Whose job is this and how do we get it done?

# Dealing with debt

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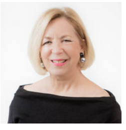
Authors and contributers



Anne Cabot-Alletzhauser

## Dealing with debt – the value destroyer for employee benefits and employee productivity

*Mind, Society and Behaviour*[1] reminds us that many interventions to change an individual or society's behaviour fail because we haven't identified the root of the problem. Think of a medic at a crash site. A preliminary scan of the victim reveals that he is suffering from a broken leg and cuts to the face. Stop the investigation there and the medic could well miss the fact that the victim has internal bleeding. The consequences of such an oversight would be dire.

When it comes to the issue of savings and retirement benefits, we are often guilty of just such an oversight. As boards of trustees, we spend hours assessing whether the asset managers of these savings vehicles are outperforming their benchmarks or their competitors. And yet, how many boards of trustees and management committees are thinking about the underlying reasons for inadequate replacement outcomes?

So, what did account for those abysmal outcomes for members? The greatest contributors to value destruction are savings periods that are too short (mainly as a result of poor preservation when changing jobs). It's not for nothing that National Treasury prioritised finding a way to enforce preservation without tipping families into economic hardship. Needless to say, their initial proposals drew heated debate. The prevailing view was that preservation couldn't become mandatory unless the government paid better attention to ensuring there were safety nets in place for individuals confronted with financial crisis.

Perhaps the question we need a better answer to is this: what's driving lack of preservation in the first place?

## Why would an individual cash in their retirement fund?

1. They were not told there were other options.
2. They are provided with no reason why not to when they change jobs.
3. The hassle factor of filling in complex forms to transfer to a preservation fund.
4. Financial pressures are so great that resigning from a job and cashing in their benefits provides some respite, albeit temporary.

**It's not totally clear which of these factors dominates the decision-making. What we do know is that we can go some ways to addressing the first two factors by:**

- making preservation the default option for anyone leaving an employer
- making it difficult for people to get access to that cash (they must present a reason why they must have the money)
- equipping the HR departments of both the old employer and the new employer with the tools to help people understand exactly what they are giving up when they don't preserve
- eliminating the hassle factor of transferring funds to a new employer or a preservation fund.

The problem is that for many South Africans, financial stress may be the driver in the decision to cash in their fund. The research results are far from conclusive, but anecdotal evidence suggests a distinct relationship between the number of garnishee orders a company has on its books and that company's level of turnover. This not only affects preservation numbers but impacts absenteeism and presenteeism[2].

The problem of debt has much broader implications than impacting on retirement benefits. It hits at the core of employee productivity and employee engagement. On one front, financial stress plays a disruptive part in keeping employees focused on work keeping employees employed and keeping employees engaged. On another front, financial stress issues undermine the best intentions (and considerable cost) of well thought out employee benefit offerings. Under financial duress, employees would rather take the cash.

Perhaps the story around preservation is the same as the story of our trauma doctor: the patient may end up dying from our treatment if we don't take the trouble to understand the problem of preservation in depth.

When an employee quits a job to access their savings, we need to be prepared to delve deeper. We need to understand how it is that so many South Africans are living in such a financially precarious situation that access to their long-term savings holds far greater sway in their lives than being able to retire comfortably in 30 years' time.


## Just how bad is it?

South Africa most decidedly has a debt problem. The numbers speak for themselves; 22.84 million credit-active consumers, 10.26 million with impaired credit records, which indicates how many people are at least three months behind in their payments. By that criteria, 55% of all active members are over-indebted[3]. But not all debt is from credit. These numbers don't include non-payment of rates and taxes, utilities or school fees. They also don't reflect the fact that one out of every two indebted people 'borrow' from informal money-lenders (mashonisas) at exorbitant rates, and often for the purposes of paying off formal debt obligations[4].

As Deborah James points out, untangling the debt web in South Africa is hugely complex[5].

Particularly telling was the response from the National Credit Regulator (NCR).

## The National Credit Regulator identified the following factors as catalysts for debt[6]:

- Bad planning
- Peer pressure
- "Wanting to live in the first-class lounge"
- Interest rate hike
- Retrenchments
- Ignorance
- Divorce

There is one important factor that the regulator failed to mention. Spending more than you earn may well be a problem, but having the means to spend more than you earn is also a problem. Nowhere on this list is the credit provider identified as a problem. Yet reckless lending and the spiralling interest rates that go with it must be held equally culpable. As James articulated in one of the interviews on her book, "I see many of these problems as structural and I view it as hypocritical that borrowers are asked to reform their behaviour when lenders are allowed to go free."

