on the prevention over-indebtedness (reckless lending and borrowing) and less on alleviating the problem. This regulatory imbalance is traceable to the fact that the primary informants of the policy formulation (notably politicians and academics) almost roundly blamed consumer debt problems on consumers borrowing beyond their means due lenders' abusive practices and asymmetric information (e.g., see Department of Trade and Industry, 2003; Department of Trade and Industry, 2004b). Scenarios where consumers could borrow within their means but later finding themselves under severe debt distress due to unforeseen negative events were never highlighted both in the literature and debates that informed the process.

As such, in its current form, the NCA provides strong and relatively modern tools to prevent over-indebtedness but intrinsically lacking in dealing with over-indebtedness once it happens (relief and rehabilitation). Hence, the debt review and restructuring provisions of the NCA are not equal to the task of providing meaningful relief and rehabilitation of consumer over-indebtedness. The primary issues influencing this conviction relate in general to the presence of overlapping procedures; absence of comprehensive legislation in some area, and lack of clarity on key issues.

Overlapping procedures

The NCA states clearly that it does not limit, amend, repeal or otherwise alter any laws other than those specifically mentioned (§ 2(7) a). Among such law not affected by the provisions of the NCA are the Insolvency Act and the Magistrates' Courts Act, yet these had been found inadequate and a case for review of the regulatory environment in general was made based on the inadequacies of such laws and the introduction of the debt review provisions in particular was a direct response to the limitations of these laws in the context of relieving consumer over-indebtedness. Notwithstanding this, creditors can still pursue over-indebted consumers for payment under the sequestration (voluntary surrender or compulsory sequestration) law which is governed by the Insolvency Act, or through administration orders which are governed by section 74 of the Magistrates' Courts Act if they should choose to circumvent the superficially more consumer-friendly debt counselling provision of the NCA. Should this happen, the NCA will be unable to override the conflicting provisions of these Acts as no mention of this can be found throughout the NCA or its regulations – noting further, that debts already under litigation (pursuant to other laws) cannot be included in a re-arrangement plan under the NCA.

It is worth noting that the primary purpose of both the Insolvency Act and section 74 of the Magistrates' Courts Act is to pursue repayment and orderly distribution to the respective creditors and therefore debt relief is not an aim of either (e.g., Boraine & Van Heerden; 2010; Roestoff & Coetzee, 2012). As such, the debtor's current or future financial health is of no consequence under these procedures – in fact, no declaration of over-indebtedness necessary.⁴⁶ It should therefore suggest that creditors are likely to recuperate a greater share of their claims if they petition under these laws rather than the debt review process. Further to the above, these two procedures also govern business insolvencies and have no separate procedure for businesses and natural persons. However, while it is normal to kill off or liquidate over-indebted businesses, natural persons have to go on supporting their dependents no matter the situations they encounter and need separate procedures that put this fact into perspective unequivocally.

I submit then that the multiplicity of laws and procedures presents various incentives for opportunistic behaviours. Notably, reports suggest that creditors often rush to invoke more creditor-friendly procedures at the slightest sign of financial trouble. For instance, they file emoluments attachment orders and place debit orders on consumers' wages even before notifying those concerned, sometimes even before they completely lose the ability to pay (e.g., Haupt *et al.* 2008; James, 2013). This renders such debtors' family lives unsustainable, living them with barely enough to survive on, which often extends the debt-cycle and other adverse outcomes. In the presence of multiple procedures, creditors may not have the incentives to renegotiate amicable settlements with their debtors as they (creditors) might not find it in their best interests knowing they can recuperate more through an attachment order. In a nutshell, the NCA's implicit proclamation that it does not limit, amend, repeal the old laws that dealt with insolvencies is a giant ambiguity which weakens the ability of the debt review provision to provide relief to consumers.

Inadequate legislation

Orderly and effective consumer insolvency procedures play a critical role in the prevention and resolution of financial crises, both at the household level and the macro-level, and may even foster growth and competitiveness if the conditions are right (IMF, 2000). Tightly regulated procedures ought to induce greater confidence and commitment from both consumers and creditors. Consumers will

⁴⁶ Under the administrative order, debts must be paid in full with interest without reference to a specific timeframe; administrators and fees are unregulated and there is no clearly defined property exemption under sequestration procedure to the effect that debtors may be left with barely enough to survive on.

enter the process with full knowledge of their responsibilities and creditors will be more agreeable to making concessions especially when rescheduling their claims.

