The regulation of micro lending in Botswana

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(Potchefstroom Campus)

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I dedicate this work to my beloved late grandfather Shadreck Zulu Bakwali. To my sweet grandmother Ntombi Lesetedi who in 1995 registered me for primary education at Makobo Primary School. This is the fruition of your investment in my education and may God be with you to witness many more of my life achievements.

To my mother Sekane Buka and my aunt Annah Kotlhao-Mogapi, you remain pillars of my strength and sources of inspiration for having given my life purpose and direction.

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ABSTRACT

The debates on whether or not to regulate micro lending have shifted to finding the appropriate regulatory models. This is because countries are in agreement that being part of the greater financial services sector, micro lending plays an important role in the economic and social development of the citizens as it enables the poor to have access to credit and better their lives. To this end, Botswana has not fallen short of this global trend. Micro lending regulation plays an important role in maintaining the financial safety and soundness of any country’s financial sector. If not properly regulated, the micro lending industry can lead to undesirable incidents like financial crisis and suicide cases as it was the case in the State of Andhra Pradesh of India where borrowers were over-indebted leading them to commit suicide.

Since there is not a perfect regulatory model, countries have over the years formulated regulatory frameworks for micro lending. Some of the laws failed and created more problems than they were in fact intended to solve like the 2010 financial crisis in India. In 2008 Parliament of Botswana enacted the Non-Bank Financial Institutions Regulatory Authority Act in order to regulate (NBFIs), including micro lenders. The primary purpose of this study is to scrutinize the mechanisms in place for the regulation and supervision of micro lenders in Botswana in light of those set internationally and subsequently deducing their effectiveness or lack thereof. The comparative analysis will focus on South Africa and India’s State of Andhra Pradesh.

Key words: Botswana, financial regulation, micro lender, twin peaks, South Africa and India
OPSOMMING

Die debat oor die vraag of mikro-lenings hoegenaamd gereguleer moet word, het verskuif na die vind van toepaslike regulatoriese modelle. Dit is omdat lande dit eens is dat mikro-leners, as deel van die groter finansiële dienstesektor, 'n belangrike rol speel in die ekonomiese en maatskaplike ontwikkeling van die burgers aangesien dit toegang tot krediet gee en lewens verbeter. Wat in Botswana gebeur, is ook aanduidend van hierdie wêreldwyse tendens. Die regulering van mikroleners speel 'n belangrike rol in die handhawing van die finansiële veiligheid en gesondheid van 'n land se finansiële sektor. As die sektor nie behoorlik gereguleer word nie, kan die mikro-leningsbedryf lei tot ongewenste voorvalle soos 'n finansiële krisis en selfmoordgevalle soos dit die geval was in die staat van Andhra Pradesh in Indië.

Omdat daar geen perfekte regulatoriese model is nie, het lande oor die jare heen regulatoriese raamwerke vir mikroleners geformuleer. Sommige van die wette het misluk en meer probleme veroorsaak as wat hulle in werklikheid geplante het om op te los, soos byvoorbeeld die 2010 finansiële krisis in Indië. In 2008 het die Parlement van Botswana die Non-Bank Financial Institutions Regulatory Authority Act verorden, ten einde NBFIs, insluitende mikro-leners, te reguleer. Die primêre doel van hierdie studie is om die mekanismes te ondersoek vir die regulering en toesig van mikro-leners in Botswana in die lig van dié wat internasionaal daargestel is, en om daarna hulle doeltreffendheid of die gebrek daaraan te bepaal. Die vergelykende analyse sal fokus op Suid-Afrika en Indië se staat van Andhra Pradesh.

Sleutelwoorde: Botswana, finansiële regulering, mikro-lener, tweelingpieke, Suid-Afrika en Indië
THE RESEARCH FOR THIS STUDY WAS COMPLETED ON THE 1st NOVEMBER 2014. THE STUDY REFLECTS THE LEGAL POSITION IN BOTSWANA, SOUTH AFRICA & INDIA’S STATE OF ANDHRA PRADESH AS OF THIS DATE
# Table of Contents

Chapter 1 Introduction ................................................................................................................. 1

1 Chapter 2 Forms of Financial Regulation .................................................................................. 5

2.1 What is financial regulation? ..................................................................................................... 5

2.2 Objectives of financial services regulation ................................................................................. 7

2.2.1 Consumer protection ............................................................................................................. 8

2.2.2 Anti-money laundering .......................................................................................................... 9

2.2.3 Safety and soundness of financial institutions ..................................................................... 9

2.3 Forms of financial regulation .................................................................................................. 11

2.3.1 Unified regulator .................................................................................................................... 12

2.4 Conclusion .................................................................................................................................. 18

Chapter 3 Botswana’s micro lending regime ................................................................................. 20

3.1 A synopsis of Botswana’s financial sector ................................................................................ 20

3.1.1 Micro lending in Botswana .................................................................................................. 21

3.1.2 The legal regulatory framework in Botswana ....................................................................... 22

3.2 How NBFIRA achieves its overarching objectives in regulating micro lending ................. 24

3.2.2 The structure of the NBFIRA ............................................................................................... 24

3.3 Micro lending regulation framework ........................................................................................ 26

3.3.1 Supervision and monitoring mechanisms ........................................................................... 26

3.4 Conclusion .................................................................................................................................. 34

Chapter 4 Trends and developments: South Africa and India’s State of Andhra Pradesh .......... 36

4.1 The system in place ..................................................................................................................... 36

4.2 Twin peaks .................................................................................................................................. 37

4.2.1 Twin peaks vis-a-vis a unified regulator .............................................................................. 42

4.3 Regulation of micro lending in South Africa .......................................................................... 42

4.3.1 Genesis of the National Credit Regulator ......................................................................... 43

4.3.1 The role of the National Credit Regulator in micro lending regulation ......................... 46

4.5 India .......................................................................................................................................... 56

4.4.1 Micro lending in the State of Andhra Pradesh ................................................................. 57

4.5 The State of Andhra Pradesh: 2010 Microfinance crisis ....................................................... 63

Conclusion ...................................................................................................................................... 63
Chapter 6 Conclusions and recommendations ................................................................. 65

6.1 Introduction .................................................................................................................. 65

6.2 Botswana and South Africa’s regulatory regimes ....................................................... 66

6.3 India’s State of Andhra Pradesh .................................................................................. 67

6.4 Recommendations ...................................................................................................... 67
   6.4.1 Debt counselling restructuring for the overly-indebted ...................................... 67
   6.4.2 Reckless lending .................................................................................................... 67
   6.4.3 Consumer education ............................................................................................ 68

6.5 Conclusions .................................................................................................................. 69

Bibliography ...................................................................................................................... 70

Literature ............................................................................................................................ 70

Thesis and dissertations .................................................................................................... 73

Case law ............................................................................................................................. 74
   Botswana .......................................................................................................................... 74
   South Africa ...................................................................................................................... 74

Legislation ........................................................................................................................... 74
   Botswana .......................................................................................................................... 74
   India .................................................................................................................................. 75
   South Africa ...................................................................................................................... 75

Conference contributions ................................................................................................. 76

Newspaper Articles ............................................................................................................ 77

Internet sources ............................................................................................................... 77
**LIST OF ABBREVIATIONS**

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
</tr>
</thead>
<tbody>
<tr>
<td>ADB</td>
<td>African Development Bank Group</td>
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<tr>
<td>CGAP</td>
<td>Consultative Group to Assist the Poor</td>
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<tr>
<td>EJHSS</td>
<td>European Journal of Humanities and Social Sciences</td>
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<td>GARJMJBS</td>
<td>Global Advanced Research Journal of Management and Business Studies</td>
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<td>GJFM</td>
<td>Global Journal of Finance and Management</td>
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<tr>
<td>JBMD</td>
<td>Journal of Business Management and Dynamics</td>
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<tr>
<td>JFRC</td>
<td>Journal of Financial Regulation and Compliance</td>
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<td>JURUT</td>
<td>Journal of Undergraduate Research at the University of Tennessee</td>
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<td>NCA</td>
<td>National Credit Act</td>
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<td>NCR</td>
<td>National Credit Regulator</td>
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<td>NBFIs</td>
<td>Non-Banking Financial Institutions</td>
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<td>NBFIRA</td>
<td>Non-Bank Financial Institutions Regulatory Authority</td>
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<tr>
<td>Nw J. INT’L L. &amp; Bus</td>
<td>North Western Journal of International Law and Business</td>
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<td>SA Merc LJ</td>
<td>South African Mercantile Law Journal</td>
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<td>UBLJ</td>
<td>University of Botswana Law Journal</td>
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<td>UK</td>
<td>United Kingdom</td>
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<td>YHRDLJ</td>
<td>Yale Human Rights and Development Journal</td>
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Chapter 1

1 Introduction

Botswana gained independence on the 30th September 1966. At the time, the country’s GDP stood at a paltry $70 million.¹ Since then, the country’s economy has undergone a tremendous growth and transformation, making it one of Africa’s development success stories despite its small population. Through a well-managed economy and political stability, the country’s GDP stands at $14.79 billion and is currently ranked as an upper middle income country.² This success story can be linked to the country’s financial system because an efficient, safe and financially sound financial sector stimulates economic growth.³ It is therefore important that financial institutions and the financial sector as a whole be closely guarded given their vital role in economic growth. Botswana has not fallen short in safeguarding its diverse financial sector. According to Bojosi,⁴ the promulgation of laws aimed at regulating all the Non-Banking Financial Institutions (NBFIs) is a welcome development which is in line with the Government’s long-term goals of economic diversification and making the country Southern Africa’s financial hub.

As part of the Government’s initiative of fostering the development of the country’s financial services,⁵ the legislature in 2006 enacted a statute which came to be known as the Non-Bank Financial Institutions Regulatory Authority Act⁶ (herein after NBFIRA Act). The objectives of this Act as reflected on its preamble are;

An Act to provide for the regulation of non-bank financial institutions for the purpose of enhancing the safety and soundness of non-bank financial institutions, setting high

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4 Bojosi UBLJ 2012 29-51.
standards of conduct of business by non-bank financial institutions, improving the
clearness, efficiency and orderliness of the non-bank financial sector and the stability of the
financial system and reducing and deterring financial crime and for purposes incidental
thereto and connected therewith.\textsuperscript{7}

The Act established a regulatory authority known as the Non-Bank Financial Regulatory
Authority\textsuperscript{8} whereby its principal object is to regulate and supervise NBFIs so as to foster
inter alia (i) safety and soundness of NBFIs,\textsuperscript{9} (ii) stability of the financial system\textsuperscript{10} and
(iii) reduction and deterrence of financial crime.\textsuperscript{11} According to the African Development
Bank,\textsuperscript{12} NBFIRA represented a risk based regulatory model which is in line with
international best practices. Since the micro lending sector in Botswana is categorized
under the NBFIs, NBFIRA is now the regulatory authority of this industry. For a long
time, this sector was operating in a free market without any form of regulation. This
however was a worrying concern because the public was at the receiving end of issues
ranging from over-indebtedness to withholding of official documents like identity cards
and usurious interest rates of up to 50 percent per month by unscrupulous micro
lenders.\textsuperscript{13} The NBFIRA Act on the other hand is umbrella legislation for all NBFIs under
its purview. Therefore the regulation of micro lending to this end was not extensively
addressed under the Act except for general provisions which dealt with all NBFIs. This
prompted the Minister of Finance and Development Planning to exercise powers\textsuperscript{14}
granted upon him and made the Non-Bank Financial Regulatory Institutions Authority
(Micro Lending) Regulations, 2012\textsuperscript{15} (herein after Micro Lending Regulations 2012).

The Micro Lending Regulations marked a new era in the regulation of micro lending in
Botswana as now there are rules of regulation in place with which all micro lenders have

\textsuperscript{7} Non-Bank Financial Institutions Regulatory Authority Act of 2006.
\textsuperscript{8} Section 6 of the NBFIRA Act 2006.
\textsuperscript{9} Section 8(a) of the NBFIRA Act 2006.
\textsuperscript{10} Section 8(d) of the NBFIRA Act 2006.
\textsuperscript{11} Section 8 of the NBFIRA Act 2006.
\textsuperscript{12} www.afdb.org/fileadmin/uploads/afdb/Documents/Project-Related-
Procurement/EOIBotswanaRBRM Rev12-10pdf.
\textsuperscript{13} Madibana Sunday Standard 5.
\textsuperscript{14} Section 105 of the NBFIRA Act 2006.
\textsuperscript{15} Statutory Instrument No 14 of 2012.
to comply. To this end, the NBFIRA Act as the enabling legislation remains the primary legislation in the regulatory framework whereas the Micro Lending Regulations are supplementary thereto. Against this background, the primary purpose of this study is to closely scrutinize the mechanisms in place for the regulation and supervision of micro lenders in Botswana in light of those set internationally and subsequently deducing their effectiveness or lack thereof.

In light hereof, the research question addressed by this study is: To what extent does the *Non-Bank Financial Institutions Regulatory Authority Act* of 2006 address the needs of the regulation of micro lenders in Botswana?

The regulation of micro lending forms part of financial regulation. Therefore as a build up from Chapter One, the study in its second Chapter aims at providing an overview of the need for financial regulation and different forms of financial regulations, the advantages thereof. The general overview of financial regulation forms a solid foundation, paving the way for Chapter Three which deals with Botswana’s micro lending regime. It is in this Chapter wherein a brief synopsis of Botswana’s financial sector will be provided so as to locate the portfolio under which micro lending falls. Once such portfolio is identified, Chapter Three will then analyse the regulatory framework of Botswana’s micro lending regime by looking at certain regulatory provisions of both the Act\textsuperscript{16} and the Regulations\textsuperscript{17} and critiquing their effectiveness or lack thereof.

Chapter Four will focus on trends and developments that have occurred or are in place in other jurisdictions, particularly South Africa and India’s State of Andhra Pradesh. With reference to South Africa, the regulation of micro lending will be comparatively discussed in light of the *National Credit Act*\textsuperscript{18} and the National Credit Act Regulations.\textsuperscript{19} The functions of the National Credit Regulator will also be put under the spot light and be thoroughly compared with those of the NBFIRA in ensuring that micro lenders are

\begin{itemize}
  \item \textsuperscript{16} *NBFIRA Act* 2006.
  \item \textsuperscript{17} Micro Lending Regulations 2012.
  \item \textsuperscript{18} *National Credit Act* 34 of 2005.
  \item \textsuperscript{19} GN R489 in GG 28864 of 31 May 2006.
\end{itemize}
regulated. The study in Chapter Four, will then consider the 2010 financial crisis in India’s State of Andhra Pradesh and the regulatory framework in that state compared with that of Botswana. Lastly, as the concluding chapter, Chapter Five will contain brief summaries of discussions and conclusions drawn in the entire study and recommendations will be made based on the findings herein.
CHAPTER 2 Forms of Financial Regulation

2.1 What is financial regulation?

Financial regulation plays a crucial role in the economic development and financial stability of any country. There is no a well-defined and universally accepted definition of what regulation means. However, Howard and David\(^\text{20}\) have defined financial regulation as

the process of authorizing, regulating and supervising financial institutions themselves, and the traded markets within which they operate.

From the above definition it is evident that financial regulation encompasses three elements being: Authorization, regulation and supervision. This definition is an all -rounder in that it recognizes that financial markets exist upon being given authority for them to operate within certain rules that are meant to regulate their conduct and such rules are enforced by way of supervision to ensure compliance. Another working definition by Carmichael and Pomerleano\(^\text{21}\) defined financial regulation as "rules that govern commercial behaviour in the financial system". The application of these regulatory rules can manifest in two ways; They may either be self-imposed by the industry players or be enforced by a government or quasi-governmental authority which will be operating as a regulatory authority tasked with the oversight of activities of financial institutions.\(^\text{22}\)


\(^{21}\) Carmichael and Pomerleano *The Development and Regulation* 21.

