

**Microcredit Regulation in South Africa:**  
**A Comparative Study of the Law in Context**



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WRGLAU002

A minor dissertation submitted in partial fulfilment of the academic requirements for  
the award of the degree of:

*Master of Laws specialising in Commercial Law*

Faculty of Law

University of Cape Town

2019

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*Research dissertation presented for the approval of Senate in fulfilment of part of the requirements for the Master of Laws in approved courses and a minor dissertation. The other part of the requirement for this qualification was the completion of a programme of courses.*

*I hereby declare that I have read and understood the regulations governing the submission of Master of Laws dissertations, including those relating to length and plagiarism, as contained in the rules of this University, and that this dissertation conforms to those regulations.*

Signature \_\_\_\_\_

Signed by candidate

Date: 23 January 2019

## CHAPTER ONE

## INTRODUCTION TO THE STUDY

*Background*

In the year 2012, over 60 per cent of all credit active consumers in South Africa had been defined as over-indebted.<sup>1</sup> By the year 2014, official estimates were that up to 40 per cent of the South African workforce's income was being spent on repaying debt.<sup>2</sup> Today, debt continues to flourish.<sup>3</sup> The National Credit Monitor has found that only 48 per cent of the 24 million credit active consumers in South Africa were up to date with their credit repayments in the first quarter of 2017.<sup>4</sup> In the year 2018, credit bureau TransUnion CEO, Lee Naik, highlighted that almost 73 per cent of personal income in South Africa goes towards the servicing of debt.<sup>5</sup> When one evaluates the fast-paced, consumption driven society that we live in, it is not surprising that most people are living well above their means. Peer pressure is a major reason for this drive for material assets, while marketing strategies of advertisers have become more intensified and far-reaching.<sup>6</sup> Subsequently, the greater the pressure there is to purchase mobile phones or other technological devices, the easier it is for advertisers to target the public

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<sup>1</sup> Milford Bateman 'South Africa's post-apartheid microcredit-driven calamity' *Law, Democracy and Development* Vol 18 (2014) 119.

<sup>2</sup> Malcolm Rees & Dane Volker "'Garnishees 'exploit all South Africans'" - Webber Wentzel' *Money Web* 15 August 2013, available at <http://www.moneyweb.co.za/moneyweb-financial/garnishees-exploit-all-south-africans--webber-wentzel>, accessed on 10 April 2018.

<sup>3</sup> Carin Smith 'First-time credit defaults highest since December – index' *Fin24* 9 April 2018, available at <https://www.fin24.com/Economy/first-time-credit-defaults-highest-since-december-index-20180409>, accessed on 10 April 2018.

<sup>4</sup> 'South Africans are big borrowers and poor savers – expert' *Fin 24* 5 March 2018, available at <https://www.fin24.com/Money/Home/south-africans-are-big-borrowers-and-poor-savers-expert-20180305-2>, accessed on 10 April 2018.

<sup>5</sup> 'High court ruling unleashes flood of new credit applications' *Fin24* 10 April 2018, available at <https://www.fin24.com/Economy/high-court-ruling-could-unleash-flood-of-new-credit-applications-20180410>, accessed on 10 April 2018.

<sup>6</sup> Deborah James 'Money-Go-Round: Personal Economies of Wealth, Aspiration and Indebtedness' (2012) 82 *Africa* 20 at 30.

through such technology.<sup>7</sup> Furthermore, there is a feeling of dignity and convenience in obtaining a loan rather than being unable to purchase household necessities or attain emergency relief.<sup>8</sup> However, a correlative to the competition raised by peer pressure is the secrecy and stigma attached to indebtedness.<sup>9</sup> The same pride that one gets when being able to purchase items on credit is quickly turned into shame when one realizes that he or she is ‘in over their heads’ and unable to afford to make repayments.<sup>10</sup> This may ultimately result in borrowers remaining silent when finding themselves over-indebted, and then spiraling into even more so-called ‘debt traps’ in order to keep up with payments.

It is often assumed that it is the salaried people in middle income brackets that find themselves in debt.<sup>11</sup> This is because formal sector credit providers are reluctant to expose themselves to the risk of debtors not paying and are thus only willing to lend to those with a regular income.<sup>12</sup> However, this dissertation will be taking a deeper look into the world of consumer debt in South Africa, focusing on the low-income segment of the population and the associated formal, but smaller-scaled ways of lending. A ‘low-income’ consumer will refer to a person that earns a relatively low salary (‘low-income households’ are described as those in Living Standard Measures 1-3<sup>13</sup>)<sup>14</sup> who is or would be denied access to mainstream or formal credit on this basis.<sup>15</sup> ‘Formal credit providers’ will refer to those commercial banks that are governed by the law and credit regulation in South Africa. It will also refer to Microfinance Institutions (MFIs) that are likewise governed by the law and credit regulation but that principally focus on smaller loans. ‘Informal credit providers’ will

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<sup>7</sup> Ibid.

<sup>8</sup> T. Wilson et al. ‘Protecting the Most Vulnerable in Consumer Credit Transactions’ (2009) *J Consumer Policy* 32:117–140 at 125.

<sup>9</sup> James op cit note 6 at 31.

<sup>10</sup> Ibid.

<sup>11</sup> Ibid at 35.

<sup>12</sup> Ibid.

<sup>13</sup> ‘Living standard measures’ *South African Advertising Research Foundation (SAARF)*, available at <http://www.saarf.co.za/lsm/lsms.asp>, accessed on 17 November 2018.

<sup>14</sup> Polly Mashigo ‘The lending practices of township micro-lenders and their impact on the low-income households in South Africa: A case study for Mamelodi township’ (2012) *New Contree*, No. 65 at 24.

<sup>15</sup> Wilson et al. op cit note 8 at 118.

refer to members of the public that disburse smaller loans while not under the governance of the law or credit regulation, namely ‘mashonisas’<sup>16</sup> or ‘loan sharks.’<sup>17</sup>

With the abovementioned high rate of indebtedness in South Africa, it is easy to assume that credit is relatively accessible in this country. However, this has not proved to be the case for the low-income segment of the population. Low-income earners find credit highly inaccessible due to collateral constraints, lack of credit history, high interest rates and the complexity of contractual information.<sup>18</sup> These low-income households only require small amounts of money to run their day-to-day expenses, yet commercial banks see this as a risky and unprofitable loan.<sup>19</sup> Informal sources of credit, on the other hand, respond to these concerns by allowing the borrowing of small amounts at any time and for any reason, as well as holding the advantage of being equipped with local community knowledge and trust.<sup>20</sup> However, although informal microlenders appear to respond to these concerns, they often use exploitative practices on the already vulnerable.<sup>21</sup> Ultimately though, it is these concerns which has led to formal microcredit being introduced to the world.

The concept of microcredit, commonly described as an industry where low-income earners are given access to loans, originally began as an economic and social experiment in developing countries.<sup>22</sup> By virtue of such, microcredit came to be introduced in South Africa: an unequal but growing economy where people sought to escape the bounds of poverty. Formal microcredit<sup>23</sup> was therefore introduced in South

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<sup>16</sup> Mashigo op cit note 14 at 25 describes ‘Mashonisa’ as an African term for informal sources of credit who provide such credit to households that have been traditionally marginalized by the formal sector. This is done within their own communities, using their own systems and methods without legal external assistance.

<sup>17</sup> The Cambridge Dictionary Online (available at <https://dictionary.cambridge.org>) defines a loan shark as a person who charges very large amounts of money for lending unsecured loans to someone at illegally high interest rates, often forcing repayment through blackmail or threats of violence. A mashonisa is a form of a loan shark.

<sup>18</sup> Mashigo op cit note 14 at 25.

<sup>19</sup> Ibid.

<sup>20</sup> Ibid at 30.

<sup>21</sup> Ibid at 25.

<sup>22</sup> Megan Whittaker ‘South Africa's National Credit Act: A Possible Model for the Proper Role of Interest Rate Ceilings for Microfinance’ (2008) 28 *Nw. J. Int'l L. & Bus.* 561.

<sup>23</sup> Formal microcredit refers to microloans that are administered by legally compliant and regulated microfinance institutions. See further explanation on page 3, paragraph 2 of this dissertation.

Africa as a development initiative,<sup>24</sup> involving the distribution of small-scale loans to low-income consumers who lack access to banking and related financial services.<sup>25</sup>

Understanding the categorical description of a microloan under South Africa's primary credit legislation, the National Credit Act<sup>26</sup> (NCA), is less clear. In general, a microloan is regularly considered a 'short term credit transaction' under the NCA.<sup>27</sup> According to reg 39(2)(a) of the National Credit Regulations,<sup>28</sup> a short-term credit transaction means a 'credit transaction in respect of a deferred amount at inception of the agreement not exceeding R8 000, and in terms of which the whole amount is repayable within a period not exceeding 6 months.' Such definition tends to fit squarely with the features of microcredit. However, for the average layperson, a first glance at the 'short term credit transaction' definition in the regulations does not lead to the immediate assumption that such is synonymous with micro credit. Furthermore, if one were in fact to have such knowledge and were to proceed to reading to reg 39(3), the definition of an 'unsecured credit transaction' could also lend to the assumption that microcredit falls within this category.<sup>29</sup> This uncertainty and lack of clarity within the regulations is problematic due to the fact that the category in which microcredit falls is of significance when evaluating the maximum prescribed interest rates and charges. Therefore, to provide an exact definition and position of microcredit within the bounds of the NCA proves difficult. This argument will be analysed in further detail in Chapter 3 of this dissertation.

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<sup>24</sup> Bateman op cit note 1 at 92-93.

<sup>25</sup> P. Meagher & B. Wilkinson 'Filling the Gap in South Africa's Small and Micro Credit Market: An Analysis of Major Policy, Legal, and Regulatory Issues' *IRIS Discussion Paper No.02/11* (2002) 12-19.

<sup>26</sup> Act 34 of 2005.

<sup>27</sup> Jonathan Campbell 'Short-term credit: Recent developments and the new limits on the cost of micro-loans' (2016) *SA Merc LJ* 462.

<sup>28</sup> GN R489 in *GG* 28864 of 31 May 2006.

<sup>29</sup> The definition states that "an 'unsecured credit transaction' means a credit transaction in respect of which the debt is not supported by any pledge or other right in property or suretyship or any other form of personal security."

*Contemporary issues with Regard to Microcredit*

The emergence of the microlending industry is said to be one of the greatest achievements in ensuring that communities have access to financial resources.<sup>30</sup> However, the reality has been that microcredit has now morphed, in contemporary times, into another technique of transferring finance from the poorest individuals and communities at the bottom class of society into the hands of the financial elites at the top.<sup>31</sup> One of the main problems is the fact that almost all microcredit is supplied to employed individuals to meet basic consumption needs, and not to those that require such credit to start new businesses as an income generating project, as was the original microcredit model's intention.<sup>32</sup> However, the consumption needs are regarded as a necessity by these low-income earners, who often out of desperation proceed to sign contracts for credit without fully understanding them.<sup>33</sup> Low-income consumers may not have finished school, with English not being a first language, ultimately creating a reaction of being overwhelmed by the length of contracts and the language used in them.<sup>34</sup> These low-income consumers may also not have a network of family or friends to assist them in difficult financial times due to having low-incomes themselves.<sup>35</sup> Furthermore, there has been a mistaken belief that commercialised MFIs would obediently stick to their declared mission and thus responsibly lend to consumers.<sup>36</sup> It has however arisen that certain MFIs in South Africa have been deliberately targeting vulnerable and exploited individuals.<sup>37</sup> This only increases South Africa's position as one of the most unequal countries in the world. As one of South Africa's financial analysts once stated: '[c]redit made available to households in South Africa is anything but developmental.'<sup>38</sup> Many debtors are unable to afford to pay back loans at the end

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<sup>30</sup> David Porteous & Elizabeth Hazelhurst *Banking on Change: Democratising Finance in South Africa, 1994-2004 and Beyond* (2004) 77.

<sup>31</sup> Bateman op cit note 1 at 99-100.

<sup>32</sup> Meagher P 'Microfinance regulation in South Africa: A comparative perspective' *Development Bulletin* (2002) 57.

<sup>33</sup> Wilson et al. op cit note 8 at 125.

<sup>34</sup> Ibid at 123.

<sup>35</sup> Ibid at 125.

<sup>36</sup> Bateman op cit note 1 at 126.

<sup>37</sup> Ibid at 132.

<sup>38</sup> Melzer I 'Banks exploit financial illiteracy of clients' *BD Live* 3 December 2013, available at <http://www.bdlive.co.za/opinion/2013/12/03/banks-exploit-financial-illiteracy-of-clients>, accessed on 17 November 2018.

of the month, which results in repeated loans being taken out to finance the original loans, adding to the high costs of credit.<sup>39</sup> The high price of small credit for low-income consumers increases over-indebtedness and perpetuates poverty.<sup>40</sup> This is particularly concerning as poverty alleviation is a government priority and low-income consumers are especially vulnerable to the economic conditions in South Africa.<sup>41</sup> It is the poor who borrow small amounts of money and who pay the most for credit, and ultimately who have little voice in policy making to address these concerns.<sup>42</sup> It is thus of paramount importance that low-income consumers are aware of their rights and know where to turn to for redress or assistance from competent governmental policies.<sup>43</sup>

South Africa's primary credit legislation, the NCA, is intended to be the source of protection for these low-income consumers. Although the NCA has been powerless with regards to informal money lending and associated informal credit agreements,<sup>44</sup> it does govern formal microcredit. Section 3 of the NCA sets out that 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.'<sup>45</sup> This effectively demands that not only should the low-income segment of the population have access to credit, but any credit handed out must be done so responsibly in order to prevent too readily available cash which can finance a consumption driven society. The NCA further created the National Credit Regulator (NCR) whose purpose is to 'promote and support the development, where the need exists, of a fair, transparent, competitive, sustainable, responsible, efficient, effective and accessible credit market and industry to serve the needs of historically disadvantaged persons, low income persons and communities, and remote, isolated or low density populations and communities, in a manner consistent with the purposes of this Act.'<sup>46</sup> The NCR thus ensures that credit lending is responsible and made accessible. However, South

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<sup>39</sup> Jonathan Campbell 'The Excessive Cost of Credit on Small Money Loans under the National Credit Act 34 of 2005' (2007) 19 *SA Merc LJ* 251 at 268.

<sup>40</sup> Campbell *op cit* note 27 at 472.

<sup>41</sup> *Ibid.*

<sup>42</sup> Campbell *op cit* note 39 at 262-263.

<sup>43</sup> Wilson et al. *op cit* note 8 at 130.

<sup>44</sup> James *op cit* note 6 at 28. Note that stokvels are expressly excluded from the NCA in s 8(2)(c).

<sup>45</sup> Section 3 of the NCA.

<sup>46</sup> Section 13(a) of the NCA.

Africa's legislators still face significant challenges in ensuring that these primary aims of the NCA, relating to responsible and accessible credit, are balanced. It is essential that the regulatory framework governing the microcredit industry gives effect to this balance and does not militate against the NCA's goals. Ultimately, this is a crucial factor in ensuring that the socio-economic experiences of South Africans are protected and advanced. The financial and social circumstances of members of society can be improved through equitable access to credit in financing businesses, education, and emergency healthcare. However, it can just as easily be destroyed with irresponsible access to credit.

I shall consequently address the following matters in this dissertation: First, what the objectives are of the NCA relating to microcredit are, namely promoting accessible and responsible credit. Secondly, what shortcomings the NCA faces with regard to its microcredit regulations that attempt to give effect to such objectives. Lastly, by referring to a case study based on Bangladesh and its comparable experiences with the microcredit industry, I will identify what potential amendments could be made to the legislative framework.

#### *Objectives of the Research and Significance of the Study*

In this dissertation I shall highlight the shortcomings of the microcredit regulations in the NCA to develop proposals that ensure that the microfinance regulatory framework is not only made sensible on paper but in practice. Furthermore, it is hoped that these proposals will reflect a prosperous reality for South Africa's socio-economic context, at present and in the future. Through analysing South Africa's unique context, and drawing on experiences of the microcredit industry in Bangladesh (a similar developing country), I shall contribute to South Africa's policy framework in making recommendations on amendments. These recommendations will support the objective of giving effect to the aims of the NCA relating to equally accessible and responsible credit and in ensuring that the social and economic welfare of South African citizens are advanced.

Research into this topic is essential for two reasons: The first reason is that it is a necessary contribution to the literature on microfinance in South Africa. Not only will this dissertation focus on highlighting all the main aspects of microcredit regulation in South Africa, but it will also tell a cohesive story from the introduction of microcredit regulation to present-day recommendations on the improvements of such. The second reason is that this dissertation will contribute to policy reform in South Africa, intended to be a feed for further research and action on creating amendments to the microcredit policy framework. In sum, this dissertation will have both theoretical and practical significance.

### *Research Questions*

In Chapter 2 of this dissertation, the first research question that I will be considering is what the objectives of the NCA regulations on microcredit are, namely those set out in s 3 of the NCA relating to accessible and responsible credit. This entails a grammatical interpretation, but also a value based, contextual and purposive approach to statutory interpretation which looks at the purpose for which and context in which microlending was introduced in South Africa, and how its role remains essential today in current socio-economic conditions. In Chapter 3, the second research question explores what the shortcomings of the NCA regulations on microcredit are, focusing on interest rates, service fees and initiation fees and how each rate or fee subsequently affects accessible and responsible access to microloans. Although these rates and fees are essential to the upkeep of the microcredit industry, they require vast re-evaluation to maintain a balance between the interests of both creditors and debtors. The 2016 NCA regulations 39 to 48 have generally reduced the cost of credit in terms of interest rates, but the introduction of the initiation fee and service fees has increased the cost of credit, particularly for short-term credit transactions.<sup>47</sup> In Chapter 4, the third research question looks at what lessons could be drawn from an analogous developing country with a similar socio-economic, political and historical background. This aspect

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<sup>47</sup> Campbell op cit note 27 at 462.

of the dissertation will be based on a comparative case study on Bangladesh, where the success and failures of the microcredit system in this country will be analysed. I have chosen Bangladesh due to its long history in the microcredit industry, its comparable socio-economic context and political past, and its genuine commitment to the success of microcredit in search of a developmental framework. Chapter 5 introduces the fourth research question, which looks at what potential amendments could be made to the regulations on microcredit in South Africa in order to promote accessible and responsible credit. Chapter 4's findings will be used here in considering what lessons and perspectives could be of use to the South African microcredit industry. These amendments will also take into account the analysed objectives of the NCA along with the identified shortcomings that require modification to realise such objectives.

### *Methodology and Theory*

The methodology used in this dissertation shall be based on desktop research. This involves consideration of journal articles written by scholars in this field, as well as textbooks, online books, reports and web-based articles on views pertaining to the microfinance industry. There will also be a strong relation to the NCA, with an analysis of its microcredit regulations. Furthermore, legislation will also be used in the Bangladesh case study and in any general referrals to the South African legislative framework.

Regarding Chapter 4, it is important to understand what case study research entails. It is a qualitative approach in which one investigates a bounded system over time through data collection involving multiple sources of information, ultimately reporting a case description or theme.<sup>48</sup> Put more simply, comparative analysis involves comparing the law of one country to that of another country and then assessing how the two legal systems are similar or different.<sup>49</sup> In a single instrumental

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<sup>48</sup>John W. Creswell 'Chapter 4: Five Qualitative Approaches to Inquiry' *Qualitative inquiry and research design: choosing among five approaches* 3 ed (2013) 73.

