

# **Tackling Responsible Lending Obligation in Malaysia: A Diverse Approach**

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## **Abstract**

*This paper examines responsible lending obligation among various credit providers under the present legal and institutional framework in Malaysia. The scope of consumer credit industry includes banking, hire-purchase, moneylending and pawnbroking. The study finds an inconsistent approach in dealing with responsible lending whereby only banking institutions regulated by the Central Bank of Malaysia are subject to this obligation while non-bank institutions are not. Several recommendations for future improvements are proposed by referring to the practice of several other jurisdictions. The suggestions will help the policymakers to seriously consider imposing this obligation on all credit providers. Eventually, the protection against the irresponsible lending practice is accorded to a wide range of financial consumers in consumer credit industry in Malaysia.*

**Keywords:** *consumer protection, consumer credit, responsible lending, regulatory control*

## **1. Introduction**

Access to credit can be of great value to consumers. Consumer credit can be considered the lubricant of economic life'[1], and as 'one method of reducing income inequality and poverty' [2]. The effects of credit, however, are not homogeneously beneficial. Negative

attitude of living beyond means [3] supported with a lower cost of borrowing due to financial deregulation [4] as well as easy access to credit often entice individuals into excessive credit and costly debt with dreadful consequences for the consumers and their families. Many consumers also suffer hardship after being induced to over-commit themselves due to the flattery of sales or promotional techniques and finally default on their repayment when faced with unexpected critical events such as illness or unemployment [5]. Hence, despite various reasons contributing to over-indebtedness, reckless lending can be one of the major contributing factors [6].

Credit is supplied indiscriminately, without a rigorous assessment of creditworthiness, driven by greed, commercial and competitive pressures [7]. Likewise, credit is effortlessly granted although the consumers do not know or fully understand the terms under which they borrow. Also, it is not the concern of the credit providers if the consumers are borrowing beyond their means just so long as they can make a profit. Moreover, they can charge extra fees if consumers, later on, are trapped in financial difficulties [6]. The absence of responsible lending provisions encourages borrowing specifically among middle or low-income earners who are excluded from mainstream financial institutions due to poor credit history. The situation is further exacerbated by rampant unregulated advertisements encouraging borrowing despite being blacklisted. This has been a predominant factor in triggering the worrying incidence of bankruptcy in Malaysia which shows an upward trend since 2011 as depicted in Figure 1. The figure indicates consumer credit, particularly hire purchase, housing loan and personal loan as major contributors to the high number of bankrupts in Malaysia. This is reminiscent of the trend in 2016 when vehicle loan emerged as the major contributory factor to bankruptcy among Malaysian [8][9].

Legislation aiming at protecting consumers from over-indebtedness has become a global phenomenon although different mechanisms are adopted within the framework of local needs.[10] It is against such background that this study examines the cogency of a responsible lending regime based on fragmented laws governing consumer credit in Malaysia. Specifically, the industry covered by this paper comprises of banking, hire purchase, moneylending and conventional pawnbroking. The responsible lending regime under the purview of Australian Securities and Investment Commission (ASIC), the UK Financial Conduct Authority (FCA) and the South Africa National Credit Regulator (NCR) is examined for the purpose of comparative study.

