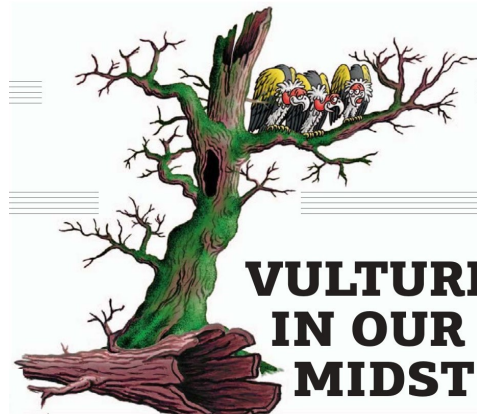


VULTURES IN OUR MIDST

More than half the 7.8-million South Africans with unsecured credit are in default on their loans. It's a broken system — and no-one seems to mind

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The whole mess is a betrayal of the initial promise of using lending to 'empower people'



Naeem Badat isn't your typical hedgefund manager. After graduating cum laude with a Bcom Hons in finance as the top student in his year, Badat started his career as an analyst at Investec before moving to Visio

Capital as a fund manager.

In November 2018, he and two top-rated analysts at

SBG Securities, Vincent Anthonyrajah and Musa Malwandla, set up their own outfit, Differential Capital. Their first major piece of research, published last week, is a 48-page vivisection of the unsecured lending industry, which they flag as "dysfunctional" and a "threat to society".

Now, some of SA'S blue-chip companies won't want to hear this. Certainly Capitec, which made its name through microloans, ostensibly in the name of "financial inclusion", would hotly dispute this. Ditto for African Bank, Finbond or furniture retailers such as Lewis.

But it's hard to disagree with their thesis: "Aggressive collection practices and extortionate pricing have ensured that even though about one-half of all unsecured lending consumers are in default, the lending industry remains highly profitable."

Speaking to the FM, Badat says he and his partners studied these lenders extensively as analysts. "We spent years getting into the guts of how they work, and the mechanics. That's how we can say that it's an industry that isn't effectively regulated, that, far from helping the country, has become one of its biggest problems."

Differential used data from credit bureau XDS, rather than relying on figures from the National Credit Regulator (NCR), which he says are not "as reliable". And the figures are arresting: 7.8-million South Africans owe R229bn in unsecured loans, roughly R29,000 each on average. And 56% of these people are in default.

Well, you might argue, what about "financial inclusion"? How can you empower people to better themselves without credit? It would be a valid argument — except that 75% of these loans are spent on straight consumption: food, cars, fuel, TV sets, things like that. And only one in 10 of those borrowers has a home loan.

The report concludes that far from being a mechanism by which poor black South Africans could extricate themselves from poverty, "high-cost unsecured loans used for personal consumption by largely financially illiterate con

sumers have blighted the chance of financial emancipation for many".

The demographics attest to this. Most borrowers earn less than R15,000 a month, either through salaries or social grants, and then use about a third of this to repay that loan. Take the mining sector: more than half of SA'S 450,000 miners have an unsecured loan, are paid less than R15,000 a month, and spend R7,500 of

their income servicing debt. "Is that sustainable?" Badat asks.

What makes this especially indefensible is the interest charged on these loans. The research shows that someone who takes out a one-month "payday loan" will end up paying, on average, an annualised interest rate of 225%.

This rate drops as the term extends. But even for an unsecured loan of between 60 and 90 months, the borrower will have to pay 37% annual interest. "The all-in cost of credit is egregious by any measure," the researchers say. "A person in need of a one-month loan is not likely to be able to pay an annualised yield of 225% without likely needing further loans, thus ensnaring them in a debt trap."

The lenders then make ludicrous profits. The annualised return on equity (ROE) for an unsecured loan of between two and six months, that doesn't end up in default, is 534%. For periods of one to two years, that ROE drops to 67%.

Is that a lot, you ask? Well, yes: Absa's entire business made a 16.4% ROE last year. It's a return that, Differential argues, "dwarfs all other forms of lending". In this way, "expensive loans used for consumption purposes create a transfer of wealth from the borrower to the lender — in

SA'S case, from the poor to the rich".

The whole mess is a betrayal of the initial promise of using lending to "empower people", and consumers have been badly let down by the NCR. So, for example, when African Bank was found guilty of reckless lending in 2013, it was fined just R20m. As if that was any incentive to change its ways.

Thankfully, Differential Capital proposes some ideas to change the status quo. Among them: set an upper loan limit of R40,000 for anyone earning less than R15,000 a month; prevent anyone from having more than one microloan at a time; keep the term of any loan to less than three years; and institute a seven-day "cooling off" period for any loan. Importantly, the analysts also propose limiting the "all-in cost" that borrowers must pay to whichever is lower: prime plus 15% (now 25.25%), or 30%.

It's a searing critique from a fledgling company that only recently began managing money. But what does Differential hope to get from this?

"We want to be strong on governance, and we want to use our position to change the country. In particular, we want to challenge the asset management industry to seriously question whether it's right that they invest in businesses like this," he says.

Badat, during his time at Visio, met the trustees of the Government Employees Pension Fund to discuss the issue. "Everyone says they're 'investing responsibly', but is that really true? Who is having these discussions, or holding people accountable?" he asks.

The time for looking the other way is past, he says. At this point, inaction is action.