THE SUPREME COURT OF APPEAL
OF SOUTH AFRICA

Reportable
Case no: 346/04

In the matter between:

THE MICRO FINANCE REGULATORY COUNCIL Appellant

and

AAA INVESTMENT (PTY) LIMITED First Respondent

THE MINISTER OF TRADE & INDUSTRY Second Respondent

Coram: *Mpati DP, Streicher, Navsa, Nugent JJA et Combrinck AJA*

Date of hearing: **26 August 2005**

Date of delivery: **21 September 2005**

Summary: Private regulator appointed for micro-lending industry – s 21 company – entitled to make rules in terms of its memorandum of association – whether making of such rules constituted the exercise of public powers requiring legislative authority.

JUDGMENT

NAVSA *et* NUGENT JJA:

[1] 'Neither a borrower nor a lender be;

For loan oft loses both itself and friend,

And borrowing dulls the edge of husbandry.'[1]

Shakespeare's words are lost in the reality of the modern commercial world.[2] The poor, especially, are exponentially becoming borrowers[3] in what is known as the micro-lending industry, which, as the name suggests, is the industry in which lenders principally provide credit to low-income earners in relatively small amounts, at high monthly interest rates, justified on the basis of high risk.

[2] The present appeal concerns the regulation of the micro-lending industry in South Africa and, more particularly, the powers of a statutorily approved regulator.

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[1] Polonius to Laertes in *Hamlet* Act I Scene III

[2] In a proposal for a directive of the European Parliament and of the Council on the harmonisation of the laws, regulations and administrative provisions of the Member States concerning credit for consumers dated 11 September 2002, the following appears: 'Today credit is made available to consumers via a wide range of financial instruments and it has become the lubricant of economic life…
In macroeconomic terms the amount of credit circulating in the 15 Member States of the European Union exceeds EUR 500 000 million corresponding to more than 7% of GPD.'

[3] According to the research of Professor PG Du Plessis of the University of Stellenbosch – *The Micro-lending Industry in South Africa, July 1998* – it was estimated that 80% of South Africa's adult population were denied access to retail credit within the mainstream financial services industry. The research indicated the size of the cash loan industry to be approximately R10.1bn-R15bn and that it increased by 280% over the past two years. It also showed that there are over 3 500 formal lending agencies and over 27 000 informal lending outlets with a large geographic dispersion. Statistics indicate a current and near future individual market of approximately 3 million borrowers.

[3] Historically, persons who earned low incomes could not obtain credit from established banks or other financiers. The main reason for this was that such institutions were subject to interest rate limitations imposed by the Usury Act 73 of 1968 and were loath to lend money to low-income earners because of the perceived risk of default and the disproportionate cost of advancing small loans. Section 15A of the Usury Act, however, permits the responsible Minister to exempt categories of money-lending transactions from its provisions on such conditions and to such extent as he or she may deem fit. [4]

[4] In 1992, the then responsible Minister, in response to representations, exempted certain categories of small loans from its interest rate restrictions. As a result, a burgeoning micro-lending industry came into existence.[5] Predictably, abuses resulted in this industry, which, at the time, was unregulated. Government threatened to withdraw the exemption. The second respondent, the Minister of Trade and Industry, who is presently the responsible Minister in terms of the Usury Act, took advice from an advisory panel about the best manner in which to regulate the

[4] Section 15A provides: 'The Minister may from time to time by notice in the *Gazette* exempt the categories of money lending transactions, credit transactions or leasing transactions which he may deem fit, from any or all of the provisions of this Act on such conditions and to such extent as he may deem fit, and may at any time in like manner revoke or amend any such exemption.'

[5] See fn 3 above.

industry. He consequently decided that he would do so through an approved independent private body in which all interested parties would be represented.

[5] On 1 June 1999 the Minister issued a notice under s 15A of the Usury Act in terms of which he exempted micro-lending transactions from the provisions of the Usury Act but only on condition that:

'(a) the entity concluding the … money lending transaction is registered as a lender with a regulatory institution; and

(b) the lender shall at all times comply with this notice.'

The notice defined a 'regulatory institution' as a legal entity that, amongst other things, is approved by the Minister as having the capacity and mechanisms to ensure compliance by lenders with the notice.

[6] The notice went on in annexure A, entitled *Rules for Purposes of Exemption Under Section 15A of the Usury Act*, to set out various rules in protection of the interests of borrowers, such as methods of confidentiality of transactions, disclosure to borrowers and methods of collection of repayments.