In addition to the foregoing problems of overlapping procedures, the debt review and adjustment provisions are inadequate in terms of substance, process and application. The NCA does not provide for a comprehensive, integrated and standardised system for consumer debt relief and rehabilitation. The law does not define a fixed process with respect to the recuperation of claims. There are no standardised terms for the re-arrangement order under the regime⁴⁷ in terms of the amount of assets to be committed to repayment and no defined limits for exempt assets or the minimum portion of the debt to be repaid. What is likely to happen then is that parties will agree on unrealistic re-arrangement plans, only for debtors to abandon them a few months down the line when they realise they cannot afford them.

The gist of the above problem is the fact that the Act and regulations are silent on how insolvency debtors will repay the re-arranged obligations (i.e., whether from future (employment) incomes or by liquidating their assets). Certain types of debtors are better-off using either one of future incomes or available asset to repay while others can afford both (e.g., just like Chapters 7 and Chapter 13 of the U.S. Code). Moreover, there are those with neither meaningful assets nor income prospects and subjecting such debtors to an elaborate re-arrangement where they have to make monthly payments would be a futile exercise. Debtors would do well to accept re-arrangement plans they know they will not be able to fulfil if they think that doing so would give them momentary relief – although this would only exacerbate their miseries.

Another flaw of the debt review provisions, is the lack of specificity on the overall rights and responsibilities of debtors and creditors. Debt counsellors and/or the courts have a lot of leverage to decide most matters at their own discretion, with the risk that similar cases under different proceedings will get different outcomes. One might see worse-off debtors getting heavier repayments burdens in the re-arrangement order while the better-off ones getting off lightly. In addition, this lack of specificity might create an incentive problem for potential filers or discourage good faith with a consequence that consumers and their respective creditors may resort to prejudicial ways to solve over-indebtedness problems.

Another inadequacy of the process relates to the provision for extending the repayment period as a means of relief. This has a potential to damage debtors' wellbeing rather than improve it. Consumers seek debt relief because they are

⁴⁷Same as the conventional insolvency plan (Re-arrangement plan).

unable to continue repaying their debts and need a timely discharge so they may be able rebuild their financial health (rehabilitation). Merely extending their period of payment will not solve their over-indebtedness, it might simply increase it as they might try to borrow from other sources (often more dangerous underground sources) in order to fulfil the new payment requirements.

Then there is the specific issue of discharge and rehabilitation. The NCA does not foresee a straightforward form of discharge and release from liability. The debt review provisions are intended to provide relief and rehabilitation but based on the ‘principle of satisfaction by the consumer of all responsible financial obligations.’ True to this principle, the law only provides for a re-arrangement of credit agreements – based on a plan that enables the debtor to repay the debt on terms creditors are willing to accept or enforced by court. This in essence means that discharging of debt is not an objective of this process, but rather ensuring that creditors get paid regardless of how long it takes – whether or not the over-indebted debtor will have the real means to repay under the order.

The submission here is that the absence of a simple, clear and straightforward debtor discharge mechanism will perpetuate the debtors’ over-indebtedness. Debtors might even stay encumbered for a lifetime trying to repay the rearranged obligations (with interest and debt counsellors’ monthly fees) without enough or any resources to do so, and this directly defeats the possibility of attaining a fresh start or rehabilitation. It is worthwhile to remember that the misfortunes that lead many debtors into this situation often have permanent effects especially given the chronic inability of most South Africans to muster even the modest form of precautionary investment. In summation, the absence of a foreseeable form of discharge under the debt review provision means that consumers facing long-lasting or permanent financial troubles will not benefit from the process, rather, their distress might be compounded by the re-arrangement orders they are not able to meet. It seems then that only those facing momentary financial distress will benefit (i.e., those who still have the resources to repay under the re-arrangement plan).

Lack of clarity on important issues

Given all the costs associated with legal debt-relief procedures, including the significant interferences in the legal and economic positions of debtors and creditors, initiation of the process should be subject to clearly defined outcomes and responsibilities so that candidates can judge for themselves whether these are compelling enough to justify such costs and interferences. The IMF (1999) states that without an effective and orderly procedure that is applied in a predictable manner, the rights of debtors may not be adequately protected and different creditors may not be treated equitably.