\(^{22}\) Olorunshola "Financial System Regulation in Nigeria: Theoretical Framework and Institutional Arrangements".
Although the terms ‘regulation’ and ‘supervision’ are sometimes used interchangeably, ‘supervision’ according to CGAP\textsuperscript{23} is "the systematic oversight of market participants to ensure they comply with the rules." On the other hand, ‘regulation’ as per Llewellyn\textsuperscript{24} is the process of monitoring that institutions are conducting their business either in accordance with regulations or more generally in a prudent manner.

Therefore ‘regulation’ typically refers to the rules that govern the behaviour of financial institutions whereas ‘supervision’ is the oversight that takes place to ensure financial institutions comply with those rules.\textsuperscript{25} The above distinction is important as observed by Chiumya\textsuperscript{26} because where the two components are split between different agencies, they may have different policy implications. Therefore ‘regulation’ and ‘supervision’ denote respectively the establishment of rules relating to a particular industry and the monitoring and enforcement thereof.\textsuperscript{27}

Financial regulations in practice tend to be a mosaic of both externally radiated and self-imposed regulations. This may be reflective of the ongoing tug of war, and perhaps a compromise, between competing regulatory ideologies. On one hand there are arguments for self-regulation which are based on the free market ideology comprising a whole gamut of postulates- the idea that markets are more apt at making decisions concerning them to the idea that government is ill-equipped to regulate the markets.\textsuperscript{28} The counter argument is that under a self-regulation model, the financial markets will be subjected to abuse, thus exposing the system to financial risk.\textsuperscript{29} Despite these divergent ideologies, most jurisdictions have regulatory authorities which promulgate extensive regulations for financial institutions. Even though there are variations in terms of the

\textsuperscript{23} CGAP 2012 http://www.cgap.org.
\textsuperscript{24} Chiumya The Regulation of Microfinance Institutions: A Zambian case study.
\textsuperscript{25} Barth, Caprio and Levine 2002 Bank Regulation and Supervision
\textsuperscript{26} Chiumya "The Regulation of Microfinance in Zambia".
\textsuperscript{28} Wood The Law and Practice of International Finance 341.
\textsuperscript{29} Wood The Law and Practice of International Finance 341.
regulatory authorities, the manner of regulations and types of regulations, it appears that all these debates are in agreement that there is a need for regulation. 30

Therefore ‘regulation’ must be understood in the context of rules that have been put in place in order to govern the behaviour conduct of financial ‘institutions’, whereas ‘supervision’ will be comprised of an oversight body which is tasked with ensuring that financial institutions comply with the set rules as per Llewellyn. 31

2.2 Objectives of financial services regulation

The importance of financial systems as a key factor to economic drive and development is accepted and well established world-wide. Financial regulation serves a number of objectives. 32 Beston 33 argues that regulation in practice serves the interests of Governments, regulators and financial firms, but it is mostly detrimental to the consumers. Contrary to Beston, 34 Llewellyn 35 highlights three core objectives: (i) to sustain systematic stability (ii) to maintain the safety and soundness of financial institutions and (iii) to protect the consumer. Therefore Llewellyn’s 36 understanding of the objectives of financial regulation is the most favoured as it encompasses the three parties involved in the regulation of the financial sector. Another school of thought on the objectives of financial regulation as propounded by Mwenda 37 is that there is no theory of financial services regulation. Nevertheless the following is comprised of some broad objectives for regulation: 38

Protecting investors to help build their confidence in the market, ensuring that the markets are fair, efficient and transparent, thereby reducing systematic risk,

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30 Mwenda Legal Aspects of Financial Services and the Concept of a Unified Regulator 9.
31 Llewellyn Regulation and supervision of financial institutions 19.
32 Aspinwall Conflicting Objectives in Financial Regulation 53.
37 Mwenda Legal Aspects of Financial Services 21.
38 Llewellyn "Institutional structure of financial regulation".

7
protecting financial businesses from malpractice by some consumers (such as money laundering) and maintaining consumer confidence in the financial system

Therein lies the financial institutions offering different products and services, and consumers who make use of such commodities. On the other hand there is the Government which must ensure that the transaction between the two parties is in line with the best financial business practice which will enhance and foster economic growth.

The following, though not conclusive, are some of the main objectives of financial regulation:

2.2.1 Consumer protection

Financial regulation is also designed to protect customers and investors through business conduct rules.\textsuperscript{39} Policies and laws which are consumer orientated within a financial sector are vital as they contribute not only to protecting consumers of financial credit but also towards ensuring that financial markets remains competitive and by so doing leading to financial stability.\textsuperscript{40} While it is important to protect consumer rights, it is also important to recognize that these rights do come with consumer responsibilities.\textsuperscript{41} Therefore financial regulation as per the Financial Stability Board\textsuperscript{42} must be understood in the context that:

"Consumer protection is not about protecting consumers from bad decisions but about enabling consumers to make informed decisions in a market place free of deception and abuse."

It is against this backdrop that it is submitted that consumers can only make informed decisions, provided there has been availability of information to enable them thereto. The protection of the consumer must not only arise from the institution which such consumer is engaged into a transaction, but it must also extend to protecting a

\begin{itemize}
\item [40] Financial Stability Board \textit{Consumer Finance Protection with particular focus on Credit 3}.
\item [41] Financial Stability Board \textit{Finance Protection with particular focus on Credit 1}.
\item [42] Financial Stability Board \textit{Finance Protection with particular focus on Credit 3}.
\end{itemize}
consumer from other future transactions.\textsuperscript{43} Therefore, financial literacy is fundamental to any regulatory or supervisory mechanism aimed at consumer protection within the financial services sphere.

\subsection*{2.2.2 Anti-money laundering}

Financial regulation acts as a tool to aid against money laundering. Through supervision and enforcement of financial laws, criminal activities that pose risks to the reputation and financial strength of an institution are detected and averted before they can destroy the livelihood of the financial sector.\textsuperscript{44}

\subsection*{2.2.3 Safety and soundness of financial institutions}

According to White\textsuperscript{45}

The general goal is to protect the liability holders of such institutions from the losses that would arise from the insolvencies of the institutions, as well as specifically to preserve the systematic stability of banking systems.

It is therefore without doubt that through supervision and regulation of financial institutions, a sound and safe financial system can be attained.

\subsection*{2.2.4 Mitigation of systematic risk}

Systematic risk was defined by the G30\textsuperscript{46} as "impairment of the overall functioning of the system caused by the breakdown of one or more of the key market components". The main basis of financial supervision is to ensure the monitoring of the financial system as a whole and guard against and even mitigate systemic risk which may ensue. Some regulators have achieved this goal by statutory mandate whereas others, simply

\begin{thebibliography}{99}
\bibitem{44} Kioga \textit{Journal of Business Management Dynamics} 01-14.
\bibitem{45} White "The role of Credit Reporting Systems in the International Economy".
\bibitem{46} G30 2008 http://www.group30.org.
\end{thebibliography}
appreciated the concept, understood and adopted it.\textsuperscript{47} According to a report by the G30\textsuperscript{48} this would seem to be the most incontrovertible goal, and the most challenging to achieve. Financial systems cannot function effectively without confidence in the markets and financial institutions. A major disruption to the financial system can reduce confidence in the ability of markets to function, impair the availability of credit and equity, and adversely impact real economic activity.

\textbf{2.2.5 Fairness and efficiency of the markets}

The ultimate criterion for devising a structure of regulatory agencies must be the effectiveness and efficiency of regulation: Effectiveness relates to whether the objectives are met while efficiency relates to whether they are met in an efficient way and without imposing unnecessary costs on consumers and regulated firms.\textsuperscript{49} Well-functioning markets are characterized by efficient pricing, which is achieved through market rules concerning the wide availability of pricing information and prohibitions against insider trading and anticompetitive behaviour.\textsuperscript{50} Therefore optimal decisions can be arrived at on the basis of availability of information and transparency.

\textbf{2.2.6 Financial inclusion}

Financial inclusion as defined by Sarma\textsuperscript{51} is "a process that ensures the ease of access, availability and usage of the formal financial system for all members of an economy". Therefore, an inclusive financial system is one which has many consumers of financial credit especially those drawn from the low income sectors of society and the unbanked. To this end, laws aimed at financial regulation must encompass elements of financial inclusion as observed by Moloi\textsuperscript{52} who is of the view that by decreasing the cost of service, financial institutions will increase access to credit by the unbanked.

\textsuperscript{49} Llewellyn 1998 \textit{JFRC} 312-319.  
\textsuperscript{50} G30 2008 http://www.group30.org.  
\textsuperscript{51} Sarma "Index of financial Inclusion".  
\textsuperscript{52} Moloi \textit{Strategies for optimizing financial inclusion in South Africa} 93.
Moreover, the use of technology such as mobile money is great initiatives geared towards financial inclusion. To this end, financial regulation plays a vital role in ensuring that a majority of the poor class and the unbanked have access to financial credit either formal or non-formal.

2.3 Forms of financial regulation

Traditionally financial regulation and supervision centered on distinct and separate bodies with different responsibilities, with each entity tasked with the regulation of a specific financial sector. Perhaps this model was influenced by a lack of understanding and appreciation of the relationship between different financial sectors. However trends show a gradual shift and restructuring of financial regulation and supervision methods favouring unified regulatory model which basically supervises two or more financial sectors.\(^{53}\) Countries have gradually moved towards some form of unified regulation based on a twin peaks or multiple peaks model or even on a single peak model.\(^{54}\)

As observed by Mwenda,\(^{55}\) a regulator may be partially unified or fully unified. The term 'single regulator' commonly refers to a fully unified regulator. It is therefore submitted that the model or form of financial regulation which any country may seek to adopt is dependent on several factors but not limited to market size and the underlying objectives forming the basis for regulation. That is to say, what exactly does a given proposed financial regulation mechanism seek to achieve? The 2008 global financial crisis has demonstrated the weakness of a light-touch financial regulatory system.\(^{56}\) The dilemma that faces most countries is that the financial sector is integrated, but regulated nationally. For this reason, there needs to be minimum international standards and greater co-ordination among different national regulators.\(^{57}\) Internationally, debates have gradually shifted to whether there should be regulation to what form regulation

\[\text{References:}\]
\(^{53}\) Mwenda 2003 German Law Journal 1010-1011.
\(^{54}\) Madise Developing an Independent Regulatory Framework 1.
\(^{55}\) Mwenda Legal aspects of Financial Services Regulation 28.
\(^{56}\) The task team, known as the Financial Regulatory Reform Steering Committee.
\(^{57}\) The task team known as the Financial Regulatory Reform Steering Committee.
should take.\textsuperscript{58} It is therefore argued that the issue of whether there is need for financial regulation is well settled but now the main challenge is the forms which such regulation must take in order to safeguard the financial stability and interests of any given state. With that been said, it is important to acknowledge that a financial system is made up of different financial sectors.

Therefore the issue at hand is finding a form or forms of regulation which can effectively regulate these diverse financial sectors. Therefore the very existence of a plethora of financial regulatory regimes supports the prevalent view that there is no single ‘model’ regulatory regime.\textsuperscript{59} Increasingly, debates have focused on whether there should be a single or unified regulator for each sector within the financial system or whether there should be separate regulators for each of the sectors as propounded by Mwenda.\textsuperscript{60}

\textbf{2.3.1 Unified regulator}

In major markets globally there has been a growing restructuring trend towards unification of responsibility for the regulation of different financial sectors such as banks, and insurance companies.\textsuperscript{61} The unified or integrated model is where the financial regulation and supervision covering banking, securities and insurance markets is completely integrated. In the integrated model there is a single universal regulator that conducts both safety and soundness oversight and conduct of business regulation for all the sectors of financial services.\textsuperscript{62}

For countries that are major financial centers,\textsuperscript{63} an important argument in favor of the single regulator model is that it matches the nature of their markets, in that the

\begin{itemize}
\item \textsuperscript{58}Bojosi 2012 \textit{UBLJ} 29-51.
\item \textsuperscript{59}Bojosi 2012 \textit{UBLJ} 29-51.
\item \textsuperscript{60}Mwenda \textit{Legal Aspects of Banking Regulation} 38.
\item \textsuperscript{61}Mwenda and Fleming "International Developments in the Organizational Structure"
\item \textsuperscript{62}Botha and Makina 2011 \textit{International Business and Economic Research Journal} 30.
\item \textsuperscript{63}Briault "The rationale". See also Abrams and Taylor "Issues in the unification". The said authors are of the view that the argument that a single regulator is suitable in countries which are major financial centers, maybe less significant to countries with smaller or less mature markets.
\end{itemize}
emergence of financial ‘supermarkets’ and increasing use of sophisticated techniques such as securitization and derivatives trading have broken down the traditional sectorial distinctions.64 Under this model, the prudential supervision of all financial firms vests in one agency which is also responsible for conduct of business regulation and supervision of such firms.65 This form of regulation is a combination of both prudential regulation and conduct of business regulation housing all financial institutions and markets under one roof. This is in line with Mwenda66 who is of the opinion that "a fully unified financial services regulator will normally supervise all business activities in the financial sector."

A classic example of this model is the one adopted by the UK in 1997.67 Several scholars have advanced arguments for the advantages of a unified model.68 The arguments relate to such factors as the economies of scale and scope that arise because a single regulator can take advantage of a single set of central support services; increased efficiency in allocation of regulatory resources across both regulated firms and types of regulated activities; the ease with which the unified regulator can resolve efficiently and effectively the conflicts that inevitably emerge between the different objectives of regulation; the avoidance of unjustifiable differences in supervisory approaches and the competitive inequalities imposed on regulated firms when multiple specialist regulators have inconsistent rules; and, where a unified regulator is given a clear set of responsibilities, the possibility of increased supervisory transparency and accountability.69

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64 Briault "The Rationale".
65 Llewellyn "Institutional structure of financial regulation".
66 Mwenda Legal Aspects of Financial Services Regulation 38.
67 According to Llewellyn, in May 1997, the incoming Government in the UK announced a wide range of reforms of institutional structure of financial regulation and the creation of the Financial Services Authority responsible for all prudential and conduct of business regulation. This new single regulator was responsible for prudential and conduct of business regulation and supervision for all financial institutions and markets, thus a unified regulator concept.
68 Mwenda Legal Aspects of Financial Services Regulation 41.
69 Mwenda made reference to Briault "The rationale for a single national financial services regulator" Occasional paper series no.2 (Financial Services Authority May 1999). See also Briault "A single regulator for the UK financial services industry".
2.3.1.1 Advantages of a unified regulator

The following are some of the reasons in favour of a unified regulator and they do not aim to be exhaustive but rather give a summary form of those advantages as discussed and analyzed by other scholars.

2.3.1.1.1 The economies of scale

The proponents of a single supervisory body underline the economies of scale and the improvement in the overall comprehensive monitoring of different financial institutions.\(^70\) To Taylor and Fleming\(^71\) the economies of scale can be achieved through centralized regulatory functions that permit the development of joint administrative, information technology, and other support functions. This notion is also supported by Richard and Taylor\(^72\) who are of the opinion that a unified regulator offers a better prospect of coordination and the exchange of information than would occur between separate agencies. By placing all the financial sector supervisors for a given conglomerate under a single agency, one creates a single management structure that should be able to instruct and if need be, force the various operating divisions to closely cooperate and share information as it becomes available.\(^73\) Therefore armed with a single set of central support services, it is argued that a unified regulator is better placed to address major financial regulatory issues. To Mwenda\(^74\) a simplified single regulator can provide a system of operation that is user-friendly to both regulated firms and consumers.

2.3.1.1.2 Regulatory flexibility

A unified regulator allows for the development of regulatory arrangements that are more flexible than can be achieved with separate specialists' agencies. Whereas the effectiveness of a system of separate agencies can be impeded by “turf wars” or a

\(^{70}\) Siregar and Williams "Designing an integrated financial supervision".
\(^{71}\) Taylor and Fleming "Integrated financial supervision".
\(^{72}\) Richard and Taylor "Assessing the case for unified financial sector supervision" 22.
\(^{73}\) Richard and Taylor "Assessing the case for unified financial sector supervision" 470.
\(^{74}\) Mwenda Legal Aspects of Financial Services Regulation 43.
desire to “pass the buck”, these problems can be more easily limited and controlled in a unified regulatory organization.\textsuperscript{75}

2.3.1.3 Regulatory efficiency

According to Richard and Taylor,\textsuperscript{76} as a matter of general principle, a larger size of organization permits finer specialization of labour and a more intense utilization of inputs. In a regulatory context, unification may permit cost savings on the basis of shared infrastructure, administration and support systems.\textsuperscript{77} Therefore when all financial sectors are unified, the coordination and implementation of resources are not duplicated as the case may be with specialized agencies.