[7] On 16 July 1999 the Minister gave notice that the appellant, a company that was incorporated in terms of s 21 of the

Companies Act 61 of 1973, was an approved regulatory institution as contemplated by condition (a) of the exemption notice. The Minister must have given his approval in the knowledge and with the intention that the company would henceforth ensure compliance with the terms of the exemption notice, and would regulate the industry in accordance with its own powers as conferred upon it by its memorandum of association.

[8] The appellant company came into being in anticipation of being appointed as a regulatory body for the micro-lending industry. The founding members of the company included Government and representatives of the micro-lending industry and consumers. We shall for the sake of convenience refer to the appellant as the company.

[9] The company's memorandum of association states that its main object is 'to promote the common interests of money lenders advancing small loans through the regulation of the small loans industry'.

[10] The specific powers of the company, provided for in its memorandum of association, include the power:

'To make and enforce rules to be complied with by money lenders advancing small loans registered with the company and any category of small loans in particular.'

[11] In the exercise of its powers in terms of its memorandum of association the company made a set of rules that were later revised. Amongst other things, both sets of rules allow for lenders to register with the company. A lender who wishes to be registered with the company is required to complete and to submit an application for registration. In the application form the lender undertakes to abide by the provisions of the Usury Act exemption and the rules of the company. Upon acceptance of the application by the company, and registration of the lender, the lender becomes contractually obliged to abide by the exemption to which we have referred and by the rules made by the company. Those rules provide, amongst other things, for the manner in which the lender must conduct various aspects of his or her business and for the exercise by the company of discipline over the lender.

[12] Apart from that, the detailed provisions of the initial and the revised rules are not material to this appeal except in one respect. The revised rules (Rule 6) require lenders to submit to an 'information broker' (a person appointed by the company to maintain a national loans register) 'accurate data in respect of all loans granted for the purposes of such data being captured on the national loans register.' The purpose of the national loans register

is to enable lenders, by consulting the registrar, to determine whether a borrower will be able to make loan repayments. (One of the revised rules prohibits lenders from making a loan without first being satisfied that the borrower will be able to do so.)

[13] Thus the effect of the various measures to which we have referred is that in order to conduct micro-lending transactions a lender is required, as a condition of his or her exemption from the provisions of the Usury Act, to register with the company. By registering with the company the lender binds himself or herself to the company contractually to abide by all its rules, and with the ministerial rules that are contained in the exemption notice.

[14] The first respondent is a company with limited liability, incorporated in terms of the Companies Act, operating in King Williamstown in the Eastern Cape as a micro-lender, advancing small, short term loans in return for interest. It advances loans of up to R3 000-00 with a maximum loan repayment period of six months.

[15] After the Minister approved the company as a regulatory institution, the first respondent duly registered with it as a lender

and appears to have conducted its business within the company's rules.

[16] During June 2001 the company announced its intention to introduce the revised set of rules. This spurred the first respondent into objecting to the proposed changes to the rules. It alleged, *inter alia*, that the rules introduced by the company were unconstitutional on various grounds, and it threatened legal proceedings. Its principal objections related to the introduction of the national loans register with the concomitant obligation upon lenders to submit information for inclusion in the register, and the prohibition upon lenders making loans without first satisfying themselves that the borrower was able to make the required repayments.

[17] After the company introduced its revised rules on 1 July 2002 it informed the first respondent that the introduction of the national loans register was to promote responsible lending. The Department of Trade and Industry, responding to the first respondent's objections (apparently on behalf of the Minister), whilst not taking a final position on the issue before legal proceedings commenced, stated that it considered the changes to the rules as not infringing the provisions of the Constitution.

[18] The first respondent then launched an application in the Pretoria High Court for various forms of relief that were all aimed at invalidating the company's initial and revised rules.

[19] The grounds upon which the first respondent sought to attack the validity of the rules in its application went beyond those that it had advanced earlier. Apart from the various constitutional grounds upon which it had earlier relied the essence of the first respondent's attack upon the validity of the rules and which formed the core of its argument before us, was this: It submitted that the company, by making rules that bound lenders in the industry, was purporting to exercise public regulatory powers, and that it had no legislative authority for doing so. To phrase it in language that was used by the first respondent, it was submitted that by making the rules the company was purporting to legislate, without any constitutional or other legislative powers to do so. Its further submission, repeating an objection that it had made earlier, was that the rule requiring disclosures to be made for the purposes of the national loan register (which was introduced with the revised rules) was in conflict with s 14 of the Constitution, which guarantees the right to privacy.

