

MEMORANDUM ON THE OBJECTS OF THE COMMUNITY REINVESTMENT (HOUSING) BILL, 2002

BACKGROUND

The South African Government, in its Department of Housing, decided during late 1997 to investigate the possible introduction of legislation to promote increased disclosure and lending by financial institutions, specifically for housing. It has become increasingly apparent that many financial institutions are quite prepared to take a community's money but are not prepared to reinvest money in that community, particularly in the form of mortgage lending. The communities, which are hardest hit, are invariably the poorer communities.

In terms of the Record of Understanding signed on 20 October 1994 the Association of Mortgage Lenders (AML) was to aim at providing 50 000 loans in the first year to eligible borrowers falling within income categories qualifying for government investigation, with the intention of thereafter annually growing the level of lending. In addition the government undertook through the Mortgage Indemnity Scheme (MIS) for a period of 3 years, to cover any losses, which mortgagees might sustain due to a breakdown in the due process of law.

DISCUSSION

AML fell dismally short of the target and since the MIS came to an end in June 1998 there was a void in housing policy in terms of managing access to credit in order to facilitate housing delivery. A government intervention was clearly necessary as a replacement mechanism for the MIS.

The first Government intervention was the Home Loan and Mortgage Disclosure Act, 2000 (Act No. 63 of 2000). This Act sets out what financial institutions must disclose in terms of their home loan business. It not only provides what home loans were approved in the reporting

period but also how many home loan applications were refused and the reasons for such refusal. The Act will come into operation later this year when the regulations have been finalised. The disclosure by the financial institutions should identify problem areas regarding the provision of home loans, for example, an area which has been redlined by financial institutions will be identified by the number of applications for home loans in that area which have been refused by financial institutions. Part of the information to be disclosed is the geographical area in which the proposed home is situated.

When the Government started drafting the above legislation it was felt that the Disclosure Act should be followed by a Community Reinvestment Act. Disclosure alone is not sufficient to address the problem of the financial institutions' failure to service lower and medium income groups in respect of home loans. What is disturbing to the Department of Housing is that at the time of the Memorandum of Understanding with the banks in 1994 six per cent of all housing subsidies were credit linked. Over the years the percentage has steadily dropped and now stands at less than two percent. The banks are clearly not meeting their obligations in providing home loans to the lower and middle -income groups.

The Community Reinvestment (Housing) Bill aims to compel financial institutions in the business of providing home loans to set aside a portion (to be prescribed) of their home loan funding to lower and middle income households. The Bill specifically states that in making such lending financial institutions are not expected to resort to any unsound business practices. Furthermore, the Bill gives financial institutions certain options when discharging their obligations in terms of the Bill. For example a financial institution does not have to deal directly with potential mortgagors but may lend its prescribed portion of home loan funds to a niche market lender who will on lend to the end user.

Briefly, the Bill can be summarised as follows:

After the Preamble there follows the definition section (clause 1). Importantly, a “financial institution” includes (in addition to traditional banks) any other registered institution whose business is, in full or in part, either the acceptance of deposits from the general public or the advance of credit to persons or both such acceptance and advance, with the security of a registered mortgage bond or any other form of accepted security. Clause 2 of the Bill provides that the Bill applies to all financial institutions.

Clause 3 sets out the functions of the Office of Disclosure which is the regulator and which must collate, verify, analyse and evaluate the data which is to be furnished by financial institutions. The Office of Disclosure will also monitor the progress of financial institutions in meeting their targets in terms of the Bill and intervene where necessary to ensure compliance with the provisions of the Bill.

Clause 4 sets out the principles applicable to Community Reinvestment for housing. Financial institutions must refrain from refusing home loan finance to borrowers purely on the grounds of the current or future expected socio-economic characteristics of the residents in the neighbourhood in which the home is located. Another principle prohibits financial institutions from redlining a home other than where dictated by safe and sound business principles. Redlining occurs when a financial institution does not offer a home loan to a borrower or household mainly on account of the home being located in a particular geographical area (see definition section). The clause also sets out principles of courtesy, transparency and openness which financial institutions must adhere to when dealing with borrowers. The clause then sets out the options which are available to financial institutions which cannot lend directly to the end-users.

Finally, the clause lists a range of practices which financial institutions should not carry out.

Clause 5 sets out a financial institution's reporting requirements. Clause 6 deals with financial institutions' performances and ratings. Regulations must prescribe targets and standards applicable to financial institutions; an assessment instrument which includes minimum criteria; and a rating model in order to assess a financial institution's performance in respect of its obligations relating to community reinvestment in housing. The model must incorporate four categories of performance from outstanding to substantive non-compliance.

Clauses 7, 8 and 9 provide for a written assessment for each financial institution by the Office of Disclosure, a Report to the Minister and the making of Regulations, respectively. Clauses 10 and 11 provide for exemptions and offences and penalties. The final clause 12 contains the short title and commencement date which takes effect on a date determined by the President by proclamation in the Gazette.