<sup>49</sup>Edward J. Eberle 'Comparative Law' (2007) 13 *Ann. Surv. Int'l & Comp. L.* 93.

case study, the researcher is to focus on a single issue while subsequently selecting a bounded case (in this case, country) to represent this issue.<sup>50</sup> It is noteworthy though that case studies acknowledge that there can be no generalisations from one case to another as the contexts of cases will differ.<sup>51</sup> A case study method is therefore used in this dissertation to investigate the legislative microcredit policy space in Bangladesh that may be useful in comparing South Africa's microcredit regulation.<sup>52</sup>

With regards to the matter of context in this dissertation, there is often a distinction made between the law itself and the context in which laws are applied in practice. This is why it is of paramount importance to study the legal culture of a country to see what rules apply, how they function and how effective they are.<sup>53</sup> There are underlying forces that operate within society to help form and influence the law and give it substance,<sup>54</sup> and the law is therefore never set in a purely black letter or hard positivist space. Positivism is described as a separation between law and morals, in that legal rules exist as they are rather than what we think they should be.<sup>55</sup> However, a positivist studies the morals of society when evaluating the law of a society, even though the approach will be more scientific than narrative.<sup>56</sup> In contemporary times, there has come to be a new stream of positivism, namely soft legal positivism which accords due respect to the constrained role of moral considerations in adjudication.<sup>57</sup> It also, however, recognises the institutional constraints in society on legal rule-making.<sup>58</sup> As stated by legal positivist philosopher H.L.A. Hart, a conceptual analysis of the words is important to sharpen the awareness of the words.<sup>59</sup> Furthermore, legal positivist philosopher Joseph Raz has admitted that '[W]e do not want to be slaves of words. Our aim is to understand society and its institutions.'<sup>60</sup> Soft positivism therefore does create the conceptual space in which the law may be judged morally and politically, however, it is silent on the outcome of the question of political morality.<sup>61</sup>

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<sup>50</sup> Creswell op cit note 48 at 74.

<sup>51</sup> Ibid.

<sup>52</sup> Yin, R. K. *Case study research: Design and method* 3 ed (2003) 13.

<sup>53</sup> Eberle op cit note 49 at 95.

<sup>54</sup> Ibid at 97.

<sup>55</sup> Herbert Hovenkamp 'Positivism in Law & (and) Economics' (1990) 78 *Cal. L. Rev.* 815 at 818.

<sup>56</sup> Ibid.

<sup>57</sup> Brian Leiter 'Positivism, Formalism, Realism' (1999) 99 *Colum. L. Rev.* 1138 at 1139.

<sup>58</sup> Hovenkamp op cit note 55 at 820.

<sup>59</sup> Yin op cit note 52 at 14.

<sup>60</sup> Joseph Raz 'Legal Positivism and the Sources of Law' in *The Authority of Law* (1979).

<sup>61</sup> Leiter op cit note 57 at 1160.

On the other hand, legal realism refers to the awareness of the flaws and limitations of judges who sometimes make choices based on their own political and moral views.<sup>62</sup> Accordingly, the creation of law can also be influenced by these political and moral influences in society.

In this dissertation, I therefore adopt a positivist, black letter approach to evaluating legislative regulations and their amending, while also adopting a law-in-context, realist approach to understand the context in which these regulations govern. This may be considered soft positivism, but the appropriate method of inquiry is one that tests the law in action, makes a comparative analysis and acknowledges that commercial law should reflect commercial practice by considering the context in which it operates.

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<sup>62</sup> Brian Z. Tamanaha 'Understanding Legal Realism' (2009) 87 *Tex. L. Rev.* 731 at 732.

## CHAPTER TWO

### OBJECTIVES IN THE NCA AND THEIR MICROCREDIT CONTEXT

#### *Purpose of Act*<sup>63</sup>

3. The purposes of this 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, by-

- (a) promoting the development of a credit market that is accessible to all South Africans, and in particular to those who have historically been unable to access credit under sustainable market conditions;
- (b) ensuring consistent treatment of different credit products and different credit providers;
- (c) promoting responsibility in the credit market by-
  - (i) encouraging responsible borrowing, avoidance of over-indebtedness and fulfilment of financial obligations by consumers; and
  - (ii) discouraging reckless credit granting by credit providers and contractual default by consumers;
- (d) promoting equity in the credit market by balancing the respective rights and responsibilities of credit providers and consumers;
- (e) addressing and correcting imbalances in negotiating power between consumers and credit providers by-
  - (i) providing consumers with education about credit and consumer rights;
  - (ii) providing consumers with adequate disclosure of standardised information in order to make informed choices; and
  - (iii) providing consumers with protection from deception, and from unfair or fraudulent conduct by credit providers and credit bureaux;
- (f) improving consumer credit information and reporting and regulation of credit bureaux;
- (g) addressing and preventing over-indebtedness of consumers, and providing mechanisms for resolving over-indebtedness based on the principle of satisfaction by the consumer of all responsible financial obligations;
- (h) providing for a consistent and accessible system of consensual resolution of disputes arising from credit agreements; and
- (i) providing for a consistent and harmonised system of debt restructuring, enforcement and judgment, which places priority on the eventual satisfaction of all responsible consumer obligations under credit agreements.

#### *Statutory Interpretation*

The purpose of this chapter is to use statutory rules of interpretation to understand the objectives of the NCA in a more detailed light as well as assess the context in which these objectives, and their association with microcredit, came about. This is an important task if one seeks to successfully amend current regulations on microcredit

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<sup>63</sup> Section 3 of the NCA.

as one first apprehends what such amendments should look like in order to give effect to the objectives of the NCA. The task of interpreting legislative provisions is not an easy exercise, but interpretation is something that people subconsciously do on a daily basis, such as interpreting body language.<sup>64</sup> We are constantly required to ‘read between the lines’ to understand the proper meaning of things.<sup>65</sup> With regards to interpreting the wording of statutes, the meaning of a word is derived from the total structure of the language, including the context in which the language is used.<sup>66</sup> However, this contextual approach was not always the approach taken by the legal profession. Originally, an orthodox text-based approach was used by legal professionals to interpret statutes, which focused principally on the literal meaning of the legislation.<sup>67</sup> The idea was that if the meaning of the text was clear, it was to be applied exactly as to the intention of the legislature.<sup>68</sup> If the meaning of the text was unclear, or if a strict literal interpretation would result in ambiguity, then the court could use the so-called ‘golden rule’ to deviate from the literal meaning and attend to ‘secondary aids’ of interpretation to determine the intention of the legislature.<sup>69</sup> ‘Secondary aids’ include the headings of sections, the long title of the statute, and the text in another official language.<sup>70</sup> Only where these secondary aids to interpretation were insufficient could one turn to ‘tertiary aids’ such as common law presumptions where context becomes relevant.<sup>71</sup> This was a form of structuralism where the meaning of the language was deemed to be ascertained from the grammatical structure<sup>72</sup> and the intention of the legislature was gathered from the literal meaning of the text.<sup>73</sup>

On the other hand, the text-in-context approach to statutory interpretation states that ‘the purpose of the legislation is the prevailing factor in interpretation’ and that the political and social context must therefore be taken into account.<sup>74</sup> This

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<sup>64</sup> Christo Botha *Statutory Interpretation: An introduction for students* 5 ed (2012) 83.

<sup>65</sup> Ibid.

<sup>66</sup> Ibid at 85; *Investigating Directorate: Serious Economic Offences and Others v Hyundai Motor Distributors (Pty) Ltd and Others: In Re Hyundai Motor Distributors (Pty) Ltd and Others v Smit No and Others* 2001 (1) SA 545 (CC) para 21; *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA) para 17.

<sup>67</sup> G E Devenish *Interpretation of Statutes* (1992) 28. Also see for example *R Koster & Son Pty Ltd & another v CIR* 47 SATC 24.

<sup>68</sup> *Principal Immigration Officer v Hawabu* 1936 AD 26.

<sup>69</sup> *Grey v Pearson* (1857) 6 HL Cas 61, 106; *Venter v R* 1907 TS 910 914.

<sup>70</sup> Botha op cit note 64 at 91.

<sup>71</sup> Devenish op cit note 67 at 28.

<sup>72</sup> Botha op cit note 64 at 88.

<sup>73</sup> Ibid at 93.

<sup>74</sup> Ibid at 97.

approach requires a purpose-orientated perspective which always recognizes context, not only in cases where a text-based approach has been unsuccessful.<sup>75</sup> However, it is noteworthy that this approach still requires a balance between the grammatical and contextual meanings.<sup>76</sup> An approach to statutory interpretation that completely ignores the text of the legislation is a threat to the separation of powers and the rule of law.<sup>77</sup> This is because an interpretation that completely ignores the text created by parliament threatens a situation arising where the judiciary is deemed to be overriding the intention of the legislature and disrespecting its powers. It may also be seen as counter-majoritarian as the unelected judiciary appears to be overriding the elected legislature's will. Accordingly, courts must respect the legislation that parliament enacts, ensuring that personal bias disguised as a contextual analysis does not have a prejudicial influence.<sup>78</sup> Courts have thus been willing to use this wide interpretation power but have been conscious of its limits<sup>79</sup> to avoid circumstances in which the legislature cannot predict how its laws will be interpreted.<sup>80</sup>

This context-based approach has, however, been mandated by s 39(2) of the 1996 Constitution,<sup>81</sup> as well as by the Constitutional Court itself.<sup>82</sup> Section 39(2) of the Constitution, the so-called 'interpretation of statute clause,' provides that 'when interpreting any legislation, and when developing the common law or customary law, every court, tribunal or forum must promote the spirit, purport and objects of the Bill of Rights.' This mandatory provision means that statutory interpretation therefore has to be conducted with the values of the Constitution in mind.<sup>83</sup> Sections 36(1) and 39(1) of the Constitution refer to these values, relating to an open and democratic society based on freedom, equality and human dignity. It is noteworthy though that this

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<sup>75</sup> Devenish op cit note 67 at 36.

<sup>76</sup> Ibid at 37.

<sup>77</sup> Michael Bishop & J Brickhill "'In the beginning was the word': the role of text in the interpretation of statutes" (2012) 129 *SALJ* at 715.

<sup>78</sup> Ibid at 691. See also *S v Jordan and Others (Sex Workers Education and Advocacy Task Force and Others as Amici Curiae)* (CCT31/01) [2002] ZACC 22.

<sup>79</sup> Bishop & Brickhill op cit note 77 at 687.

<sup>80</sup> Ibid at 699.

<sup>81</sup> Constitution of the Republic of South Africa, 1996 (hereinafter 'the Constitution').

<sup>82</sup> *Bato Star Fishing (Pty) Ltd v Minister of Environmental Affairs and Tourism* 2004 (4) SA 490 (CC); *Khosa and Others v Minister of Social Development and Others*; *Mahlaule and Others v Minister of Social Development and Others* 2004 (6) SA 505 (CC); *Government of RSA v Grootboom* 2001 (CC); *Doctors for Life International v Speaker of the National Assembly and Others* (CCT12/05) [2006] ZACC 11; *Jaftha v Schoeman and Others, Van Rooyen v Stoltz and Others* 2005 (2) SA 140 (CC).

<sup>83</sup> Botha op cit note 64 at 99.

context-based approach in s 39(2) of the Constitution also does not envisage that the meanings for statutes bear no relation to their words.<sup>84</sup> Extra-textual factors are still considered in preference to the legislative text.<sup>85</sup> As stated by Ngcobo J in *Bato Star Fishing (Pty) Ltd v Minister of Environmental Affairs and Tourism*:<sup>86</sup> ‘The emerging trend in statutory construction is to have regard to the context in which the words occur, even where the words to be construed are clear and unambiguous.’<sup>87</sup> Furthermore, since the values underlying the Constitution are not absolute, interpreting statute is about balancing conflicting rights and values too.<sup>88</sup> This balance of conflicting interests is thus required when interpreting the objectives in the NCA.<sup>89</sup>

When considering the text of s 3 of the NCA which sets out the objectives of the NCA, the wording is quite clear and unambiguous. It seems that there are three main objectives set out. The first primary objective is to ‘promote and advance the social and economic welfare of South African citizens.’<sup>90</sup> The second primary objective is to ‘promote a fair, transparent, competitive, sustainable, responsible, efficient, effective and accessible credit market and industry.’<sup>91</sup> The third primary objective is to protect consumers in a number of ways, as listed in the relevant subsections. Textually, these three objectives are separately listed, but contextually these three objectives are very much interlinked and lead to the same intention. Protecting consumers and promoting an accessible and responsible credit market both adds to the social and economic welfare of South Africans. Microcredit is understood to be a primary contributor to social and economic inclusion for South Africans, thus essentially being directed by these objectives. To completely understand this link though, the context in which microcredit was introduced and its contributing factors to social and economic inclusion must be analysed. It is here where we can begin to understand how microcredit has sought to comply with these objectives in the NCA by creating a fair, transparent, competitive, sustainable, responsible, efficient, effective and accessible credit market and industry. Importantly, microcredit also

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<sup>84</sup> Bishop & Brickhill op cit note 77 at 716.

<sup>85</sup> Botha op cit note 64 at 101.

<sup>86</sup> 2004 (4) SA 490 (CC).

<sup>87</sup> Ibid at paras 72, 80 and 90.

<sup>88</sup> Botha note 64 at 103. See also *Nkata v Firstrand Bank Limited and Others* (CCT73/15) [2016] ZACC 12 where the court spoke much about the need to balance rights and interests.

<sup>89</sup> Act 34 of 2005.

<sup>90</sup> Section 3 of the NCA.

<sup>91</sup> Ibid.

seeks to protect consumers by promoting an accessible credit market ‘to all South Africans, and in particular to those who have historically been unable to access credit under sustainable market conditions.’<sup>92</sup> Again, this leads to uplifting both the social and economic welfare of South Africans. Given that the rules of statutory interpretation require a contextual analysis, this chapter will continue to assess the context in which the microcredit industry was enacted and remains functional today. It is based on this context that we understand how microcredit gives effect to the objectives of the NCA.

### *Contextual Analysis*

#### *Background*

In the year 2012, South Africa was jointly ranked first in the ‘Doing Business’ World Bank Report in ‘getting credit’ i.e. highest access to credit.<sup>93</sup> This is a testament to both South Africa’s great access to credit but also the consumption driven credit market that has left a debt-stressed population.<sup>94</sup> A more accurate reality of South Africa’s economy, however, is that its Gini coefficient is amongst the highest in the world with great income disparity between the rich and poor.<sup>95</sup> South Africa still faces a number of challenges today, mainly related to poverty, unemployment and income inequality.<sup>96</sup> The country essentially has two economies that are vastly divided in terms of class, race and employment. The first economy is assumed to be a sophisticated, advanced economy based on skilled labour and secure employment.<sup>97</sup> The second is

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<sup>92</sup> Section 3(a) of the NCA.

<sup>93</sup> BANK SETA ‘From Microfinance to Financial Inclusion’ *The Microfinance Review 2013* 11.

<sup>94</sup> *Ibid.*

<sup>95</sup> *Ibid* at 13.

<sup>96</sup> Pamhidzai Bamu, Joachim Schuckman & Shane Godfrey ‘The National Credit Act: Will it increase access to credit for small and micro enterprises?’ (2007) 11 *Law Democracy & Dev.* 33.

<sup>97</sup> *Ibid.* Note, however, that this narrative is challenged by some anthropologists. In this regard, the idea of a ‘popular’ economy is that it avoids this dialectic due to the fact that the formal sector influences the informal sector and vice versa. For the purposes of explaining the economic inequality gap, however, the separate economy narrative is used here.

known as a marginalised, mainly informal, and unskilled economy populated by the unemployed or informally employed.<sup>98</sup> Policies and programmes have therefore been introduced to try and bridge this inequality gap, one of them being the financial project of microlending.<sup>99</sup> Microlending, as previously stated, is an industry that seeks to give low-income persons access to a range of financial services.<sup>100</sup> These financial services are offered at the low end of the market by different categories of suppliers.<sup>101</sup> There are seven categories of suppliers of microfinance services in South Africa: microenterprise lenders; salary-based microlenders; co-operative financial institutions such as commercial banks; alternative banks; affordable housing finance suppliers; and retailers.<sup>102</sup> Furthermore, although access to financial services under microcredit immediately assumes merely access to credit, it is also about including access to savings and insurance, which are other forms of financial services that become more accessible once the credit market has opened up.

With regard to the divide between the poor and wealthy, South Africa's two economies are essentially based upon the South African financial services sector which includes both formal and informal providers.<sup>103</sup> Formal financial service providers adhere to sanctioned laws and regulations, and examples of such include large banks.<sup>104</sup> Although generally available in South Africa's urban regions, formal services are often unsuited to the needs and circumstances of the poor who may find formalized banking incomprehensible and intimidating.<sup>105</sup> This is somewhat attributable to South Africa's legislative framework being detached from the circumstances of those whom it serves, but is also a result of the general assumptions about the country's commercial banks.<sup>106</sup> The informal financial services sector is large and can include anything from 'stokvels'<sup>107</sup> to burial societies and loans from

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<sup>98</sup> Ibid.

<sup>99</sup> Ibid.

<sup>100</sup> Mashigo op cit note 14 at 32.

<sup>101</sup> Porteous & Hazelhurst op cit note 30 at 78.

<sup>102</sup> BANK SETA op cit note 93 at 12.

<sup>103</sup> Greg Skowronski 'The Microcredit Sector in South Africa: An Overview of the History, Financial Access, Challenges and Key Players' *Paradigm Shift* at 2.

<sup>104</sup> Ibid.

<sup>105</sup> Ibid.

<sup>106</sup> Ibid.

<sup>107</sup> Stokvels are a form of a rotating savings club, commonly known for in South Africa. A group of individuals will agree to regularly contribute an amount of money from which they will each receive a lump sum payment at an agreed time. 'Stokvel' is also defined in s 1 of the NCA.

mashonisas within communities.<sup>108</sup> This sector is defined by lack of adherence to any laws.<sup>109</sup> Research shows though that a relationship with the formal or informal financial services is generally correlated to income.<sup>110</sup> In South Africa, income is closely related to race, and race, although genetic, is also of influence in history and culture.<sup>111</sup> These factors therefore all interlink and play a role in household decisions on whether the unregulated financial sector is more convenient and better understood or whether people are more trusting of the formal sector.<sup>112</sup>

In the developing world, a large segment of the poor population lives beyond the scope of their nation's legal system,<sup>113</sup> living in the so-called 'informal sector' as expressed above. This is of particular concern, as it is believed that the law under the formal sector is one of the main mechanisms in controlling societal action and creating development.<sup>114</sup> As a result of the realities of poverty, people living in the developing world find alternative means of participating in the commercial sector through informal, accessible and inexpensive forums.<sup>115</sup> Although this alternative might seem to be a generally logical route to take, it in fact creates major implications for the economic framework of a country. Due to these alternatives used as informal ways of participation, the poor become more and more disconnected from the formal sector, eventually without any way of escaping from such. For instance, without original access to the formal sector, if someone were to eventually seek access to the formal sector through a loan of sorts, they would have difficulty in proving credit histories or establishing access to bank accounts.<sup>116</sup> Because they remain marginalised in this way, there is little opportunity to escape poverty through credit loans, especially when accessing credit loans helps decrease exposure to unpredictable events like illness, food insecurity and death.<sup>117</sup> A formal framework does, however, need to be readily accessible and appealing to the poor should they feel comfortable in participating and trusting such a framework to help them escape the realms of poverty. Therefore,

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<sup>108</sup> Skowronski op cit note 104 at 2.