2.3.1.4 Accountability

One advantage of a unified agency is that by creating a single management structure, it should be clear to politicians, industry and the public who should be held to account for particular regulatory actions or failures.\textsuperscript{78} This is so because the hierarchy of management is easily identifiable and every sector may have an overseer who is responsible for its daily management.

2.3.1.2 Disadvantages of a unified regulator

Some of the possible shortcomings of this model as pointed out by Mwenda\textsuperscript{79} is the possibility that a unified regulator may erode traditional functional distinctions between financial institutions and that it may not have a clear focus on the objectives and rationale of regulation.\textsuperscript{80} There is also fear that a unified regulator may lead to cultural conflict within the agency when regulators come from different sectors. It is also argued

\begin{itemize}
  \item Richard and Taylor "Assessing the case for unified financial sector supervision" 472.
  \item Richard and Taylor "Assessing the case for unified financial sector supervision" 472.
  \item Richard and Taylor "Assessing the case for unified financial sector supervision" 473.
  \item Richard and Taylor "Assessing the case for unified financial sector supervision" 476.
  \item Mwenda Legal Aspects of Financial Services Regulation 43.
  \item Mwenda is of the view that a unified regulator does not make the necessary differentiations between different types of institutions and businesses, such as wholesale and retail
\end{itemize}
that setting up a unified regulator may create an overly bureaucratic agency that has excessively concentrated power, posing the possibility that the risk spectrum among financial institutions may disappear or at least become blurred. Here, even the merits of economies of scale would be watered down where the unified regulator is seen as supervising almost everything under the sun and thus becoming monopolistic. Such an overwhelming “Christmas tree” effect can, in turn, lead to inefficiencies, such as bureaucratic red tape and possibly corruption if the regulatory and institutional framework does not provide for effective checks and balances.  

2.3.1.2 Twin Peaks

The twin peaks (horizontal) model is premised on the differences among public goals of regulation and assigns a different regulatory authority to every goal. According to Hussain twin peaks is

A model where one institution is in charge of prudential supervision in all sectors of the financial system and another institution is responsible for consumer protection, market conduct and corporate governance throughout the financial system, hence the title ‘twin peaks’.

To Llewellyn under this type of model, all prudential regulation and supervision is conducted by one institution and all conduct of business regulation is conducted by the other. It is defined by the G30 report as a form of regulation by objective, one in which there is a separation of regulatory functions between two regulators whereby one performs the safety and soundness supervision function, while the other focuses on conduct of business regulation. It is an approach designed to incorporate the efficiencies and benefits from the intergraded approach but also to make provision for conflict that may exist between consumer protection and transparency and the safety

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81 Mwenda Legal Aspects of Financial Services Regulation 43.
83 Hussain Integrated Financial Supervision and its Implications for Banking Sector stability 7.
84 Llewellyn "Institutional structure of financial regulation".
and soundness of regulation objectives.86 The Australian Prudential Regulation Authority and the Australian Securities and Investment Commission are an example of the twin peaks framework.87 The ‘twin peaks’ idea and nomenclature are attributable to Michael Taylor, a former officer of the Bank of England, and a director of a course in financial services regulation at London Guildhall University in the mid -1990s. In 1995, Taylor wrote an article entitled “Twin Peaks,” a regulatory structure for the new century, which was published by the Centre for the Study of Financial Innovation in London.88 Under this model, there are two regulators, one dealing with the prudential regulation of all financial entities which needs to be prudentially regulated whereas the other is tasked with the regulation of financial products offered to consumers. South Africa has made tremendous strides towards the implementation of the ‘twin peaks’ model.89

2.3.1.3 Silo or institutional approach

Traditionally, a ‘silo’ or institutional approach to financial regulation has been applied. This is a system whereby the three broad financial sectors –banking, insurance and securities sectors- have been regulated separately.90 In other words, it follows the boundaries of the financial system in different sectors, and where every sector is supervised by a different agency. The central bank is usually assigned the responsibility for prudential and systemic regulation of the banking sector. The regulation of the conduct of business in the sector is partially done through self-regulation whereby a

87 The Australian Prudential Regulation Authority (APRA) is the prudential regulator of banks, insurance companies and superannuation funds, credit unions building societies and friendly societies. Whereas The Australian Securities and Investments Commission (ASIC) is an independent government body that enforces and administers Corporations Law and consumer protection law for investments, life and general insurance, superannuation and banking (except lending) throughout Australia. Their purpose is to reduce fraud and unfair practices in financial markets and financial products so consumers use them confidently and companies and markets perform effectively.
88 Cooper “The Integration of Financial Regulatory Authorities-the Australian experience” 2.
89 The twin peaks model soon to be implemented in South Africa will be discussed in chapter four of the study.
council or a committee selected by the regulators and industry players is assigned.\textsuperscript{91} However the fact that countries are now exploring other new forms of regulation is a clear indication that this model might be lacking in one way or the other. As Botha and Makina\textsuperscript{92} state, the ‘silos’ model has a number of shortcomings, especially with regard to regulating financial conglomerates which are now a common feature of financial institutions. Typically, the model introduces inconsistency when a financial conglomerate or group operates in the three main industries of the sector, namely banking, insurance and securities sectors. Such a financial group would then be required to be regulated by three different regulators.

This provides space for regulatory arbitrage whereby tighter regulation in one sector is compensated by moving operations to sectors where regulation is not too tight. A financial group would for example reduce the required aggregate capital in the banking sector by spreading risks to the securities and/or insurance sectors where capital requirements are generally lower. The second problem is that each sector, by virtue of having a different regulator, may be viewed as a separate entity from the holding company. As a result, the risk assumed by a financial group could end up being larger or smaller than the sum of the risk of its subsidiaries, depending on whether all are regulated or not. However, the less regulated subsidiaries of a financial group could pose instability to the entire group.\textsuperscript{93} It is on the above basis that the financial industry is shifting in favour of all-rounder forms of regulations which will address all if not almost all of the challenges.

\textbf{2.4 Conclusion}

Over the years financial regulation and supervision has, in most countries, been organized around specialist agencies that have distinct and separate responsibilities for banking, securities and insurance sectors. It now appears that there is a growing trend towards restructuring the financial supervisory function in many countries, and in

particular moving to unified regulatory agencies—that is, agencies that supervise two or more of these areas. However, as Llewellyn\textsuperscript{94} rightly put it, it is an illusion to believe that there is a single, superior model of institutional structure that is applicable to all countries. To some extent, the optimal structure may depend upon the structure of a country's financial system etc. Equally, it is an illusion to believe that any structure is perfect or guarantees effective and efficient regulation and supervision of the financial system. Changing the institutional structure of regulation should never be viewed as a panacea, or as a substitute for effective and efficient conduct of regulation and supervision.

\textsuperscript{94} Llewellyn "Institutional structure".
Chapter 3 Botswana’s micro lending regime

3.1 A synopsis of Botswana’s financial sector

At a time when many countries are still reeling and recovering from the 2009 global financial crisis, Botswana seems to be doing fairly well in terms of economic growth and stability. The said crisis did not impact much on Botswana’s financial sector. As rightly put by Kebonang,\(^{95}\) there were no incidents of bank collapses thanks to Botswana’s financial sector for not being fully integrated into the global economy, thus resulting in very limited cross-border banking system linkages. With a population of about 2 million people, and a Gross Domestic Product growth standing at 3.3% for the first quarter of 2014,\(^ {96}\) the country has made enormous strides in terms of economic stability despite the 2009 global economic crisis which saw world financial markets collapsing.

Botswana’s financial sector can be categorized into two broad sectors: The banking sector and the non-banking financial sectors. The banking sector consists of banking institutions which are mostly private banks under the oversight regulation of the central reserve bank, the Bank of Botswana. The non-bank financial sector on the other hand is a plethora of financial institutions like capital markets, the insurance industry, pension and provident funds, collective investment undertakings, micro lenders and assets managers.\(^ {97}\) All these form a mosaic of service providers falling under the non-banking financial sector which are regulated by the Non-Bank Financial Institutions Regulatory Authority (hereinafter NBFIRA). NBFIRA is a single independent regulator tasked with the regulation of non-bank financial institutions (NBFI). It is worth noting at this juncture that NBFIRA Act of 2008\(^ {98}\) established and mandated NBFIRA to regulate and enforce compliance within the NBFI sector in order to safeguard the stability, fairness and efficiency of the non-bank financial sector.\(^ {99}\) This was consistent as argued by Bojosi,\(^ {100}\)

\(^{97}\) Bojosi 2012 *UBLJ* 29-51.
\(^{98}\) NBFIRA Act of 2008.
\(^{100}\) Bojosi 2012 *UBLJ* 29-31.
with the government’s long term goal of economic diversification and also positioning the country as a major financial economic hub in Southern Africa, which could only be achieved through a unified regulatory framework to oversee NBFIs for purposes of ensuring their safety and soundness.

3.1.1 Micro lending in Botswana

Micro lending does not have a universally accepted definition. However, Reifner\textsuperscript{101} has defined micro lending as

a range of social policy initiatives in which public or non-profit agencies use credit as a tool to further objectives such as social welfare, employment, urban development, financial education and not least to develop the self-esteem of people excluded from ordinary economic activity. The primary purpose of micro lending is therefore not banking. It does however incorporate core banking functions such as lending, deposit-taking or guarantee business.

To Coetzee, Grant & Mohane\textsuperscript{102} micro lending is the provision of credit to people who are unable to obtain loans or credit from commercial banks because their only security is the fact that they only have a regular source of income. Put differently, micro lending is understood to be the provision of short term unsecured interest bearing credit to those who do not qualify for secured finance with commercial banks. This is so because commercial banks often require some form of security when extending a loan so that in default of payment, they can have something to hold onto. Whereas that case, such secured loans are not just available to anyone. Instead some commercial banks require one to pass a certain thresh hold salary bracket in order to qualify for a loan. These stringent requirements deter low income earners from obtaining loans with commercial banks, the last resort being micro lenders.

A micro lender on the other hand has been defined by the NBFIRA Act\textsuperscript{103} as

\textsuperscript{102} Coetzee,Grant & Mohane 2010 http://www.tandfonline.com.
\textsuperscript{103} Non-Bank Financial Institutions Regulatory Authority Act 2008.
A person who advances loans to persons where the loans do not exceed the prescribed amount, but does not include a person licensed in terms of the Banking Act or the Building Societies Act.

From this definition it is evident that micro lending is excluded from those carrying out banking activities in accordance with the Banking Act\textsuperscript{104}. The preamble of the said Act is "to provide for the licensing, control and regulation of banks and for matters incidental thereto". This clearly draws a further distinction between micro lending activities and banking business which in the case of Botswana is carried out by commercial banks. Furthermore the Act\textsuperscript{105} defines banking business in a manner which clearly shows that micro lending activities cannot equate the equivalence of banks. An interesting understanding of what micro lenders are is provided by Reifner\textsuperscript{106} who is of the view that "micro lenders may be banks or any other institution able to fulfil micro lending objective". The above definition, correct as it may be, falls short to the definition of a micro lender as provided for under the NBFIRA Act. This is because the Act herein acknowledges that even though micro lending involves certain banking aspects such as advancing interest bearing loans, the distinguishing factor between the two lies with licensing. Once licensed in terms of the Banking Act or the Building Societies Act, one ceases to qualify as a micro lender but rather acquires a banking status.

3.1.2 The legal regulatory framework in Botswana

The need for financial regulation cannot be overemphasized. The reasons behind such needs as alluded to in the previous chapter clearly show that if not guarded closely, financial sectors can collapse and cause a global catastrophe with dire financial and economic consequences. Inadequate supervision and/ or lack of financial regulation are

\begin{itemize}
\item \textsuperscript{104} Banking Act 1995.
\item \textsuperscript{105} The Act defines banking business as the business of accepting deposits of money repayable on demand or after fixed periods or after notice, as the case may be, by cheque or otherwise; and or the employment of deposits in the making or giving of loans, advances, overdrafts or other similar facilities and in the making of investments or engagement in other operations authorized by law or under customary banking practice, for the account of, and at the risk of, the person or persons accepting such deposits, and includes the discounting of commercial paper, securities and other negotiable instruments, for the purpose of extending loans or other credit facilities.
\item \textsuperscript{106} Reifner 2000 http://www.emnconference.org.
\end{itemize}
the major factors behind the global financial crisis as observed by Kebonang.\textsuperscript{107} Therefore there is a need for countries to put national regulatory frameworks in place which will regulate the activities of financial institutions and guard against and even minimize the risk of financial failure of such institutions. Botswana has not fallen short of such a need.

The Micro lending sector in Botswana is regulated by the NBFIRA through a hybrid system combining different systems of regulation as observed by Bojosi.\textsuperscript{108} Through this system, Botswana adopted a unified regulatory approach which has a separate regulator for commercial banks and a single regulator for all NBFIs. The NBFIRA (the authority) is a corporate body established by an Act of parliament with powers to sue and be sued.\textsuperscript{109} This authority is tasked with, amongst other things, the regulation and supervision of NBFIs in order to foster financial stability and ensure safety and soundness of NBFIs.\textsuperscript{110}

According to Mwenda\textsuperscript{111} for a regulatory body to be effective in the course of its mandate, it must have amongst other things, clear objectives, adequate powers, resources and accountability. This is very crucial because clearly outlined objectives serve as a guiding tool which helps the body to know what its mandate entails and how such mandate can be achieved. Adequate powers and resources are important because they facilitate the realization of the set objectives. In the case of Botswana, micro lending, as already alluded to above, is categorized under NBFIs which are regulated by the NBFIRA. Botswana’s micro lending regulatory framework is a combination of primary enabling legislation and secondary legislation issued pursuant to the enabling statute. The NBFIRA Act is the primary legislation whereas the micro

\begin{itemize}
\item \textsuperscript{107} Kebonang 2013 \textit{GJFM} 1-13.
\item \textsuperscript{108} Bojosi 2012 \textit{UBLJ} 29-51.
\item \textsuperscript{109} Section 6 (1) (2) NBFIRA Act 2008.
\item \textsuperscript{110} Section 8 NBFIRA Act 2008.
\item \textsuperscript{111} Mwenda \textit{Legal Aspects of Financial Services} 30.
\end{itemize}
lending regulations issued by the Minister\textsuperscript{112} of Finance and Development Planning serve as the latter.

3.2 How NBFIRA achieves its overarching objectives in regulating micro lending

3.2.1 Principal objectives of the NBFIRA

As already noted in the previous chapter, NBFIRA was established as a regulatory authority\textsuperscript{113} resembling a body corporate with the power to sue and be sued in its own name.\textsuperscript{114} According to the Act,\textsuperscript{115} the principal object of the regulatory authority is to regulate and supervise NBFIs so as to foster namely, (i) safety and soundness of non-bank financial institutions, (ii) highest standards of business by non-bank financial institutions (iii) fairness, efficiency and orderliness of the non-bank financial sector (iv) stability of the financial system (v) reduction and deterrence of financial crime. These objectives were discussed in the previous chapter as a basis for why there is need for financial regulation.

3.2.2 The structure of the NBFIRA

The authority’s organizational structure is divided into five directorates namely, (i) corporate services directorate (ii) capital markets directorate (iii) insurance directorate (iv) pensions directorate and (v) lending activities. Micro lending is the main issue of discussion in this paper, as a great deal of emphasis will be placed on its structure so as to see how effective or lack thereof the system in place addresses micro lending regulation in Botswana. To achieve this task, reference will be made to the micro lending regulations as promulgated in 2012 by the Minister of Finance and Development Planning.