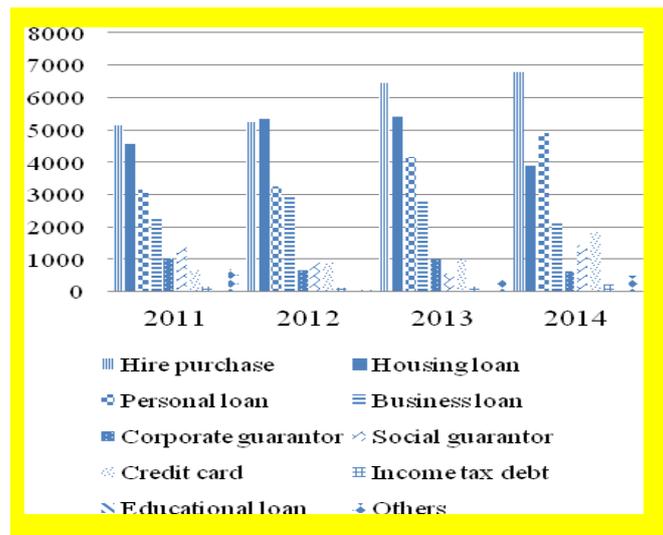


Figure 1 Causes of Bankruptcy in Malaysia from 2011-2014

Source: Malaysian Department of Insolvency

## 2. BANKING INDUSTRY

One of the initiatives implemented by BNM is protecting financial consumers against over-indebtedness is by introducing the GRF. The GRF makes it mandatory for the financial service provider to conduct suitability and affordability assessment for each new and additional credit facilities it offers. It is an obligation of the financial service provider to ensure that its intermediaries comply with the GRF and suitable actions are taken in the case of a breach. Affordable in the context of financial product is when the amount and terms of the said product enable the financial consumers to 'reasonably meet the repayment obligations in full throughout the course of financing without recourse to debt relief or substantial hardship'. Other than borrower's repayment history and credit scores, complementary method of assessing affordability established by the GRF is by observing a prudent Debt Service Ratio (DSR) computed in accordance with the following formula:-

With regards to income assessment, the financial service provider must enquire the financial consumers on its sources and amount for the purpose of determining the DSR. If consideration is given to various sources of income such as overtime, allowances, commission and contractual bonus payment; variability of such income for a period of at least three months which only include a prudent portion of the average amount should be evaluated as the financial consumers' income in assessing affordability. A month-to-month variance of income must be taken into account as well. In the case of high month-to-month variance is observed, a longer period of evidence of variable income should be applied to establish the amount that may be regarded as the financial consumer's stable income. One-off variable income such as bonus should be excluded in the assessment of income. Pertaining to financial consumers with no permanent employment or self-employed, evaluation should be made on the stability of the primary sources of income by demanding the financial consumers to provide evidence of income over a period of at least 6 months. Verification of income is also crucial to ensure the authenticity of the evidence on sources of income. Income should be proved against reliable sources which are independent of the financial consumers such as EPF statement, bank statement or tax return. Sole reliance on financial consumers' self-certification of income is not allowed.

In establishing a prudent level of DSR for the purpose of deciding the approval or otherwise of the application, there must be sufficient buffers for expenditures and contingencies considering relevant circumstances of the financial consumers. Such considerations include nature of employment, number of dependants, the location of residence and other factors affecting the financial consumer's level of expenditures. Assessment of affordability must rely on the DSR despite the existence of collateral pledged by financial consumers. Thus, if the financial consumers are assessed to be unaffordable except with the provision of collateral, financing should not be extended. Nevertheless, as opposed to vulnerable financial consumers, flexibility can be given to high net-worth financial consumers whereby their deposit or asset can be taken into account in assessing repayment capacity. It is a requirement that the basis for financing decision should be properly documented and supported by information that supports the decision.

Apparently, a longer tenure of financing merely provides short-term benefit to the financial consumers because, in the long run, it may expose the financial consumers to higher risks due to the overall debt burden. The GRF specifies the maximum loan tenure for vehicle financing is 9 years. In addition to the GRF, another measure adopted by BNM to strengthen prudent lending practice is by restricting the loan tenure for the purchase of residential properties as well as personal financing, to 35 years and 10 years, respectively.

The GRF, however, does not explicitly stipulate the effect of non-compliance though in general, BNM may exercise appropriate enforcement power if the guidelines are

breached. In the event of material non-compliance, responsibility lies with the senior management and the board to take necessary action to rectify contravention.