<sup>109</sup> Ibid.

<sup>110</sup> Ibid.

<sup>111</sup> Ibid.

<sup>112</sup> Ibid.

<sup>113</sup> Karol C. Boudreaux 'The Legal Empowerment of the Poor: Titling and Poverty Alleviation in Post-Apartheid South Africa' (2008) 5 *Hastings Race & Poverty L.J.* 309 at 312.

<sup>114</sup> Dave Kruger 'Fighting Poverty with Property Law' *Asian Development Bank Review* (2003).

<sup>115</sup> Boudreaux op cit note 113 at 312.

<sup>116</sup> Ibid.

<sup>117</sup> Mashigo op cit note 14 at 24.

empowering the poor essentially requires meaningful changes to the legal framework.<sup>118</sup> This is about empowering individuals to make decisions to use resources under their control, thereby shifting responsibility and countering systems that see the poor as incapable or undeserving of managing their own financial assets.<sup>119</sup> In this regard, the poor no longer need to reject capitalism as an enemy that has abandoned them, because capitalism is now working for them too in creating a safe space of participation.<sup>120</sup> This again highlights the role of culture in the economy. Although cultural practices are seen to be ‘informal,’ culture carries extremely valuable elements of trust and comfortability which can be used as a tool to formalise practices. Ultimately, formalisation is said to be ‘a path to legal empowerment’ and legal empowerment helps people become economically productive in numerous ways.<sup>121</sup>

On the other hand, to escape from the informal sector in South Africa is not simple. Apartheid still has long lasting effects that have created inhibiting circumstances which are difficult to change. For instance, during apartheid, the government increased the rent of government-provided housing, occupied by people of colour who had little access to employment, thus making it almost impossible for them to fulfil their debt commitments.<sup>122</sup> This eventually led to widespread protest where renters either refused to pay the increase or stopped paying rent in boycott.<sup>123</sup> Therefore, as the rate of default increased, formal sector banks grew wary of lending in townships.<sup>124</sup> Not only did this create a lack of trust and presence of banks operating in townships, but the poor, mostly black, segment of the population in return grew highly distrustful of formal financial institutions. When commercial banking services are seen as untrustworthy, intimidating and too costly, people tend to develop ‘self-help’ institutions to access capital.<sup>125</sup> In fact, some studies have found that small businesses in South Africa are often financed with personal savings or stokvels rather than commercial loans as people trust themselves or the community more than they

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<sup>118</sup> Boudreaux op cit note 113 at 310.

<sup>119</sup> Ibid at 333-334.

<sup>120</sup> Bateman op cit note 1 at 98.

<sup>121</sup> Hernando De Soto *The Mystery of Capital* (2002) 7.

<sup>122</sup> Boudreaux op cit note 113 at 321-322.

<sup>123</sup> Ibid.

<sup>124</sup> Ibid at 322.

<sup>125</sup> Ibid.

trust commercial banks.<sup>126</sup> Peer pressure from the community is a major aspect of influence in rural communities,<sup>127</sup> whereas this kind of personal relationship cannot be created with commercial banks. Lending, on the other hand, is also hindered by risk assessment, as it is based on credit histories which rule out many people, including micro entrepreneurs, because they lack documented credit histories or are too overwhelmed by the paperwork.<sup>128</sup> Therefore, issues related to risk assessment, trust and perceived complexity of the paperwork involved create institutional barriers or social norms held against formal institutions, that may be difficult to overcome.<sup>129</sup> Provided that these disincentives to formalise remain, the poor will continue to prefer using personal savings and self-help institutions to finance their livelihood or to start up small businesses.

### *Introduction of the Regulatory Framework*

Credit has played an important role in society for decades, and legislation governing usurious interest rates has thus existed from a very early stage.<sup>130</sup> In South Africa, certain types of credit were regulated by different provincial legislation until the first usury statute was enacted in 1926.<sup>131</sup> This Act was then drastically amended and named the Usury Act of 1968.<sup>132</sup> The purpose of this Act was to place limitations and responsibilities on microlenders to protect consumers from usurious exploitation.<sup>133</sup> However, it ended up having the unintended consequence of excluding the low-income group of the South African population from access to credit.<sup>134</sup> This legislation was also implemented during apartheid and therefore entailed the exclusion of the

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<sup>126</sup> Ibid at 336-337.

<sup>127</sup> Ibid at 337.

<sup>128</sup> Jaffer J 'Microfinance and the mechanics of solidarity lending: Improving access to credit through innovations in contract structure' (1999) *Transnational Law and Policy* 183.

<sup>129</sup> Boudreaux op cit note 113 at 339.

<sup>130</sup> Michelle Kelly-Louw & Philip N Stoop *Consumer Credit Regulation in South Africa* (2012) 7.

<sup>131</sup> Ibid; the Usury Act 37 of 1926.

<sup>132</sup> Ibid; Act No. 73 of 1968.

<sup>133</sup> Mashigo op cit note 14 at 34-35.

<sup>134</sup> Kelly-Louw & Stoop op cit note 130 at 8.

country's majority black population.<sup>135</sup> However, the concept of microcredit was beginning to become known as an economic and social experiment in the developing world, often regarded as an 'anti-poverty mechanism.'<sup>136</sup> Possibly being influenced by such, the Minister of Trade and Industry signed the Usury Exemption Notice<sup>137</sup> to the Usury Act into law on the 31 December 1992.<sup>138</sup> This exemption allowed credit providers to charge unregulated interest on small loans so that credit providers could cover the full cost of the loan, making microlending institutions more attractive.<sup>139</sup> This resulted in the emergence of commercial microlending in South Africa and subsequently an improved rate of access to credit.<sup>140</sup> On the other hand it also resulted in the exploitation of desperate and vulnerable borrowers, contributing significantly to their over-indebtedness.<sup>141</sup> By the Minister's signature, the microlending industry was now legitimized, making possible 'limitless profit' for lenders 'unbounded by any finance charge at all.'<sup>142</sup> The reality that apartheid was falling and that the ANC government would be left with a bitter legacy of a disorientated and failing economy meant that a radical and far-reaching programme, such as microfinance, was desperately needed.<sup>143</sup> Although moshonisas had been around for a long time,<sup>144</sup> there was now a formal credit industry that provided small-scale loans and spoke to the needs of a growing upward and increasingly mobile urban population that had been largely excluded from the mainstream banking sector.<sup>145</sup> Thus, even though South Africa has a long history of community-based self-sustainable finance, the commercial microcredit model was seen as radically better.<sup>146</sup>

Under the enthusiasm for microcredit, a number of international development microcredit programmes were established in South Africa such as the Get Ahead Foundation (GAF) and the Small Enterprise Foundation (SEF).<sup>147</sup> By the early 2000s,

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<sup>135</sup> Patrick Meager 'Microfinance Regulation in South Africa' (2005), available at <http://www.microfinancegateway.com/content/article/detail/25525>, accessed on 21 March 2018.

<sup>136</sup> Whittaker op cit note 22 at 561-562.

<sup>137</sup> GN 3451 of 31 December 1992.

<sup>138</sup> Kelly-Louw & Stoop op cit note 130 at 8.

<sup>139</sup> Meager op cit note 135.

<sup>140</sup> Porteous & Hazelhurst op cit note 30 at 77.

<sup>141</sup> Kelly-Louw & Stoop op cit note 130 at 8.

<sup>142</sup> Yacoob J in *AAA Investments (Pty) Ltd v The Micro-finance Regulatory Council & the Minister of Trade and Industry* 2006 (11) BCLR 1255 (CC) in paras 9-10.

<sup>143</sup> Bateman op cit note 1 at 117.

<sup>144</sup> Porteous & Hazelhurst op cit note 30 at 79.

<sup>145</sup> Kelly-Louw & Stoop op cit note 130 at 3.

<sup>146</sup> Bateman op cit note 1 at 117.

<sup>147</sup> *Ibid* at 118.

the microcredit model had become the most high profile and well financed international developmental policy of all time.<sup>148</sup> Former United Nations Secretary General Kofi Annan had been quoted as stating that access to credit ‘helps alleviate poverty by generating income, creating jobs and allowing access to schools and healthcare’ which supported the interest in microcredit as a developmental tool.<sup>149</sup> Commercial banks that traditionally did not serve low-income earners and that were reluctant to enter the microcredit market due to the high costs involved were now also becoming interested in offering small loans.<sup>150</sup> This exemption to the Usury Act did not last long though. In 1999 the Microfinance Regulatory Commission (MFRC) was established which, through a technical committee in 2002, identified several problems with the existing credit legislation.<sup>151</sup> These were that it provided ineffective consumer protection for low-income groups; credit costs were still too high; and some credit providers were engaging in reckless behaviour.<sup>152</sup> It soon became a concern that the introduction of microcredit was having little impact on poverty, inequality and social exclusion.<sup>153</sup> Therefore, after careful consideration of this report, the Department of Trade and Industry drafted the ‘Consumer Credit Policy Framework’ which subsequently led to the drafting of the National Credit Bill.<sup>154</sup> As a result of such, the South African Government passed the NCA which came into effect in 2007, officially repealing both the Usury Law of 1968 and the Usury Law Exemption of 1992.<sup>155</sup>

According to the then Minister of Trade and Industry, Mandisi Mphahla, the original purpose of the NCA was to ‘promote a credit market that is fair, transparent, accessible and responsible. It also aims to promote a market that is competitive and sustainable... It specifically prohibits practices such as reckless lending and automatic increases in credit limits and regulates interest and fees.’<sup>156</sup> Many formal credit providers objected to a number of provisions on the basis that they imposed costly and

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<sup>148</sup> Ibid at 97.

<sup>149</sup> Jay Lee ‘Equity and Innovation: Using Traditional Islamic Banking to Reinvigorate Microlending in Urban America’ (2006) 16 *Ind. Int’L & Comp. L. Rev.* 524.

<sup>150</sup> Andrie Schoombie ‘South African banks and the unbanked: Progress and prospects’ *Stellenbosch Economic Working Papers* (2004) at 5.

<sup>151</sup> Ciaran Ryan ‘Consumers in the Credit Driver’s Seat’ *Sunday Times* 24 July 2005 at 14.

<sup>152</sup> Ibid.

<sup>153</sup> Bateman op cit note 1 at 118.

<sup>154</sup> Bamu et al op cit note 96.

<sup>155</sup> Kelly-Louw & Stoop op cit note 130 at 3.

<sup>156</sup> Themba Gadebe ‘Ban’ *ALL AFRICA* 1 June 2006.

burdensome obligations on credit providers.<sup>157</sup> However, it was essential that checks and boundaries would be placed on both ends of the credit market for credit providers and debtors. Today it is important that there is a balance struck between access to credit and credit risks which are in fact interlinked.<sup>158</sup> For instance, higher costs of credit likely leads to a higher risk appetite on the part of credit providers, which in turn would result in increased reckless credit providing, higher default rates, and over-indebtedness.<sup>159</sup> On the other hand, lower costs of credit could deter credit providers from providing small loans to the low-income segment of the population, which could create a demand for informal or unregulated credit which could in turn also create exploited and debt-stressed individuals. The objectives of the NCA aim is to strike this balance and it seems that the legislature at the time was aware of the context in which these objectives were to operate. The question, however, is whether the NCA's objectives are actually met when the regulations on microcredit are applied in practice. Therefore, the construction and potential amendments to the microcredit legislative framework need to continuously refer to the above context in which microcredit was introduced in South Africa and continues to operate. Only then will the NCA's objectives be truly met.

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<sup>157</sup> Bamu et al. op cit note 96.

<sup>158</sup> Campbell op cit note 27 at 469.

<sup>159</sup> Ibid.

## CHAPTER THREE

## SHORTCOMINGS OF THE NCA

*The NCA Regulations on Microcredit*

On 6 May 2016, new limits on the cost of credit became effective with the amendment of specific provisions in the NCA under the National Credit Regulations.<sup>160</sup> These amendments focused on changing the maximum permissible interest rates and fees, aiming to reduce the cost of credit for most categories of credit.<sup>161</sup> A reduced cost of credit did seem to occur for most categories, but there was little to no relief for consumers of short-term credit, otherwise known as microlenders, for whom credit had become more expensive.<sup>162</sup> These maximum credit costs do differ according to each subsector of the consumer credit market and are thus considered appropriately for each credit transaction category.<sup>163</sup> Chapter 5 of the Regulations in the NCA sets out the maximum permissible interest rates and other costs of credit, such as service fees and the initiation fee, that may be charged on credit agreements.<sup>164</sup> More specifically, these interest and fee limits are set out in regulations 39 to 48 of the National Credit Regulations. In general, though, the cost of credit, interests, charges and fees are dealt with in sections 100 to 106 of the NCA. Section 101(1) of the NCA provides a closed list of the type of payments that a consumer may be required to make, namely the principal debt; an initiation fee; a service fee; interest; credit insurance; default administration charges; and collection costs. These payments are together referred to as the deferred amount.<sup>165</sup>

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<sup>160</sup> Ibid at 461.

<sup>161</sup> Ibid.

<sup>162</sup> Ibid.

<sup>163</sup> Ibid at 462.

<sup>164</sup> Michelle Kelly-Louw 'The Prevention and Alleviation of Consumer Over-indebtedness' (2008) 20 *S. Afr. Mercantile L.J.* 200 at 216.

<sup>165</sup> Campbell op cit note 39 at 255.

The category divisions of credit transactions have raised a number of concerns, notably around microcredit regulation. As one concern, Jonathan Campbell has highlighted that microloans are categorised as ‘short-term credit transactions’ in the NCA, but that these loans are invariably unsecured, and so it may be necessary to consider them in the different context of ‘unsecured credit transactions.’<sup>166</sup> As previously stated, a short-term credit transaction is defined as ‘a credit transaction in respect of a deferred amount at inception of the agreement not exceeding R8 000, and in terms of which the whole amount is repayable within a period not exceeding six months.’<sup>167</sup> On the other hand, an unsecured credit transaction is defined as ‘a credit transaction in respect of which the debt is not supported by any pledge or other right in property or suretyship or any other form of personal security.’<sup>168</sup> There is no limit as to the amount of the credit transaction or the repayment period and the hallmark of this category is that there is no security for the debt at all.<sup>169</sup> Campbell argues that it is puzzling why it has been ignored that short-term credit is invariably unsecured,<sup>170</sup> and that this cross-over has a great impact when interest rates are concerned.<sup>171</sup> Any unsecured loan that is for less than R8 000 and is repayable over less than six months is classified as a short-term loan, yet it is no less unsecured than an ‘unsecured credit transaction.’<sup>172</sup> The difference in interest rates that exists between unsecured credit transactions and short-term credit, with short-term credit being more than twice the price of unsecured credit transactions, is said to be ‘incomprehensible given that both forms of credit are unsecured.’<sup>173</sup>

Section 105(1) of the NCA provides that the Minister of Trade and Industry may prescribe ‘a method for calculating’ a maximum rate of interest and the maximum fees contemplated in the Act. This means that the Minister of Trade and Industry bears the responsibility for prescribing such credit costs, and is required to consider a number of factors in the process.<sup>174</sup> These factors include:<sup>175</sup> ‘access to credit for

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<sup>166</sup> Campbell *op cit* note 27 at 462.

<sup>167</sup> Regulation 39(2)(a) of the NCA.

<sup>168</sup> Regulation 39(3) of the NCA.

<sup>169</sup> Campbell *op cit* note 39 at 256.

<sup>170</sup> Campbell *op cit* note 27 at 472.

<sup>171</sup> *Ibid.*

<sup>172</sup> *Ibid.*

<sup>173</sup> *Ibid.*

<sup>174</sup> *Ibid.*

<sup>175</sup> Section 105(2) of the NCA.

historically disadvantaged persons, low-income persons and communities, and remote, isolated or low-density populations and communities; conditions prevailing in the credit market, including the cost of credit and the optimal functioning of the consumer credit market; and the social impact on low-income consumers.<sup>176</sup> Although it is not an easy task to consider such factors and decide on the appropriate credit costs for each category of credit, the absence of regulations has far more detrimental consequences. Without regulations, microlenders can, and often do, exploit vulnerable and desperate borrowers of credit and significantly contribute to their over-indebtedness.<sup>177</sup> In fact, by allowing the microlending industry to function without properly regulated credit costs, the government effectively makes it possible for the exploitation of the lower-income segment of the population, which arguably amounts to legislated economic abuse.<sup>178</sup> This brings into question though whether failed credit market regulation also amounts to legislative abuse through negligently, and indirectly, allowing exploitation and over-indebtedness to thrive.

The reference to a ‘failed credit market’ entails sides of an argument from both creditors and debtors. On the one hand, debtors argue that costs of credit are too high for microloans and that they are inadequately regulated. On the other hand, creditors argue that the fees in the regulations relating to microcredit are too stringent and have thus been making it increasingly more difficult for suppliers of credit to make ends meet.<sup>179</sup> Although a low fee structure seems to be good for market access, this is not always accurate as there may be less suppliers of credit that are willing to lend to the low-income segment of the population. Profit margins for these suppliers of credit are in fact being drained by increasing competition from other creditors, compliance requirements by the NCA, and the issue of unemployment in South Africa.<sup>180</sup> In 2012, Micro Finance South Africa (MFSA) identified ten factors which are increasing operational expenses for microlenders.<sup>181</sup> These are: issues relating to debt counselling; protraction of unpaid loan collection; codification of the *in duplum* rule; under-disclosure of living costs; under-disclosure of consumer expenses relating to affordability; higher operational risks due to crime; inaccurate credit data on lower

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<sup>176</sup> Campbell op cit note 27 at 462.

<sup>177</sup> Bamu et al op cit note 96 at 38.

<sup>178</sup> Campbell op cit note 39 at 253.

<sup>179</sup> BANK SETA op cit note 93 at 28.

<sup>180</sup> Ibid at 100.

<sup>181</sup> Ibid.

income consumers; visible growth in the number of non-compliant operators; and value added tax application to loan fees.<sup>182</sup> The MFSA thus argues that the maximum monthly fees in the NCA Regulations, namely the service fees and initiation fees, should be adjusted each year with inflation.<sup>183</sup> On the other hand, the low-income members of society find it more difficult to keep up with these inflation costs.

Furthermore, it has been argued that there are actually several other reasons that commercial banks do not lend to the low-income segment of the population.<sup>184</sup> Some of these include: ‘default rates being high in the low-income market where repossessing homes is also proved to be difficult – this highlights the non-profitable market accompanied by a high-risk environment; sporadic income in the informal sector creating further hesitations to lend; banks charge relatively high fees and provide relatively low returns – this is not attractive to the low-income segment of the population where fees on accounts, deposits and transactions have a huge impact on financial means; the history of defaults in townships has created strong social norms and community action to work together to prevent evictions and repossessions which makes lending a lot more costly and possibly dangerous for banks; and banks may require homeowners seeking home improvement loans to prove that they are using certified artisans – this makes it more costly for the low-income segment of the population and thus makes these types of loans less attainable.’<sup>185</sup> The spread of microlending in South Africa has thus not been as broad as some had originally expected.<sup>186</sup>

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<sup>182</sup> Ibid.