\textsuperscript{112} Section 105 of the NBFIRA ACT empowers the Minister of Finance and Development Planning to make micro lending regulations which regulates the conduct of micro lenders in their course of business.
\textsuperscript{113} Section 6(1) of the NBFIRA Act.
\textsuperscript{114} Section 6(2) of the NBFIRA Act.
\textsuperscript{115} Section 8 of the NBFIRA Act.
3.2.2.1 Capital markets

Capital markets are comprised mainly of The Botswana Stock Exchange together with its brokering firms. Therefore the Directorate of Capital Markets is tasked with the development of the regulatory framework for Capital Markets and ensures that all regulated activities in the sector are conducted in strict compliance with the governing laws.116

3.2.2.2 Insurance

This division deals mainly with insurance services for both short term and long term insurance services. Service providers under this sector are but not limited to insurance agents and insurance brokers.

3.2.2.3 Pension funds

The pension funds are regulated by both the NBFIRA Act and the Pension and Provident Fund Act and Regulations.117 Both Acts require that pension funds providers be licensed according to the law.118

3.2.3.4 Micro lending

The Directorate of lending activities department at NBFIRA is mandated with the implementation of provisions of the micro lending Regulations of 2012 and the NBFIRA Act, defined as Financial Services Law under NBFIRA.119 It is worth noting that this division is tasked with the monitoring, inspections, licensing and complaint handling and even consumer protection.

118 Section 42(1) of the NBFIRA Act makes it an offence for one to operate an NBFI without a license and such person will be liable to a fine or a prison term.
3.3 Micro lending regulation framework

As noted in the prior chapter, the Minister of Finance and Development Planning has been conferred with powers under the Act to make regulations governing any matter under the Act. Accordingly Section 105 (1) provides that

The Minister may, by statutory instrument, make regulations providing for any matter which under this Act is to be provided for by regulations or is to be prescribed or which, in the Minister’s opinion, is necessary or convenient to be prescribed for the better carrying out of the objects and purposes of this Act or to give force or effect to its provisions or for its better administration.

In exercising these powers, on March 9th 2012 the Minister of Finance and Development Planning promulgated micro lending regulations which were later published in the Government Gazette.\textsuperscript{120} These regulations together with the Act serve as a regulatory frame work used for monitoring the business conduct of micro lenders.

3.3.1 Supervision and monitoring mechanisms

As noted earlier, NBFIRA is tasked with the overarching mandate of supervision and regulation of NBFIs in Botswana. Micro lending or micro lenders form part and parcel of those NBFIs. In order to fulfil its mandate with reference to the regulation of the micro lending sector, systems have been put in place to ensure that all those conducting the business of micro lending operate within the ambits and scope of the regulatory regime. A subsidiary legislation as noted above was promulgated to specifically address the business conduct of micro lenders\textsuperscript{121} which were until March 9th 2012 not regulated.

\textsuperscript{120} \textit{Statutory Instrument} No. 14 of 2012

\textsuperscript{121} There was an outcry from the general public that individuals and companies engaged in the business of micro lending were engaged in unethical conduct such as retaining personal identification numbers of clients together with their identification cards. Therefore there was a need for prompt action to curb this void that had existed over the years. Therefore the establishment of the NBFIRA and the promulgation of the 2012 Micro Lenders Regulations served as a milestone because now the micro lending industry operated within a regulated environment suitable for both clients and service providers.
3.3.1.1 Licensing of micro lenders

According to Bojosi\textsuperscript{122} market entry qualifications and licensing requirements are meant to enhance the safety and soundness of market participants. The requirement for licensing is an important aspect of regulation of micro lenders. It is on the foregoing that section 42\textsuperscript{123} makes it mandatory for all NBFs to be licensed in accordance with the Act. This statutory provision even though not explicitly making reference to micro lenders, is well on point because micro lending activities falls within the scope of NBFs. As such the provisions herein are interpreted to mean that micro lenders ought to be licensed.

The said provisions are supplemented by the Micro Lending Regulations of 2012\textsuperscript{124} which provide that "no person shall carry out a business as a micro lender without a license issued by the Regulatory Authority". Therefore this regulation generally deals with an application for a license to carry out a business as a micro lender. It is worth noting that the Regulatory Authority referred to herein is the NBFIRA as per the provisions of section 6(1) (2).\textsuperscript{125} Regulation 2\textsuperscript{126} is to the effect that such an application will be made to the NBFIRA in a prescribed form accompanied by inter alia evidence of human resources to show that the applicant is in a position to effectively manage its operations.\textsuperscript{127} It only makes sense that as the oversight regulatory authority, NBFIRA be the sole entity issuing micro lending operators with licenses in accordance with its mandate.

Analyses of all the license requirements show that they were tailor made to vet out prospective micro lending operators who lack the financial capacity and technical know-how of being part of a sound and safe financial system adhering even to international standards. The Regulatory Authority in the year 2013 received approximately 185
license applications but only 12 entities across the country were successful. These statistics shows that the Regulatory Authority takes the issue of licensing very seriously and will not compromise for those not meeting the requisite market entry standards.

A fine in the amount of P2500.00 is payable for each day on which the offence of trading as a micro lender without a license is committed with the alternative of a prison sentence not exceeding five years or both. It is therefore submitted that this fine is not stiff enough to deter unscrupulous individuals or entities from illegally operating as micro lenders contrary to the Act. Instead a bar should be raised high in terms of fines imposed on those trading without licenses so that the beneficiary of such an offence is out-weighed by the penalty one is likely to face. It is suggested that since the regulations require an applicant for a micro lending license to have a minimum of P20 00.00, the same amount can be imposed on those who carry out the business of micro lending without being issued a license.

As part of ensuring that micro lending institutions and participants conduct their business operations with integrity, due diligence and prudence, regulation 5 provides the requirement for a fit and proper person. This is an interesting provision because the financial sector on its own is delicate and ought to be treated as such because failure to do so can lead to dire consequences with long term effects on the industry, as is evidenced by the Madoff crisis. The aforesaid provisions seek to ensure that only those with personal integrity are allowed to operate as micro lenders because they will be forming part of the whole financial system of the country and will be expected to ensure that the system maintains stability and soundness through their business dealings with the general public.

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129 Section 42(1) of the NBFIRA Act.
130 Regulation 6(1) of the NBFIRA Micro Lending Regulations 2012.
131 NBFIRA Micro Lending Regulations 2012.
132 Henrique New York Times 5. Bernard Madoff was an investment banker who ran a Ponzi scheme which lead to investors losing $19.5bn. In 2009 after pleading guilty to money fraud and financial crimes, he was later sentenced to 150 years in prison by US court for the financial crimes he committed spanning for over 30 years.
3.3.1.2 Financial solvency

Regulation 6(1)\textsuperscript{133} requires those applying for a license to carry out a business of a micro lender and those issued with such licenses to maintain a minimum financial balance of P20,000 at all times. This provision is a welcome development in terms of regulating micro lenders because it ensures that there is financial liquidity and solvency within the micro lending sector. This is because financial liquidity and solvency plays a vital role in the continued existence of any financial institution. To ensure compliance with this provision, a licensed micro lender is mandated to always demonstrate its financial solvency to the Regulatory Authority whenever required to do so.\textsuperscript{134}

The regulations did not leave this obligation solely to the micro lender but also empowers the Regulatory Authority to conduct financial analyses on the operations of a micro lender in order to ensure that such operations are financially solvent in accordance with regulation 6 (3).\textsuperscript{135} In order for this initiative to be effective, it is suggested that notice ought not to be given to a micro lender whenever this exercise is to be carried out. Instead it must always be a random exercise such that micro lending operators are always alert to a possible financial analysis and in that way they will fully comply. If notice is to be given in advance, that will give non-complying micro lenders an opportunity to put their affairs in order for the sake of such audit. If a micro lender fails to demonstrate financial solvency or fails to maintain the stipulated minimum balance as per the regulations, section 47(2)\textsuperscript{136} empowers the Regulatory Authority to either suspend or cancel the issues license. Suspension and cancellation are not enough. It is therefore suggested and recommended that there be some sort of financial penalty imposed on operators found to be in default.

3.3.1.3 On-site routine inspections

\textsuperscript{133} NBFIRA Micro Lending Regulations 2012.
\textsuperscript{134} Regulation 6(2) of the NBFIRA Micro Lending Regulations 2012.
\textsuperscript{135} NBFIRA Micro Lending Regulations 2012.
\textsuperscript{136} NBFIRA Act 2008.
Section 54\textsuperscript{137} empowers the Regulatory Authority to appoint an inspector or investigator who will from time to time inspect the affairs of those licensed as NBFIs to ensure, among other things, that they comply with financial services laws and conditions of their licenses. The interesting part of this provision is that it does not limit the inspectors to only inspect compliance with those regulations and laws under the Act.\textsuperscript{138} Instead it includes inspection of any conduct by a licensed micro lender which is prohibited by financial law services. This is a welcome development as it covers instances which the Act might have overlooked, yet such conduct is bad for the country’s financial well-being. Financial services laws must be understood within the meaning of section 2\textsuperscript{139} to encompass a whole gamut of laws pertaining to financial services providers as submitted by Bojosi.\textsuperscript{140}

3.3.1.4 Repayment and collection methods of loan advanced

The business of micro lending as already highlighted in previous chapters, involves advancing money repayable within a certain period of time with interest. Unlike banks which have facilities like debit orders commonly known as stop orders, most micro lenders do not have any sophisticated collection methods at their disposal. For that, they rely on the goodwill of their clients to make monthly repayments in order to service the loans obtained. This arrangement has however proved to be cumbersome because these loans are mostly unsecured. Therefore dishonest clients were taking advantage of this to defraud micro lenders. This development led to micro lenders devising ways of ensuring that they get paid by \textit{inter alia} taking possession of clients’ official documents like passports and as security requiring borrowers to surrender their bank cards (ATM) together with personal identity identification numbers for such cards so that when the payment date is due, they simply withdraw what is due to them.

\textsuperscript{137} NBFIRA Act 2008. Also see section which deals specifically with investigators which may upon reasonable suspicion that an operator is or has violated financial law, enter any place used by such person and carry out investigation son such suspected deeds.
\textsuperscript{138} NBFIRA Act 2008.
\textsuperscript{139} NBFIRA Act 2008.
\textsuperscript{140} Bojosi 2012 \textit{UBLJ} 29-51.
This practice however led to an outcry by members of the public and the promulgation of the Micro Lending Regulations\textsuperscript{141} was a welcome development towards curbing such practice. On the above basis, regulation 14\textsuperscript{142} prohibits micro lenders from taking possession of borrowers’ official documents and bank cards as security for loans advanced. By taking possession of the borrower’s bank card and disclosure of their personal identity number, micro lenders were basically violating the rules of banking confidentiality.\textsuperscript{143} Both the Act and the Regulations are silent on a suitable method of collection, thus leaving it to the industry to come up with effective arrangements so long as they are not contravening any financial services laws inclusive of the Act and the regulations. With that being the case, it is still a welcome development because over-regulation could lead to more problems than it can solve. Thus the need to have the parties agree on a suitable repayment arises, be it a bank deposit or paying directly to the lender in cash.

\subsection*{3.3.1.5 Client assessment}

The normal practice with banks, not only in Botswana, is that before issuing a customer with a bank loan, they run a background check on such potential loan beneficiary. This exercise is meant to eliminate the risk of issuing bank loans to serial debtors with bad credit history because such borrowers might fail to repay the loan which will be bad for business. In order to address this lacuna, regulation \textsuperscript{9(1)}\textsuperscript{144} provides for assessment mechanisms which micro lenders must implement in order to avoid running the risk of advancing cash to customers who are not credit worthy. The provision therein mandates a micro lender to ensure that the borrower’s debt is such that he or she will be in a position to discharge the obligation of repaying the loan. Perhaps the most striking provisions to this regulation is regulation \textsuperscript{9(4) (a) (b)}\textsuperscript{145} which is to the effect that failure to carry out proper assessment by a micro lender, will be considered by the Regulatory Authority as failure to carry out the business of micro lending with integrity, prudence

\begin{thebibliography}{9}
\bibitem{141} NBFIRA Micro Lending Regulations 2012.
\bibitem{142} NBFIRA Micro Lending Regulations 2012.
\bibitem{144} NBFIRA Micro Lending Regulations 2012.
\bibitem{145} NBFIRA Micro Lending Regulations 2012.
\end{thebibliography}
and professional skill. Put differently, these three elements are very crucial for the continued survival of a sound and well-functioning financial system.

The interpretation of this client assessment mechanism is that it is a double edged sword. Micro lenders will avoid issuing loans which will not be paid within the agreed time or sometimes not even paid at all which is bad for business. Not only that, they will also avoid running the risk of being considered to have disregarded doing business with integrity, prudence and professional skill. On the other hand the provisions protect the consumers from burdening themselves with debts and in extreme situations being caught in a debt trap by borrowing more than they can afford. It is therefore submitted that this vetting mechanism ought not to be too stringent lest it stifles business, but must balance the interests of both lenders and borrowers.

3.3.1.6 Interest capping

One of the main reasons behind the regulation of micro lending in Botswana is the issue of interest rates. Prior to the establishment of the NBFIRA and its enacting laws, micro lenders were charging their customers exorbitant interest rates which led to over indebtedness and never ending credits. The issue of interest rate capping is addressed under Regulation 23\(^{146}\) which deals with the maximum cost of credit. Accordingly, micro lenders are forbidden from charging unreasonable maximum cost of credit on loans advanced. To control this, the Regulatory Authority is empowered under the Regulations Act to appoint a person to carry out investigations on this matter at any stage of the credit and even when such conduct has not been reported to the Regulatory Authority. As a way of ensuring compliance, the Regulatory Authority is empowered to issue operational rules, directives and guidelines stipulating the maximum total monthly cost of credit and maximum annual interest rate.\(^{147}\)

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146 NBFIRA Micro Lending Regulations 2012.
147 NBFIRA Micro Lending Regulations 2012.
The capping of maximum cost of credit is a welcome development as a regulatory aspect but it is not good enough because the Regulations do not provide for any interest ceiling or a method of calculating such interest which can act as a compass to both lenders and customers. Even though interest capping is a welcome development, Coetzee, Grant and Mohane\textsuperscript{148} are of the view that imposing an interest ceiling on micro lenders will create more problems because charging higher interest rates is the obvious reason that such borrowers cannot afford to service their loans at lower interest rates, which in turn will be uneconomical to lenders and thus deny borrowers access to credit as lenders would not want to operate at a loss. Be that as it may, it is submitted that the notion of consumer protection should be the primary objective, taking priority over profit maximization.

\textit{3.3.1.7 Complaints handling}

Regulation 21\textsuperscript{149} mandates micro lenders to devise a Dispute Resolution Policy and Procedure to be approved by the Regulatory Authority. A dispute will be handled by the micro lender’s appointed dispute resolution handler, failure of which such dispute will be lodged with the Regulatory Authority.\textsuperscript{150} Therefore complaints monitoring is one of the procedures put in place not only to monitor but also supervise the conduct of micro lenders to ensure that borrower’s rights are protected. In order for this mechanism to be effective, it is submitted that its scope should not only be limited to handling complaints which involves borrowers who have entered into money transactions with micro lenders. Instead is must encompass a whistle blowing initiative which allows the general public to report any misconduct by micro lenders. This can be achieved by setting up a whistle blowing toll-free telephone number or any other forms of communication which give a whistler protection from disclosure of identity. To this end, the Regulatory Authority in

\begin{footnotesize}
\begin{tabular}{ll}
\textsuperscript{148} & Coetzee, Grant and Mohane 2000 http://www.tandfonline.com. \\
\textsuperscript{149} & NBFIRA Micro Lending Regulations 2012. \\
\textsuperscript{150} & Regulation 21(2) of the Micro Lending Regulations mandates micro lenders to ensure that the names and contacts of those persons responsible for dispute resolution are displayed within the business premises. This is because borrowers in most cases will not be privy as to who is responsible for what within a business. By displaying such valuable information within the place of business customers will have unlimited access to such information and even use it without any difficulties whenever the need arises.
\end{tabular}
\end{footnotesize}
the year 2013 received 35 complaints relating to *inter alia* interest calculations, penalty interests and unexplainable repayments amounts.\(^\text{151}\)

### 3.4 Conclusion

Prior to the establishment of the NBFIRA as the regulatory authority of all NBFIs, micro lenders were operating in a vacuum without any rules or legal basis with which to abide. It was perhaps a very risky situation given the importance of the financial sector to the economic well-being of a country which is struggling to diversify its economy and avoid too much reliance on diamond revenue as its major source of income.\(^\text{152}\) To that end, the Government was faced with a daunting task of adopting a suitable regulatory regime which will govern all NBFIs, including the micro lending sector.