Some of the important issues not clarified under the Act or regulations include the time limitation on the debt review process, the treatment of creditors with encumbered collateral, operations and conducts of debt counsellors, and provisions for no-income/no-asset debtors. The failure to clarify these issues might also contribute to more burdens for debtors.

While the Act provides grounds for closure of proceedings, there is no regulation on the length of the process or the repayment plan and if payments should be extended, the maximum length of time is not specified. The law in its current state suggests that a re-arrangement order will stay in place indefinitely pending fulfilment of the provisions therein. This may have two negative effects: first, debtors may drag their feet in executing an indefinite repayment plan which damages creditors' positions (as they may not be able to recuperate meaningful value from the small payments that stretch over many years and cannot exercise their right to collateral). Second, an unfortunate debtor might face a generation under the shackles of bankruptcy with all the associated restrictions (e.g., being debarred from certain financial activities or from accessing new debt until the fulfilment of the restructuring order).

On the issue of collateralised debt, the absence of special provisions to deal with holders of encumbered collateral is a major caveat in the legislation. Because secured debts are usually bulky, re-restructuring these under the same repayment plan as the rest of the unsecured debts will inflate the repayment plan, thereby casting an even bigger burden on the debtor and it may require years or decade to fulfil such a plan, hence eroding any prospects of rehabilitation.

Furthermore, the debt counselling process is not well articulated in the Act and its regulations. Although Act requires debt counsellors to measure up to certain standards, problems still exist. Firstly, some of these standards are too low: especially the requirement for a minimum education level of Grade 12 is agonisingly low for such a professional service. The other problem is the fact the law does not prescribe enough as to how debt counsellors shall do the job. In practice, reports suggest that the process has been affected by arbitrary standards for filing consent forms, engagement between debtors and creditors, debtors being misinformed by counsellor and profiteering by lawyers-turned debt counsellors (e.g., Roestoff *et al.* 2009; James, 2013).

Another major shortcoming is the absence of provisions for debtors who might not have any reasonable income or assets with which to pay for the rearranged claims. It seems to suggest that these will have to carry the debts as natural obligations with no chance of a clean slate.

In summation, this contribution submits that the debt review provision in its current form is not able to bring about meaningful relief and rehabilitation of over-indebted debtors due to the reasons discussed above. The tools provided can only offer very limited relief to some consumers who may still have the ability to repay the restructured claims but these are likely to be in the minority. Without a straightforward form of discharge, debtors subjected to the process might even find their over-indebtedness situation getting worse. Over-indebtedness means an inability to continue repaying debts (and it is defined as so in the NCA), and viable legal responses should be geared at assisting the debt to exit this unfortunate situation as quickly as possible. However, simply rearranging insolvent obligations, extending the payment period, or recalculating the interest and fees is unlikely to bring about meaningful relief but might instead perpetuate the over-indebtedness as it is merely an effort to recoup as much value as possible for creditors. In a market beset by frequent income and health shocks, high unemployment and low financial buffering, one cannot go far in relieving consumer over-indebtedness ‘based on the principle of satisfaction by the consumer of all responsible financial obligations.’

Policy recommendations

The issues presented above underscore the argument for a more thorough review of the NCA’s debt review and re-arrangement procedures. In the context of consumer protection, it is imperative to implement a harmonised statutory debt relief process which does not only speak to a balance between creditor and debtor interests, but also conscious of consumer vulnerability in the credit market. Policymakers especially need to take stock of recent developments in advanced credit societies with regards to dealing with debt problems of individuals; the causes of these problems; the efficacy of current measures (under the NCA); as well as the individual and social effects of over-indebtedness. The primary task should be to explore ways of protecting individual debtors from becoming slaves to their indebtedness without curbing credit supply, whilst minimising prospects for abuse and distortion. The Commission on International Trade Law’s (UNCITRAL) Legislative Guide on Insolvency Law⁴⁸ suggested standards for global best practice which speak to achieving a balance between the four basic aspects of post-contractual regulatory intervention: relief; rehabilitation; repayment of creditor claims; prevention of abuse and efficiency of the process. Legislators in South Africa would do well to incorporate these suggestions and

⁴⁸The World Bank (2011). ‘Principles for effective insolvency and creditor/debtor regimes’ (Revised). Available on: http://siteresources.worldbank.org/INTGILD/Resources/ICRPrinciples_Jan2011.pdf [accessed: 20/08/2012].

devise tightly regulated but, simple, accessible debt relief procedures where both credit providers and consumers recognise their responsibilities and the importance of a functioning credit market.