<sup>183</sup> Ibid.

<sup>184</sup> Boudreaux op cit note 113 at 338.

<sup>185</sup> Ibid.

<sup>186</sup> Patrick Meagher & Betty Wilkinson ‘Filling the Gap in South Africa’s Small and Micro Credit Market: An Analysis of Major Policy, Legal, and Regulatory Issues’ *Center for Institutional Reform and the Informal Sector at the University of Maryland, Working Paper No. 02/11* (2002).

### *Interest Rates*

According to s 101(1)(d) of the NCA, the interest rate must be expressed in percentage terms as an annual rate; must be calculated in the prescribed manner; and may not exceed the applicable maximum prescribed rate in terms of s 105 of the NCA. In terms of reg 40, interest may be calculated daily and may be added to the deferred amount monthly. As stated above, money loans fall under different categories of credit transactions introduced by either the Act or the Regulations, each of which has an interest rate limit.<sup>187</sup> The maximum permissible interest rate on short-term credit transactions is 5 per cent per month on the first loan and 3 per cent per month on subsequent loans within a calendar year.<sup>188</sup> The maximum interest rate on unsecured credit transactions is linked to the South African Reserve Bank Repurchase Rate.<sup>189</sup> With regard to short-term loans (microloans) the interest rate reduction from 5 per cent to 3 per cent per month occurs only in the case of second or subsequent loans within the same calendar year. With the onset of each new calendar year the slate is wiped clean and the next loan will be charged at 5 per cent per month. The ill-advised practice of consumers taking out repeated one-month payday loans from the same microlender is common, frequently resulting in permanent debt traps from which consumers rarely escape.<sup>190</sup> Therefore, this reduction in terms of multiple loans assists consumers.

These kinds of regulations not only assist consumers, but it also helps avoid socio-economic hardships for low-income individuals and their respective communities.<sup>191</sup> A high percentage of personal income is often used to service microlending debt, leaving very little of borrowers' personal income to pay for other household necessities.<sup>192</sup> Interest rates are therefore particularly important here and have an impact on financial inclusion. This is due to the fact that interest rates influence borrowing decisions of the consumer, who may or may not be able to afford the rates charged.<sup>193</sup> High interest rates are said to be associated with low levels of financial

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<sup>187</sup> Campbell op cit note 39 at 256.

<sup>188</sup> Regulation 42, Table A of the NCA.

<sup>189</sup> Ibid.

<sup>190</sup> Campbell op cit note 27 at 472.

<sup>191</sup> Campbell op cit note 39 at 252.

<sup>192</sup> Ibid.

<sup>193</sup> BANK SETA op cit note 93 at 23.

inclusion as it increases the cost of borrowing and therefore reduces access to credit for those who are deterred by these costs.<sup>194</sup> It has been argued that the NCA supports financial inclusion by paying attention to the promotion of development credit as well as ensuring that interest rates are controlled and regulated.<sup>195</sup> There are, however, disadvantages of controlled, low interest rates where providers of credit find the return on interest less worthy of the risk of maintaining small loans. Due to the fact that smaller loans are relatively costly it appears that commercialised banks are not willing to enter the MFI market below a certain threshold, which has created a gap in credit delivery for smaller loans.<sup>196</sup>

### *Initiation Fees*

The initiation fee is broadly defined in s 1 of the NCA as a fee in respect of the costs of initiating a credit agreement, but neither the Act nor the Regulations give any further indication of exactly what costs the fee is intended to cover.<sup>197</sup> Practically though, the initiation fee is a once-off payment made by the consumer on conclusion of the credit agreement or charged to the consumer.<sup>198</sup> It may also not exceed the prescribed amount relative to the principal debt.<sup>199</sup> Due to the fact that it is not clear what costs the fee is intended to cover, there are concerns regarding the reason for the existence of the initiation fee.<sup>200</sup> Not only is it not clear what the fee is intended to cover, but it is also almost impossible for consumers to find the necessary cash up front to pay the initiation fee at a time when they are taking out a loan precisely because they are in need of finance.<sup>201</sup> Many debtors of different income levels are thus unable to afford to pay the initiation fee when taking out a loan, particularly in the case of the very poor

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<sup>194</sup> Ibid.

<sup>195</sup> Ibid at 27.

<sup>196</sup> Berry A, et al. 'The Economics of SMMEs in South Africa' *Paper for Trade and Industrial Policy Strategies* (2002) at 74-79.

<sup>197</sup> Campbell op cit note 27 at 463.

<sup>198</sup> Campbell op cit note 39 at 257.

<sup>199</sup> Section 101(1)(b)(i) of the NCA

<sup>200</sup> Campbell op cit note 27 at 472.

<sup>201</sup> Campbell op cit note 39 at 260.

and those who are borrowing money for consumption purposes.<sup>202</sup> However, the Act seems to have anticipated this possibility, providing that the initiation fee may be capitalised. This is, however, then considered a short-term credit transaction, in which case it attracts the appropriate permissible interest.<sup>203</sup> Borrowers of credit are thus forced to accept that the initiation fee will be capitalised and re-paid, possibly in the same number of instalments as the initial loan, subject to the same interest rate as the initial loan taken out.<sup>204</sup> The end result is that the monthly cost of credit increases to a greater extent than anticipated.

The purpose of the initiation fee, it is argued, is to cover expenditures incurred by the credit grantor, rather than to allow the credit grantor to make a profit.<sup>205</sup> Should this be the case, it is puzzling why the charge is called a 'fee' which is often associated with compensation for services rendered.<sup>206</sup> It is also concerning why the expenditures such as credit checks, mortgage bond costs and evaluation costs are not accurately charged according to their actual cost, and that an arbitrary fee is used instead.<sup>207</sup> If one argues that the initiation fee does not cover expenditures only, then it has to be compensating the credit provider with some kind of profitable fee.<sup>208</sup> However, as questioned by Campbell, 'what justification could there be for such compensation, when the lender is already earning interest on the loan *and* charging a monthly service fee?'<sup>209</sup>

Furthermore, even though the real intended purpose of the initiation fee is unknown, there is still an argument made that there should be an inflation-linked increase for the initiation fee.<sup>210</sup> This increase is arbitrary and lacking in sound reasoning when there is not even justification for the fee in the first place.<sup>211</sup> It is therefore argued that the price captured in the initiation fee might as well be built into the interest rate, which would be more appropriate and provide consumers with a

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<sup>202</sup> Ibid.

<sup>203</sup> Campbell op cit note 27 at 463.

<sup>204</sup> Campbell op cit note 39 at 260.

<sup>205</sup> Ibid at 261.

<sup>206</sup> Ibid.

<sup>207</sup> Ibid.

<sup>208</sup> Ibid.

<sup>209</sup> Ibid.

<sup>210</sup> Campbell op cit note 27 at 473.

<sup>211</sup> Ibid.

clearer indication of the total cost of credit.<sup>212</sup> Although it helps to keep interest rates low to make credit look less expensive, if we wish to reduce over-indebtedness then we need to accurately reflect the true cost of credit.<sup>213</sup> More logically though, if the existence of the initiation fee cannot be justified, then it should be removed altogether, or at least implemented with reference to the actual expenses incurred.<sup>214</sup>

### *Service Fees*

The service fee in matters of credit is defined in the NCA as ‘a fee that may be charged periodically by a credit provider in connection with the routine administration cost of maintaining a credit agreement.’<sup>215</sup> Essentially, it is intended to pay for actual expenses or disbursements associated with administering a credit agreement,<sup>216</sup> and is paid either monthly, annually or on a transaction basis.<sup>217</sup> As provided for in the Act, the maximum monthly service fee applicable to all categories of credit agreements is set by the Minister of Trade and Industry.<sup>218</sup> The fee that has been set is a ‘flat rate’ fee and does not vary according to the size of the loan, as in the case of the initiation fee.<sup>219</sup> This is despite the Act's explicit requirement that the service fee prescribed by the Minister 'must not exceed the prescribed amount relative to the principal debt.'<sup>220</sup> Similar to the initiation fee, the increase of the service fee in the amended 2016 Regulations from R50 to R60 appears to be arbitrary and unrelated to actual costs, aimed only at trying to set the total cost of credit at a desired level.<sup>221</sup> Although it is generally accepted that this ‘flat rate’ applies because the cost of servicing a loan is the same regardless of the amount involved,<sup>222</sup> this equal treatment has discriminatory effects for microcredit. In this regard, the transaction cost is much higher for small

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<sup>212</sup> Ibid.

<sup>213</sup> Campbell op cit note 39 at 262.

<sup>214</sup> Ibid.

<sup>215</sup> Section 1 of the NCA.

<sup>216</sup> Campbell op cit note 27 at 474.

<sup>217</sup> Section 101(1)(c) of the NCA.

<sup>218</sup> Section 105(1)(b) of the NCA.

<sup>219</sup> Campbell op cit note 27 at 464.

<sup>220</sup> Section 101(1)(c)(iii) of the NCA.

<sup>221</sup> Campbell op cit note 27 at 474.

<sup>222</sup> Kelly-Louw op cit note 164 at 74-79.

loans than for larger loans, making smaller loans more profitable for creditors and more expensive to pay back for debtors.<sup>223</sup> The 'flat rate' service fee of R60 per month therefore ends up being out of proportion to the initial loan amount in the case of smaller credit,<sup>224</sup> and the effect of the standardised service fee has been to maintain the pricing of small loans at unreasonable levels.<sup>225</sup> This result also conflicts with s 101 of the Act, which provides that the service fee 'must not exceed the prescribed amount relative to the principal debt,' meaning that the amount of the service fee should vary relative to the principal debt, and should thus be higher for bigger loans and lower for smaller loans.<sup>226</sup>

On the other hand, the standardised fee is a result of the Department of Trade and Industry's main objective based on the need for a distinct piece of legislation that treats all credit transactions and credit providers 'equivalently.'<sup>227</sup> This is also expressed in one of the purposes of the NCA, namely to ensure 'consistent treatment of different credit products and different credit providers.'<sup>228</sup> However, when the full effect of the standardised service fee is taken into account, it is noteworthy that this objective has been achieved at the expense of the 'consistent treatment' of consumers.<sup>229</sup> In this regard, taking out loans will result in unfair and discriminatory treatment against debtors who have taken out very small loans and who are almost always from the poorest communities.<sup>230</sup> The stated purpose of the standardisation of fees in the name of consumer protection and equal treatment is therefore strange.<sup>231</sup>

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<sup>223</sup> Ibid.

<sup>224</sup> Campbell op cit note 27 at 474.

<sup>225</sup> Ibid.

<sup>226</sup> Campbell op cit note 39 at 258.

<sup>227</sup> Ibid at 259.

<sup>228</sup> Section 3(b) of the NCA.

<sup>229</sup> Campbell op cit note 39 at 259.

<sup>230</sup> Ibid.

<sup>231</sup> Ibid.

*Evaluation*

In evaluating the total cost of credit for the consumer, it is now clear that one needs to carefully consider the combined impact of interest rates, the initiation fee and the service fees that are charged.<sup>232</sup> Therefore, when the initiation fee and service fee was first introduced into South African credit regulation, there was a major increase in the cost of credit even though it was argued that interest rates were now being capped.<sup>233</sup> As argued by Campbell, 'the implications of the reduction in interest rates cannot be considered in isolation and demands thorough analysis in the context of the total cost of credit.'<sup>234</sup> The issue that arises here, however, is that often such service fees and the initiation fee can remain hidden with the emphasis placed on interest rates due to the fact that consumers are more familiar with interest rates and that these are therefore more easily marketed on products.<sup>235</sup> The result of this is that the distorting of credit costs away from interest and towards fees, with which consumers are not familiar, may lead to the misleading of the actual total cost of credit. This results in unexpected high costs when borrowing money.<sup>236</sup> Ultimately, this inhibits disclosure, one of the requirements in the NCA, and aggravates rather than combats over-indebtedness which is another main focus that the Act aims to address. Furthermore, in the case of small loans, this skewing of credit by decreasing interest relative to the fees, is particularly concerning as those that are taking out these small loans are often the poorest of the population and are ill-equipped to overcome this masking of the true cost of credit.<sup>237</sup> In other words, consumers of small credit tend to be from lower-income communities in which lack of education and numeracy skills is more common, thus more likely to be misled by credit costs.<sup>238</sup> To address the masking of credit costs, the NCA does require that interest 'be expressed in percentage terms as an annual rate...'<sup>239</sup> However, in the case of short-term credit, this requirement seems to have

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<sup>232</sup> Campbell op cit note 27 at 477.

<sup>233</sup> Campbell op cit note 39 at 260.

<sup>234</sup> Ibid.

<sup>235</sup> Ibid at 264.

<sup>236</sup> Ibid.

<sup>237</sup> Campbell op cit note 27 at 477.

<sup>238</sup> Ibid.

<sup>239</sup> Section 101(1)(d) of the NCA.

been ignored.<sup>240</sup> Given that the repayment period for short-term credit is a maximum of six months, this does seem logical. However, the effect of making interest a monthly amount figure further obscures the true interest rate in making it look lower than it actually is, compared to the other categories of credit.<sup>241</sup>

Furthermore, the general increase in administration costs for credit providers, together with the caps that have been placed on interest rates and other costs of credit in the NCA, also has a negative effect on the providers of credit. Providers of small loans to low-income consumers may find that the small returns on high-risk loans are not worthy of handling.<sup>242</sup> If this is so, these provisions might force low-income consumers to continue to make use of expensive credit in the informal sector due to the fact that there are few formal sector providers of short-term credit.<sup>243</sup> This would clearly not be in line with the intentions of the NCA to make credit accessible. Furthermore, this reality is highlighted in MFIs where there is a noticeable absence of large formal MFIs that are sustainable in encouraging microfinance.<sup>244</sup> This is said to be due to the fact that MFI loan officers are highly skilled and thus demand relatively high salaries, which is unattainable compared to the small loan sizes and the returns received on such.<sup>245</sup> It has already been established that the cost of microcredit is higher than in commercialised banking and therefore MFIs generally have to charge higher rates to cover the applicable costs and still retain enough profit to sustain themselves.<sup>246</sup> This is due to the inherent nature of microfinance which demands high transactional costs to make many small loans other than that required to make one big loan.<sup>247</sup> Unfortunately though, those that create interest rate ceilings are often composed of politicians from government, not financial experts, and therefore do not adequately take into account these practical considerations in their calculations.<sup>248</sup> This is problematic in that if an MFI cannot cover the costs of its general operations, it will

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<sup>240</sup> Campbell op cit note 27 at 477.

<sup>241</sup> Ibid at 478.

<sup>242</sup> Kelly-Louw op cit note 164 at 226.

<sup>243</sup> Ibid at 226.

<sup>244</sup> Porteous & Hazelhurst op cit note 30 at 89.

<sup>245</sup> Ibid.

<sup>246</sup> 'Interest rate ceilings and micro-finance: the story so far' *Consultative Group to Assist the Poor, Occasional Paper No. 9* (2004) available at <http://www.cgap.org/portal/site/CGAP/menuitem.1b5d171ad6c9e30167808010591010a0/>, accessed on 10 April 2018 at 2.

<sup>247</sup> Ibid at 3.

<sup>248</sup> Ibid at 9.

either reduce access to loan recipients or go out of business altogether, which leaves no access to the low-income segment of the population.<sup>249</sup> Therefore, the primary reason for allowing microcredit providers to recover the maximum possible interest is to facilitate full cost recovery. This is in light of the greater risks involved and the exceptional methods that they may use - such as not requiring collateral.<sup>250</sup>

Not only are providers of microcredit faced with high risk and operation costs, but microcredit providers in South Africa, particularly, face multiple challenges resulting from South Africa's first and third world economies, financial regulatory environment and social history. These challenges include the following:<sup>251</sup>

1. Economic Dualism: This speaks to the fact that MFIs in South Africa must pay first-world salaries to skilled employees while earning revenues from third-world loan sizes.
2. Formal Competition: This speaks to the fact that MFIs face significant competition from formal credit lenders such as commercial banks who offer a broader array of financial services in a greater number of locations. This may attract good credit borrowers who are not only serious and educated on credit repayment but may also eventually seek larger sums of credit.
3. Informal Competition: This refers to the fact that the low-income segment of the population can still access credit through informal sources such as stokvels and mashonisas. As discussed in Chapter 2, these informal sources of credit are perceived as more trustworthy for a number of reasons.
4. Higher Loan Sizes: This refers to the fact that with the developing economic market in South Africa, more people are demanding higher loan sizes, meaning that MFIs are less able to diversify their risk and have higher operating costs.
5. Banking Fees: With banking fees, MFIs often have to deposit high volumes of small loan repayments to commercial banks which charge a fee, ultimately eroding profitability for these MFIs.
6. Formal Employment Market: Due to South Africa's high unemployment rate, many borrowers of small loans are unemployed. However, should the opportunity arise, many would switch to formal employment and, via integration, would make use of commercial banking services.
7. Cost of Regulation: South Africa has a first-world regulatory environment which imposes many compliance costs on MFIs that are considerably higher than other countries that don't have formal government agencies.

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<sup>249</sup> Ibid.

<sup>250</sup> Bamu et al op cit note 96 at 46.

<sup>251</sup> Skowronski op cit note 103 at 4-5.

8. Limited Entrepreneurial Training: As previously stated, microcredit borrowers are often entrepreneurs due to South Africa's high unemployment rate. However, it is not guaranteed that they have the skills to operate small businesses. If their business fails, this impacts their ability to repay the loans taken out. 9. Urbanization and Immigration: Foreigners or those from rural based communities lack the long-term relationships and associated trust with MFIs, which does not assist with attraction.<sup>252</sup>

The balance between credit provider and consumer, advocated in Chapter 2 of this dissertation, is therefore important when considering the above shortcomings and their respective critiques. I believe that both debtors and creditors are struggling with the current microcredit regulations in the NCA.

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<sup>252</sup> Ibid.

## CHAPTER FOUR

## CASE STUDY ON BANGLADESH

*Background*

In 1971, Bangladesh emerged in the developing world as an independent nation, recovering from a history of war and natural disaster destruction.<sup>253</sup> As the country began to recover from these conditions, the Bangladeshi people, filled with newfound energy and commitment, began to see hope in building a nation.<sup>254</sup> However, it soon became evident that the Bangladeshi government was failing to meet these expectations, which resulted in driving the population to create development themselves on a community basis.<sup>255</sup> In 1976, with this sense of self-help expanding through the nation, an economics professor at Chittagong University, Muhammad Yunus, came up with a research project known as the ‘Jobra experiment.’<sup>256</sup> This experiment sought to lend small amounts of money (microloans) to poor households in nearby villages.<sup>257</sup> By doing so, Yunus argued that the poor would be able to escape their poverty if they had access to such microloans which involved simple, informal income generating activities.<sup>258</sup> The research project organised borrowers into small peer monitoring groups that met weekly with other groups of borrowers to make loan repayments.<sup>259</sup> Each week all transactions were closed and cleared by the members which ensured that debt did not spiral into something unmanageable.<sup>260</sup> The idea was

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<sup>253</sup> David Hulme & Karen Moore ‘Why has microfinance been a policy success in Bangladesh (and beyond)?’ *Global Poverty Research Group* (2006) 6.