Self-regulation was an option, which according to Nzaro\(^\text{153}\) is advantageous in the sense that the monetary and supervisory responsibilities lies with the market participants themselves who are well vested with the technical know-how and expertise of the market operations. Countering that argument, Christen and Rosenberg\(^\text{154}\) are of the view that self-regulation has proven to be ineffective owing to the issue of conflict of interest. This turns out to be a favoured argument in that the appointed regulatory board or oversight body normally comprises of market players who have business interests and are profit oriented. For that, chances are very low for such conflicted individuals to carry out their functions without having their judgments clouded by the motive to capitalize and make more profits.

It is therefore submitted that Botswana’s micro lending regulatory regime model is one of a kind to have all NBFIs under a single unified regulatory authority with divisions tasked with regulating specific financial sectors. The Bank of Botswana, which is the central bank, has not been divorced from the regulation of micro lending in Botswana.

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\(^{153}\) Nzaro 2013 *GARJM&BS* 429-438.

careful look at the principal objectives of the Bank of Botswana, which *inter alia* involve the "promotion and maintenance of monetary stability and proper functioning of a soundly based financial system in Botswana,"\(^{155}\) re in line with the preamble of the NBFIRA Act.\(^{156}\) That is why section 40(1)\(^{157}\) mandates the Regulatory Authority to enter into arrangements and consult with the Bank of Botswana and other Government agencies whose functions are related with regulation or supervision of amongst other things, financial services.

Even though there is no perfect model for micro lending regulation, the NBFIRA Micro Lending Regulations of 2012 provide a comprehensive and detailed rules of regulation not only aimed at protecting consumers but also ensuring that there is financial soundness and stability within the micro lending sector. Perhaps one would have expected the regulations to deal with the issue of interest rates charged by micro lenders and common law principles governing interest rates and capping like the *in duplum* rule. The shortcomings of this regulatory framework will be dissected in chapters to follow when a comparative analysis with other trends and developments are interrogated.

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\(^{155}\) Bank of Botswana Act 1996.

\(^{156}\) NBFIRA Act of 2008 preamble provides that it is an Act to provide for the regulation of non-bank financial institutions for the purpose of enhancing safety and soundness of the non-bank financial institutions, setting high standards of conduct of business by non-bank financial institutions, improving fairness, efficiency and orderliness of the non-bank financial sector and the stability of the financial system and reducing and deterring financial crime and for purposes incidental and connected therewith.

\(^{157}\) NBFIRA Act 2008.
Chapter 4 Trends and developments: South Africa and India’s State of Andhra Pradesh

4.1 The system in place

South Africa is undoubtedly a major economic player not only in the African region but in the world at large. This is evidenced by its membership of the G20\textsuperscript{158} as the only African country therein. This would not have been possible if the country had a poor financial system. To this end, South Africa is one of the highly ranked African best managed economies with a sound banking sector globally.\textsuperscript{159} This perhaps must be credited to the country’s financial regulation model and financial laws in place which were acknowledged by the Minister of Finance\textsuperscript{160} when he said: "The financial services sector is at the heart of the South African economy and touches the life of each and every citizen." It is therefore evident that a sound and safe financial services sector plays an important role in boosting economic growth.

The banking sector in South Africa is regulated and supervised by the Reserve Bank\textsuperscript{161} under the Bank Supervision Department (BSD) which seeks to promote soundness of the domestic banking system and contribute towards realization of financial stability. The Reserve Bank is governed by the South African Reserve Bank Act No 90 of 1989. Non-bank Financial Services Industry (NBFSI) on the other hand is regulated by the Financial Services Board which is a statutory body established by section 2 of the

\begin{flushleft}
\textsuperscript{158} 2014 http://www.g20.org The Group 20(G20) membership comprises a mix of the world’s largest advanced and emerging economies, representing about two-third of the world’s population, 85 percent of the global gross domestic product and over 75 per cent of the global trade.
\textsuperscript{159} Bank Seta 2013 http://www.bankseta.org.za. See also http://www.stanlib.com/EconomicFocus/Pages/SouthSAfricanranked50thinthe20112012World CompetitivenessReport.aspx
\textsuperscript{160} Mr Pravin Gordhan is the Minister of Finance of the Republic of South Africa and he delivered a speech entitled "A safer Financial Sector to serve South Africa better" on the 23\textsuperscript{rd} February 2011.
\textsuperscript{161} The Reserve Bank is established by Section 9 of the Currency and Banking Act No 31 of 1920.
\end{flushleft}
Financial Services Board Act (Hereinafter FSB Act).\textsuperscript{162} The Act defines financial services as

\begin{quote}
any financial service rendered by a financial institution to the public or a juristic person and includes any service so rendered by any other person and corresponding to a service normally so rendered by a financial institution;\textsuperscript{163}
\end{quote}

### 4.2 Twin peaks

The 2008 global financial crisis served as a wakeup call to most countries' financial regulation systems and South Africa was no exception. With a country that has several financial regulators for different financial sectors, the Government found it fit to revise the existing system in place and work towards ensuring that there is co-ordination amongst these different national regulators so as to make the financial sector not only safe from financial crisis but also better and in line with international minimum standards. With the financial sector having grown nationally to being globally integrated, it only makes sense and is logical to have a financial system that at least meets the international yard stick. South Africa is a member of several international institutions concerned with financial regulation such as; (i) The Financial Stability Board (ii) The International Monetary Fund (iii) The Basel Committee on Bank Supervision (iv) The International Organizations of Securities and Commissions and The Group 20. South Africa’s membership to these renowned international organizations shows the country’s commitment towards becoming a global participant to the fight against financial crimes and maintaining international monetary regulation standards.

As such the country’s Minister of Finance in the 2011 Budget proposed that the country move towards the ‘twin peak’ model of regulation.\textsuperscript{164} This bold step was perhaps influenced by lessons learnt from the 2008 global financial crisis. Accordingly, the twin

\begin{flushleft}
\textsuperscript{162}  \textit{Financial Services Board Act} 97 Of 1990.  \\
\textsuperscript{163}  Section 1 FSB Act 1990.  \\
\textsuperscript{164}  Pravin “Transformation of the financial sector”. When delivering the 2011 Budget Speech, the Minister of Finance highlighted the need to enhance the regulatory framework which will improve financial services. This included a shift to the implementation of the ‘twin peak’ financial regulation.
\end{flushleft}
peaks model was necessitated by the country's desire to ensure that there is "consumer protection and market conduct in the financial services sector and to create a more resilient and stable financial system."\(^{165}\) Not only that, in order to maintain a sustainable economic growth and development, there was a need to ensure that the country's financial services sector remains safe and stable. To achieve this, the country had to consider all factors which contribute to economic growth and financial services regulation formed part of those factors. It must be noted that there is no single financial regulatory model which can be considered to be the best model. This submission is supported by Bojosi\(^{166}\) to the effect that there is no single regulatory regime and the choice of a regulatory model is dependent inter alia on the size and state of development of the financial system itself and the policy objectives informing the introduction of a new model or a change from one model to another. To this end, South Africa moved towards the implementation of the ‘twin peaks’ model based on policy considerations such as sustainable economic growth, consumer protection and having a stable financial system.

In February 2011, the National Treasury published a draft financial sector policy document entitled "A safer financial sector to serve South Africa better" which was later adopted by Cabinet in July 2011.\(^{167}\) This was part of the country's commitment to overhaul its existing financial regulatory regime so as to align itself with international minimum standards. A wide range of reforms were suggested, eventually leading to the adoption of the ‘twin peaks’ as the preferred financial regulatory model.

A task team called the Financial Regulatory Reform Steering Committee (FRSC)\(^{168}\) was set up to review the country’s financial regulatory system and align it with the twin peaks model. The proposed twin peaks model would comprise of two regulators (i) a

\(^{165}\) FSB 2014 http://www.fsb.co.za.
\(^{166}\) Bojosi 2012 UBLJ 29-51.
\(^{168}\) This task team comprised of senior officials drawn from the country’s three key financial regulatory institutions being The National Treasury, the South African Reserve Bank and The Financial Services Board. The involvement of these major regulators was very important because they are the major industry players and their input on the proposed reforms was of great value in achieving that mammoth task.
prudential regulator under the South African Reserve Bank and (ii) the market conduct regulator within the Financial Services Board. Its main focus will be on business conduct and consumer protection.\textsuperscript{169} This regulatory model is contrary to Botswana’s version which is a unified single regulator tasked with the regulation of all non-bank financial institutions. As part of the South African Government’s commitment towards achieving a more stable and resilient financial system characterized by strong aspects of consumer protection, legislation was proposed in the form of a draft bill known as The Financial Sector Regulation Bill of 2013. One of the most notable objectives of this Bill is to "establish regulatory authorities for the purposes of strengthening financial stability and the fair treatment of financial customers in the interest of a safer financial sector."\textsuperscript{170}

The draft bill outlines an improved regulation of the financial sector as a whole and aligns the country’s regulatory mechanism with international standards. To this end, other policy considerations apart from achieving financial stability will be covered, unlike the system in place which does not adequately address other issues such as consumer protection and market integrity. The following are some of the notable proposed provisions of the Bill:

(i) Under the bill, a Financial Stability Oversight Committee (FSOC) will be established with the mandate of assisting the Reserve Bank in maintaining, protecting and enhancing financial stability in the country.\textsuperscript{171} Compared with Botswana’s NBFIRA, the relationship between the Reserve Bank and the FSOC is well defined and creates a system wherein the two organizations compliment each other with the overarching objective of preserving the country’s financial system. The same can be said with Botswana’s NBFIRA

\textsuperscript{169} FRRSC 2013 http://www.treasury.gov.za.

\textsuperscript{170} Financial Sector Regulation Bill 2013. See also GG R988 in GG 37140 11 December 2013 wherein The National Treasury invited public comments on Draft Financial Sector Regulation Bill, 2013. According to the said invitation, the Bill gives effect to the shift towards a twin peaks system of regulation the financial sector for consumer protection and financial soundness of financial institutions.

\textsuperscript{171} Section 5 (1) of the Financial Sector Regulation Bill 2013. See also section 5(2) wherein the established board will monitor financial risks, take necessary actions to mitigate and or remedy the detected risks and promptly advises the Minister of Finance on any trends which may destabilize the country’s financial system.
because section 40\textsuperscript{172} allows the regulatory authority to enter into arrangements with other Government agencies like the Bank of Botswana, exchange information and ensure enforcements of financial services laws through joint conduct examinations. Credit must therefore be given to Botswana’s system in place because it does not limit the financial regulation and stability solely within its borders. Instead can also enter into similar arrangements with other organizations outside Botswana in pursuit of its regulatory and supervision functions under financial service laws.\textsuperscript{173} The provisions herein show that Botswana appreciates that financial markets are globally linked and there is a need to ensure that countries work hand in hand in order to achieve financial stability at a global level.

(ii) The Proposed Financial Services Tribunal is a welcome development under the draft bill. This tribunal will be tasked with the hearing of appeals by aggrieved persons.\textsuperscript{174} This development is similar to what Botswana adopted when establishing the NBFIRA because normal courts of law in most countries are battling with the issue of case back logs. Therefore to have a specialized court dealing with a specific area of law is a milestone achievement in consumer protection because the rules of procedure are much more customer friendly than ordinary rules of procedure which can be very stringent and lead to a miscarriage of justice.

(iii) Management and mitigation of financial crisis are proposed under section 62-68\textsuperscript{175} which outlines all the necessary steps which all concerned regulatory bodies ought to take in order to avert systematic failure of the country’s financial sectors. To this end the Reserve Bank plays an important role as it is tasked with crisis management in the event a particular risk or development

\textsuperscript{172} NBFIRA Act 2008.  
\textsuperscript{173} Section 40(2) of the NBFIRA Act 2008.  
\textsuperscript{174} Section 71-81 of the Financial Sector Regulation Bill 2013.  
\textsuperscript{175} Financial Sector Regulation Bill 2013.
has been detected by the FSOC. Accordingly it must manage and mitigate the crisis as speedily as possible.\textsuperscript{176}

(iv) The draft bill also proposes the establishment of a body known as Council of Financial Regulators which will be tasked with the coordination of all matters related to legislation, consumer protection and most importantly financial stability. According to Du Preez\textsuperscript{177} this council will address the stand-off concern of lack of co-ordination between the NCR and the FSB which have been regulating different financial sectors. To that end, under this proposed bill, all financial institutions will be regulated and there will be no lacunas for consumer exploitation. This compared with Botswana’s financial sector regulatory regime, it is safe to conclude that a similar arrangement cannot be attained in Botswana given the size of its financial market. This conclusion is backed by Mwenda\textsuperscript{178} who is of the opinion that in order for policy drafters to design a sound financial services regulatory framework, attention ought to be given to different aspects such as the size, the structure and the role which the regulator is going to play. Against this backdrop, Botswana’s financial market in terms of size is much smaller than that of South Africa and as such the two countries’ regulatory frameworks ought to differ based on the above influencing factors.

Whilst the Financial Sector Regulation Bill which is going to give birth to twin peaks in South Africa is yet to be made law, it will be too premature to comment on its effectiveness or how financial markets are going to receive it. Instead one is left speculating as to whether this new regulatory model will be able to address the needs of South Africa’s ever-growing prominent financial conglomerates and

\begin{footnotesize}
\begin{enumerate}
\item Section 65 of the Financial Sector Regulation Bill 2013. See also the provisions of section 64 of the draft bill tasking the Minister of Finance with crisis management responsibilities and section 65(2) (a-c) which emphases the importance and role of the Reserve Bank in maintaining and protecting the financial stability of the country.\textsuperscript{176}
\item Du Preez 2013 http://www.iol.co.za.\textsuperscript{177}
\item Mwenda \textit{Legal Aspects of Financial Services} 6.\textsuperscript{178}
\end{enumerate}
\end{footnotesize}
enhance the financial stability of the country which is vital for economic growth and development.

4.2.1 Twin peaks vis-a-vis a unified regulator

As observed in previous chapters, Botswana has established a unified regulator for non-bank financial institutions whereas the banking sector remains regulated by its central bank, Bank of Botswana. Contrary to this, South Africa’s proposed twin peaks approach is one under which different regulatory aspects are divided amongst two regulators, one regulator being tasked with the safety and soundness of financial markets whereas the other one deals with the conduct of business regulation. On the other hand a Unified regulator, also known as the ‘integrated’ approach, is one under which all financial services sectors are regulated by a universal regulator. This model is crafted such that both the safety and soundness oversight of financial services are housed under a single regulatory body as is the case with Botswana’s NBFIRA. Even though the integrated approach is viewed as an effective and efficient form of regulation and supervision, it also exposes financial markets to a danger risk of single point regulatory failure as a result of having all financial services sectors regulated by a single entity. The ‘twin peaks’ model is based on regulation by objective, which means that regulatory authorities mandates are well defined, thereby reducing the risk of market failure.

