Opinion on payroll deductions

Overview

1. My advice is requested regarding the legal implications of payroll deductions.
2. I have been furnished with narrative statements from debtors impacted by these deductions, as well as various documents containing examples of the use of this mechanism by South African creditors. These documents include *inter alia*:
   2.1 Credit agreements.
   2.2 Affordability determination schedules.
   2.3 Debtor pay slips.
   2.4 Creditor statements.
3. Since the factual matrix relevant to this issue often involves intricate financial calculations, I sourced assistance from a senior lecturer at the Stellenbosch University Department of Statistics and Actuarial Science. This actuary considered and reported on limited samples of statements provided to him in the case of one particular debtor.
4. The purpose of this memorandum is to present a focussed, clear, and concise summary of the relevant factual and legal landscape. This will be done by briefly considering the micro context (excluding the wider socio-economic picture), the factual pattern emerging from the evidence provided, the legal implications, and recommended next steps.

Context

5. Remuneration (salaries and wages) earned by employees are assets belonging to employees that are transferred (paid) from the estates of their employers to those of employees. As such, salaries and wages can be attached in settlement of civil debts against employees. Like other forms of assets, this income is,

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however, also protected against arbitrary deprivation in terms of section 25 of the Constitution of South Africa.

6. In South Africa, lawful, court-sanctioned wage garnishment aimed at the collection of civil debts is facilitated through the emolument attachment order ("EAO") mechanism. Colloquially known as a "garnishee order", it is more accurately stated a specialised form of a garnishee order, where the creditor recovers their debt from their debtor's debtor, the latter party being the debtor's employer.
7. The EAO mechanism presents an attractive solution to mitigate against the risk of defaulting on loan repayments, since salaries and wages offer a relatively secure form of recurring income. This is especially true in South Africa, where factors like protective labour laws and influential worker unions safeguard employee's income stream.
8. The security provided by the EAO mechanism encouraged unscrupulous creditors to extend numerous reckless loans to low-income earning debtors. The situation was aggravated by a fragile EAO-related legislative framework that allowed for the egregious over-collection of debt. Consequently, insignificant loans could grow into substantial passive-income generating investments as many creditors enriched themselves by fleecing vulnerable debtors of their income.
9. Important amendments were introduced to section 65J of the Magistrates' Courts Act 32 of 1944 ("MCA") in 2018, following the Constitutional Court's judgment in *University of Stellenbosch Legal Aid Clinic v Minister of Justice and Correctional Services [2016] ZACC 32*. These amendments introduced advanced protection to debtors who had previously suffered from widespread exploitation by unscrupulous creditors abusing the EAO mechanism.
10. The most significant and relevant amendments to section 65J of the MCA involved:
    10.1 The introduction of judicial oversight as a condition for the issuing of an EAO. This measure was primarily implemented to prohibit the abuse of consents to EAOs which were frequently obtained on a fraudulent basis from desperate debtors, including being requested in advance at the commencement of the loan agreement.

10.2 The creation of a duty on employers of EAO debtors to object to the issuing or continuation of an EAO if the amounts claimed are erroneous or not in accordance with the law.

10.3 The introduction of a limit on EAO deductions where 25% of a judgment debtor's basic salary is already committed to other EAOs and / or the debtor will not have sufficient means left for his or her own maintenance or that of his or her dependants.

11. The amendments to the MCA had an immediate impact on the civil judgment and debt collection landscape post 2018. While EAOs remained a potentially lucrative and secure collection instrument, it was now considerably more difficult to issue EAOs. Consequently, creditors pivoted to alternative methods to keep expanding their lucrative business enterprises by extending reckless loans while continuing to reap the benefits of wage garnishment.

Factual pattern

12. In considering the documentary evidence of the various cases brought to my attention, certain often recurring patterns emerge.
13. Creditors enter into small and intermediate credit agreements with debtors on the basis that, as is the case with EAOs, the loan, interest, and fees will be collected from the debtor's employer. The formal EAO process is, however, sidestepped by the debtor agreeing in the initial loan agreement to a stipulation such as, for example, "I hereby irrevocably instruct the Payroll department of my employer to deduct the instalments as reflected in the 'Pre-agreement Statement and Quotation' from my remuneration until the total outstanding amount payable by me to … has been repaid in full".
14. Credit agreements are not always accompanied by affordability assessments. Where present, these assessments frequently raise concerns regarding the thoroughness and veracity of information contained therein, inter alia failing to provide for reasonable living expenses.