<sup>254</sup> *Ibid.*

<sup>255</sup> *Ibid.*

<sup>256</sup> David Pine ‘The microfinance sector in Bangladesh: Innovation or Stagnation’ *CMF Thesis Series no. 6* (2010) 4.

<sup>257</sup> Hulme & Moore *op cit* note 253 at 7.

<sup>258</sup> Bateman *op cit* note 1 at 95.

<sup>259</sup> Hulme & Moore *op cit* note 253 at 7.

<sup>260</sup> Munim Kumar Barai ‘The Success of Microcredit in Bangladesh: Supplementing ‘Group Lending’ Explanation with Institutional Understanding’ (2013) *Rev. Integr. Bus. Econ. Res.* Vol 2(1) at 473.

that peer monitoring would rely on Bangladeshi community practices where peer pressure and trust was a big aspect of their daily lives.<sup>261</sup> Therefore, although loan contracts were made in the name of individuals, the delivery and recovery process of loans used community groups as an essential tool.<sup>262</sup> Although generally there was no group-guarantee or joint liability in the legal sense, credit discipline was an important condition for a loan which was managed through collective borrower responsibility.<sup>263</sup>

After a few years of the research project in operation, demand for credit grew rapidly amongst the poor who were now able to access credit while repayment levels were also proving to be successful.<sup>264</sup> Subsequently, by 1983, Professor Yunus was able to attract international funding to establish the Grameen Bank, otherwise known as the 'Bank for the Poor' or the 'Rural Bank' in local language.<sup>265</sup> The Grameen Bank then became regulated by government through a special government ordinance in 1984.<sup>266</sup> Through this ordinance, it has become the only MFI in Bangladesh to be awarded a license to operate as a distinct bank for microfinance while other MFIs act as NGOs.<sup>267</sup> Furthermore, an important aspect of this project, that had now developed into a large bank, was that it has focused primarily on microcredit loans to women.<sup>268</sup> Essentially, the core values of the Grameen Bank are about solidarity lending, group hedging and women empowerment which cover all of the loans that the bank has to offer.<sup>269</sup> The Grameen Bank offers various types of loans with different conditions attached. These various types of loans include: 'a basic loan, which has flexible terms regarding duration, timing of the loan, scheduling and size of instalments; a flexi loan which is a rescheduled basic loan with special conditionalities; bridge loans which are offered for those borrowing beyond the normal loan ceiling if the client has a high enough savings balance; and a life insurance loan which pays for the entire outstanding debt in case of the client's death.'<sup>270</sup> Several other loan types exist such as housing loans, special investment loans, education loans, and loans being offered to vagrants

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<sup>261</sup> Pine op cit note 256 at 4.

<sup>262</sup> Ibid at 11.

<sup>263</sup> Ibid.

<sup>264</sup> Hulme & Moore op cit note 253 at 7.

<sup>265</sup> Bateman op cit note 1 at 95.

<sup>266</sup> Hulme & Moore op cit note 253 at 7.

<sup>267</sup> Pine op cit note 256 at 10.

<sup>268</sup> Barai op cit note 260 at 473.

<sup>269</sup> Ibid.

<sup>270</sup> Pine op cit note 256 at 12.

with no interest rate.<sup>271</sup> Not only are there different types of loans, but the bank also coordinates different types of savings accounts when a client takes out a loan.<sup>272</sup> Part of the loan goes into a client's personal account and the other part goes into a special savings account where they may only draw from under certain conditions.<sup>273</sup> This ultimately ensures responsible credit lending. The Grameen Bank, by the end of 1994, had served over 2 million borrowers with a loan recovery rate of over 90 per cent, being among the most successful credit programmes for the poor that the world has ever seen.<sup>274</sup> This, in turn, led to Yunus being awarded the Nobel Peace Prize in 2006.<sup>275</sup>

Although the Grameen Bank was the success story and central focus of microcredit in Bangladesh, other MFIs emerged too. The primary MFIs in Bangladesh are essentially categorised into four groups: MFI-NGOs; specialised institutions; commercial banks with microfinance programmes; and administrative divisions.<sup>276</sup> The credit services carried out by these groups can be further categorized into six basic groups: General microcredit for small-scale self-employment based activities; microenterprise loans; loans for the ultra-poor; agricultural loans; seasonal loans; and loans for disaster management.<sup>277</sup> The most common microfinancial service rendering group are MFI-NGOs which were established from the 1970s onwards. For instance, the Bangladesh Rural Advancement Committee, known as BRAC, was established in Bangladesh in 1972.<sup>278</sup> It is now active in 11 countries and was ranked in 2018 by NGO Advisor as the number one NGO in the world.<sup>279</sup> BRAC's main objective is to promote positive social change through development programmes, social enterprises, investments and education.<sup>280</sup> Another original NGO named Proshika was established

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<sup>271</sup> Ibid.

<sup>272</sup> Ibid.

<sup>273</sup> Ibid.

<sup>274</sup> Pitt, Mark, & Shahidur Khandker 'The Impact of Group-Based Credit Programs on Poor Households in Bangladesh: Does Gender of the Participant Matter?' (1998) *Journal of Political Economy* 106 at 958–96.

<sup>275</sup> Pine op cit note 256 at 10.

<sup>276</sup> Ibid at 8.

<sup>277</sup> 'An Overview of Microcredit in Bangladesh' at 1, available at

[http://www.mra.gov.bd/index.php?option=com\\_content&view=article&id=104&Itemid=80](http://www.mra.gov.bd/index.php?option=com_content&view=article&id=104&Itemid=80), accessed on 6 May 2018.

<sup>278</sup> Hulme & Moore op cit note 253 at 5.

<sup>279</sup> NGO Advisor carries out research, evaluates and ranks NGOs across the world; 'BRAC ranked top global NGO of 2018' *Brac.net* 26 March 2018, available at <http://www.brac.net/latest-news/item/1145-brac-ranked-top-global-ngo-of-2018>, accessed on 24 April 2018.

<sup>280</sup> Ibid.

in 1976. However, the present status of Proshika is unclear due to its registration as an NGO having been cancelled.<sup>281</sup> In 1978 the Association for Social Advancement (ASA) was established as an NGO, although its microfinance operations only began in 1991.<sup>282</sup> It focuses on group development and training among the rural poor, offering savings, credit and insurance facilities.<sup>283</sup> ASA has now become the topmost MFI in Bangladesh in terms of loan disbursement, outstanding loans and number of branches, as well as having the second highest number of clients during 2016 and 2017.<sup>284</sup> In the 1990's, a wholesale financing institution named 'Palli Karma-Sahayak Foundation' (PKSF) also emerged.<sup>285</sup> This was established by the Bangladeshi government and international donors to be an instrument for driving the scope of microfinance in Bangladesh.<sup>286</sup> PKSF helped digress from the International Development Association (IDA) project of the World Bank that provided a large amount of aid to smaller MFI-NGOs.<sup>287</sup> The PKSF now provides NGOs with technical assistance to enhance their institutional structure and management information systems, which has helped improve efficiency, expand outreach and reduce dependence on grants.<sup>288</sup> In the beginning days of the Grameen Bank, it relied heavily on grants from international donors to fund its operations.<sup>289</sup> However, it now claims to be funded entirely from deposits of its members, not having relied on grants since 1998.<sup>290</sup> The sector is broadly financed by 'savings collected from clients, cumulative surplus (profit), concessional loans received from sources such as PKSF, grants received from national and international donors, and commercial bank borrowing.'<sup>291</sup> The most important source of funding is client's savings, while cumulative surplus is the second most important source of funds, followed by loans from commercial banks

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<sup>281</sup> Hulme & Moore op cit note 253 at 5.

<sup>282</sup> Ibid.

<sup>283</sup> Ibid at 7.

<sup>284</sup> 'ASA Emerges as the Top MFI of Bangladesh' *Asa.org* 29 March 2018, available at <http://www.asa.org.bd/asa-emerges-top-mfi-bangladesh/>, accessed on 6 May 2018.

<sup>285</sup> Hulme & Moore op cit note 253 at 7.

<sup>286</sup> Shahidur R. Khandker et al. 'Beyond Ending Poverty: The Dynamics of Microfinance in Bangladesh' *World Bank Group* (2016) 4.

<sup>287</sup> Ibid.

<sup>288</sup> Pine op cit note 256 at 6.

<sup>289</sup> Jonathan Morduch 'The Role of Subsidies in Microfinance: Evidence from the Grameen Bank' (1999) 60 *J. Dev. Econ.* 229, 243 at 236.

<sup>290</sup> 'Grameen Bank at a Glance' *Grameen Bank*, available at <http://www.grameen-info.org/grameen-bank-at-a-glance/>, accessed on 6 May 2018.

<sup>291</sup> 'An Overview of Microcredit in Bangladesh' *MRA.gov*, available at [http://www.mra.gov.bd/index.php?option=com\\_content&view=article&id=104&Itemid=80](http://www.mra.gov.bd/index.php?option=com_content&view=article&id=104&Itemid=80), accessed on 6 May 2018.

and from PKSF, while the least important source appears to be grants from the donor agencies.<sup>292</sup>

Furthermore, in 1992, the Credit and Development Forum (CDF) was established to provide 7 main services to the Bangladeshi microfinance industry: ‘building capacity; lobbying, networking and advocating; undertaking research; developing and becoming an information hub; identifying and disseminating the industry best practices; building resource linkages between the MFIs and the banks plus the apex lending agency and facilitating exposure visits for organizations from within and outside Bangladesh.’<sup>293</sup> CDF also maintains a strong relationship with the microfinance sector’s primary stakeholders, regulators, think-tank agencies, apex funding agency, banks, and donors.<sup>294</sup> The CDF’s goal is promotion and development of the microfinance industry, its vision is sustainable poverty reduction through developing such microfinance industry, and its mission is to create an efficient microfinance industry through striking a balance between outreach and sustainability.<sup>295</sup>

During this period of the 1990’s, ‘second generation’ innovations also began to emerge due to the rapid development of technology, the competitive demand for microfinance and a wider range of financial services, as well as a call for more flexibility and financial access for the poor.<sup>296</sup> This ‘second generation’ demand calling for more financial savings services sparked the emergence of SafeSave in 1997 as an experiment for a savings-led individual microfinance project.<sup>297</sup> SafeSave is now a project of BRAC and its aim is to offer poor people reliable tools to manage their money, and it works in eight low-income areas of Dhaka, the capital of Bangladesh.<sup>298</sup> SafeSave became a permanent, self-sustaining microfinance institution in 2002.<sup>299</sup> With this rapid establishment of new microfinance branches throughout

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<sup>292</sup> Ibid.

<sup>293</sup> Credit & Development Forum (CDF) Home Page, available at <http://www.cdfbd.org/new/>, accessed on 24 April 2018.

<sup>294</sup> Credit Development Forum (CDF) Annual Report 2016-17 *Bangladesh Micro Finance Statistics* (2017).

<sup>295</sup> Ibid.

<sup>296</sup> Hulme & Moore op cit note 253 at 7.

<sup>297</sup> Ibid.

<sup>298</sup> SafeSave Home Page, available at <http://www.safesave.org>, accessed on 24 April 2018.

<sup>299</sup> Hulme & Moore op cit note 253 at 6.

Bangladesh, as well as the extension of financial services and intensified disbursements, microfinance operations grew at an enormous rate.<sup>300</sup>

### *Has Microcredit Worked in Bangladesh?*

In comparison to the 1990's, microcredit now plays a more prominent role than ever in Bangladesh with more than 750 registered MFIs and a network of over 17 000 branches.<sup>301</sup> The question, however, is whether this major role is due to the larger number of MFIs that exist, or whether it is due to the impact that it has had on social development. Studies have shown that microcredit has been successful in improving the economic conditions of the members,<sup>302</sup> but other macro studies have argued that there hasn't been much of a decline in overall poverty levels.<sup>303</sup> However, even if microfinance hasn't conquered poverty as a whole, it has still been successful in providing access to financial services.<sup>304</sup> Not only is it focused on financial services, but microfinance is now also an instrument for initiating employment, facilitating savings mobilisation among the poor and smoothing consumption.<sup>305</sup> Therefore, participation in microcredit programmes in Bangladesh does not necessarily imply borrowing, although the majority of individuals do mainly make use of the borrowing facilities.<sup>306</sup> Poverty reduction as well as access to finance has been argued to be a success, however, with one source highlighting statistics that overall poverty had fallen to 32 per cent by 2010 from its original figure of 57 per cent in 1991 and that it had an average annual reduction rate of 1.25 percentage points.<sup>307</sup> It is argued that 10 per cent of the total reduction in poverty among the rural population is attributed to microfinance.<sup>308</sup> Furthermore, by 2012 the Grameen Bank, BRAC and other MFIs had

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<sup>300</sup> Khandker et al. op cit note 286 at 38.

<sup>301</sup> Ibid at 2.

<sup>302</sup> The most famous study on microcredit in Bangladesh was that of Khandker 1998; Pitt and Khandker 1996; 1998.

<sup>303</sup> Dr. Salehuddin Ahmed 'Microcredit in Bangladesh : Achievements and Challenges' *Microfinance Gateway* (2004) 10.

<sup>304</sup> Khandker et al. op cit note 286 at 2.

<sup>305</sup> Ibid.

<sup>306</sup> Ibid at 62.

<sup>307</sup> Ibid at 9.

<sup>308</sup> Ibid at 129.

reached over 10 million rural households in Bangladesh.<sup>309</sup> What these statistics don't show, on the other hand, is how profit-seeking behaviour of microlenders has increased and household borrowing has risen rapidly which does not assist development in the long run.<sup>310</sup> This is in line with neo-Marxist perspective which argues that microfinance can be criticised for focusing on the low-income segment of the population's liquidity instead of the socio-economic structures that underlie poverty.<sup>311</sup> In this regard, it is argued that 'the very success of microfinance is based on failure to challenge the foundations of class structure.'<sup>312</sup>

Whether microcredit as an industry has worked is something that has been debatable for many years now. One thing is certain though; the Grameen model of microcredit has been successful.<sup>313</sup> It is a product which meets client needs, has developed relatively low-cost delivery mechanisms, and has generated further resources and services that allow it to expand.<sup>314</sup> The Grameen Bank also works on a peer pressure, group based lending model which ensured that the target market would filter itself through peer selection in ensuring that 'bad' clients were avoided, as it effected not only the bank but those who decided to participate in a group related to the bank.<sup>315</sup> Repayments are also ensured through intensive borrower supervision by field staff; peer group monitoring; compulsory savings; and performance incentives.<sup>316</sup> Group-based lending is therefore an essential factor in many of the ways in which microcredit has been a success in Bangladesh, mainly by creating social collateral.<sup>317</sup> Group-based lending is particularly useful in an economic setting where poverty exists mainly due to socio-political inequity and where financial intermediation requires social intermediation that is less expensive to provide to groups than individuals.<sup>318</sup> However, whether group-based lending will work in other countries requires a proper assessment of whether social and political mechanisms can serve as vehicles for credit

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<sup>309</sup> Ibid at 37.

<sup>310</sup> Ibid at 44.

<sup>311</sup> Hulme & Moore op cit note 253 at 15.

<sup>312</sup> Ibid.

<sup>313</sup> Ibid at 16.

<sup>314</sup> Ibid.

<sup>315</sup> Ibid.

<sup>316</sup> Ibid.

<sup>317</sup> Shahidur R. Khandker 'Fighting Poverty with Microcredit: Experiences in Bangladesh' *Poverty Alleviation and Microcredit Programs* (1998) 154.

<sup>318</sup> Ibid.

delivery, if it is cost effective, and what the needs of the poor are.<sup>319</sup> Moreover, once applied, the actual success of the model depends on the commitment to its application, working for both programme officials and borrowers.<sup>320</sup> There are many factors that relate to the environment in Bangladesh that are comparable to South Africa's environment. For instance, Bangladesh's high population density means that the cost of delivery could be brought down; the basic infrastructure for delivery is available; there is a regular supply of university graduates with few employment opportunities; and levels of law and order are relatively secure.<sup>321</sup>

Of the various employment activities for development, small-scale business/trade is the most important and accounts for more than 40 per cent of funds disbursed by MFIs.<sup>322</sup> This proves that Bangladesh has been committed to the initial aim of microcredit being a developmental tool in starting businesses. It has also kept a relatively low rate of service charge compared to other countries, which has kept the cost of credit down but has still acknowledged the expenses in maintaining microloans by lenders.<sup>323</sup> A problem that has arisen however, is that of 'overlapping' loans. There are many MFIs to borrow from in Bangladesh, but this has increased the opportunities of borrowers taking out multiple loans from multiple MFIs, which has resulted in over indebtedness and a threat to the microlending industry.<sup>324</sup> It could be suggested that there is a connection between borrower defaults and the overlapping lending from a number of MFIs.<sup>325</sup> Therefore, although multiple sources of credit appears to be beneficial to the accessibility of credit, where borrowers have many opportunities to borrow money from multiple MFIs, it is not necessarily beneficial to the borrowers welfare.<sup>326</sup> It is therefore beneficial that financial institutions such as PKSF have been trying to introduce a credit bureau in the microfinance sector to regulate this overlapping concern.<sup>327</sup> This credit bureau would be different to the Credit Information

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<sup>319</sup> Ibid.

<sup>320</sup> Ibid.

<sup>321</sup> Hulme & Moore op cit note 253 at 20.

<sup>322</sup> Ahmed op cit note 303 at 4.

<sup>323</sup> Ibid at 12.

<sup>324</sup> Yasuhiko Yuge 'The Current Situation of Microfinance in Bangladesh: A Growing Concern about Overlapping Loan Problems – From a Field Visit to Rajshahi and Comilla' *Center for Emerging Markets Enterprises: Student Research Series* (2011) 2.

<sup>325</sup> Ibid at 4.

<sup>326</sup> Ibid at 5.

<sup>327</sup> Ibid at 8.

Bureau (CIB) which provides reports to commercial banks.<sup>328</sup> Rather, a microfinance credit bureau would be one that holds information on MFIs in a centralised system.<sup>329</sup>

According to some politicians, academic writers and the popular press, the Grameen Bank's model of microcredit has been based on three particular characteristics which have ultimately led it to success.<sup>330</sup> The first of these characteristics is the so-called 'solidarity circle' which is said to serve as a replacement for physical collateral.<sup>331</sup> This 'solidarity circle' requires borrowers to form groups of approximately five people, where only two loans are administered by the Bank to two people in the group<sup>332</sup> while the other members will need to guarantee repayment of these loans.<sup>333</sup> It is only after these two borrowers successfully repay the loans, will the Bank lend to the other members of the group.<sup>334</sup> Therefore, although there is no form of physical collateral for the loans, the peer pressure that the circle members impose on each other is said to be the collateral.<sup>335</sup> The second of these characteristics is the Bank's requirement that borrowers comply with the 'Sixteen Decisions'<sup>336</sup> which is where the Bank requires borrowers to memorize and repeat to their loan officers as a condition of receiving loans.<sup>337</sup> This agenda for social development directs borrowers to refrain from socially unhealthy behaviour<sup>338</sup> and to act economically as it reminds them of the importance of entrepreneurialism, hard work, business judgment and discipline.<sup>339</sup> The third characteristic is the Bank's focus on lending to women, whom make up about 95 per cent of its borrowers.<sup>340</sup> This is based on the general assumption that women require social, political and economic empowerment.<sup>341</sup> Muhammad

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<sup>328</sup> Pine op cit note 256 at 43.

