FINANCIAL JOURNEY
FOR A SECURE AND PLANNED FUTURE

CLIENT HANDBOOK

DEBT REVIEW EXPLAINED

2023

www.financialjourney.co.za

My Financial Journey

CONTENT

WHAT IS OVER-INDEBTEDNESS?

01

Overindebtedness is when the debt situation has worsened to the point of having to choose between life (personal expenses) and debt. This is when your income can either pay your debts or your personal expenses, and cannot do both.

Being in debt is not the same experience for everyone. Buying on credit is not a bad thing, it can actually be a good thing as it offers convenience of buying now and paying later, and one can obtain assets, etc. they cannot otherwise afford in cash.

Debt problems start when there is no control over the use of credit, mostly because of lack of information about how credit works.

CAUSES OF DEBT PROBLEMS

02

Debt problems vary in severity and there are a number of solutions to address those various levels of severity.

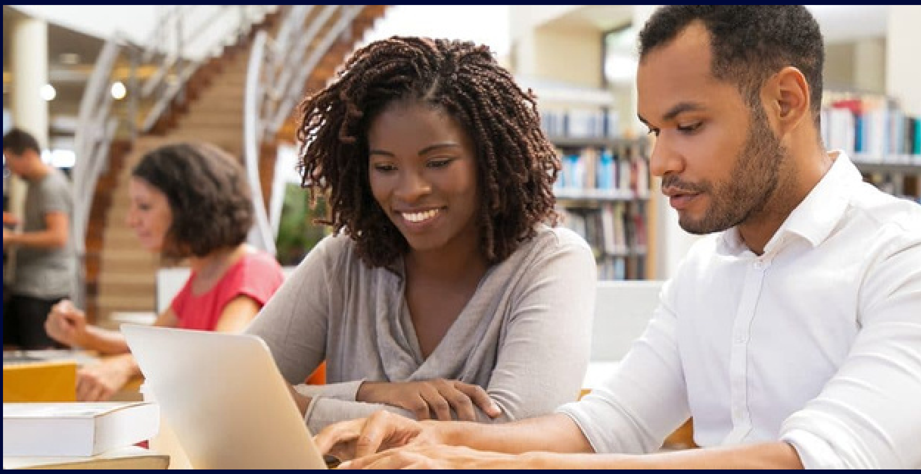
Problems caused by lack of money management: At times we don’t have a sufficiently clear idea of how much we should have available for our monthly lifestyle/personal expenses (groceries, school fees, etc.) as well as how much to commit to debts and we end up committing our money more than we should. This usually creeps in slowly over time. It starts with not being able to pay one debt, escalates to more and more debts being unpaid. It is also known as the debt trap. At times, this happens very abruptly, when there is an event that changes your financial situation, such as loss of income/employment, loss of a financially contributing partner, illness, other crises, etc. For some people, there is not enough income in the first place, i.e. low income or underemployment.

03

HOW CREDIT WORKS

When any kind of credit is offered, it includes the following:

- The principal debt – the amount of debt given
- Interest – charges depend on
- The type of credit product: home loan, car finance, unsecured credit, e.g. retail credit, personal loan, etc. – the NCR provides a guideline of maximum interest allowed by type of credit product.



This guideline is based on the repo rate. The repo rate is the interest rate offered by the reserve bank to other banks. Think of it as the cost price/rate of credit. Credit providers charge extra to make a profit. The NCR gives a guideline for the maximum extra that can be charged so that consumers are not charged too much.

- Service fee – Maximum guided by the NCR. This fee is the same amount each month for the entire credit term.
- Credit Insurance - Maximum guided by the NCR. This is mostly provided by a registered insurance company, to insure against the inability to pay installments as a result of loss of income, due to retrenchment, disability, or death for instance. Most credit insurance policies pay for a limited time, in the event of claims. Always read the terms and conditions.
- Initiation fee - Maximum guided by the NCR. This is a once-off fee that could be paid upfront or included/spread out in the monthly installments. However, interest should not be charged on this fee.

04

WHEN DOES ONE PAY THE FEES?

Every month. Monthly instalment pays all fees before it pays the principal debt. Interest is calculated monthly according to the account balance. E.g. Personal loan R100 000 – R3838 monthly instalment at 24% p.a. interest for 48 months:

- Service fee @ R69 per month
- Credit insurance @ 2.58 - 4.50 per R1000 per month: R450
- Once off initiation fee: R1 207.50 or R25.16 over 48 months
- Interest at month 1: R2000
- Total fees for month 1: R2 544.16
- This means for month 1: Instalment R3 838 minus fees R2 544.16 = R1293.84 which will be paying the principal debt.