15. While credit agreements typically contain details explaining the total cost of credit which the debtor will incur, there are no similar details demonstrating the consequences of debt escalation due to non-payment.
16. Payroll deductions in service of loans are made on an indiscriminate basis by employers. Amounts are often completely disproportionate to a debtor's salary. In many examples, deductions are made in favour of multiple creditors and for amounts well above 25% of the debtor's salary. For example, in a specific case, a payroll deduction of R11 178 was processed against a debtor's monthly salary of R15 041. In another case, payroll deductions totalling R14 566 were processed in favour of two creditors against a debtor's monthly salary of R21 475. In both cases, these debtors received a net pay of zero rand with which to maintain themselves and their dependants for the relevant months.
17. The relevant payroll deduction clause in some of the initial loan agreements contain references to agreements between creditors and employers, for example "I acknowledge that the loan granted to me would not have been granted had my Employer not concluded an agreement with [the creditor], in terms whereof my Employer is contractually bound to make the aforementioned deductions from my renumeration until the contractual amount owing is paid in full". It is unclear what the content of these agreements between creditors and employers are, and what benefits employers derive from entering into same.
18. When employees query salary deductions with their employers, they are informed that employers are obliged to keep deducting amounts as long as the creditor insists on this, based on the credit agreement and the debtor's irrevocable instruction.
19. There are instances of payroll deductions appearing as misleadingly identified items on debtor salary slips. For example, a deduction on the salary slip of a debtor who is a member of the South African Municipal Workers Union (SAMWU) is identified as "X Finance SAMWU", while the particular creditor had no affiliation to said union.
20. Loans for small amounts are granted on the basis of relatively high interest rates and attract initiation fees and monthly service charges.

21. Loans are refinanced by being extended in order to settle previously existing loans from the same and other creditors. Creditors whose loans are settled in this manner (by receiving payment of the full due amount from another creditor), eagerly extend more loans to the same debtor.
22. The creditor statements that indicate the running balances of the outstanding loans are normally complicated and lack clarity and transparency. The efforts of the actuary involved in inspecting some of these statements produced mixed results. Of concern, was that he was unable to accurately replicate the figures provided in these statements in all instances.
23. In addition, the actuary found that the cost of the credit insurance (in the case in point stipulated as R5,50 per R1 000 of the deferred amount) added to these loans by creditors is based on the full initial loan amount and not the decreasing outstanding balance. As a result, the total insurance premium is excessive relative to the size of the loan - R32 000 insurance cost for a loan of R97 000. Had the premiums been based on the decreasing outstanding balance of the insured loan, the total cost would be R19 000 instead of R32 000.

Legal implications

24. Certain legal principles apply to the facts and circumstances indicated above.
25. The formal EAO process described above has been carefully developed by the courts and legislature, over the course of several decades, to balance the interests of the debtor and creditor. Measures have been implemented to restrict wage garnishment's propensity for the forms of abuse widely inflicted on debtors by creditors in the past.
26. The facts above demonstrate how the payroll deduction mechanism is employed by certain creditors to avoid the specific legal requirements and safeguards enforced by the EAO mechanism. In this manner, the payroll system operates outside the confines of the legal system, as creditors are at liberty to attach the debtor's salary without the need to involve the judicial oversight of the courts.
27. The dubious consent to EAO that was previously outlawed by the 2018 amendments to the MCA, is replaced by an "irrevocable instruction". This clause

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forms part of the credit agreement that is concluded before the debt is incurred and is relied on by the creditor to compel employers to process payroll deductions.

28. The irrevocable instruction to allow payroll deductions is central to the matter as creditors will argue that it represents the debtor's consent to attachment of their salaries. In the absence of this consent or a valid court order (specifically an EAO), the attachment would be nothing short of theft, and illegal. Should the debtor default on any payment in terms of the credit agreement, the terms of the instruction to deduct can be changed on a unilateral basis by the creditor. While a debtor may have consented to reduce their monthly salary by a manageable amount (calculated based on an affordability assessment), no employee would instruct their employer to deduct amounts that would cause them to receive no income, as transpired in some of the cases mentioned above. This irrevocable instruction, which can only be amended in favour of the creditor, places the debtor in an untenable position and demonstrates the vulnerability caused by the payroll deduction mechanism.
29. The affordability assessment required by section 81 of the National Credit Act 34 of 2005 ("NCA") in order to avoid granting reckless credit has been, and remains, contentious. The facts above lend support the often-repeated claims by debtors that creditors do not always conduct these assessments with the required level of care or accuracy to ensure that debtors do not enter into reckless and unaffordable loans.
30. In this regard, for example, the judgment of the National Consumer Tribunal in *Summit Financial Partners (Pty) Ltd V Direct Axis SA (Pty) Ltd (NCT/145402/2019/141(1)(b))* noted that

> "it is evident that little regard is given to [the debtor's] understanding of the information that [the creditor] was giving. Instead, '[the creditor's] call centre agents rush over important parts of the affordability assessment and steer the consumer away from making statements that would prevent the loan from being granted' and prompt consumers to provide answers that improve the likelihood of the loan being granted."