<sup>329</sup> Ibid.

<sup>330</sup> Rashmi Dyal-Chand 'Reflection in a Distant Mirror: Why the West has Misperceived the Grameen Bank's Vision of Microcredit' (2005) 41 *Stan. J. Int'l L.* 217 at 220.

<sup>331</sup> Grameen Bank 'Credit Delivery System' *Grameen Bank News* 2011, available at <http://www.grameen-info.org/credit-delivery-system/>, accessed on 6 May 2018.

<sup>332</sup> Ibid.

<sup>333</sup> David Bornstein *The Price of a Dream: The Story of the Grameen Bank and the Idea that is Helping the Poor to Change Their Lives* (1996) 100; Aminur Rahman op cit note 357 at 78.

<sup>334</sup> Grameen Bank op cit note 331.

<sup>335</sup> Dyal-Chand op cit note 330 at 220.

<sup>336</sup> Grameen Bank op cit note 331.

<sup>337</sup> Steven D. Jamar 'A Lawyering Approach to Law and Development' (2001) 27 *N.C. J. INT'L L. & COM. REG.* 31 at 44-45.

<sup>338</sup> Grameen Bank 'The Sixteen Decisions of Grameen Bank' available at <http://grameen-info.org/bank/the16.html>, accessed on 6 May 2018.

<sup>339</sup> Dyal-Chand op cit note 330 at 233.

<sup>340</sup> Grameen Bank website, available at <http://www.grameen-info.org>, accessed on 12 October 2018.

<sup>341</sup> Dyal-Chand op cit note 330 at 264.

Yunus claimed that the Grameen Bank's focus on women is due to the fact that women are better 'fighters against poverty' and are 'more likely to use the money to improve their family's situation rather than for unproductive purposes.'<sup>342</sup> It must be borne in mind though that Bangladesh has a largely Islamic culture, often bearing specific views on gender-roles.<sup>343</sup>

To ensure successful repayment, there are a number of signature features that exist in the Grameen Bank.<sup>344</sup> These include: a progressive increase in loan sizes, where initial loans are small and when borrowers successfully repay these loans then they become entitled to larger loans;<sup>345</sup> intensive staffing, where loan officers are to visit clients weekly to collect repayments in public view;<sup>346</sup> the Sixteen Decisions which intends to encourage personal development and progress out of poverty;<sup>347</sup> insurance schemes that combine linked savings accounts, emergency loans, and life insurance to minimize loan defaults;<sup>348</sup> and lastly, reasonable and transparent pricing of credit costs.<sup>349</sup> Another form of insurance is the Grameen Bank's policy of always negotiating and modifying repayment terms when borrowers find repayment difficult.<sup>350</sup> The Grameen Bank's success in also being free of corruption and other negative practices is said to be due to the unique characteristic of the Grameen Bank which focuses on feeling 'at one' with the poor and having a great deal of dedication and drive for such.<sup>351</sup> In this regard, the Grameen Bank is viewed as a non-profit organisation but it does in fact act as a for-profit organisation.<sup>352</sup> In other words, although the Grameen Bank provides financial services to the vulnerable and focuses on development; it is not a charity due to its financial operations being similar to a

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<sup>342</sup> Muhammad Yunus *Banker to the Poor: Microlending and the Battle Against World Poverty* (1999) 71-72.

<sup>343</sup> Amit K. Misra 'Creating Microcredit Programs to Empower the Microentrepreneur: The Grameen Bank in Bangladesh' (1994) 6 *LBJ J. Pub. Aff.* 64 at 72.

<sup>344</sup> Alan M. White 'Credit and Human Welfare: Lessons from Microcredit in Developing Nations' (2012) 69 *Wash. & Lee L. Rev.* 1093 at 1115.

<sup>345</sup> 'Grameen Bank at a Glance' *Grameen Bank website* available at <http://www.grameen-info.org/grameen-bank-at-a-glance/>, accessed on 6 May 2018.

<sup>346</sup> *Ibid.*

<sup>347</sup> Yunus op cit note 342 at 135-7.

<sup>348</sup> *Ibid* at 137-40.

<sup>349</sup> White op cit note 344 at 1138.

<sup>350</sup> *Ibid* at 1135.

<sup>351</sup> Charles Mann, Merilee S. Grindle & Parker Shipton, eds., *Seeking Solutions: Framework and Cases for Small Enterprise Development Programs* (1991) 260-261.

<sup>352</sup> Dyal-Chand op cit note 330 at 224.

commercial lender, albeit on a smaller scale.<sup>353</sup> Other operations within the Bank, however, are highly different to a traditional commercial bank. For instance, with regards to the solidarity circle, the Grameen Bank uses this group-based lending mechanism to avoid spending money and resources on oversight or screening functions. By setting the condition that members of a circle may only get further loans if all the members of their circle guarantee repayment, the Grameen Bank uses informal peer pressure to its advantage.<sup>354</sup> It is hoped that members of a circle will be careful as to who they rely on for repayments. Even if this screening mechanism doesn't work and there is a delinquent borrower in the group, the Grameen Bank still has four other guarantors from whom to seek repayment.<sup>355</sup> This means that the screening and compliance costs are transferred to the borrowers themselves.<sup>356</sup>

Some have argued that these three characteristics of the Grameen Bank's model in fact encourages the poor to continue to engage in informal behaviour that still leaves them outside of the financial market.<sup>357</sup> However, I argue that although these characteristics tend to appear as informal, they are instead a way of moulding the formal sector to suit the needs and circumstances of those that come from the informal sector, so that there is an easier sense of integration and comfortability. Informality is said to result in quicker, easier and deeper market penetration by new entrants due to the attractiveness of a familiar and unthreatening space.<sup>358</sup> The line between the formal and informal sector also tends to be blurred when one attempts to regulate the informal sector. This term in itself could be considered an oxymoron as regulation is associated with the formal sector while the informal sector is typically unregulated. I recommend a compromise or middle ground, where the principles of the informal sector are used but are still governed by regulation. In other words, there is a pocket of informality inside the formal loan transaction.<sup>359</sup> As stated by Muhammad Yunus, 'credit without strict discipline is nothing but charity, and charity in the name of credit will destroy the poor, not help them. Thus credit institutions must make sure that loans

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<sup>353</sup> Ibid.

<sup>354</sup> Ibid at 225.

<sup>355</sup> Ibid.

<sup>356</sup> Ibid at 270-271.

<sup>357</sup> Ibid at 221.

<sup>358</sup> Chi-kan Richard Hung 'From South to North: Comparative Study of Group-Based Microcredit Programs in Developing Countries and the United States' in James H. Carr & Zhong Yi Tong eds. *Replicating Microfinance In the United States* (2002) at 240.

<sup>359</sup> Dyal-Chand op cit note 330 at 284.

get paid back in full, and in due time.’<sup>360</sup> Moreover, the Rule of Law assumes that the formalisation of credit transactions plays a critical role in increasing the efficiency and access to markets.<sup>361</sup> It is in fact through the loan transaction that the value of a physical asset changes from being purely physical value to its utility as collateral.<sup>362</sup> Regulation is therefore very important, particularly to ensure repayment, which can be done in many different ways. One of these ways has been that the Bank tracks a borrower’s microenterprise by regularly confirming that the borrower has actually used their loan funds for the purposes of starting up a small business.<sup>363</sup> Officials from the MRA observe a group of members in monitoring its compliance with rules regarding weekly meetings, administering savings accounts, developing business proposals, and even overseeing basic skills like being able to write their own names.<sup>364</sup> With sufficient resources, this is an excellent way of ensuring that loans are used for developmental purposes and that they are capable of being repaid. However, further studies have revealed that the Bank only requires leaders in the borrowing circle to complete and update forms that report on the borrower’s uses of loan funds, which often results in misreporting on such forms.<sup>365</sup> These forms are said to be rarely verified by loan officers through visits or other devices, even though spot checks by senior bank officers are part of the Bank’s policy.<sup>366</sup>

The Grameen Bank’s success, therefore, has not been dependent on a strict Rule of Law model.<sup>367</sup> The conditions for a loan and means of enforcing repayment are largely extra-legal that suit the unique circumstances in Bangladesh.<sup>368</sup> In terms of formality, the verbal reciting of the ‘Sixteen Decisions’ is however concerning as one questions how enforceable this condition is in court.<sup>369</sup> Furthermore, studies have also revealed that the solidarity circles are not always as effective as they appear to be. The purpose of formalisation is primarily to ensure that consumers are protected, however, there have been instances where members of a circle have not been able to make

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<sup>360</sup> David Bornstein op cit note 327 at 231 (quoting Muhammad Yunus, the Grameen Bank's founder).

<sup>361</sup> Dyal-Chand op cit note 330 at 281.

<sup>362</sup> De Soto op cit note 121 at 40-46.

<sup>363</sup> Aminur Rahman *Women and Microcredit and Microcredit in Rural Bangladesh* (1999) at 115.

<sup>364</sup> Mahabub Hossain ‘Credit for the Rural Poor: the Experience of Grameen Bank in Bangladesh’ *Dhaka: Bangladesh Institute of Development Studies* (1984) at 7.

<sup>365</sup> Rahman op cit note 363 at 116.

<sup>366</sup> *Ibid* at 115-17.

<sup>367</sup> White op cit note 344 at 1134.

<sup>368</sup> *Ibid*.

<sup>369</sup> Dyal-Chand op cit note 330 at 282.

repayment and as such have suffered violence and threats from other members of the circle.<sup>370</sup> Another critique is that although it seems economically viable for an MFI to transfer screening and monitoring costs to the borrower through solidarity circles, it is not an ideal move considering that the borrowers are the ones that cannot afford to bear these costs the most.<sup>371</sup> Borrowers are required to spend time and resources in peer group meetings to learn about each other's businesses and monitor each other's compliance.<sup>372</sup> Some argue that this creates inefficiency, but I would rather argue that it is beneficial as borrowers consequently learn fundamental business skills. It is also fair to expect some form of participation in exchange for accessible and affordable credit. It is further argued that by imposing joint liability through its guarantee requirement, the solidarity circle hinders borrowers from taking the risks that mainstream businesses are able to.<sup>373</sup> Again, I would contend this, and argue that this is an important factor in protecting microlenders from taking irresponsible risks at start-up stages.

There are therefore many arguments for and against adopting the Grameen Bank's model, particularly when placing it in another country. One of the countries that have in fact attempted to do so is the United States of America (USA). However, through considering the above critiques and the differing contexts, the USA has adjusted certain principles of the model. For instance, instead of using the 'Sixteen Decisions,' the USA has rather transformed the social development agenda into a training plan.<sup>374</sup> This training plan offers a range of classes on business development and financial management, although it primarily focuses on behavioural or psychological development towards market integration.<sup>375</sup> Some USA microlenders find this training aspect even more important than the actual granting of the loan.<sup>376</sup> However, development thinkers have still recognised the importance of incorporating local values and habits to increase the chances of a programme being adopted and sustained in new contexts.<sup>377</sup> It can be difficult, however, when local values and habits

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<sup>370</sup> Rahman op cit note 363 at 121-122.

<sup>371</sup> Dyal-Chand op cit note 330 at 271.

<sup>372</sup> Ibid.

<sup>373</sup> Ibid at 272.

<sup>374</sup> Ibid at 260.

<sup>375</sup> Lisa J. Servon *Bootstrap Capital: Microenterprises and the American Poor* (1999) at 95.

<sup>376</sup> Dyal-Chand op cit note 330 at 238.

<sup>377</sup> Ibid at 286.

are seen as informal, and therefore cannot be easily ascertained and enforced. This is a challenge that countries will have to face if they should regulate through loan documentation and they therefore need to define the informality to some extent so that courts know how to enforce it.<sup>378</sup> At the same time, such regulation will need to remain true to indigenous values and goals.<sup>379</sup> This entails a clear understanding of the market before one can begin to define a path towards integration in any country.<sup>380</sup>

### *Microcredit Regulation in Bangladesh*

From the emergence of MFIs as far back as the 1970's, no MFI-NGOs offering microfinance in Bangladesh had been regulated or supervised by the central bank, the Bangladesh Bank or any regulatory authority, except in the case of the Grameen Bank.<sup>381</sup> Regulation in this regard essentially refers to 'a set of enforceable rules that aim to restrict or direct economic behaviour of market participants,'<sup>382</sup> and one of the major arguments for regulation is 'improving efficiency of the institutions, in addition to protecting the interests of the microfinance members and borrowers.'<sup>383</sup> Towards the end of 1997, the Bangladesh Bank authorised a study to assess the regulatory aspects of MFIs and their link with the formal financial sector.<sup>384</sup> Completed in 1998, the major findings of the study were: the statutory regulations under the existing banking and financial system did not cater to the special needs of this sector; MFIs needed to be legally recognised through the enactment of law to gain access to formal sources of funds and operate under an agreed 'Code of norms/Conducts' of special licensing arrangements; and that self-regulation may supplement the existing or new

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<sup>378</sup> Ibid at 284.

<sup>379</sup> Ibid at 306.

<sup>380</sup> Ibid at 305.

<sup>381</sup> Pine op cit note 256 at 30.

<sup>382</sup> M. A. Baqui Khalily 'Impact of Regulation on the Cost Efficiency of Microfinance Institutions in Bangladesh' *Working Paper No.22* (2014) at 5.

<sup>383</sup> S. Badruddoza 'Rules of Microcredit Regulatory Authority in Bangladesh: A Synopsis' *Munich Personal RePEc Archive* (2013) at 1.

<sup>384</sup> 'History of Microcredit Regulatory Authority (MRA)' *Microcredit Regulatory Authority*, available at [http://www.mra.gov.bd/index.php?option=com\\_content&view=article&id=40:history-of-%20microcredit-regulatory-authority-mra&catid=23:about-us&Itemid=76](http://www.mra.gov.bd/index.php?option=com_content&view=article&id=40:history-of-%20microcredit-regulatory-authority-mra&catid=23:about-us&Itemid=76), accessed on 24 April 2018.

government regulation being introduced.<sup>385</sup> In light of the above recommendations on regulations, the Bangladeshi government formed a committee in 1999 which sought to 'a) recommend an effective credit and savings policy for this sector; b) ensure transparency and accountability into their activities and; c) make some recommendations regarding a regulatory framework and to propose a body to regulate and supervise these institutions.'<sup>386</sup> In March 2000, the committee submitted its report, making major recommendations based on removing overlapping MFI issues; establishing linkages between NGOs and the formal financial sector to solve NGO funding; policies for loan classification, interest rates, savings, and investments; recovering default loans; proper definitions; uniform accounting standards; limit of administrative expenses; prudential guidelines for the microfinance sector; formulation of performance standards of NGO-MFIs and; the creation of a separate regulatory body.<sup>387</sup> Subsequently, a Unit was established named the 'Microfinance Research and Reference Unit' (MRRU) through a government order on 18 June 2000 and this unit was supervised by the National Steering Committee made up of members from the Ministry of Finance, the Social Welfare Ministry, NGO Affairs Bureau, PKSF, Grameen Bank, BRAC, and others.<sup>388</sup> The Terms of References (TORs) of the Committee were based on formulating policy guidelines to regulate MGO-MFIs, prepare monitoring activities for the proper performance of these guidelines, and prepare a new regulatory authority for MFIs.<sup>389</sup> These TORs were achieved by June 2003, although the regulatory body could not be established due to time constraints.<sup>390</sup> As a result of this, the Steering Committee prepared a draft law for the setting up of a regulatory authority and submitted it to the government.<sup>391</sup> The draft law essentially spoke of a need for an independent regulatory authority that is responsible for providing licences to MFIs and monitoring their activities.<sup>392</sup> Bangladesh has thus been said to have established a different approach to regulation, through establishing a separate entity under a separate Act.<sup>393</sup>

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<sup>385</sup> Ibid.

<sup>386</sup> Ibid.

<sup>387</sup> Ibid.

<sup>388</sup> Ibid.

<sup>389</sup> Ibid.

<sup>390</sup> Ibid.

<sup>391</sup> Ibid.

<sup>392</sup> Ibid.

<sup>393</sup> Badruddoza op cit note 383 at 1.

With effect from 27 August 2006, the Microcredit Regulatory Authority Act<sup>394</sup> (MRA Act) was passed on the basis of the above suggestions of the Steering Committee.<sup>395</sup> Before this Act, the microfinance industry had been quasi-formal and MFIs had been registered under various Acts as NGOs.<sup>396</sup> The new Act therefore ensured that the microfinance industry had been formalised with a linkage to the central bank, and that the industry was now being properly regulated and monitored under its own specialist legislation.<sup>397</sup> The MRA Act divided MFIs into four broad categories by the number of borrowers and then set differentiated licensing charges for each.<sup>398</sup> This was different from the usual approach that most countries take with microcredit, where microfinance is regulated by the central bank under existing banking laws.<sup>399</sup> The most important aspect of this newly enacted law, however, was the role of licensing. MFIs were now required to apply for licensing through the relevant authority.<sup>400</sup> This relevant authority was established under the MRA Act as the ‘Microcredit Regulatory Authority’ (MRA) which monitors microfinance operations of NGOs in Bangladesh.<sup>401</sup> The Authority has the duty to ensure transparency and accountability of microcredit activities and has been given the power to issue and cancel licences for MFIs through overseeing, supervising and facilitating the activities of these MFIs.<sup>402</sup> Chapter 4 of the MRA Act sets out that no micro credit organisation can be established and run without receiving a certificate from the Authority while s 21 of the MRA Act states that the Authority shall make public a list of micro credit organisations that have been duly registered. The MRA also has the power to prepare detailed rules and conditions related to the operations of microcredit and may take punitive measures if an institution does not comply with the rules.<sup>403</sup> Put more simply, the MRA has three primary functions: ‘to license MFIs, to supervise MFIs for compliance with licensing requirements and to enforce sanctions in cases of

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<sup>394</sup> Act 32 of 2006.

<sup>395</sup> Pine op cit note 256 at 33.

<sup>396</sup> Baqui Khalily op cit note 382 at 7.

<sup>397</sup> Ibid.

<sup>398</sup> Ibid at 8.

<sup>399</sup> Ibid at 7.

<sup>400</sup> Pine op cit note 256 at 8.

<sup>401</sup> Julia Marin ‘MICROCAPITAL BRIEF: Microcredit Regulatory Authority (MRA) of Bangladesh Launches Lead Microfinance Institution System to Coordinate Poverty-reduction Programmes’ *MicroCapital* 13 January 2013, available at <https://www.microcapital.org/microcapital-brief-microcredit-regulatory-authority-mra-of-bangladesh-launches-lead-microfinance-institution-system-to-coordinate-poverty-reduction-programmes-2/>, accessed on 24 April 2018.

<sup>402</sup> Baqui Khalily op cit note 382 at 33.