### **3. HIRE-PURCHASE INDUSTRY**

Ensuring observance with responsible lending obligation is outside the duty of Ministry of Domestic Trade and Consumer Affairs (MDTCA) since there is no direct provision in the HPA requiring the financier to assess the hirer's suitability and affordability before entering into hire-purchase agreement. The absence of responsible lending provisions encourages borrowing by financial consumers notwithstanding their restricted financial capability. This fact is supported by the statistic issued by the Malaysian Department of Insolvency which shows that hire-purchase loan is the highest contributor to the bankruptcy cases in Malaysia for the year 2011 and 2015 recording 27.94% or about 28,374 cases [11].

The trend recurred in 2016 whereby vehicle loan ranked the major contributor to bankruptcy incidence among Malaysians [12]. Widespread hire-purchase advertisements allowing those who are blacklisted by credit reporting agencies to apply for loans inopportunely promote over-indebtedness [13], [14]. While this is true in respect of non-bank institution, banking institutions offering hire purchase are subject to the FSA, the GRF and internal credit risk assessment via CCRIS. This different treatment forces those disqualified by the mainstream financial institutions to resort to non-bank credit providers which are less stringent. As a result, the financial consumers are still exposed to over-indebtedness issue.

### **4. MONEYLENDING AND PAWNBROKING INDUSTRY**

Ministry of Urban Wellbeing, Housing and Local Government (MHLG) is under no obligation to oversee irresponsible lending practice among moneylenders and pawnbrokers. The Moneylenders Act 1951, the Pawnbrokers Act 1972 and the applicable regulations do not require moneylenders or pawnbrokers to conduct an assessment on the financial standing of prospective borrowers or pawners. The absence of responsible lending provisions encourages borrowing specifically among middle or low-income earners who are excluded from mainstream financial institution due to poor credit history. Over-indebtedness issue may arise, and this vulnerable group of financial consumers will inevitably be in a continuous debt spiral. Moneylending advertisements in some local newspapers prove irresponsible lending practice among moneylenders when a loan is extended to borrowers who are blacklisted by the credit rating agencies. [13], [14].

### **5. REFERENCE TO OTHER JURISDICTIONS**

One of the distinctive features of Australian consumer credit regime is the imposition of a responsible lending obligation on the holder of the Australian Credit License as enumerated in Chapter 3 of the National Consumer Credit Protection Act 2009 (NCCP). ASIC exercise its regulatory role by publishing Regulatory Guides 209, Credit Licensing: Responsible Lending Conduct (RGRL) setting out the mechanisms to comply with the obligation. Among others, ASIC must ensure that licensees have adequate systems and processes in place to make assessments of unsuitability. Other than publishing the RGRL, ASIC can exercise various regulatory powers for contravening responsible lending conducts. For instance, ASIC may proceed with the action for a civil penalty of up to 2000 penalty units, application for an injunction and application for compensation for loss or damage arising from breach of a civil penalty provision or for the commission of an offence.

Briefly, unsuitability assessment can be exercised via online or face-to-face approach. Consumer's financial standing may be verified without direct information from him albeit

with extra care since the option does not reflect the overall financial position of the consumer. A credit is unsuitable if, firstly, a financial consumer cannot fulfil the financial obligations under the contract except with substantial hardship; or secondly, the loan does not meet the consumer's objectives and requirements; or thirdly the circumstances stipulated in the National Consumer Credit Protection Regulation 2010 (NCCPR) will arise rendering the credit unsuitable. A licensee is prohibited from suggesting or assisting a consumer to enter into or increase the credit limit under an unsuitable credit contract. With regards to a person providing credit assistance, he is prohibited from suggesting that a consumer remains in an unsuitable credit contract.

Remedies available if a consumer is granted an unsuitable contract by a credit provider including an injunction to prevent the credit provider from collecting interest payments; compensation for any loss or damage; or an order to vary the contract or declare all or part of the contract void.

The FCA's priority in ensuring consumer's affordability is demonstrated by setting out a specific guidance on responsible lending comprised in CONC 5 of the FCA Handbook. Assessment of the consumer's creditworthiness including affordability is compulsory prior to entering into a credit agreement with a potential consumer. The assessment takes into account the consumer's financial wellbeing intended to determine the consumer's ability to repay the loan as it falls due throughout the financing tenure. It should be based on sufficient information which may be obtained from the consumer where appropriate and credit reference agency if necessary in establishing his credit history. Other sources of information include the record of previous dealing with the consumer, evidence of income and expenditure and a credit score.