Over time, as the balance decreases, so does the amount that pays interest and insurance. This means the amount that is allocated to the principal debt All other fees should remain the same monthly.

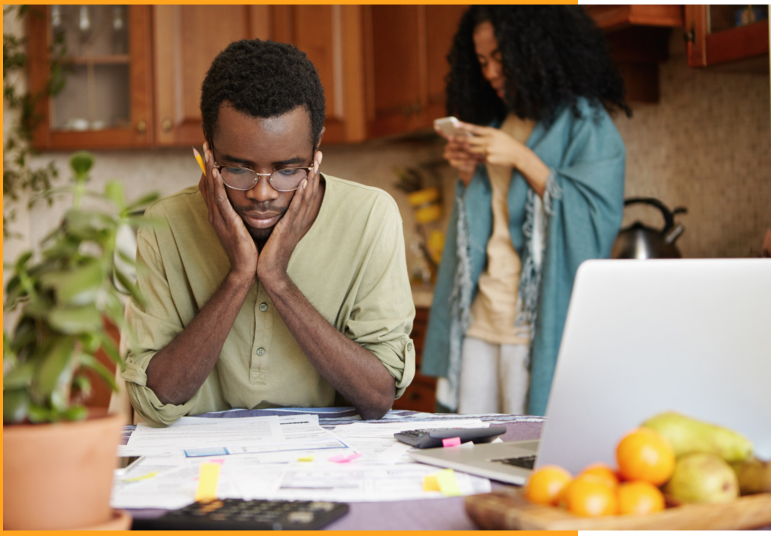
What happens when you pay less than the agreed monthly instalment?
The fees are calculated each month as indicated above. Depending on what is left after the reduced payment, the following scenarios could take place:

1. There could be much less left to pay the principal debt, meaning the balance will decrease slowly.
2. There could be nothing left to pay the principal debt, meaning only fees are paid and the balance will stay the same over time.
3. The amount paid could be less than the fees required, meaning the fees shortfall will be added to the balance. The balance will increase even if there is a payment made.

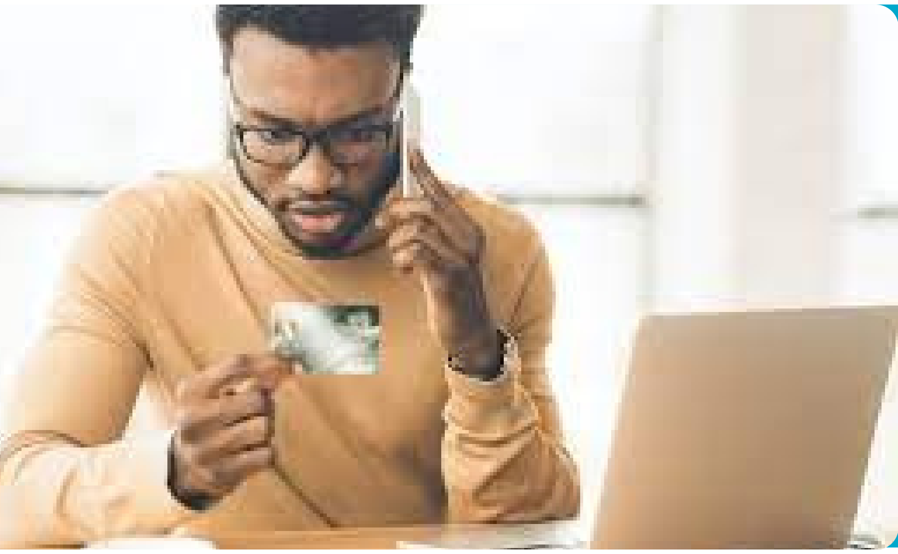
AVAILABLE SOLUTIONS

05

1. DIY: Do it yourself
2. Debt mediation
3. Debt consolidation
4. Debt prescription
5. Debt counseling/review

06



SOLUTIONS

DO IT YOURSELF

This process involves communicating with your credit providers, negotiating for a short-term solution for your debt problems. What you negotiate for will vary according to your circumstances.

Example: You could ask for 3 months without paying your instalment, while 'your situation' improves. Remember to also negotiate for freezing interest. This is advisable to do only for a short amount of time, preferable not more than 4 months. Discuss with your credit provider how this will affect your credit profile. Make sure that your agreement is in writing.