<sup>403</sup> Ibid at 34.

non-compliance.<sup>404</sup> It is also expected to conduct audits and address customer complaints.<sup>405</sup> This new regulatory framework was introduced to play a crucial role in protecting members' savings, ensuring the sustainability of lenders, improving the efficiency of microcredit markets, and to safeguard the stability of the microfinance industry.<sup>406</sup>

Section 2 (22) of the MRA Act clearly defines 'micro credit' to mean 'loan facilities offered by micro credit organisations certified under this Act for poverty alleviation, employment generation and to facilitate a small entrepreneur.' Furthermore, s 9 of the MRA Act sets out the responsibilities and activities of the Authority, to (a) issue certificates for running micro credit organisations to alleviate poverty of the country's poor people and their overall welfare, as well as cancellation of certificates; (b) preserve, examine and analyse the data on establishment of micro credit organisations and their field level supervision; (c) merge of micro credit organisations; (d) take necessary steps for auditing the accounts of micro credit organisations at the request of the financing agency; (e) send information as sought by the financing agency and; (f) administer grants received from any foreign government, agency or international organisations with prior permission of the government. In line with its responsibilities, s 24(2) of the MRA Act states that micro credit organisations shall carry out their services with the objectives of: (a) providing loan supports to low-income consumers to make them more comfortable and self-reliant; (b) providing advice and support to low-income consumers to carry out economic activities; (c) accepting deposits from members of the micro credit institutions; (d) opening bank accounts for offering micro credit; (e) receiving loans or grants from banks or any other sources for developing funds; (f) investing the surplus funds in sectors approved by the Authority; (g) receiving a service charge for the credit services at a rate determined by the Authority and; (h) rendering other different types of insurance services and other social development orientated loan facilities. Section 27 of the MRA Act also ensures that there is no conflict of interest with regard to those sitting on the Board for the Authority and those being paid as an official or member of a micro credit organisation. This is to ensure that there is an impartial, outside body doing checks on

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<sup>404</sup> Marin op cit note 401.

<sup>405</sup> Ibid.

<sup>406</sup> Baqui Khalily op cit note 382 at 6.

the industry. With regard to these checks, the sixth chapter of the MRA Act deals with compliance and sets out the offences and punishments for non-compliance with the Act or the Authority.

On 19 December 2010, the ‘Microcredit Regulatory Authority Rules 2010’<sup>407</sup> were brought into force.<sup>408</sup> The rules define licensing procedures, conditions for licenses, temporary suspension or withdrawal of approval, cancellation of licenses, and licensing charges.<sup>409</sup> For instance, the MRA Rules 2010 require all licensed MFIs to maintain cash liquidity at 15 per cent of total net deposits.<sup>410</sup> It also allows MFIs to collect voluntary deposits from clients if the organization has a minimum of five years of experience in conducting microcredit operations,<sup>411</sup> if it is profitable for the last three years,<sup>412</sup> its accumulated loan recovery rate is at least 95 per cent and current loan recovery rate is at least 90 per cent during the last five years,<sup>413</sup> it maintains liquidity of deposits,<sup>414</sup> and the total voluntary deposits do not exceed 25 per cent of the total capital of the organization.<sup>415</sup> These rules and regulations have a direct influence on the efficiency of MFIs and therefore make licensed MFIs more attractive to microfinance clients than non-licensed MFIs.<sup>416</sup> The MRA Rules 2010 describe in more detail the procedure, conditions, cancellation, suspension and withdrawal of licenses, as well as the managerial structure of the Board, Council and other committees dealing with the Authority in regulating microfinance. The MRA Rules 2010 also describe the financial conditions and restrictions on microfinance funds and services, including the conditions for deposits and maintenance of liquidity. It further speaks of maintaining registers, records and audits to ensure accountability and transparency,<sup>417</sup> and focuses on some new points like insurance, reception of deposit, classification of loans and provisioning.<sup>418</sup>

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<sup>407</sup> Hereinafter, ‘MRA Rules 2010.’

<sup>408</sup> Ibid.

<sup>409</sup> Ibid.

<sup>410</sup> Rule 34(1) of the MRA Rules 2010.

<sup>411</sup> Ibid at rule 28(a).

<sup>412</sup> Ibid at rule 28(b).

<sup>413</sup> Ibid at rule 28(c).

<sup>414</sup> Ibid at rule 28(d).

<sup>415</sup> Ibid at rule 28(e).

<sup>416</sup> Ibid.

<sup>417</sup> MRA Rules 2010.

<sup>418</sup> Badruddoza op cit note 383 at 3.

The MRA is also known to coordinate sectoral quarterly meetings with the CDF.<sup>419</sup> These meetings focus on contemporary sectoral issues which benefit a well-functioning microcredit industry in Bangladesh.<sup>420</sup> On 16 April 2017, the CDF organised a sectoral meeting to discuss the launching of a study in assessing the economic and social impact of microfinance on the lives of the poor, that would be done by an independent, reputed research organisation.<sup>421</sup> It was agreed that this two-year study would, on the one hand, assess the socio-economic effects of MFIs through a case-study, and on the other hand, conduct an impact assessment of the linkage programme named ‘Barga Chashi Unnayan Prakalpa’ (BCUP) or sharecropper development project.<sup>422</sup> Furthermore, the CDF has published ‘Microfinance Statistics’ which is a valuable source of statistical information that provides the overall data for MFIs in Bangladesh.<sup>423</sup> From the data gathered in considering the microcredit industry and its effects on poverty, the CDF strongly supports the efforts aimed at establishing a Credit Bureau for the MFIs which would then work as a central database for information on clients, outreaches, geographic coverage and microfinancial services.<sup>424</sup> In this regard, it is clear that the microfinance industry in Bangladesh is closely monitored and continuously improved. The organising of meetings, development projects and studies aim at creating policy recommendations. Some of these recommendations include: improving skills training and marketing so that the poor can use credit to their best advantage; lowering interest rates in comparison to realising sufficient returns; and encouraging more competition between MFIs by protecting smaller MFIs and reducing a monopolisation of the sector.<sup>425</sup> Smaller MFIs help accessibility in having greater outreach to remote places, and they are also said to be more efficient in handling local clients.<sup>426</sup> It has also been discussed that there are certain conditions needing to be met should financial institutions be sustainable in developmental rural settings.<sup>427</sup> For instance, it is argued that the government should

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<sup>419</sup> Credit Development Forum op cit note 294 at 23.

<sup>420</sup> Ibid.

<sup>421</sup> Ibid at 26.

<sup>422</sup> Ibid.

<sup>423</sup> Ibid at 34.

<sup>424</sup> Ibid at 37.

<sup>425</sup> Sara Gustafson & Shahidur Khandker ‘How microfinance has reduced rural poverty in Bangladesh’ *IFPRI* 2016, available at <http://www.ifpri.org/blog/how-microfinance-has-reduced-rural-poverty-bangladesh>, accessed on 6 May 2018.

<sup>426</sup> Baqui Khalily op cit note 382 at 25.

<sup>427</sup> Shahidur R. Khandker ‘Fighting Poverty with Microcredit: Conclusions and Policy implications: What have we learned?’ *Poverty Alleviation and Microcredit Programs* (1998) at 145.

not see MFIs as profit mechanisms or interfere with them in any way except to provide regulation and supervision.<sup>428</sup> Although MFIs should not be seen as profit mechanisms, it has, however, been claimed that savings mobilisation is an integral part of credit delivery so that programmes learn to depend on markets rather than on donors for funding.<sup>429</sup> To survive as an industry, profit will always be relevant, and so there is therefore a call to avoid a purely profit focus but to ensure sustainability which is ultimately dependent on some form of profit.

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<sup>428</sup> Ibid.

<sup>429</sup> Ibid.

## CHAPTER FIVE

## AMENDMENTS AND CLOSING

The growth of microfinance throughout the years, both in South Africa and elsewhere around the world, has brought about increasing calls for regulation.<sup>430</sup> However, the way in which the microfinance industry should be regulated is debatable. The structure and governance of MFIs is unique,<sup>431</sup> and there are concerns around complying with prudential regulations and associated supervision policies that can be costly for MFIs.<sup>432</sup> As highlighted in this dissertation, the assets of MFIs remain substantially less than those of banks and other more formal financial service providers, meaning that there are less resources to carry out such compliance measures.<sup>433</sup> On the other hand, seeing as MFIs deal primarily with the poor and vulnerable sector of the population, protecting their deposits is essential, which provides a rationale for improved regulation and supervision dealing with compliance measures.<sup>434</sup>

*Twin Peaks*

In 2017, a new regulatory framework for South Africa's financial sector was introduced by the Financial Sector Regulation Act.<sup>435</sup> This is the so-called 'Twin Peaks' model which governs credit providers and therefore has relevance in the microcredit industry. The 'Twin Peaks' model is a financial system regulation that

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<sup>430</sup> Robert Cull Asli Demirguc-Kunt & Jonathan Morduch 'Does Regulatory Supervision Curtail Microfinance Profitability and Outreach?' *World Development* Vol. 39, No. 6 (2011) at 949.

<sup>431</sup> Ian Davis 'Rural Banking: Designing an Effective Legal Framework for Microfinance' (2009) 2 *J. Bus. Entrepreneurship & L.* 394 at 400.

<sup>432</sup> Demirguc-Kunt & Morduch op cit note 430 at 949.

<sup>433</sup> Ibid.

<sup>434</sup> Ibid.

<sup>435</sup> Act 9 of 2017 (hereinafter 'FSRA' or 'the Act').

calls for the establishment of two, independent, peak regulatory bodies.<sup>436</sup> The one body is charged with ensuring safety and soundness in the financial system while the other aims to prevent market misconduct and the abuse of consumers in the financial sector.<sup>437</sup> On the one hand, a bank regulator should address the 'financial soundness of institutions - including capital adequacy and large exposure requirements, measures relating to systems, controls and provisioning policies, and the vetting of senior managers to ensure that they possessed an appropriate level of experience and skill.'<sup>438</sup> This is called 'prudential regulation.' On the other hand, a second regulator should be charged with ensuring that consumers are treated fairly and honestly by protecting them against 'fraud, incompetence, or the abuse of market power.'<sup>439</sup> Essentially, it is proposed that the two primary goals should be to protect the stability and integrity of the financial system ('systemic protection') under the one peak, and to ensure that the interests of individual depositors, investors, and policy-holders are protected ('consumer protection') under the other.<sup>440</sup> The benefit of this Twin Peak model is that it will eliminate regulatory overlap and create regulatory bodies that are open and accountable with a clear vision.<sup>441</sup>

Historically, South Africa had adopted an 'institutional' approach in the financial sector where regulation was typified by lack of coordination.<sup>442</sup> This institutional approach is a model that sees entities either regulated according to the sector in which they operate, or according to their legal form.<sup>443</sup> However, as South Africa saw the growth of the private sector becoming more complex in offering a wide variety of financial services; an agency dedicated to market conduct and consumer protection became more necessary.<sup>444</sup> South Africa therefore introduced this 'Twin Peak' regulatory model approach through the enactment of the FSRA.<sup>445</sup> The preamble

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<sup>436</sup> Andrew Schmulow 'Financial Regulatory Governance in South Africa: The Move towards Twin Peaks' (2017) 25 *Afr. J. Int'l & Comp. L.* 393.

<sup>437</sup> *Ibid.*

<sup>438</sup> M. W. Taylor "Twin Peaks!: A Regulatory Structure for the New Century" *Centre for the Study of Financial Innovation*, No. 20 (December 1995) at 3.

<sup>439</sup> *Ibid* at 1-3.

<sup>440</sup> *Ibid* at 1-8.

<sup>441</sup> *Ibid* at 1.

<sup>442</sup> D. Rajendaran, 'Approaches to Financial Regulation and the Case of South Africa' *IFMR Finance Foundation* (6 March 2012).

<sup>443</sup> Andrew Godwin, et al. 'Twin Peaks: South Africa's financial sector regulatory framework' (2017) *SALJ* 665.

<sup>444</sup> Andrew Schmulow *op cit* note 436 at 415.

<sup>445</sup> Act 9 of 2017.

to the Act highlights the objectives and structure of the Twin Peak model in South Africa:

[T]o establish a system of financial regulation by establishing the Prudential Authority and the Financial Sector Conduct Authority, and conferring powers on these entities; to preserve and enhance financial stability in the Republic by conferring powers on the Reserve Bank; to establish the Financial Stability Oversight Committee; to regulate and supervise financial product providers and financial services providers; to improve market conduct in order to protect financial customers; to provide for co-ordination, cooperation, collaboration and consultation among the Reserve Bank, the Prudential Authority, the Financial Sector Conduct Authority, the National Credit Regulator, the Financial Intelligence Centre and other organs of state in relation to financial stability and the functions of these entities; to establish the Financial System Council of Regulators and the Financial Sector Inter-Ministerial Council; to provide for making regulatory instruments, including prudential standards, conduct standards and joint standards; to make provision for the licensing of financial institutions; to make comprehensive provision for powers to gather information and to conduct supervisory onsite inspections and investigations; to make provision in relation to significant owners of financial institutions and the supervision of financial conglomerates in relation to eligible financial institutions that are part of financial conglomerates; to provide for powers to enforce financial sector laws, including by the imposition of administrative penalties; to provide for the protection and promotion of rights in the financial sector as set out in the Constitution; to establish the Ombud Council and confer powers on it in relation to ombud schemes; to provide for coverage of financial product and financial service providers by appropriate ombud schemes; to establish the Financial Services Tribunal as an independent tribunal and to confer on it powers to reconsider decisions by financial sector regulators, the Ombud Council and certain market infrastructures; to establish the Financial Sector Information Register and make provision for its operation; to provide for information sharing arrangements; to create offences; to provide for regulation-making powers of the Minister; to amend and repeal certain financial sector laws; to make transitional and savings provisions; and to provide for matters connected therewith.<sup>446</sup>

It is clear from the preamble that the Act aims to introduce various regulatory bodies, councils and schemes as well as aims to ensure their coordination and cooperation in supervising and administering financial sector laws. Most importantly, however, is that this model entails two ‘peak’ regulators, namely a Prudential Authority (PA), which is to ‘supervise the safety and soundness of banks, insurance companies and other financial institutions,’ and a Financial Sector Conduct Authority (FSCA), which is to ‘supervise how financial services firms conduct their business and treat customers.’<sup>447</sup> The specific objectives of these regulatory bodies are respectively

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<sup>446</sup> Preamble to the FSRA.

<sup>447</sup> 'TWIN PEAKS: Second draft of Financial Sector Regulation Bill and draft Market Conduct Policy Framework discussion document published for comment' *National Treasury Media Statement* (11 December 2014).

found in s 33 of the Act<sup>448</sup> and s 57 of the Act.<sup>449</sup> Furthermore, in terms of structure, the National Treasury has noted that the 'FSCA will be a stand-alone market conduct authority, while the PA will be an authority established within the South African Reserve Bank (SARB).'<sup>450</sup> The benefit of integrating prudential regulation with monetary policy (the PA within the SARB) is said to be that it results in joint knowledge of monetary policy and financial market developments within supervisory practice.<sup>451</sup> Although the FSCA is a stand-alone market, the PA under the authority of the SARB is still obliged to co-operate and collaborate with the FSCA to maintain, protect and enhance financial stability.<sup>452</sup> In sum, the effectiveness of these regulatory bodies depends on a 'clear allocation of objectives and responsibilities between each regulator; effective co-ordination between the regulators; transparency and accountability on the part of each regulator; effective powers of supervision and enforcement; operational independence of each regulator; a sound governance system and adequate resources.'<sup>453</sup>

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<sup>448</sup> The objective of the Prudential Authority is to — (a) promote and enhance the safety and soundness of financial institutions that provide financial products and securities services; (b) promote and enhance the safety and soundness of market infrastructures; (c) protect financial customers against the risk that those financial institutions may fail to meet their obligations; and (d) assist in maintaining financial stability.

<sup>449</sup> The objective of the Financial Sector Conduct Authority is to — (a) enhance and support the efficiency and integrity of financial markets; and (b) protect financial customers by — (i) promoting fair treatment of financial customers by financial institutions; and (ii) providing financial customers and potential financial customers with financial education programs, and otherwise promoting financial literacy and the ability of financial customers and potential financial customers to make sound financial decisions; and (c) assist in maintaining financial stability.

<sup>450</sup> 'A safer financial sector to serve South Africa better' *Republic of South Africa National Treasury* (Report, 23 February 2011) at 10.

<sup>451</sup> Godwin et al., op cit note 443 at 675

<sup>452</sup> Gerda van Niekerk & Corlia van Heerden 'Twin Peaks: The Role of the South African Central Bank in Promoting and Maintaining Financial Stability' (2017) 80 *THRHR* 636 at 650.

<sup>453</sup> Michael W Taylor op cit note 437 at 1-3; Michael W Taylor "The road from 'Twin Peaks' - and the way back" (2009-2010) 16 *Connecticut Insurance LJ* 64; Michael W Taylor 'Regulatory reform after the financial crisis - Twin Peaks revisited' *Lecture delivered at the Law and Finance Senior Practitioner Lecture Series, Oxford University* 16 February 2011, available at <https://www.law.ox.ac.uk/events/regulatory-reform-after-financial-crisis-twin-peaks-revisite>.

The FSRA generally applies to financial institutions rendering financial services<sup>454</sup> and provides financial products<sup>455</sup> in the South African financial system.<sup>456</sup> For purposes of the Act, ‘financial institution’ means a financial product provider; a financial service provider; a market infrastructure; a holding company of a financial conglomerate; or a person licensed or required to be licensed in terms of a financial sector law.<sup>457</sup> It is therefore understood that ‘financial institution’ includes MFIs, and so the governance of MFIs falls under this Act. According to s 34(1)(e) of the Act, one of the functions of the PA is to support financial inclusion,<sup>458</sup> and according to s 58(1)(e) of the Act, one of the functions of the FSCA is to promote financial inclusion.<sup>459</sup> This emphasis on the support and promotion of financial inclusion speaks to the administering of microcredit, and therefore highlights the importance of the Twin Peaks in supporting, promoting and protecting the microfinance sector. Furthermore, s 58(5)(a) of the FSRA states that ‘when performing its functions, the FSCA must take into account the National Credit Act and regulatory requirements for financial institutions that are authorised and regulated under that Act,’ while s 76(1)(a)

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<sup>454</sup> Section 3 of the FSRA provides that ‘financial service’ means – ‘(a) any of the following in relation to a financial product, a foreign financial product or a financial instrument: (i) Offering, promoting, marketing or distributing; (ii) providing advice, recommendations or guidance; (iii) dealing or making a market; and (iv) operating or managing, or providing administration services; (b) dealing or making a market in a financial product, a foreign financial product, a financial instrument or a foreign financial instrument; (c) a service provided by a financial institution, being a service regulated by a specific financial sector law; (d) a service related to the buying and selling of foreign exchange; (e) a service, including a debt collection service, provided to a financial institution through an out-sourcing arrangement, being a service provided in relation to the provision by a financial institution of a financial product, a foreign financial product, a financial instrument or a financial service; and (f) a service related to the provision of credit, excluding the services of a debt counsellor, payment distribution agent or alternative dispute resolution agent, each as defined or referred to in the National Credit Act.’