We can't tackle reckless lending in this publication – or why it seems to be a particularly South African problem[7]. That debate should exist in a different forum. But we do need to address why getting out of debt is unnecessarily difficult.

## The problem is not so much how South Africans get into debt, but how difficult it is to get out of debt.

While the National Credit Act may be an admirable starting point for providing reasonable and fair protection of consumer interests, the industry tasked with helping people pay off their debt and repair their credit standing is problematic. Rife with conflicts of interests, ineffective oversight or monitoring, inadequate levels of professionalism or value-enhancing administration, it is an industry in serious need of a regulatory overhaul.

The debt counselling industry is one of the newest entries in the vast variety of services that have emerged to address problems that affect an individual's financial wellbeing. Yet, from a regulatory perspective, standards, training requirements and market oversight for the industry have historically rested outside of the FSB. The National Credit Regulator reserves this power and reports into the Department of Trade and Industry. As such, regulation of the debt counselling industry is more closely aligned to banking than it is to the provision of a financial service.

At some level, this seems a rational division of labour. But the problem is that it creates a schism in the advisory industry. Financial advisers deal with people who have money that they need advice on, and debt counsellors deal with people who had money (at least in the form of credit) but one way or another ended up mismanaging their decisions around that access to money. Surely though, these are two sides of the same coin. Credit (debt) represents a critical financial lever for attaining such necessary lifetime assets as housing or transportation and other items that would require financing over time. Every financial advisory template should provide some insight into how to manage these commitments. And yet dealing with the consequences of debt mismanagement falls out of the ambit of financial advisers. Once an individual goes 'under water' on their credit commitments, they are handed over to debt counsellors, debt consolidators and debt managers whose sole focus is to deal with the legal threats of debt, not the long difficult business of restoring an individual to financial well-being.

# The debt industry

Case study/lesson

Dealing with debt has now become big business. Debt counsellors have become the largest collection agents for the banking industry[8]. But if we understand more about where the embedded conflicts and contradictions are in this highly profitable industry, then we can begin to appreciate why this is one industry that is due for a significant transformation, and what that transformation should look like.

We need to look at three core issues:

- Entrenched conflicts of interest
- Inadequate qualifications and professional processes
- The legal and regulatory quagmire of debt.

**Entrenched conflicts of interest**

Let's try to understand the business model of debt counselling. Regulations cap how much a service provider can earn in providing formal debt counselling services as stipulated in terms of section 86 of the *National Credit Act 34 of 2005 (NCA).* This means that, as a business, there is a strong incentive to:

- Find other related sources of revenue such as:
  - owning the payment distribution agency that takes fees on every transaction between the debtor and the creditor
  - providing a debt consolidation service that repackages debt and rolls it forward
  - providing insurance coverage for people applying for repackaged loans while service providers earn commission without being FAIS approved.
- Build a high-volume business by:
  - establishing tie-ups with entities such as credit providers to ensure that there is a steady stream of business
  - creating a high-volume servicing platform (call centres) that sacrifices personalised service.

From a business perspective, these would all seem like rational economic choices. But then ask this key question about each business choice the debt counsellor might make: how does that choice incentivise the counsellor to get the individual out of debt and keep them out of debt?

Each individual's debt crisis is personal. For each one there would be different reasons and circumstances that got them to that point of indebtedness. For that reason, getting them out of debt must also be understood from this highly individual-specific perspective. Logically we should see a close synergy between the debt counselling and the financial planning and advisory industries, but as it currently stands, there is a huge gap between these two entities.

## Qualifications and professional processes

Consider what a debt counsellor needs to be able to do to get a person out of debt:

1. Understand how and when someone can apply for debt review and determine whether that person is over-indebted.
2. Read and interpret credit bureau reports and information about the person's debt. Understand their spending and payment habits.
3. Investigate reckless credit and acquire all relevant documentation from both consumer and credit provider.
4. Investigate Section 103(5) Statutory In Duplum – this determines at the date of default, the maximum amount that a consumer can be charged. Interest charges, admin fee charges, insurance charges and all legal and collection costs are included in this determination.
5. Understand why the consumer is in their situation and put an action plan in place that mitigates the risks.
6. Restructure debt according to each consumer's personal needs.
7. Negotiate an agreement or arrangement in an authentic work situation, ensure legal work is completed and monitor consumer payments.
8. Counsel the consumer back into financial health and assist them to understand current laws and issues within the process and industry, and encourage them to change spending behaviours.
9. Complete annual assessments throughout their debt review cycle, and inform credit providers of changes of circumstances and of new repayment plans.
10. Issue a clearance certificate and communicate verbally with clients in a financial environment.

