**EXECUTIVE SUMMARY:**

ASSESSING THE POSSIBLE REGULATOR IMPACT OF THE NATIONAL CREDIT ACT ON MICROFINANCE INSTITUTIONS: A CASE STUDY OF A SMALL TO MEDIUM SIZED CONSUMER CREDIT PROVIDER


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Governments usually introduce regulation to remedy perceived market failures and protect consumers. However, regulation introduced with proper scrutiny, in respect of its possible risks, costs and benefits to society at large has the potential to cause as many challenges as it offers solutions. Amongst others, regulation may result in unintended consequences, increase compliance burdens for businesses and also impact disproportionately on the affected parties.

The current research showed that regulatory impact assessments were adopted and are being implemented by the majority of the OECD countries as a direct response to this challenge. Policy makers have the daunting task of creating a balance, which is sometimes illusive, between social, business and political objectives. They are consequently expected to improve regulation, without creating new and undesirable consequences, particularly for small to medium enterprises. Regulatory impact assessments serve as a tool to appraise the costs and benefits of a regulation on affected parties, which inevitably include businesses, consumers, non-governmental organisations, community-based organisations and government.

During the regulatory impact assessment governments are expected to evaluate the best possible regulator instruments to employ in order to achieve specific objectives that address the identified problems. Regulations should not be expected to serve as panacea for addressing all market failure and consumer protection. Research shows that governments are exposed to various regulatory instruments or options that they should consider before a decision is taken to employ explicit government regulation. Other regulatory options that governments should consider include self-regulation, quasi regulation, co-regulation, and other alternative instruments such as the imposition of standards, taxes, service charters and the introduction of subsidies and information and education awareness programmes to achieve the desired change in market conduct.

The Department of Trade and Industry introduced the National Credit Act (NCA) in 2006 as a response to perceived market failures and consumer protection challenges that the repealed Usury (including the Exemption Notice) and Credit Agreements Acts could not longer address. The department introduced the NCA without first determining the possible impact of this legislation on the affected parties. Unlike with most OECD countries, state departments in South Africa are not obliged to conduct regulatory impact assessments before they introduce regulation.

The primary objective of this study was to assess the costs and benefits that will possibly accrue or decrease as a result of compliance with the legislation by a small to medium-sized consumer credit provider, which was registered with the MFRC. It was not the intention to conduct a full government-initiated RIA process, which is recommended to precede the law-making process.

The NCA regulates the conduct of institutions operating within the microfinance sector. The sector is constituted by a variety of institutions of varying sizes. The microfinance sector in South Africa comprises banks constituting a small percentage of all institutions operating within this sector but having amassed a greater market share. On average, the annual total disbursements of each bank are 30 times greater than private companies and over 500 times greater than close corporations. Public companies, section 21 companies, trusts and cooperatives constitute the remainder of the sector. In relation to other institutions operating within the sector, the banking institutions, on average, enjoy a greater branch network.

This study, which was initially intended to be approached as a survey, was subsequently conducted as a case study, after various data-gathering and sampling challenges were experienced. The possible impact of the NCA was determined using a small to medium-sized credit provider, who was registered with the MFRC and whose market profile resembles that of many small to medium-sized credit providers.

Prior to the introduction of the NCA, credit providers that were registered with the MFRC were permitted to charge unlimited interest rates, charges and fees; on condition that they were registered with the MFRC and that the interest rates and fees levied were agreed to by the consumer. Key amongst new NCA consumer protection measure introduced, such as reckless lending rules, giving effect to consumer rights, suspension of credit agreements, credit information reporting requirements, was the capping of fees, charges and interest rates. Greater emphasis was therefore placed on assessing the possible impact of the provisions of the NCA that relate to fees, charges and the interest rate on the profitability of a small to medium-sized credit provider. The impact was determined by means of a comparative analysis between the actual and estimated interest, charges and fees income generated before and after the provisions relating to fees, interest rates and charges come into force.