[20] The application to the High Court succeeded and the rules were set aside. The learned judge in the court below reasoned that in making rules that bound participants in the micro-lending industry the company was purporting to exercise legislative powers, which it had no authority to do. In view of his finding it was not necessary for the learned judge to consider the further constitutional challenge to the validity of the rules. This appeal against that decision is before us with the leave of the court below.

[21] Before turning to the merits of the appeal there is a preliminary matter that can be disposed of briefly. On 8 August 2005, subsequent to the filing of the heads of argument by the parties, the Minister repealed the notice by issuing a new exemption notice,[6] which also embraced all the rules adopted by the company. It was contended on behalf of the first respondent that this rendered the dispute academic and that the appeal should be dismissed on the grounds set out in s 21A of the Supreme Court Act 59 of 1959, namely, that any judgment or order would have no practical effect.

[22] We disagree. The company and the Minister both contend that the company has the right to continue making rules and do not

[6] Government Notice 1407 of 2005 in Government Gazette 27889.

rule out the possibility of such rules being made in the future. Furthermore, the company correctly points out that it has regulated the affairs of lenders and borrowers who have subscribed to its rules and that they, and it, thus require certainty in relation to their existing and future rights and obligations. It is clear that a decision by this Court will have a practical effect.

[23] The object of the company in terms of its memorandum of association is to make and to enforce rules that are to be complied with by micro-lenders that are registered with the company. That is not an unlawful object, whether under the Usury Act or otherwise, and the achievement of that object is not inconsistent with the terms upon which the Minister approved the company as a regulatory institution. On the contrary, the company was approved by the Minister precisely to assume that function.

[24] The attack upon the validity of the rules made by the company, on the grounds that it was not authorised to make the rules, is in our view misconceived. That attack proceeds from the premise that the company is a public regulatory authority that is purporting unilaterally to impose a regulatory regime on micro-lenders. That is not correct. The company is not, and does not purport to be, a public regulator with authority unilaterally to

exercise powers over outside parties. It is a company that conducts business as a private regulator of lenders who choose to submit to its authority by agreement. In regulating micro-lenders who agree to such regulation it does not purport to be exercising legislative or other public powers that require a constitutional or legislative source. It purports only to regulate those who are willing to submit to its regime and the source of its authority to do so is their consent.

[25] Moreover, insofar as the consent of lenders to submit to that regime might be said to be extracted by coercion, the source of that coercion is not the rules of the company, or its act in making those rules, but is rather the provision of the exemption notice that compels any person who wishes to conduct business as a micro-lender to submit to the company's regulatory regime. We are not called upon in this appeal to consider whether the Minister was entitled to assert that coercion by requiring lenders to submit to that private regulatory regime as a pre-condition to engaging in micro-lending and we do not do so. The first respondent has pointedly refrained from attacking the validity of the exemption notice and the conditions that it contains. There is also no attack in the present proceedings upon the validity of the first

respondent's consent (or that of other micro-lenders) to abide by the company's rules, whether on the grounds that it had no alternative but to do so if it wished to conduct business or on any other grounds. The first respondent's attack is directed solely to the validity of the company's act in making the rules.

[26] The validity or otherwise of the company's act in making the rules does not fall to be determined with reference to principles of public and constitutional law, as contended for on behalf of the first respondent, because the company does not purport to be exercising public powers of legislation. On the contrary, it purports only to be making rules that will be binding upon those who agree to abide by them, in pursuance of the business that it conducts as a private regulator. The validity of its act in making those rules falls to be determined with reference to trite principles of company law and in particular, whether it was empowered by its memorandum of association to do so. We have already referred to the material power conferred upon the company by its memorandum, which clearly authorised it to make the rules. In those circumstances the attack upon their validity on those grounds ought to have failed.

[27] The invasion of privacy attack on the revised rule relating to the submission of information for purposes of the national loan

register is based on the view that the rule operates within the public and constitutional law sphere. It was never suggested that consent to such a rule in the private law context is impermissible either in terms of the Constitution or otherwise. We were, in any event, not called upon to address that question. In the light of the conclusions set out above it is unnecessary to consider this point any further. For these reasons the appeal is upheld with costs, including the costs of two counsel. The order of the court below is set aside and the following order is substituted:

'The application is dismissed with costs including the costs of two counsel if applicable.'

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M S NAVSA
JUDGE OF APPEAL

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R W NUGENT
JUDGE OF APPEAL

CONCUR:

MPATI DP
STREICHER JA
COMBRINCK AJA