Understanding that unfortunate events (beyond a consumer's control) explain much of consumer over-indebtedness should be the starting point in reviewing the current consumer debt relief procedures. It is also worth noting that staying in a perpetual state of debt distress with no prospects of getting out is not only detrimental to the individual concerned but also to society at large. As such, it would be both morally and practically wrong to leave over-indebtedness consumers at the mercy of their creditors. With that in mind, this contribution proposes a comprehensive review of the entire consumer insolvency system in favour of a single, simple and straightforward mechanism for debt relief which, should entail some form of repayment but only to the extent possible and discharge of the residual debt. It should preclude debtors whose debt problems resulted from gross financial mismanagement and those acting in bad faith, whilst these should also have an alternative non punitive mechanism. More specifically:

- Discharge should be definitive, giving regard to the debtor's pre-insolvency financial situation and current responsibilities.
- The discharge should follow a specified period of good conduct which should ideally be between 12 months and three years – long enough to allow time for repayment efforts and adjustment of behaviour and not too long, to allow for a relatively early exit and rehabilitation. The debtor's wealth prospects should be the deciding factor for the length of this period.
- The terms of the discharge should be specific and simple with precisely worded clauses on the rights and responsibilities of each party. This should build confidence in the process and reduce conflict of law.
- Regulations should clarify alternative measures for those who, for some reason, are unable to get a discharge. If an appeal is possible, clarify grounds and procedures thereof.

With regards to repayment, the scope of assets and repayment plan should be clear. Vitally important, the Act or regulations should clearly explicate the terms and provisions of the repayment plan to the extent that they are predictable and discernible so that consumers can readily calculate the opportunity cost of availing themselves to the procedure before they do. For instance, the law should provide for liquidation of assets (if any) as a means for early release of debtors from the process. Both creditors and debtors may propose any sale that maximises the value

of the assets being liquidated, and the most convenient, but supervised means of sales (e.g., public auctions).

- The law should clarify the proportion of resources (i.e., property and/or future income) necessary for repayment and should be fair enough to represent a meaningful contribution to the debt repayment.
- The proportion and type of exempt assets should be clear and this should be fair enough for debtors and their dependents to live a minimally acceptable standard of comfort (and the standard clearly defined in the regulations).
- The law should enable expedient discharge for no-income/no-asset debtors or those whose income and assets are too low to represent meaningful payment. Perhaps discharge without any further action or after a short period of community service.
- Allow secured creditors to exercise their security interests outside the debt review process or exclude secured credit from the provisions of the debt review altogether.

With regards to the goals of prevention of abuse and efficiency, a comprehensive system for consumer bankruptcy is necessary with standardized procedures for entry, observance and exit to avoid ambiguities. Regulations should list all possible abuses and provisions to prevent. In that way, debtors will not use the insolvency process as cover for their dishonesty; attorneys will not use the process for profiteering and debt counsellors will not abuse their powers, while the process should be made accessible to those who badly need it.

- It is necessary to introduce tools that will enable earlier commencement of the proceedings, while there is still value for creditors and debtors to rescue and/or not have to wait until the debtor is irreversibly destitute.
- The necessity for a facts-sensitive test of over-indebtedness and future repayment capacity: currently, there are no clear boundaries for the debtors' resources, prospects and obligation.
- Unify and harmonise insolvency procedures where liquidation other than sequestration is the only action taken in respect of a debtor's property as a means to expedite exit from indebtedness. Specifically, the NCA should repeal sequestration and administration orders in

respect of natural persons in favour of a uniform debt adjustment procedure under the NCA.

- With regards to the types of debt falling under the NCA, it is imperative that the NCA is able to override any other laws (notably, Insolvency Act and Magistrates' Courts Act), with a narrowly worded clause to that effect.

Legislators should evaluate ways to minimise the role of courts and the need to pay for the service. This should help to expedite the process, reduce case backlogs and profiteering by interested parties, as an over-indebted debtor will usually be in a precarious financial state and often unable to meet even the modest fees while a long unwieldy process may make his/her rehabilitation untenable.