DEBT MEDIATION

This process involves getting a professional, a debt mediator, to do the Do-It-Yourself process on your behalf. This is advisable to do when your situation is complex, or if you are not confident with your ability to Do-It-Yourself.

07 SOLUTIONS

DEBT CONSOLIDATION

This process involves applying for a consolidation loan, which will be used to settle your most or all of your unpaid unsecured debt. Remember, this is a loan which should be paid back. Get a proper financial assessment to assess whether or not this solution will remedy your situation or make it worse. Consolidation loans are designed to be expensive, they attract a high interest rate. Why? Because high risk loans attract high interest. Failing to pay back your existing debt in time makes you a high risk credit consumer.

Why would you consider consolidation? To reduce your monthly debt obligations. How? By stretching your loan term up to 5 years. Remember, consolidation loans are loans, they also attract interest and other fees as per the National Credit Act. This means you would pay more in the long run. However, there are no actions without consequences. Buying on credit is expensive. Failing to pay debts on time is even more expensive.

DEBT PRESCRIPTION

If there is no activity on an account for a minimum of 3 years, it expires, or prescribes. The process of activating prescription involves challenging the credit providers to provide proof that there was any activity on an account in the past 3 years. If there is no proof, the credit provider sends a letter of prescription which is sent to the credit bureaus to remove the account from the credit profile.

DEBT REVIEW/ COUNSELLING

08

Debt review is a voluntary legal process. This is the only process that can change the contents of an existing credit contract, reduces the instalment amount paid on each and every account owed, including interest rate charged on the account. Reducing interest ensures that even if there is a reduced monthly instalment paid on each account, the balance does not increase but it actually is reduced over time.

This is done through the following summarized process:

- Once contacted by a consumer, a debt counsellor will give a form (Form 16) to the consumer for completion and request some documents: ID copy, payslips, bank statement, proof of residence and if married, proof of marriage.
- The debt counsellor will request a credit report and use the provided information to conduct an overindebtedness assessment using NCR guidelines. Once the assessment result finds that the consumer is overindebted, the debt counsellor will initiate the debt review process, in consultation with the consumer.
- This means:

1. There will be a discussion on which personal expenses to prioritize so that there are funds freed up to be used to pay current debts. If the consumer is overindebted, the amount for debts will be less than required, e.g. if R5000 is required to pay all monthly instalments in full, say the consumer only has R3000 left...
2. The debt counsellor will, in agreement with consumer, negotiate with all credit providers on how to split the R3000 to pay all accounts monthly. This is how the monthly instalments are reduced. All fees are taken into consideration. Once all credit providers agree, a court application is given to an attorney to request a debt review order from the court. All of the above must happen in 60 days.
3. During the 60 days, the consumer pays the agreed R3000 instalment and it will pay the debt counsellor for their services and the attorney for theirs. Credit providers will be informed at the beginning of the process that the consumer has applied for debt review and they will know not to expect any instalment payment during the 60 days. The consumer is asked to change their bank account so that there are no double deductions.

4. After the 60 days are complete, the consumer will start paying their debts with the agreed R3000 monthly instalment. This will be paid into a Payment Distribution Agency account, where the amount will be distributed to pay all accounts as agreed with consumer.
5. Consumer has a right to see all documents that are part of this process, including monthly statements showing all contributions and distribution of monthly instalments.

- While under debt review, the creditors are not allowed to collect or initiate any legal process on any of the accounts. This is how assets are protected under debt review. Credit providers should only communicate with a debt counsellor during the debt review period.
- A reduced instalment will allow one to cover both personal expenses as well as monthly debt payments. Debt review provides a controlled, safe process.
- While under debt review, the consumer is not allowed to use credit. Remember, if one is drowning in water, it does not make sense to pour more water on them. The debt counsellor should be able to show how long the debt review process will last. Also, bear in mind that if you are married in community of property, you will jointly be under debt review with your spouse.
- Once the process comes to an end, the consumer will be debt free and will be given a certificate of clearance, which will remove the debt review flag from their credit profile and the consumer will have zero debt and will be able to use credit again. Hopefully, this time it would be a better use of credit. Debt review is similar to rehabilitation.
- The pros and cons are implied in the above explanation.

There is also debt sequestration and debt administration, however those processes will not be explained here. You should not use any of the above methods mentioned in this document without consulting with a professional to give advice and guidance in accordance with a personal financial health analysis. The above is offered for educational purposes only.

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