31. In *National Credit Regulator v Dacqup Finances CC trading as ABC Financial Services - Pinetown (382/2021) [2022] ZASCA 104*, the Supreme Court of Appeal concurred with the Tribunal's earlier finding that the creditor

    "had merely engaged in a 'tick box exercise' to create the impression of complying with the NCA when, in reality, it did not comply with the stringent assessment requirements and did not conduct proper affordability assessments".

32. However, the Tribunal held in *Summit Financial Partners (Pty) Ltd v Direct Axis SA (Pty) Ltd NCT/177859/2021/141(1)(b))* that, even in the face of seemingly unrealistic information contained in the assessment, no duty rested on "the credit provider to independently verify the information a consumer provides regarding their living expenses".

33. As mentioned above, the documents provided for my consideration evidence instances where loans were granted to settle previous loans by the same and other creditors. This also happened in circumstances where the previous loan payments were already in arrears. In terms of section 79 of the NCA, determining a consumer's over-indebtedness (and ability to afford a loan) should have regard to the consumer's:

    "(a) financial means, prospects and obligations; and

    (b) probable propensity to satisfy in a timely manner all the obligations under all the credit agreements to which the consumer is a party, as indicated by the consumer's history of debt repayment."

34. Further loans were therefore granted despite debtors' struggles to meet existing responsibilities. This information was available to the creditor, who arranged for the settlement of the previous outstanding loans.

35. Still, should the creditor produce a proper affordability assessment as prima facie defence against a claim of reckless credit, the debtor will bear the onus to prove that the assessment was conducted in an improper manner. Many vulnerable debtors will likely find this burden too challenging to meet, irrespective of the circumstances that prevailed at the signing of the agreement.

36. When loans are granted on a reckless basis, debtors are likely to default on payments and are in this manner set up for failure. It is therefore troubling that

debtors seem to be lured into debt traps from which they are unable to escape as outstanding loans are simply incorporated into new loans, which opens the way for yet more loans to be extended to these debtors. It is arguable, and this is what the evidence suggests, that the availability of the unregulated payroll deduction mechanism encourages this behaviour by creditors.

37. It is also troubling that the credit agreements considered do not contain details demonstrating the escalating effect that missed payments will have on the outstanding balances of loans. Objectively determinable and verifiable terms and amounts are only applicable as long as the debtor abides by their repayment obligations. When debtors default, creditors practically become the sole arbiters to determine what the outstanding balance entails and what amounts should be deducted from the payroll in service thereof. The payroll deduction mechanism makes no provision for taxation or intervention by a third party to confirm that the creditor's calculations are accurate. As mentioned above, the statements provided to employers, if requested, lack transparency and are very difficult to interpret (as found by the actuary who considered a sample thereof). Creditors are also able to abuse the "irrevocable instruction" to deduct any amount they please.
38. This contractually mandated ability of the creditor to exercise a discretion and thereby unilaterally change the terms of repayment is highly problematic. In *NBS Boland Bank Ltd v One Berg River Drive CC 1999 (4) SA 928 (SCA)* the Court of Appeal confirmed that such a discretion is invalid if it lacks reasonableness and certainty. There can be no doubt, as evidenced in the factual examples mentioned above, that payroll deductions occur in an unreasonable and uncertain manner. In addition, the Constitutional Court in the seminal case of *Beadica 231 CC v Trustees for the time being of the Oregon Trust 2020 (9) BCLR 1098 (CC)* held that contract terms can be voided for offending against the principle of fairness: "*Ubuntu*, which encompasses the values of fairness, reasonableness and justice, is now recognised as a constitutional value, and in the scales of public policy, might sometimes outweigh sanctity of contract". I am of the opinion that the relevant clause would also fail judicial scrutiny based on public policy considerations due to its use in undoing the affordability requirements of the NCA.