- It should be useful to regulate integrated amicable out-of-court settlements to avoid lengthy litigation processes. An attempt at out-of-court settlement should be a prerequisite for admission failing which, the parties can use the court⁴⁹.
- To make the process more accessible, state-sponsored local agencies, professionals and paralegals, stationed at municipalities should take a central role in the consumer debt-adjustment process.
- Furthermore, the system should not leave post-insolvency debtors to their own devices lest they regress. It is necessary to regulate mechanisms for post-insolvency debtor education, monitoring and counselling (at the municipal level) to enable full rehabilitation of debtors.

Conclusion

In countries where the 'fresh start' is an established law (e.g., the U.S., Britain, Germany), discharge lies at the heart of the consumer debt relief policy. Reasoning underpinning this policy lies primarily with a recognition that unanticipated shock (over which consumers or lenders have no control) will have a devastating effect on the financial health of families and wider implications for

⁴⁹ While the debt counsellor is empowered to recommend out-of-court negotiations, these are not regulated by the NCA and even where these succeed, the case will still have to end in court in order to ratify the agreement reached thereby putting unwanted strain on an already backlogged court.

the entire credit system. The narrowest argument here is in this regard is that should a consumer lose the means to pay his/her debts and with no reasonable prospects of doing so within a reasonable timeframe, it may lead to far worse outcomes for that consumer and his dependants. As such, the state has a moral obligation to rescue that consumer by discharging him/her of that indebtedness he/she may get an opportunity to reclaim his/her financial health and be a productive member of society again.

In contexts like South Africa where socio-economic shocks are widespread and in some cases have permanent effects and where most households are unable to afford even the modest buffering against risk, it can be argued that such regulatory interventions are even more relevant. Here, many families rely on a single (low-income) bread-winner who actively consume debt to supplement his/her low wages. Such a person often has no form of insurance against risk and where insurance exists, it is often agonisingly inadequate. For such a person, even the slightest income shortfall will have a large effect on his/her debt repayment performance. Even worse for one who loses the job altogether or a family bereaved of the only breadwinner.

In motivating the need for the NCA, such scenarios were hardly highlighted by the politicians and academics alike. They singled the credit provider (and his exploitative ways) as the culprit and the result of which, was the formulation of an unbalanced credit legislation with strong and modern tools to prevent over-indebtedness and weaker provisions for alleviation of over-indebtedness (debt review).

The NCA contemplates providing debt relief to an over-burdened consumer but 'based on the principle of satisfaction of all responsible financial obligations' by the consumer, but this principle provides the basis for the weakness of these debt relief provisions. It suggests that the law is more about recuperating creditors' claims and therefore not up to the challenge of providing meaningful relief and rehabilitation of consumers facing unmanageable debt. This is underscored by the fact that the legislation does not provide for discharge of debt but only re-arranges obligation to enable the debtor to repay at relaxed terms. Such a mechanism will only offer very limited relief to the very few debtors who still have the ability to repay the re-arranged obligations. However, it is useful to note that (for whatever reason), debtors often choose to discontinue their debt repayment, because they have lost the means to do so or continuing to do so will render them incapable of affording the daily subsistence of their families. For most of these debtors, simply re-arranging their encumbered obligations without any form of discharge will not make the situation any better. Henceforth, these consumers need a meaningful fresh start.

In fact, the current political climate had never been more supportive of the fresh start approach to consumer debt relief and two factors inform this conviction. First, the ANC government and its political allies (notably COSATU and SACP) have always had a strong predisposition to consumer protection in the credit market especially for the wage earners and the previously disadvantaged. These political entities have always motivated the need to offer some form redress to these groups (for past injustices by capitalistic lenders) which includes measures that seek to relieve them of their debt distress (which is blamed, to some extent, on the political and economic structures under apartheid) on an on-going basis. Second, the Public Service Commission and the NCR have issued reports that highlight the disturbing levels of indebtedness among civil servants and other salaried workers. The Public Service Commission has also highlighted causality between the over-indebtedness of public servants and financial misconduct, noting further that the Garnishee orders and debit orders placed on these workers' salaries exacerbate their financial distress leaving them with hardly enough to survive on.

Forget the credit information amnesties, these consumers need a concrete legal mechanism that can enable them to discharge some or all of their indebtedness (on simple, clarified conditions) not only as a means of offering them consumption insurance, but also as a way to reclaim their financial health.

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