4.3 Regulation of micro lending in South Africa

Micro lenders, also known as cash lenders, fall under Micro Finance Institutions (MFIs) in South Africa. These involve the issuing of short-term personal loans without conventional collateral. The Micro Finance Industry within which micro lending falls is regulated by the National Credit Regulator (NCR). The industry plays an important role in the country’s economy by ensuring that people have access to funding. For the quarter period which ended in June 2014, the total value of credit granted increased

from R105.60 billion to R107.19\(^{182}\) wherein other credit providers such as micro lenders contributed a significant share of 8.13 percent, translating to a staggering R8.72 billion. These figures are expected to grow in future, as is evidenced by the legislative reforms that have since been put in place to regulate both micro lenders and other credit providers in South Africa.

### 4.3.1 Genesis of the National Credit Regulator

According to Campbell\(^{183}\) on 31\(^{st}\) December 1992, the Minister of Trade and Industry exempted micro-loans from the Usury Act 73 of 1968. The implication of this exemption meant that loans up to the amount of R6000 were excluded from the interest rate cap. It is worth noting that the Usury Act capped interest rates for money lending up to R500 000\(^{184}\) thus placing no limit on interest rates which micro lenders could charge for lesser amounts.\(^{185}\) Moreover this exemption was viewed to have legitimized the micro lending industry as suggested by Campbell\(^{186}\) leading to a spiraling and mushrooming of unregulated micro lenders throughout the country. Its implications lead to higher households debts as micro lenders were charging exorbitant interest rates which left consumers in debt traps. Micro lenders charged interest as high as thirty percent per month and in other extreme instances, interest rates charged were much more than those charged by the formal banking sector.\(^{187}\) The issue of high exorbitant interests charged by micro lenders operating in an unregulated environment was summed up by Yacoob J in *AAA Investment (Pty) Ltd v The Micro Finance Regulatory Council & the Minister of Trade and Industry*\(^{188}\) when he said

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187 GN 1100 in GG 26809 OF 17 September 2004 provided for maximum interest capping rate of 20% for all credit transactions less than R10 000
188 2007 1 SA 343 BCLR 9-10.
It is fair to conclude that this Notice made it possible for moneylenders to advance small loans (that would largely be required by poor people) free from almost all of the constraints of the Usury Act and unbounded by any finance charge limit at all!

The Department of Trade and Industry in the year 2001 initiated a holistic review of the credit legislation in place and established challenges which the market faced at that time.\(^{189}\) The Technical Committee found *inter alia* the following: (i) excessive predatory behavior that lead to high levels of debt for certain consumers and unmanageable risk to all credit providers; (ii) inappropriate debt-collection and personal insolvency legislation that created an incentive for reckless credit provision and prevented effective rehabilitation of over-indebted consumers and (iii) an unrealistically low Usury Act cap that caused low income and high-risk clients to be marginalized.\(^{190}\) According to Kelly-Louw\(^{191}\) the Technical Committee upon consultation with relevant stakeholders, recommended that there be a single piece of legislation governing all those financial sectors that were subject to the Usury Act of 1968 and the Credit Agreement Act 75 of 1980. This meant that the aforesaid pieces of legislation had to be repealed as they had proved to create more problems than they were actually promulgated to solve.

It was on the above basis that the South African Government found it fit as Kelly-Louw\(^{192}\) puts it, "to curb predatory lending, consumer abuses and outdated, piecemeal and ineffective legislation on consumer credit through the introduction of the National Credit Act\(^{193}\) (hereinafter NCA) and Regulations." Government legislative intervention was necessary not only owing to the size of the industry but most importantly the need

\(^{189}\) Kelly-Louw 2008 *SA Merc LJ* 200-226. See also the South African Law Reform Commission, Project 67 at Page 30 wherein the Usury Act of 1968 was reviewed and see also the Policy Board for Financial Services and Regulation’s Report on Small and Medium Enterprises’ Access to Finance in South Africa (2001). All these measures were followed by the setting up of a Technical Committee which its main task was the reviewing of consumer-credit policy and legislation and to supervise all the relevant research through co-ordination by the Micro Finance Regulatory Council.


\(^{191}\) Kelly-Louw 2008 *SA Merc LJ* 200-226.

\(^{192}\) Rossouw *The impact of National Credit Act 2*.

\(^{193}\) *National Credit Act* 34 of 2005.
for consumer protection which is the basis for financial regulation. The main objectives of the Act\textsuperscript{194} are

to promote and advance the social and economic welfare of South Africans, and to promote a fair, transparent, competitive, efficient and accessible credit market for all, particularly those who have historically been unable to access credit under sustainable market conditions. It also aims to prohibit unfair credit and credit-marketing practices and to protect the consumers of credit. A further objective is to encourage responsible borrowing, the avoidance of over-indebtedness and reckless lending, and to provide for a consistent and harmonized system of debt restructuring, enforcement and judgment.\textsuperscript{195}

In order to achieve its overarching objectives, the NCA established the National Credit Regulator (NCR). The NCR was established in 2005 by the National Credit Act\textsuperscript{196} as a juristic person, independent and subject only to the Constitution and the law.\textsuperscript{197} The NCR represents a single regulator administering all entities involved in the credit industry. To achieve its mandate, the NCR made Regulations supplementing the NCA\textsuperscript{198}. Compared to Botswana’s Micro Lending Regulations, the South African set up is such that the NCR Regulations are not only tailor made for a single financial sector. Instead the regulations are meant for the regulation of all activities within the credit industry, micro lending inclusive. This move complements the NCA because it also deals with the credit industry in general. Perhaps at this point it is worth noting that there once existed a body called The Micro Finance Regulatory Council (MFRC).\textsuperscript{199} This body does not offer much assistance when dealing with the regulation of micro lending in South Africa because the establishment of the NCR marked the end of the road for the

\textsuperscript{194} NCA 34 of 2005.
\textsuperscript{195} Section 3 of the NCA. See also the preamble of the NCA 34 of 2005.
\textsuperscript{196} NCA 34 of 2005.
\textsuperscript{197} Section 12(1)(a-f) of the NCA.
\textsuperscript{198} Section 171 of the NCA empowers the Minister of Trade and Industry to make regulations. Therefore in the year 2006, the Minister exercised her powers vested on her by the Act and passed Regulations thereto.
\textsuperscript{199} The Micro Finance Regulatory Council of South Africa was established with the assistance of the South African Reserve Bank’s Bank Supervision Department. According to the council’s website, the main aim behind its formation was the fear of subjecting the financial system to loss of income and to avert consumers from suffering at the hands of unregulated micro lenders charging roof top interest rates. Therefore it was meant to curb organized crime in the form of loan sharks from proliferating.
MFRC, which saw all its affairs being transferred to the NCR\textsuperscript{200} which became the single regulator for the whole credit industry.

4.3.1 \textit{The role of the National Credit Regulator in micro lending regulation}

The NCR was established and tasked with the regulation of the credit industry in South Africa. The NCA does not define what a micro lender is nor does it define the term micro lending. To this end, the definition of credit under the Act encompasses micro lending activities and by so doing making the Act applicable and rendering micro lenders under the regulation of the NCR.\textsuperscript{201} Therefore all the provisions to be discussed herein under both the Act and the Regulations will be solely addressing the regulation of micro lending by the said pieces of legislations. The objectives of the NCA as envisaged under Section 3\textsuperscript{202} are

\begin{quote}
\begin{itemize}
    \item to promote and advance the social and economic welfare of South Africans, and to promote a fair, transparent, competitive, efficient and accessible credit market for all, particularly those who have historically been unable to access credit under sustainable market conditions. It also aims to prohibit unfair credit and credit-marketing practices and to protect the consumers of credit.
\end{itemize}
\end{quote}

Another important objective is to encourage responsible borrowing, the avoidance of over-indebtedness and reckless lending, and to provide for a consistent and harmonized system of debt restructuring, enforcement and judgment. Therefore this Act is basically centred on consumer protection.

4.3.1.1 Registration

\begin{itemize}
    \item[200] Kelly-Louw 2008 \textit{SA Merc LJ} 200-226. See also item 8 of Schedule 3 of the National Credit Act.
    \item[201] Section 1 of the National Credit Act of 2005 defines credit. According to the said provision, credit when used as a noun, means a deferral of payment of money owed to a person, or a promise to defer such a payment; or a promise to advance or pay money to or at the direction of another person.
    \item[202] \textit{NCA 34} of 2005.
\end{itemize}
In discharging its primary objectives under the Act, the NCR as the sole body tasked with the regulation of the credit industry in South Africa, will register, cancel and suspend micro lenders.\textsuperscript{203} This exercise is similar to the functions of the NBFIRA in Botswana where the Regulatory Authority is empowered by the Regulations to issue micro lending licenses. The registration of micro lenders is very important not only for statistics purposes but also ensures that those registered with the Regulator comply with the conditions of their registration. The NCR is mandated to establish and maintain a registry of all those in the business of advancing credit, micro lenders included.\textsuperscript{204} This registry is important because consumers can inspect it to check if their prospective borrowers are registered therein. Most importantly, the registration process ends with the issuance of a certificate by the NCR as proof thereof.\textsuperscript{205} The issuance of a certificate of registration is captured under Regulation 8\textsuperscript{206} read with Section 52 of the Act. The registration requirement herein is interpreted as a way of giving public notice of registration because the issued certificates must be visibly displayed on the premises of a credit facility for public consumption. This regulation is an equivalent of the license issued by the NBFIRA in Botswana. Such a license must be displayed on the premises or place of business of an entity or person engaged in the micro lending business.

\textbf{4.3.1.2 Interest capping}

One of the major public outcries which lead to the need to have laws regulating micro lenders in South Africa was the issue of higher interests rates which lead to consumers being highly indebted to unscrupulous lenders.\textsuperscript{207} This was owing to the fact that the Usury Act\textsuperscript{208} which aimed to achieve consumer protection later removed interest capping on loans less than R6000. This meant that micro lenders offering loans amounting to less than R6000 were operating in a vacuum without any legal means or

\begin{footnotes}
\footnote{\textsuperscript{203} Section 14 of NCA. See Regulation 4(1) dealing with application for registration. See also section 45(1) of the NCA which requires a person applying for registration to provide relevant information to the NCR.}
\footnote{\textsuperscript{204} Section 53 of NCA.}
\footnote{\textsuperscript{205} Section 53(4) of NCA.}
\footnote{\textsuperscript{206} National Credit Act Regulations, GN R489 in GG 28864 OF 31 May 2006.}
\footnote{\textsuperscript{207} Coetzee, Gant and Mohane 2000 http://www.tandfonline.com.}
\footnote{\textsuperscript{208} Usury Act 73 of 1968.}
\end{footnotes}
regulatory mechanisms in place deterring them from charging usurious interest. The passing of the NCA was a welcome development in the micro lending sector because there are clear regulations on interest, even the method of how such interest must be calculated. The NCA forbids credit providers from the unilateral increasing of interest rates without giving a consumer prior notice to that effect.\textsuperscript{209} Moreover, the NCA deals with the issue of cost of credit which must not exceed the initial principal debt.\textsuperscript{210} The 2006 Regulations\textsuperscript{211} provides for a fixed interest rate and interest calculation formulae applicable to different credit facilities.

Micro lending will therefore fall under short term credit transactions with an interest rate calculated at five percent per month.\textsuperscript{212} Interest capping for micro lenders is very important as it puts credit consumers in a position to make well informed decisions before obtaining a credit facility in that one will be able to know the total cost of the credit and the monthly installments payable thereto. The same cannot be said about Botswana because both the NBFIRA Act\textsuperscript{213} and the NBFIRA Micro Lending Regulations\textsuperscript{214} are silent on the issue of interest capping for micro lenders.

To this end, NBFIRA does not cap the maximum interest that micro lenders can charge. This is a worrying concern because there is a need to have clear legislative provisions outlining the issue of interest rates than leaving it to the industry, a conduct which does not promote consumer protection. To this end, NBFIRA has been criticized for having failed to put a lid on the operations of micro lenders despite the promulgated regulations and some economists blamed the organization’s structure and mandate as being too

\textsuperscript{209} Section 104 of the NCA. See also Regulation 23 of the National Credit Regulations which regulates the maximum cost of credit. According to this Regulation, a micro lender is forbidden from charging unreasonable maximum total amounts of monthly cost credit rates. To control this, the Regulatory Authority is empowered under the Regulations to appoint a person to carry out investigations on this matter at any stage of the credit and even when such conduct has not been reported to the Regulatory Authority. As a way of ensuring compliance, the Regulatory Authority is empowered to issue operational rules, directives and guidelines stipulating the maximum total monthly cost of credit and maximum annual interest rate.

\textsuperscript{210} Section 101 of the NCA.

\textsuperscript{211} GN R489 in GG 28864 of 31 May 2006.

\textsuperscript{212} Regulation 42(1) GN in GG R489 of 31 May 2006.

\textsuperscript{213} NBFIRA Act of 2008.

\textsuperscript{214} NBFIRA Micro Lending Regulations 2012.
broad which hinders it from focusing and scrutinizing the industries under its jurisdiction.215 To this end, Botswana can benchmark from South Africa’s NCR which went as far as even providing formulae for the calculation of interest rates for different credit facilities. Such development shows a shift by NCR from the traditional approach of promoting consumer protection to providing consumer protection.

4.3.1.3 The In duplum rule

A further interpretation and reading of the provisions under section 103(5)216 envisages the common law principle of the in duplum rule which has been part of the South African law for many years now. The in duplum rule is to the effect that interest stops running when the total amount of interest equals the initial principal capital amount.217 Therefore a careful look at the provisions of the NCA218 as read with Regulations 39-49219 incorporated the in duplum rule into the South African consumer law. Section 103(5)220 reads

> Despite any provision of the common law or a credit agreement to the contrary, the amounts contemplated in section 101(1) (b) to (g) that accrue during the time that a consumer is in default under the credit agreement may not, in aggregate, exceed the unpaid balance on the principal debt under that credit agreement as at the time that the default occurs.

To understand this provision better, perhaps it is worth visiting the provisions of section 101(1) (b)221 dealing with other amounts which a consumer may be required to pay under the credit. These fees include, (i) an initiation fee (ii) a service fee (iii) interest (iv) cost of any credit insurance (v) default administration charges and collection fee

216 Section 103 of the NCA.
217 1973 2 SA 137 T. See also Administrasie van Transvaal v Oosthuizen & n’ Ander 1990 3 SA 383 W wherein it was held that interest stops running when unpaid interest equals the outstanding capital amount.
218 Section 100-106 of the NCA.
220 NCA 34 of 2005.
221 NCA 34 of 2005.
costs. Moreover this common law was confirmed by the Supreme Court of Appeal of the Republic of South Africa in the case of *Nedbank v National Credit Regulator* wherein the court held that the object of the rule was to limit a further recovery of interest from a defaulting credit consumer once the unpaid interest reached the unpaid capital amount. The codification of this rule is a welcome development in the regulation of micro lending in South Africa because it prevents credit consumers from being consumed with debts beyond their financial means which can be very hazardous to the country’s financial systems.

The *in duplum* rule plays a crucial role in the regulation of micro lenders and to that extent, it protects consumers from exploitation by unscrupulous micro lenders who have no regards for public policy consideration. This submission was substantiated by Kelly-Louw to the effect that the rule is a public policy consideration aimed at protecting debtors from being exploited by creditors. Therefore, the NCR of South Africa must be commended for incorporating this common law principle into its enabling statute because the rule goes to the heart and soul of consumer protection. As a point of departure, the South African courts have been very helpful in ensuring that this statutory *in duplum* rule is enforced. In the case of *F & I Advisors (Edms) Bpk en 'n Ander v Eerste Nasionale Bank van Suidelike Afrika Bpk* the court had the following to say:

> The Courts have a duty *mero motu* to raise the illegality of interest claimed in contravention of the *in duplum* rule, if this is clear from the facts, even if the *in duplum* rule was not pleaded.