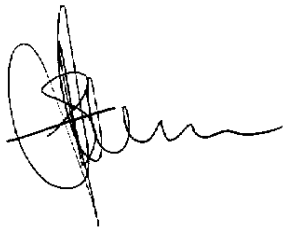
39. The clause which allows creditors to unilaterally inflate the monthly payroll deductions also offends against section 48 of the Consumer Protection Act 68 of 2008. In terms of this section, a creditor cannot enter into an agreement on terms that are unfair, unreasonable, or unjust. Terms in contracts will be unjust if they are "excessively one-sided" or "so adverse to the consumer as to be inequitable".
40. Employers who process the demands for payroll deductions received from creditors are protected from liability vis a vis their employees due to the provisions of the Basic Conditions of Employment Act, 75 of 1997. According to section 34(1)(a) of this Act, employers may make deductions from their employee's salary if "the employee in writing agrees to the deduction in respect of a debt specified in the agreement".
41. In this respect debtors are again prejudiced by the payroll deduction mechanism's replacement of the EAO process. In the case of EAOs, the MCA contains detailed provisions which establish a duty on the debtor's employer to play an active role in monitoring deductions and intervening when necessary to protect their employee's rights. In the case of payroll deductions and based on the documentation considered, it appears that some employers are not only indifferent to their employee's financial woes but are acting as agents in facilitating the exploitation by creditors. As mentioned above, it appears that creditors are purposefully engaging in contracts with employers to facilitate this payroll deduction process. The motives of, and incentives for, employers to enter into these agreements, which undoubtedly places an administrative burden on employers, should be questioned.
42. Possibly the most concerning aspect of the unregulated payroll deduction mechanism's replacement of the regulated EAO process is the unfettered and egregious disproportionality in monthly deductions. As stated above, the evidence frequently demonstrates how payroll deductions claimed in excess of 50% of monthly wages and left debtors with insufficient means for maintenance. In some cases, employees received zero income. While the lack of clarity and transparency described above makes it difficult to establish as fact, it is, as was the case with EAOs, very probable that the payroll deduction mechanism is also abused to over-collect on the total lawful amounts of debts due.

43. *University of Stellenbosch Legal Aid Clinic v Minister of Justice and Correctional Services [2016] ZACC 32* held that this unrestricted deprivation of a debtor's earnings and means of support has a direct impact on several constitutionally enshrined human rights of the debtor and their family, including the right to access to healthcare, food, education, housing, shelter, family life and human dignity.
44. Here again the impact of the "irrevocable instruction", causing indefinite hardship on the debtor and their dependents, is highly problematic. It can be argued that each monthly deduction constitutes a separate attachment for an amount that should, in the absence of the judicial restrictions imposed by the EAO process, be consented to specifically.
45. There can therefore be no doubt that the deductions facilitated by the payroll deductions mechanism, as evidenced in the documents provided, are unconstitutional. The mechanism has enabled creditors to contrive the exact unlawful and contemptible ends previously achieved through EAOs.
46. In terms of section 106(1)(a) of the NCA as read with Government Gazette 40606 (9 February 2017), the cost that a credit provider may charge a consumer in relation to credit life insurance may not exceed R4,50 per R1 000 of the amount "calculated either on the deferred amount at the inception of the credit agreement or on the deferred amount from time to time under the credit agreement life insurance". While currently legal, the practice of charging credit insurance costs on the full initial loan amount instead of on the decreasing outstanding balance has been widely criticised. It has been described as the "rip-off gap in credit life insurance rules" (Business Day, 11 September 2017) and presents a significant weakness in the regulations as currently written. The controversial calculation method results in disproportionately high insurance premiums relative to the loan amounts, which further exploits debtors and runs up unnecessary costs to insure amounts no longer due. It also appears that some creditors are guilty of exceeding the maximum allowable charges for credit insurance.

Next steps

47. In light of the above analysis, I am of the opinion that urgent intervention is required to veto the prevailing unconstitutional and unconscionable abuse of the payroll deduction mechanism to exploit wage and salary earning debtors.
48. Research confirms the power imbalance between creditors and consumers, especially vulnerable consumers who are illiterate (or at least financially illiterate), as is largely the case in South Africa. The NCA requires parties to work towards striking a balance between the interests of creditors and debtors, the inference being that they must proceed from a position of imbalance due to the inequalities of the past. The Constitutional Court confirmed as much in *Nkata v Firstrand Bank Ltd 2016 4 SA 257 (CC)*, where it cautioned that creditors had to be "astute to recognise the imbalance in negotiating power between themselves and consumers".
49. Research also demonstrates that it is unrealistic to expect vulnerable debtors and their generally indifferent employers, who, as indicated above, are sometimes party to the abuse, to offset the efforts of unscrupulous creditors. These debtors rely on assistance from usually unaffordable private legal representation or from the limited free legal aid resources. More importantly, they rely on the courts and the legislature to improve the framework and protect them from the forms of exploitation evidenced and discussed herein.
50. A piecemeal solution to address the problem is for individual debtors to approach the Tribunal or courts with their individual matters. This approach is unpractical in light of the restrictions on debtors' access to justice mentioned above. An alternative would be to consider instituting an impact case similar to the approach followed in *University of Stellenbosch Legal Aid Clinic* in order to present the court with the cases of a number of employees. The court could be requested to intervene in the specific unregulated payroll deductions and to set precedent for dealing with similar matters.
51. Ultimately, legislature should be lobbied to affect legislative development to protect vulnerable debtors against payroll deductions. The mechanism should not serve as incentive to unscrupulous creditors to gain financial windfall by inflating reckless loans with disproportionate costs based on inter alia high rates, initiation fees,

monthly service fees, and credit insurance. The prevailing lack of regulation in this regard is quite simply irresponsible.



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