<sup>455</sup> Section 2 of the FSRA provides that ‘financial product’ means – ‘(a) a participatory interest in a collective investment scheme; (b) a long-term policy as defined in section 1(1) of the Long-term Insurance Act; (c) a short-term policy as defined in section 1(1) of the Short-term Insurance Act; (d) a benefit provided by - (i) a pension fund organisation, as defined in section 1(1) of the Pension Funds Act, to a member of the organisation by virtue of membership; or (ii) a friendly society, as defined in section 1(1) of the Friendly Societies Act, to a member of the society by virtue of membership; (e) a deposit as defined in section 1(1) of the Banks Act; (f) a health service benefit provided by a medical scheme as defined in section 1(1) of the Medical Schemes Act; (g) credit, as defined in section 1 of the National Credit Act, provided in terms of a credit agreement as defined in that section; (h) a warranty, guarantee or other credit support arrangement as provided for in a financial sector law; (i) a facility or arrangement designated by Regulations for this section as a financial product; and (j) a facility or arrangement that includes one or more of the financial products referred to in paragraphs (a) to (i).’

<sup>456</sup> ‘Financial system’ is defined in s 2 of the FSRA to mean ‘the system of institutions and markets through which financial products, financial instruments and financial services are provided and traded, and includes the operation of a market infrastructure and a payment system.’

<sup>457</sup> Section 1(1) of the FSRA.

<sup>458</sup> Section 34(1)(e) of the FSRA.

<sup>459</sup> Section 58(1)(e) of the FSRA.

states that ‘the financial sector regulators and the Reserve Bank must cooperate and collaborate when performing their functions in terms of financial sector laws, the National Credit Act, and the Financial Intelligence Centre Act, and must for this purpose generally assist and support each other in pursuing their objectives in terms of financial sector laws, the National Credit Act and the Financial Intelligence Centre Act.’ It is therefore essential that the FSRA and its relevant ‘peaks’ take into account the objectives in the NCA, particularly relating to microcredit, and must not only consider such but must in fact support the pursuance of achieving such objectives. Section 81(1)(f) of the FSRA further states that ‘the Financial System Council of Regulators must establish working groups or subcommittees in respect of financial inclusion,’ which shows precisely the type of commitment expected to achieving the objective of financial inclusion. Section 132 of the FSRA also gives the financial sector regulator power to conduct a supervisory onsite inspection at the business premises of a supervised entity, and therefore could mirror the strict supervisory practice in Bangladesh when it comes to MFIs.

Although the FSRA Twin Peak model does govern the microcredit industry, it could be argued that this is not direct enough. When comparing the regulatory framework in Bangladesh, South Africa lacks a separate entity under a separate Act that is governed by separate rules, which the Bangladeshi government has established. Without this specialised framework, there is a lack of clear objectives, functions, compliance measures, procedures and general guidelines when it comes to the governing of microcredit. Bangladesh is deeply committed to the governance of the microcredit industry and this is shown through its unremitting research studies, committees, units, forums and policies that aim to continuously evolve and improve the microcredit industry. The Grameen Bank’s stance of being ‘at one’ with the poor is evident and it is suggested that South Africa should follow suit if it is to truly mould its formal sector to meet the needs of its informal sector. Although the FSRA covers the microcredit industry and focuses on financial inclusion under both prudential and market conduct headings, a ‘one size fits all’ approach will not accommodate the specialised needs of the microcredit industry.

*The NCA*

When specifically looking at amending the microcredit regulations in the South African NCA, there are a number of suggestions that can be made. These suggestions need to ensure a balance between debtor and creditor interests. In *Collet v FirstRand Bank Ltd*<sup>460</sup> Malan J stated that the NCA does not only serve the interests of consumers, but requires a careful balancing of the interests of both consumers and credit providers.<sup>461</sup> In terms of amendments, firstly, the service fee could be set at a percentage of the loan amount, subject to both a minimum and maximum amount.<sup>462</sup> This appears to be a better solution than the current provision in place, considering that s 101(1)(c)(iii) of the NCA provides that the service fee prescribed by the Minister 'must not exceed the prescribed amount relative to the principal debt.'<sup>463</sup> The total cost of small loans is too high when considering that the smaller the loan, the higher the initiation and service fees are, relative to the loan.<sup>464</sup> Secondly, due to the fact that there is no statement in the NCA relating to what the 'initiation fee' is intended to cover, it is suggested that it should in fact be removed if its purpose cannot be justified.<sup>465</sup> The initiation fee is particularly onerous considering that it needs to be paid by the very people who are without financial resources in the first place and that the fee ends up being capitalized with interest, thus obscuring the actual cost of credit. This is a common trend in the regulations, where there is a skewing of credit from interest to fees. Rather, therefore, fees should be built into the interest rate so that there is a clear cost of credit. Thirdly, microcredit should be properly classified as either 'short term credit' or 'unsecured credit' due to the abovementioned issues in Chapter 3 surrounding the differing interest rates applicable to each category.

With the Draft National Credit Amendment Bill under consideration, it is also in the interests of suppliers of credit to be more cautious in their lending habits and to follow more stringent regulations. The Bill seeks to amend the NCA to include a

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<sup>460</sup> 2011 (4) SA 508 (SCA) at para 10.

<sup>461</sup> Skowronski op cit note 103 at 23.

<sup>462</sup> Campbell op cit note 39 at 263.

<sup>463</sup> Ibid.

<sup>464</sup> Ibid.

<sup>465</sup> Campbell op cit note 27 at 479.

section called ‘debt intervention’ which allows a debtor, once in their life, to make an application to have their debt written off.<sup>466</sup> The maximum amount of debt allowed is R50 000 and it is only for unsecured debts, thus often relating to microcredit transactions.<sup>467</sup> This is particularly concerning as MFIs could lose large amounts of money if numerous debtors are successful with this application. Furthermore, recent case law has been trending towards stronger accessibility for poor consumers wanting to take out small credit loans. In *Truworths Limited and Others v The Minister of Trade and Industry and Others*<sup>468</sup> Engers J highlighted that s 82(1) of the NCA has been amended to say that loans ‘must not be inconsistent with the affordability assessment regulations made by the Minister,’ in which one of these regulations, regulation 23A(4)(c), sets out that ‘a credit provider must take practicable steps to validate gross income, in relation to... (c) consumers that are self-employed, informally employed or employed in a way through which they do not receive a payslip or proof of income as contemplated in (a) or (b) above by requiring: (i) latest three (3) months bank statements; or (ii) latest financial statements.’ Engers, J continued to assess the purposes of the NCA<sup>469</sup> and the protections on reckless credit.<sup>470</sup> When assessing such, regulation 23A(4) was under attack for being discriminatory and unreasonable.<sup>471</sup> Engers J argued that ‘the attack based on discrimination and unreasonableness centres on the fact that category (c) consists largely of the poorer and less privileged members of society’ and that the regulation is ‘in many cases, impossible for them to comply with.’<sup>472</sup> He proceeded further to state that the attack was well-founded and used as an example, a flower seller in Adderley Street who does not have a bank account.<sup>473</sup> It was argued that this would be an obstacle to obtain credit in a small amount and that ‘one thinks of a parent who needs to buy a school uniform for his or her child in January, and would easily be able to pay the price over the next few months, but who cannot afford the entire amount in one go.’<sup>474</sup> These remarks could suggest that courts are leaning more towards accessibility rather than responsibility when it comes to microcredit, which pushes the mandate for a more robust, detailed and comprehensive

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<sup>466</sup> Draft National Credit Amendment Bill, Part E, s 88A.

<sup>467</sup> *Ibid* at s 88A(2).

<sup>468</sup> Case No: 4375/2016.

<sup>469</sup> *Ibid* at para 4.

<sup>470</sup> *Ibid* at para 6.

<sup>471</sup> *Ibid* at para 9.

<sup>472</sup> *Ibid* at para 45.

<sup>473</sup> *Ibid* at para 46.

<sup>474</sup> *Ibid*.

microcredit regulatory framework. As discussed under the ‘Twin Peaks’ section above, perhaps the appropriate place for this would be within a separate Act, operating separate entities. However, in absence of such, it is essential that the NCA, at the very least, addresses these issues set out above for a more clearly addressed microcredit regulatory framework.

### *The Personalised Approach*

It is highlighted in the abovementioned arguments, around the FSRA and NCA, that a more ‘personalised approach’ for microcredit is required in South Africa. Generally, when assessing how regulation should be carried out, the most important principle is that regulation is tailored to the needs of the microfinance industry in that specific country.<sup>475</sup> Any single set of regulatory considerations for microfinance will either be wrong or vague to the point of meaninglessness.<sup>476</sup> Governments should thus consider the unique microfinance environment that exists in their country, while also maintaining specific norms applicable to microfinance regulation to ensure sustainability and growth.<sup>477</sup> The idea here is to allow diversity that is compatible with the diverse needs of the market, while still ensuring a focused regulatory structure for efficiency.<sup>478</sup> The regulatory framework should thus be flexible as well as controlled.<sup>479</sup> In this regard, there are specific principles that apply across the board to MFIs, no matter their differing contexts. Some of these include that MFIs should be integrated with the formal financial sector;<sup>480</sup> that governments should engage in consultative processes; that supervisors should have a deep understanding of

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<sup>475</sup> Jacques Trigo Loubiere et al., ‘Supervising and Regulating Microfinance in the Context of Financial Sector Liberalization: Lessons From Bolivia, Colombia And Mexico’ (2004), available at [Http://Publications.Accion.Org/Publications/Supervisin\\_184.Asp](Http://Publications.Accion.Org/Publications/Supervisin_184.Asp). at 10.

<sup>476</sup> Anita Bernstein ‘The Trouble with Regulating Microfinance’ (2013) 35 U. *Haw. L. Rev.* 1 at 5.

<sup>477</sup> Trigo Loubiere et al. op cit note 475 at 10.

<sup>478</sup> Rodrigo A. Chaves & Claudio Gonzalez-Vega ‘Principles of regulation and prudential supervision and their relevance for microenterprise finance organisations?’ *Economics and Sociology Occasional Paper No. 1979* (1992) at 26.

<sup>479</sup> *Ibid* at 24.

<sup>480</sup> Davis op cit note 431 at 406.

microfinance;<sup>481</sup> and that there should be a high-level of political support for the microfinance industry.<sup>482</sup>

Political support for the microfinance industry is primarily shown in the regulations and policies adopted by government. Some countries show more support than others. For example, Kenya has enacted comprehensive microfinance regulation through the Microfinance Act;<sup>483</sup> the government of Rwanda has adopted a National Microfinance Strategy;<sup>484</sup> and, of course, specialised microfinance regulation has been adopted in Bangladesh as discussed in the previous chapter. Bangladesh particularly stands out as one of the first countries to establish an independent regulatory institution with the sole purpose of supervising the microfinance sector.<sup>485</sup> The country's MRA Act reflects a sound legal framework for microfinance.<sup>486</sup> Not only does it establish a separate entity (the Microcredit Regulatory Authority) but Microcredit Regulatory Authority Rules have also arisen as a result of this specialised legislation. The MRA, as highlighted in Chapter 4, also conducts sectoral quarterly meetings with the CDF and encourages the establishment of study units, projects and committees for the continuous re-evaluation of microcredit in Bangladesh. Ultimately, it can be argued that the success of a microcredit industry depends on the commitment to its application, and that Bangladesh is a good example of a committed and passionate approach to a successful legal framework on microcredit.

### *The Social Collateral Approach*

It is noteworthy that even though the above examples lend towards a successful microfinance regulatory framework, such is never fixed as regulations should be

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<sup>481</sup> Trigo Loubiere et al. op cit note 475 at 10.

<sup>482</sup> Ibid at 11.

<sup>483</sup> The Microfinance Act, No. 19 (2006), Kenya Gazette Supplement No. 103 §§4-10, available at [Http://www.idlo.int/Mf/Documents/Regulations/Kenya.pdf](http://www.idlo.int/Mf/Documents/Regulations/Kenya.pdf).

<sup>484</sup> United Nations Development Programme & Ministry of Finance and Economic Planning, Republic of Rwanda, Building an Inclusive Financial Sector in Rwanda 3 (2009), available at [http://www.undp.org.rw/Prodoc\\_U NCDF P73948.pdf](http://www.undp.org.rw/Prodoc_U NCDF P73948.pdf).

<sup>485</sup> Davis op cit note 431 at 419.

<sup>486</sup> Ibid at 421.

continuously evolving.<sup>487</sup> In adopting innovations, regulators should, as far as possible, take into consideration the lived experiences of those whom the regulation is effecting.<sup>488</sup> Powerlessness does tend to accompany poverty, and so ironically those people most at risk of harm from the interventions don't have much voice in their establishment.<sup>489</sup> To create a space for these voices, the enforcement of regulation should rely, as much as possible, on those that it seeks to regulate.<sup>490</sup> Not only should they have a voice in the way that the policy is administered, but they should be included in the actual enforcement of the policies, such as through peer supervision. This is also financially logical as regulation of smaller institutions require more resources while their smaller size and community focus makes private peer supervision by members more effective.<sup>491</sup> Chapter 4 has laid out an example of group-based lending in Bangladesh and how it can be useful in an economic setting where poverty exists due to socio-political inequity. Similar socio-economic and political circumstances exist in South Africa, and there is a possibility that group-based lending, as was conducted in Bangladesh, could work in South Africa. Social intermediation is not only less costly in a country that lacks the resources to administer and oversee multiple microloans at a low cost, but it also acknowledges the cultural context from which many microlenders come from while maintaining a blanket of formality. South Africa's social climate makes it eligible for group-based lending, due to peer pressure and trust being of great value, and its lack of resources make it a necessity. The challenge of implementing principles from the Bangladeshi system, however, arises where major resources are still required to ensure weekly group-closings and to ensure that loans are being administered for the original intended purposes such as starting up small-scale businesses.

Although peer monitoring can be effective, the regulatory framework should also, however, provide a supervisory agency with enough authority to perform its mandate so that there is a central body to be accountable to.<sup>492</sup> For example, in Bangladesh, the CDF not only promotes and controls the microfinance industry but it

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<sup>487</sup> Chaves & Gonzalez-Vega op cit note 478 at 23.

<sup>488</sup> Bernstein op cit note 476 at 22.

<sup>489</sup> Ibid.

<sup>490</sup> Chaves & Gonzalez-Vega op cit note 478 at 22.

<sup>491</sup> Aaron Jones 'Promotion of A Commercially-Viable Microfinance Sector In Emerging Markets' (2006) 13 *Geo. J. On Poverty L. & Pol'y* 187 at 200.

<sup>492</sup> Chaves & Gonzalez-Vega op cit note 478 at 36.

focuses on developing the industry as challenges may arise. Where officials are used in compliance checks, weekly meetings can be monitored through filling in compliance forms and doing occasional spot-checks to ensure that microcredit is being used for its intended purposes and that repayments are being made. Bangladesh's focus on ensuring that the initial aim of being a developmental tool for starting businesses has indeed contributed to its success. Moreover, there should be social performance assessments undertaken to understand the industry better and achieve desired outcomes when evolving the regulatory framework.<sup>493</sup> For instance, as highlighted in this dissertation, additional financial services, such as long-term savings and insurance products, are important to provide vulnerable members of society with protection when they are considering taking out micro loans.<sup>494</sup> The Grameen Bank is a good example of the way in which an MFI can offer specialized loans, accounts, security and other alternative financial services to its clients. The Grameen Bank is not the only example though, as Bangladesh has multiple MFI-NGOs with various microfinance programmes that focus on training, savings, investing and creating relationship networks.

The Grameen Bank's three success characteristics must be borne in mind: solidarity circles, reciting the 'Sixteen Decisions' and the focus on lending to women and business starters. However, just like the regulatory framework, a 'one size fits all' approach will not work. As mentioned with regards to the USA system, an adjustment can always be made from the Bangladeshi experience, such as changing the 'Sixteen Decisions' into a social development training programme instead. Smart thinking, coordination and management can go a long way, such as creating savings pockets as collateral, using peer group monitoring to manage and disburse loans, gaining grants from international donors seeking to assist development initiatives, and providing performance incentives.

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<sup>493</sup> Skowronski op cit note 103 at 8.

<sup>494</sup> Ibid.

### *Conclusion*

To be in debt carries a deep sense of shame and secrecy, often leading to consumers feeling alienated and hopeless. In South Africa, debt may arise through various avenues, but an important source of debt comes from microloans that have spiralled out of control. It is therefore important that our legislative framework governing microcredit does not mirror the stigma of shame and secrecy. Instead, the microcredit regulatory framework must be confident, clear and direct. This dissertation has discussed the microcredit regulatory framework in South Africa, mainly relating to the NCA. First, the objectives in the NCA were evaluated, which highlighted the need for accessible and responsible credit. By using a positivist interpretation of these objectives, they present as clear and straightforward, but when contextually evaluating these objectives, it is clear that microcredit has a much higher burden when it comes to ensuring that credit is accessible in a responsible way. The specific shortfalls on microcredit regulation in the NCA were also highlighted, and it was shown that many of these regulations are not confident, clear nor direct. Furthermore, when evaluating South Africa's broader financial sector regulatory framework, the so-called 'Twin Peaks,' it is of concern that references to financial inclusion and the objectives of the NCA force one to broadly apply this to the governance of microcredit. The FSRA sets out a body for prudential regulation as well as market conduct regulation, but nowhere in this Act is there a specific reference to the governance of the microcredit sector, even though it is clear that it does fall under the Act as a financial service. However, it must be borne in mind that the FSRA is intended to be a framework Act. Therefore more detailed, subordinate Acts are needed, such as the new Insurance Act.<sup>495</sup>

This approach in South Africa, where microcredit falls in and amongst the general financial sector, does not foster a successful microcredit industry. Microcredit, when administered properly, is indeed an anti-poverty mechanism and development initiative that has the potential to assist in starting up businesses and to provide emergency relief for the most vulnerable segments of our population. In this dissertation I have thus set out the Bangladeshi experience on the successful regulation

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<sup>495</sup> Act 18 of 2017.

of microcredit, and have compared the approach taken in South Africa. In Bangladesh, there is a specialised Act that maintains a specialised body, governed by specialised rules. This shows genuine commitment to the microcredit industry and is depicted in the various MFIs offering various micro-financial services. Although this specialised approach may initially raise concerns for the availability of resources, South Africa can learn from the Bangladeshi experience in using group-based lending to both monitor and administer microcredit to consumers. Just as peer pressure may drive the demand for material assets and ultimately result in debt-traps, so too is peer pressure powerful when being used to administer credit and monitor repayment. In Bangladesh, the socio-political climate has been optimal for the use of group-based lending where supervisory costs are transferred to the consumers themselves due to the fact that community and trust is of such value. In South Africa, community and trust is equally valued, and can be shown as a good influence in the use of informal sources of credit, such as mashonisas. On the other hand, no case study can be one hundred per cent accurately transplanted into another setting due to the fact that the contexts are never entirely the same. In this regard, I have argued in this dissertation that if one is to demand a proper regulatory framework for microcredit, the context is absolutely essential. In South Africa, as well as in Bangladesh, balancing cultural values with formalities is fundamental for accurate regulation that acknowledges the socio-political circumstances of consumers while also ensuring consumer protection. Therefore, this does not mean that culture is ignored but rather it is protected to ensure that exploitation is avoided and that microcredit lives on to be the success that it has the potential to be.

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