The above dictum shows a welcome development in enforcing and ensuring that there is compliance with the issue of interest charged by micro lenders and can be used as a defense by a defaulting credit consumer once faced with a law suit in pursuant to interest recovery. Not only that, the rule herein aims to curtail credit costs as prescribed

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222 Section 101 (1)(b) to (g) of the NCA 34 of 2005.
223 2011 ZASCA 35.
224 Kelly-Louw 2007 SA Merc LJ 337. See also the case of *LTA Construction Bpk v Administrateur Transvaal* 1992 1 SA 473 wherein the court held that the *in duplum* rule is applicable to all contracts where a capital amount owed is subject to a stipulated interest rate.
225 1998 4 SA ZASCA 65 A.
by the NCA. It is therefore submitted that in order for any regulatory mechanism to function properly, support systems such as courts of law must be able to interpret and give effect to these regulations so that consumers of credit lending can be empowered and be in a position to enforce their rights with confidence and certainty.

Botswana, like most Roman-Dutch law countries, does recognizes the common law principle of in duplum rule. In a classic case which exposed consumer exploitation by micro lenders, Kgololesego Financial Company v Bame Ketshotseng²²⁶ presented the court with an opportunity to affirm the existence of the in duplum rule in Botswana’s laws. In the said case, a customer had obtained a loan in the amount of P10 000 payable within a month at 30 percent interest per month which translated to interest in the amount of P3000. Therefore the total credit was P13000. The customer defaulted payment wherein the micro lender sought a summary judgment on an acknowledgement of debt in the amount of P66 820 comprising capital P13000, interest of P12 999 and a compounded daily administration fee of P53 820. Even though this was a contractual dispute, counsel for the defendant raised the issue of the in duplum rule pertaining to the interest charged. The court spelled out the purpose of this common law rule to the effect that

The in duplum rule serves to aid debtors in financial difficulties by holding that it is unlawful to recover interest equal to or more than the capital sum upon which interest had accrued.

The decision herein serves as a milestone to the protection of consumers who borrow money from micro lenders from being charged exorbitant interest rates in the absence of interest capping. It is therefore submitted that to avoid any ambiguity, regulators must provide interest capping.

²²⁶ 2008 2 BLR HC. See also Barclays Bank of Botswana v Mokopotsa t/a Small General Dealer 2002 1 BLR 419 at p 424 wherein the court held that the rule serves an important social function by protecting debtors. Still on that case, the court was of the view that the rule cannot be waived in a contract and courts will not tolerate any conduct which seeks to circumvent its application as that will offend public policy.
4.3.1.4 National Consumer Tribunal

The NCR was established as a regulatory mechanism mandated with ensuring compliance with the NCA as already alluded to in the previous chapters. As a way of ensuring that the NCR achieves this daunting task, the NCA established a court of law known as the National Consumer Tribunal. The primary functions of this tribunal are to adjudicate in relation to any

Application that may be made to it in terms of this Act, and make any order provided for in this Act in respect of such an application; or (ii) allegations of prohibited conduct by determining whether prohibited conduct has occurred and, if so, by imposing a remedy provided for in this Act.

The Tribunal is a separate entity from the NCR and does not have the same legal status equal to those of a court of law but rather is an administrative body. This therefore means that as a competent court, it can issue orders and interim reliefs on matters before it. The procedure for initiating applications to this tribunal is provided for by the Regulations. The tribunal forms part of the NCR’s dispute resolution and complaints handling mechanism which aggrieved parties to a credit transaction can approach if such parties have failed to reach an amicable solution between themselves. The establishment of a Tribunal specifically dealing with the issues of consumer protection within the credit industry is a welcome development in the regulation of micro lending because general courts may be faced with case back logs and that would have a great effect on the implementation and enforcement of the NCA. Through the Tribunal, matters incidental to the industry will be expeditiously resolved within a reasonable period of time.

227 Section 26(1) NCA 34 of 2005.
228 Section 27 NCA 34 of 2005.
229 Section 27 NCA 34 of 2005.
230 GG 28864 of 31 May 2006. Application to the tribunal vests with the NCR as per Section 137 of the NCA but an aggrieved party to a credit transaction can approach the court for remedies.
NBFIRA on the other hand does not have a well-defined dispute resolution platform like the National Consumer Tribunal established in terms of the NCA. Instead the authority requires micro lenders to have a Dispute Resolution Policy and Procedure which must be approved by the authority before implementation. A closer scrutiny of the above provisions shows that the said mechanism is of no purpose at all. This submission is based on the fact that in lodging complaints with NBFIRA, the only outcome of such exercise will be of no assistance to a complainant in the event the authority fails to resolve the matter, because the authority does not have any legal power to adjudicate on such matters save to act only as a mere mediator. This is a disturbing shortcoming in the regulation of micro lenders in Botswana and to that end lessons can be learnt from the National Consumer Tribunal which has the powers of a court of law.

### 4.3.1.5 Credit marketing practices

The NCA forbids certain credit marketing practices by credit providers. Section 75 restricts and outlaws the canvassing of loans by credit providers. Accordingly micro lenders are prohibited from harassing any person in a bid to persuade and encourage such individual to obtain credit or enter into any credit related transaction. In a bid to uphold integrity and ethics, micro lenders are prohibited from entering credit transactions in certain places like private dwelling places. Micro lenders are not allowed to enter into a credit agreement at a person’s work place unless such was an arrangement by a credit consumer. Advertising practices which are aimed at misleading and promoting irresponsible lending are prohibited and there are penalties thereof. Therefore the regulation of marketing and advertising practices within the micro lending industry protects consumers and instils some sense of responsible lending in the general public, which is a welcome development. The NCA also

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231 NBFIRA Micro Lending Regulations 2012.
232 NCA 34 of 2005.
233 Section 75 (3) NCA of 2005.
234 Section 75 NCA of 2005 read with National Credit Regulation 21 prohibits irresponsible advertising as a marketing tool which seeks to induce persons into obtaining credit without adequate information. Phrases like “no credit checks required,” “black listed consumers welcome” in advertisements are not allowed. The use of such phrases are likely to induce individuals who are not credit worthy to enter into credit transactions which may leave them debt ridden.
acknowledges that there are those micro lenders who are not registered yet to carry out the business of micro lending. Such entities are also prohibited from advertising the availability of credit.

The aspect of consumer protection with reference to marketing and advertising of services and products in South Africa is closely guarded as is evidenced by the promulgation of consumer protection laws such as the Consumer Protection Act. The said Act gives consumers the right to fair and responsible marketing and by so doing prohibits the marketing and advertising of services which have the effect of misleading and misrepresenting goods and services in question.

Like the NCA, NBFIRA through its regulations addresses the issue of credit advertising. Regulation 8 outlines outlawed marketing and advertising practices. Therein, a micro lender is forbidden from issuing false, misleading or extravagant statements when soliciting business. An interesting provision is the one which requires micro lenders with each advertisement or marketing material to display the following note with reasonable prominence: "CAUTION! Borrowing more than you can afford to repay could lead to severe financial difficulties." This is an equivalent of the NCA’s section 75 which prohibits irresponsible advertising as a marketing tool when soliciting business. To this end, both regulators ought to be commended for the protection of consumer rights which forms the integral part of financial regulation.

4.3.1.6 Prohibition of reckless lending and over-indebtedness

The established practice in the financial credit industry, banks inclusive, is that a financial means test is carried out prior to an approval of a loan application. This exercise helps the credit provider to be able to detect if an applicant will be in a position to fulfil his or her financial obligation of re-paying the loan under the credit agreement. The need for comprehensive consumer credit legislation not only in South Africa is a
stone that cannot be left unturned. This is because over-exposure to credit especially by low income credit consumers can easily be lead into a debt trap of over-indebtedness.\textsuperscript{238} To this end, section 82\textsuperscript{239} lays down the assessment mechanisms and procedures to be followed prior to the issuing of credit by micro lenders. In summary, the provisions herein do not allow a credit provider to enter into credit transactions without having taken reasonable steps to assess the consumer’s credit worthiness and appreciation of the cost of the proposed credit.\textsuperscript{240}

An interesting aspect of this consumer protection provision is Regulation 24(1)\textsuperscript{241} which empowers a credit consumer who is to be declared over-indebted, to apply to a debt counsellor for a declaration to that effect. This is an important aspect of the Act because the outcome of the declaration can lead to a debt restructuring court order wherein the consumer’s debt and its re-payment installments may be restructured such that the monthly installment is reduced to accommodate the credit consumer.\textsuperscript{242} It is therefore submitted that, this mechanism is a double edged sword meant to protect both micro lending credit consumers and micro lenders because a consumer who cannot re-pay back the loan advanced will be over-indebted and in some instances such debt will even affect his household income. On the other end, a micro lender will be at the receiving end of loss of profits.

One of the main reasons behind the recent collapse of the African Bank in South Africa was said to be reckless lending. On the 10\textsuperscript{th} of August 2014 the bank was placed under curatorship following the plummeting of its share prices. The NCR carried out an investigation into the bank’s dealings and discovered that the bank recklessly issued

\begin{thebibliography}{9}
\bibitem{238} Roussouw \textit{The impact of the National Credit Act} 9.
\bibitem{239} NCA 34 of 2005.
\bibitem{240} Section 81(2)(a)(i) National Credit Act 34 of 2005.
\bibitem{241} National Credit Act Regulations. See also sections 78-79 of the NCA dealing with the issue of over-indebtedness of a credit consumer. According to the provisions therein, a consumer will be deemed to be over-indebted if such person at the time of the determination has sufficient information leading to a conclusion that one will not be able to satisfy all the obligations under all credit arrangements to which such person is a party. Consideration thereto is made to the consumer’s financial means, and other elements such as the consumer’s debt history.
\bibitem{242} Sections 85 and 86 of the NCA. See also section 79 of the NCA which empowers the court to suspend a reckless credit agreement which can lead a credit consumer not to be able to fulfill its obligations of re-payment under the agreement with prospects of over-indebtedness.
\end{thebibliography}
about 670 loans to credit consumers who could not pay back the loans. This could however have been prevented if the bank could have carried out proper assessments of all loan applicants and satisfied itself of their credit worthiness. The NCR acting on its findings took the African Bank before the National Consumer Tribunal on the basis of reckless lending and through mutual co-operation, the African Bank paid an amount of R20 million as a final settlement of the matter. This demonstrates the effectiveness of the NCR in comparison to Botswana’s NBFIRA in enforcing the provisions of micro lending regulations in order to ensure that consumer rights are upheld by credit providers.

Botswana can surely adopt such progressive consumer protection initiatives into its micro lending regulation regime as it enhances the financial soundness and safety of the industry. The problem of reckless lending and over-indebtedness is a cause for concern which unfortunately NBFIRA does not adequately address like the NCR has done. Perhaps it can be safely inferred from the provisions of regulation 9 which deal with assessment mechanisms which micro lenders must put in place and implement prior to issuing credit. Therefore it can be concluded that the provisions therein are meant to protect consumers from borrowing more than they can afford to repay which can lead to over-indebtedness. The issue of reckless lending and over-indebtedness is a controversial one in that it appears to put too much responsibility on micro lenders and leave credit consumers without any responsibilities in ensuring that they do not find themselves over ridden with debts. To this end, it is therefore recommended that there be an obligation on consumers to ensure that they take reasonable steps to protect themselves from over-indebtedness because at the end of the day they are the ones at the receiving end.

4.5 India

244 Anon 2014 Africanbank.investoreports.com.
245 NBFIRA Micro Lending Regulations 2012.
India is one of the heavily populated countries in the world with a population standing at 1.2 billion with 30 percent of the citizens living below the poverty datum line. India has a much more diversified and rapidly growing financial sector made up of but not limited to (i) pension funds (ii) banking sectors (iii) insurance (iv) capital markets (v) Non-banking finance companies and (vi) cooperatives. India’s financial system just like Botswana and South Africa is supervised and regulated by different authorities. At the apex of India’s financial supervision and regulation hierarchy sits the Reserve Bank of India (RBI).

4.4.1 Micro lending in the State of Andhra Pradesh

Located in the country's southeast coast, the State of Andhra Pradesh boasts a population of 75 million inhabitants, making it one of the most populous states in India. Therefore microfinance or micro lending was not only seen as an alternative to those poor households who cannot have access to formal financial services but served as an initiative towards the realization of financial inclusion, an initiative which the Indian Government has always strived towards over the years. The importance of microfinance to the livelihood of the poor cannot be over-emphasized. To Anderson, microfinance serves the purpose of putting money "directly into the hands of the poor" so that they can improve their economic welfare. Therefore the availability of credit to impoverished families lacking access to formal credit is the basis for microfinance, not only in India but also in Botswana and South Africa as alluded to in the previous chapters. In a quest to fulfill these mandates Micro Finance Institutions (MFIs) engaged into what Subrahmanyam viewed as

246 Becker 2013 *Nw J. INT’L L. & Bus* 711-740. See also Census Info India 2011 available at www.censusindia.gov.in wherein the 2011 population census showed that the Indian population stood at a staggering 1,210,854,977


248 The Reserve Bank of India was established in 1935 by an Act of Parliament known as the Reserve Bank of India Act, 1934.

249 www.censusindia.gov.in.


252 Reddy Subrahmanyam is the Principal Secretary of the Department of Rural Development in the Andhra Pradesh Government.
Irresponsible lending leading to multiple loans without due diligence, unproductive loans for consumption and consumer durables, lack of transparency in operations, usurious interest rates, and coercive recovery practices.

The inadequate and/ or lack thereof of the regulation of micro lenders in the State of Andra Pradesh opened a can of worms as there were issues of unethical methods of debts collections, illegal operational practices, poor governance, usurious interest rates and profiteering. The situation became dire to a point where borrowers were embroiled by reckless lending leading to some of those who could not afford to pay back into committing suicide. This was because people were engaged in multiple borrowing whereby an individual would be indebted to several micro lenders culminating in over indebtedness owing to a lack of proper and adequate systems of regulation in place.

As part of its intervention measures which were aimed at addressing the situation on the ground, in October 2010 the Andhra Pradesh government promulgated an ordinance which imposed drastic curbs to MFIs. The ordinance was promulgated to "protect the women of self-help groups from exploitation by micro finance institutions in the state of Andhra Pradesh and for other matters." Perhaps it is worth noting at this juncture that the Government of Andhra Pradesh had facilitated that households living below the poverty datum line organize themselves into self-help groups (SHGs) so that their economic status can be improved through financial inclusion. Therefore the ordinance was an endeavour by the state to ensure that the interests of these SHGs are protected from usurious interests and coercive collection methods implored by micro lenders, which in other extreme cases resulted in suicides by the borrowers who were

254 Rebecca (ed) *Development Organizations* 25-32. See also *The Wall Street Journal* 12. Therein it was reported that close to 80 farmers in the State of Andhra Pradesh committed suicide as they were pressured by micro lenders who used coercive methods to collect debts.
256 Andhra Pradesh Ordinance No. 9 of 2010.
257 Andhra Pradesh Ordinance No. 9 of 2010.
258 Andhra Pradesh Ordinance No. 9 of 2010.
over-indebted and not able to fulfil their payment obligations.\textsuperscript{259} Three months later on the 14\textsuperscript{th} December 2010 the Andhra Pradesh Legislative Assembly passed a law known as the Andhra Pradesh Micro Finance Institutions (Regulations of Money Lending) Act\textsuperscript{260} which repealed the ordinance promulgated earlier. It is worth noting that section 23(1)\textsuperscript{261} empowers the Governor to make rules and in exercising the said powers, the Governor made the Andhra Pradesh Microfinance Institutions (Regulation of Money Lending) Rules 2010 which supplemented the Ordinance. To this end, these two legislations form the regulatory frame work for the regulation of the micro lending industry in the State of Andhra Pradesh and they will form the legal analysis of this chapter.

The Regulations of Money Lending Act of the State of Andhra Pradesh just like Botswana’s NBFIRA Act, provides for the regulation of micro lending and sets out rules with which micro lenders must comply.

The following are some of the notable provisions therein which will be discussed for purposes of this paper.