At the end of this study, the following key findings were made, that:

- Owing to varying degrees of economies of scale and scope of various institutions, the impact of the provisions relating to fees, charges and interest rates, is expected to be disproportionate and more adverse on small to medium-sized credit providers as opposed to larger institutions such as banks.
- Owing to the income reduction expected to be caused by the capping of fees, charges and interest rates, some of the small to medium-sized credit providers are expected to no longer be profitable, particularly the marginal ones. This situation may give rise to consolidations, and greater market concentration levels.
- The NCA is expected to create a new market segment of very small credit providers who do not need to register with the NCR. These provisions significantly challenge the product offerings of credit providers in favour of short-term credit agreements.
- Owing to very strict reckless lending rules, through which credit agreements could be suspended or re-arranged by the courts, compliance by the majority of registered credit providers is expected to improve until the consumer protection measures are tested in court. Consequently consumers are expected to enjoy significant advantages resulting from reduced repayment obligations. Over-indebted consumers are also

expected to enjoy the benefit of suspension or re-arrangement of their debt without losing their assets.

- There are certain provisions of the NCA that are not expected to have adverse impacts irrespective of the size of the institution, particularly, provisions relating to the imposition and variation of conditions of registration, compliance with provisions relating to application, registration and renewal fees, certificates, validity and public notice of registration will impact negligibly on most credit providers.
- The impact of giving effect to rights to reasons for credit being refused, information in the official languages, information in plain and understandable language and receiving documents, will similarly impact insignificantly on most credit providers as will the requirement to register credit agreements on the National Credit Register.
- Access to finance/credit will be limited to only those who are creditworthy, resulting in the dominance of the market, as is the case in the formal financial services offered, by large banks and corporates. The NCA appears to have placed greater emphasis on the protection of the borrower from over-indebtedness and predatory lending at the expense of access to finance, particularly, micro credit.

In light of these findings, the following key recommendations are made:

- The company (unless the context suggests otherwise, for purposes of this study, the word "company" is used to refer to the entity of the respondent) should consider a review of its product offerings in such a way that the return on invested capital is not eroded by the capping of fees, charges, and interest rates but is sustained or increased. At the practical level, the company and institutions that offer similar loan products to his company may need to increase their scale (the number of loans) by at least 20% of the current loan book if the current returns are to be sustained.
- The company may need to reduce operational costs in such a manner that the new dispensation does not impact negatively on the profitability of his business. The company will have to reduce operational costs by not less than the financial impact of the new regime on the profitability of its business if it wishes to continue to make the same profit. In the case of the company, operational costs should be reduced by at least 50% or R15 000 000.00
- Micro, small and medium credit providers should be protected from dominance by large sector players. One way of achieving this is to segment the supply side by introducing turnover thresholds for large, medium, small and micro sector players and confining them to advancing credit of a particular threshold to borrowers, in a similar manner to the previous dispensation, yet retaining the limitation of fees and charges. The advantage of such a system is its recognition of different cost structures prevalent in the sector. The current NCA regime presumes that regulation costs for all players are proportionately equal. In order words, the credit providers should be allowed to charge unlimited risk-based interest rates that are only limited by competition. All other fees and charges should be regulated. The difference between this proposal and the current situation, in which the Exemption Notice permits credit providers to charge unlimited interest rates and fees, is the limitation of fees and any other charges, as well as the protection offered by the reckless-lending rules and the entrenched consumer rights. In addition, under the current consumer protection rules that relate to collection methods, it is not expected that credit providers will easily be able to exploit borrowers.

In conclusion, these findings create a need for a more comprehensive study to be conducted over a period of time to assess the actual impact of the NCA on the financial viability of small to medium-sized credit providers and in general on access to finance, the resultant market structure, and market conduct.  In addition, the findings support the view that all decisions to regulate should be preceded by a government-initiated regulatory impact assessment.