> **How long do you think it takes to qualify as a debt counsellor?**

With these skills in mind, appreciate that a prospective debt counsellor only has to complete a 10- day training programme before they sit the required exam. There are no stipulations for how they would 'learn their trade' after that, and no requirements for supervision or submission of their outcomes to any regulatory scrutiny. Their only guidelines are to have:

- a matric certificate
- no criminal record
- a clear credit history
- no history of mental illness.

The open book exam that debt counsellors write deals only with the theory of how things should work and provides no practical training.

Newly minted debt counsellors are thrown into the proverbial deep end. Yet, the job of a debt counsellor is that of a counsellor in every respect and with little to no external support. Failure and stress levels are understandably exceptionally high.

Nowhere in the definition of responsibilities for a debt counsellor is there any discussion about how to keep an individual who is emerging from debt out of debt once they have become solvent again. Therein lies a flaw in the model. If, as the spokesperson for the NCR has suggested, bad planning and ignorance are two important factors, then surely a rehabilitation programme needs to go further. But how do we ensure continuity of counselling?

Four factors stand in the way of debt counsellors fulfilling this role:

- Their training requirements appear to preclude any financial planning or coaching skills.
- They aren't paid enough to integrate this service into their debt counselling process as it currently stands.
- Financial coaching veers very close to financial planning or financial advice.
- They have little administrative support in an administratively intense field so they have no time to go beyond the basic requirements of their job.

*Debt counsellors need only complete a 10-day training programme before sitting an exam*

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The NCA provides no direction on what should happen to individuals once they have been released or cleared from the formal debt counselling process. Unfortunately many consumers are also eager to get back into the credit cycle because in their minds you only pay off your debt so that you can get more credit. This is where the intersection of three sectors needs the greatest focus, namely the financial sector, the debt counselling sector and the credit provider sector.

Regulators should insist that anyone who has come out of debt counselling and is applying for credit again should be mentored through a 'half-way house' programme. As in any abusive situation, there has to be a go-between to create stability and trust. This would also ensure that credit providers acted ethically and performed adequate credit affordability tests. It takes consumers coming into debt review about two years to settle into working only with cash and coping with the changes in their life; the same should apply when reintroducing them into the credit cycle[9].

**The legal and regulatory quagmire**
The spirit of the NCA is to ensure transparency and to assist those in need of financial assistance with debt mechanisms that could be used in various aspects and applications of the act. The fact that credit providers have not fully embraced this act has had a massive knock-on effect for not only the debt counsellor, but especially for the consumers it was meant to protect. Too many people have paid the price when good faith is not adhered to or legislation is not enforced on those who breach it. The most difficult part of legislation is not in the writing of the act or in its promulgation, but rather in enforcing it.

More than seven years later, credit providers are still finding loopholes and pushing the envelope in every aspect that they possibly can to avoid consumers paying off debts while being afforded the protections of various debt mechanisms under the act.

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## What needs to be done?

Although there has been considerable drama in the press about debt counselling we need to keep in mind that debt counselling has had a positive impact on the lives of thousands, if not hundreds of thousands, of South Africans. When it works, it has the potential to transform the lives of individuals and their families. The good news is that the more people understand the system in its current form, the better we'll become at addressing the problem areas. We have to give credit here to the financial media for assessing and reporting on what is clearly a complex system with any number of arcane problems.

## Concluding thoughts

There is a sharp divide in the financial servicing continuum. Our large insurance and asset management-driven businesses target one fundamental area of the market: people with money, whether that be disposable income or retirement savings assets. The issue of debt or financial crisis is relegated to a completely separate industry: the world of debt counselling. Unless we can integrate this segment of the 'complete financial well-being picture' into our mainstream model and uplift its promise to bust the vicious debt cycle, any ambitions the financial services industry has in transforming the savings culture of South Africans will be perpetually undermined.

The debt industry requires an unconflicted 'Big Brother'. That means mainstream financial services players whose business model is not contingent on lending, and who can get the right people in the right places to consider the right answers – or at least better answers. The debt counselling industry desperately needs more muscle to lobby for the necessary legislative changes to help the lending business come right.

Getting this right will provide an important foundation for effective workplace solutions around financial well-being.

### References

1. World Bank (2015)
2 Rea (2014)
3 National Credit Regulator (2014)
4 Haupt (2015)
5 James (2014)
6 City press 1 March 2015
7 See James (2014)
8 Haupt (2015)
9 Commentary by DCI, the Debt Counselling Industry

## Article tags

DEBT | PRESERVATION | CREDIT | DEBT COUNSELLING | EMPLOYEE PRODUCTIVITY