\textbf{4.4.1.1 Application for registration}

Section 3(1)\textsuperscript{262} requires all MFIs wishing to operate in the State of Andhra Pradesh to apply to the Registering Authority\textsuperscript{263} in order for them to be registered and be issued with a license. As part of the registration requirements, an applicant must disclose \textit{inter alia} a proposed interest rate to be charged or currently charged, a system of due

\begin{itemize}
\item \textsuperscript{259} Andhra Pradesh Ordinance No.9 of 2010.
\item \textsuperscript{260} Andhra Pradesh Ordinance No. 9 of 2010.
\item \textsuperscript{261} Andhra Pradesh Ordinance No.9 of 2010.
\item \textsuperscript{262} Andhra Pradesh Ordinance No. 9 of 2010. See also the provisions of rule 3 of the Regulation of Money Lending Rules 2010 which lays out the registration requirements which applicants must comply with and also provides a standard form to be used for applications. Also rule 13 of the Money Lending Rules 2010 which does not allow dual membership to different MFIs because such can lead to people obtaining loans from different micro lenders leading to over-indebtedness and the collapse of the industry.
\item \textsuperscript{263} Section 2(k) of the Andhra Pradesh Ordinance No. 9 of 2010 defines the Registering Authority as the Project Director District Rural Development Agency for the rural areas and Project Director MEPMA for urban areas or any other person appointed by the District Collector to perform the functions of a registering authority under Ordinance for such District.
\end{itemize}
diligence of effecting recovery and a list of persons who will be involved in the lending and collection of money.\textsuperscript{264} Compared with section 42,\textsuperscript{265} the registration requirements herein are lacking in that they do not provide for a minimum start-up capital balance which a prospective micro lender ought to have in order to engage in the business of micro lending. This is very dangerous as it goes against the aspect of safety and soundness of financial regulation. A system through which any person or entity can enter into a business without proving the existence of enough financial resources with the capacity of sustaining that business will ultimately lead to a collapse of such business. Another shortcoming is to leave the issue of interest rates to be determined by the applicant which is very disturbing because it defeats the whole purpose of regulation. Instead there must be a clear interest ceiling with which all micro lenders must comply. According to rule 10\textsuperscript{266} an MFI can lose registrations status if there is a violation of any provision of the Ordinance or of the rules or the Act. It is suggested that whereas the object of the law is to regulate the industry and ensure consumer protection, it must also balance such exercise with the interest of ensuring that there is financial inclusion and access. As such, a stringent provision of revoking the license may stifle business and defeat the object and purpose for which such law was meant to achieve.

It is therefore submitted that these provisions do not come closer to those under the NBFIRA in that they are not tailor made to protect consumers from having unscrupulous entities entering the market.

\textit{4.4.1.2 Disclosure of interest rates}

The issue of interest rates forms a larger portion of micro lending regulations for many reasons. One of the reasons is that micro lenders are in a business and want to make a profit and interest is the main source of profit income in a micro lending transaction.

\textsuperscript{264} Section 3(1) of the Andhra Pradesh Ordinance No. 9 of 2010.
\textsuperscript{265} NBFIRA Act 2008.
\textsuperscript{266} Regulation of Money Lending Rules 2010.
According to Dey and Kaur,²⁶⁷ usurious interest rates lead to over-indebtedness as borrowers will fail to service their debts. Interest is addressed under section 9²⁶⁸ which does not allow lenders to recover interest which is in excess of the principal amount borrowed. This provision is supported by rules 14 and 15²⁶⁹ which outlaws the imposition of any charges other than the interest rate which must at all times be prominently displayed in the place of business. A disclosure of interest rate must be distinguished from interest capping. This is because a law which only mandates micro lenders to disclose their interest rate is different from a law which imposes maximum interest which can be charged. It is therefore argued that disclosing an interest rates to be charged and displaying it serves little purpose unlike if the regulator had capped interest and even provided a calculation formula like South Africa’s NCR. The State of Andhra Pradesh could have simply provided an interest ceiling as is the case with Botswana where interest is capped at 25 percent per month.²⁷⁰ The argument above is based on the fact that a micro lender can propose to charge usurious interest and display it as per the requirement and still be in conformity with the rules. Instead, the Registering Authority ought to have set a standard rate interest which will be binding on all lenders because the status quo is such that there will be different interest rates charged by different credit providers and this will open a lacuna for abuse by micro lenders.

4.4.1.3 Client assessment

Section 10²⁷¹ prohibits MFIs from granting loans to an SHG or its members whereas such has an outstanding loan with a bank unless such MFIs have made an application to that effect to the Registering Authority. Even though not explicitly stated, the above provision can be used as a mechanism which micro lenders use to assess if one qualifies for a loan. The major problem with this provision is that it appears to restrict this assessment to banks only at the exclusion of other financial services entities.

²⁶⁷ Dey and Kaur 2013 *GJM&BS* 695-702.
²⁶⁸ Andhra Pradesh Ordinance No. 9 of 2010.
²⁶⁹ Regulation of Money Lending Rules 2010.
²⁷⁰ Regulation 23 (2)(3)Micro Lending Regulations 2012.
²⁷¹ Andhra Pradesh Ordinance No. 9 of 2010.
Moreover, the Act is silent on the method to be used in order to find out if an applicant has an outstanding debt elsewhere. Compared with Botswana’s NBFIRA Act on this issue, it is submitted that NBFIRA Micro Lending Regulations\(^{272}\) are more detailed and comprehensive in addressing these issues because they even require a micro lender to satisfy him or herself that the applicant will be able to pay back the loan prior to issuing credit. It is suggested that this exercise could be done by requiring an applicant to produce a pay slip and consideration can be made on the applicant’s financial solvency after considering other financial obligations reflected therein. Therefore in this regard, Botswana’s regulation mechanism is much far superior to the one in the State of Andhra Pradesh.

4.4.1.4 Penalty for coercive actions

The promulgation of the Andhra Pradesh Ordinance No. 9 of 2010 was meant to remedy malpractices by micro lenders. Some of the allegations levelled against micro lenders were but not limited to unethical recollection methods, usurious interest rates and multiple borrowing which resulted in some borrowers committing suicide.\(^{273}\) In an attempt to address this issue, section 16\(^{274}\) outlaws the use of coercive force by micro lenders. Coercive force for purposes of the Act includes (i) obstructing or using violence to, insulting or intimidating the borrower or his family, (ii) persistently following the borrower or his family member from place to place or interfering with any property owned or used by him or depriving him of, or hindering him in, the use of such property, (iii) frequenting the house or other places where such other person resides or works, or carries on business, or happens to be or (iv) doing any act calculated to annoy or intimidate such person or the members of his family.\(^{275}\) Any micro lender who will violate these provisions will be liable to a prison term of up to three years or a fine of one lakh

\(^{272}\) Regulation 9 (1). See also Regulation 9 (4)(a)(b) which is to the effect that if a micro lender fails to carry out a proper assessment of a borrower, then the Regulatory Authority will consider that as a failure to carry out the business of micro lending with integrity.

\(^{273}\) Dey and Kaur 2013 GJM&BS 695-702.

\(^{274}\) Andhra Pradesh Ordinance No. 9 of 2010.

\(^{275}\) Section 16 (1) (a-f) of the Andhra Pradesh Ordinance No. 9 of 2010.
rupees or with both. Even though this is a welcome development, it would have been better if the regulations had put in place effective collection methods to be used. Fortunately in Botswana there have never been any extreme cases of violence leading to suicide except for the withholding of official documents and the retention of bank cards with personal identification numbers. Such conduct was fully addressed under the NBFIRA Act.

4.5 The State of Andhra Pradesh: 2010 Microfinance crisis

The State of Andhra Pradesh (AP) being the fifth largest and poorest state in India accounted for almost a third of India’s microfinance industry worth around $2 billion. The rapid growth of micro lenders in AP resulted in multiple borrowing as it was estimated that 83 percent of the households in AP had obtained loans from more than one micro lender. Coupled with high interest rates and unethical recovery methods, politicians encouraged borrowers to default on their payments in protest of the aforesaid malpractices which had clouded the industry. The Andhra Pradesh Ordinance No. 9 of 2010 was meant to give hope to the poor who were exploited by micro lenders through unscrupulous conduct. But that was never the case. Dey and Kaur argued that the introduction of the Act brought more problems than it could solve as it stifled business.

Conclusion

Botswana’s micro lending regime compared with that of South Africa and India’s state of Andhra Pradesh fairs well in terms of consumer protection and the general supervision of micro lenders. To this end both jurisdictions have shown strengths and weaknesses which can be addressed, bearing in mind that there is no perfect regulatory model because what works for South Africa may not work for Botswana even if it is a tried and

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276 Section 16(1) of the Andhra Pradesh Ordinance No. 9 of 2010.
280 Dey and Kaur 2013 GJM&BS 695-702.
tested initiative. Therefore countries will have to decide on a suitable model guided by the market demands and what they want to achieve with such regulation. Lastly, Botswana’s NBFIRA is advised to align itself with the latest trends and developments that have taken place recently in a bid to ensure that the micro lending industry is consumer protection oriented. This can be achieved by benchmarking with countries like South Africa wherein there is a system of consumer protection laws which complement each other. At the end of the day, the regulatory body must ensure that micro lenders do not take advantage of credit consumers through over-indebtedness and reckless lending which can lead to the collapse of the financial sector as the cash borrower’s buying power will be corroded by such bad practices.
Chapter 6 Conclusions and recommendations

6.1 Introduction

Micro lending plays an important role not only in stimulating economic growth but also in ensuring that there is financial inclusion as the low income class is able to have access to financial credit. The establishment of the NBFIRA as a regulatory authority for micro lenders in Botswana is a welcome development which does not only seek to protect consumers from unscrupulous conduct of micro lenders but also seeks to safeguard the financial stability of the country which is very crucial for attracting investors.

In this regard, the establishment of the NBFIRA served as a milestone in the general regulation of NBFIs in Botswana. With reference to micro lending, the authority is yet to yield tangible results. This is because since its inception, the authority has managed to register and issue operating licenses to only thirty-two entities out of about one hundred and eighty-five entities recorded in its data base. The authority had estimated close to nine hundred micro lenders operating in Botswana and it should be a cause for concern if there are only twelve micro lenders who have regularized with the regulatory body. With the ever increasing demand for credit on the rise, it will be incorrect to assume or conclude that those who did not regularize have shut down business; instead they are still in operation and continue exploiting borrowers. NBFIRA’s mandate is said to be too broad, thus hindering the organization from being able not only focus but also to scrutinize different financial sectors under its ambit.

282 Section 8(d) NBFIRA Act 2006.
285 According to Kenewendo, an economist at Econsult Botswana, NBFIRA’s broad mandate can be addressed perhaps by the introduction of a separate body tasked with credit regulation and data keeping.
To this end, NBFIRA still have a mammoth task ahead in ensuring that the micro lending industry is effectively regulated.

6.2 Botswana and South Africa’s regulatory regimes

South Africa’s micro lending legal framework has proved to be more effective especially in terms of its consumer protection aspects. The NCR as a regulatory body tasked with the regulation of the credit industry which includes micro lenders, does this by raising public awareness through educating the public to create awareness of the available consumer protection mechanisms which are envisaged under the Act. The element of consumer protection is echoed in most provisions of the Act and by so doing emphasizing the important role of consumer protection in micro lending regulation. Notable provisions like the one providing for debt counsellors is a well thought of move which Botswana’s NBFIRA can adopt. The restructuring of a payment plan for those who are over-indebted is not only meant to alleviate credit consumers from such financial burden but it also ensures that credit providers get paid instead of writing off such as bad debts.

Botswana’s NBFIRA can emulate the NCR especially with regard to the aspect of over-indebtedness. Mechanisms can be put in place to prevent consumers from being caught in debt traps, but again the law has to be able to make provisions for those who find themselves in this unfortunate situation. To this end, the NCA comes handy by providing for debt restructuring and debt counselling for those who are found to be overly-indebted to credit providers.

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288 NCA of 2005.
289 NCA of 2005.
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6.3 India’s State of Andhra Pradesh

Compared with India, Botswana has a better regulatory framework which is well defined and administered. This may be owing to several issues like Botswana not being overly populated like the State of Andhra Pradesh, and as such the micro lending industry is easily manageable. The fact that there is a new bill underway to regulate all NBFIs in India is an indication of the failure of the current laws. For that, there is little to be drawn from India except the fact that the 2010 crisis highlighted the importance of putting in place not just any regulatory laws for micro lending, but effective laws which will be able to avert systematic risk failure of the industry and maintain consumer protection and financial soundness.

6.4 Recommendations

6.4.1 Debt counselling restructuring for the overly-indebted

Whereas the NBFIRA under Regulation 9(1) addresses the issue of client assessment aimed at ensuring that the credit worthiness of a loan applicant is established before issuing a new loan to avoid over-indebtedness, there are no provisions addressing those credit consumers who find themselves entangled and overridden with debts which are beyond their financial means. Against this background it is recommended that NBFIRA adopts provisions similar to those envisaged under section 86 of the NCR dealing with the concept of debt review to assist those who are already overly indebted. The process of debt restructuring is a welcome development which seeks to ensure not only that the creditor is paid money owed but also eases off the debtor’s financial burden through a payment plan arrived at after consideration of all the debtors’ financial obligations.

6.4.2 Reckless lending
Both Botswana and South African regulators are in agreement in ensuring that credit providers do not engage in activities that will result in reckless lending. But South Africa has made commendable strides in combating this thorny issue as is evidenced by successful litigation which affirmed the provisions of the NCA on the matter. In the case of *Desert Star Trading v No 11 Flamboyant Edleen*\(^{291}\) the court was of the view that the creditor therein, being the appellant, was reckless in granting credit to the respondents in that no reasonable assessment was carried out which would have exposed the debtor’s inability to service the debt. This decision affirmed the provisions of section 83 of the NCA which empowers the court to set aside all or part of a credit consumer’s rights and obligation to a credit agreement, which according to the court is a reckless one. To this end, Botswana can draw lessons from South Africa on how to effectively curb reckless lending and managing it once it has been detected.

### 6.4.3 Consumer education

Consumer education plays a vital role in consumer protection. With financial literacy, consumers are able to make well informed and prudent financial decisions based on the available information which regulatory bodies and creditors provide. With outreaching consumer education mechanisms in place, issues such as over-indebtedness can be minimized. The NCR has a holistic approach aimed at equipping consumers with financial information through workshops, conferences and other media platforms such as television adverts. Even though Botswana’s NBFIRA does have similar mechanisms in place, compared to South Africa, it is not enough given the regulator’s lack of human resources capacity. According to Stoop\(^{292}\) through public awareness and good relationship with the media, the NCR is able to reach out to a majority of credit consumers through conferences, workshops and its improved website. To this end, Botswana’s NBFIRA can bench mark on the consumer awareness model used by the NCR and even make improvements to such initiatives in a bid to ensure that there is adequate financial literacy within the micro lending industry.

\(^{291}\) 2010 ZASCA 148.

\(^{292}\) Stoop 2009 *SA Merc LJ* 365-386.
6.5 Conclusions

The research question addressed by this study is to establish the extent to which the Non-Bank Financial Institutions Regulatory Authority Act of 2006 addresses the needs of the regulation of micro lenders in Botswana. This involves closely scrutinizing the mechanisms in place for the regulation and supervision of micro lenders in Botswana in light of those set internationally and subsequently deducing their effectiveness or lack thereof. Chapter 3 of the study had shown that the NBFIRA Act\textsuperscript{293} together with the NBFIRA Micro Lending Regulations have provisions which are aimed at regulating micro lending in Botswana. These provisions were comparatively analyzed in light of those in South Africa in Chapter 4 wherein the findings showed that even though regulated, Botswana’s micro lending regime framework needs to be overhauled in order for it to safely guard against consumer exploitation by credit providers. The establishment of NBFIRA as the regulatory authority is a welcome development but in order for this organization to effectively fulfil its mandate, it must be empowered in terms of qualified human resources and financial capital because without these two important tools, the organization will fail to enforce and discharge its regulatory and supervisory functions.

On the other hand, India’s State of Andhra Pradesh does not have a strong regulatory framework for micro lending which is why it was plagued by financial crisis in 2010 owing to a lack of a regulatory regime. To this end, there is not much to be drawn from the poor system in place except for lessons to be learnt by both countries on the importance of having an effective and well administered financial regulatory regime.

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