The ability to make repayments should be "sustainable". According to the FCA, sustainable means that the customer should be able to make the repayments on time without undue difficulties, whilst meeting other reasonable commitments, and should not have to borrow or sell assets in order to meet the repayments.

Additionally, CONC prescribes rules on the prohibition of unfair business practices which include sole reliance on the value of any security provided by a customer in evaluating the creditworthiness assessment and accepting an application where the firm knows or ought reasonably to know that the consumer has not been truthful in providing the information on which it will base its creditworthiness assessment.

In South Africa, the prohibition of reckless credit granting is explicit, and the consequence of non-compliance is far-reaching. In addition to the National Credit Act 2005 (NCA), the Affordability Assessment Regulations (AAR) is central to the regulation of credit particularly to curb the reckless lending practice. The AAR prescribes the criteria for affordability assessment and calls on credit providers to take practical steps to assess a consumer's income status to ascertain whether a loan can be repaid. Labelled as prohibited conduct, the role of the NCR is to ensure compliance with the legal requirements by credit providers by exercising investigation and enforcement power conferred by the NCA including to issue a compliance notice. Complaints related to the allegation of reckless credit may also be submitted to the NCR. For instance, in 2012, pursuant to complaints received from consumers, the NCR initiated an investigation on approximately 669 reckless loans by African Bank [15]. African Bank agreed to settle the matter by paying a fine of R20 million and effecting corrective measures.

Other than the NCR, the National Credit Tribunal (NCT) also assumes an important role in deterring reckless lending and it is empowered to declare that the credit agreement is reckless. Moreover, it can impose a hefty administrative fine or to cancel the registration in the event of contravention of the applicable provision. Subsequent to the finding that the agreement is reckless, the NCT is empowered to set aside all or part of the consumer's rights and obligations under the reckless credit agreement, depending on what

the court determines to be just and reasonable in the circumstances or suspending the force and effect of that credit agreement or to restructure the consumer's obligations under any other credit agreements in accordance with section 87 of the NCA.

Pursuant to the NCA, the credit provider must perform mandatory pre-agreement assessment under section 81 to determine the suitability of credit to a prospective consumer. The credit provider must determine the prospective consumer's general understanding and appreciation of the risks and costs of the proposed credit, as well as of the rights and obligations of the consumer under a credit agreement. The next assessment covers the prospective consumer's debt repayment history under credit agreements. Subsequently, the prospective consumer's existing financial means, prospects and obligations must be likewise evaluated. Interestingly, the obligation to prevent reckless lending credit also lies on the consumer whereby failure to fully and truthfully answer any requests for information made by the credit provider in the course of section 81 assessment constitute a complete defence in favour of credit provider.

Reckless credit is determined by referring to the time the agreement was entered into. Section 80 of the NCA prescribes three situations in which reckless credit granting is said to have occurred. The first case is due to failure to conduct the required assessment. Secondly, the credit agreement is made despite the fact based on the initial evaluation, there were indications that the consumer did not understand the nature of the risks, costs or obligations in terms of the proposed credit agreement. The third situation occurs when after the assessment has been conducted, the credit provider enters into a credit agreement disregarding the preponderance of information available to him or her indicated that entering into that agreement would render the consumer over-indebted.

## 6. ANALYSIS

The discussion reveals that so far, only BNM has made an effort to promote the practice of assessing creditworthiness among banks by publishing the GRF in determining the affordability of financial consumer prior to entering into credit agreement relying on repayment history, credit scores and observing a prudent DSR. Inconsistent regulatory power to combat over-indebtedness via responsible lending obligation is discernible as neither MDTCA nor MHLG is empowered to control unfair manipulations leading to widespread irresponsible lending practices among non-bank credit providers.

Income verification based on reliable sources and avoiding sole reliance on consumer's self-certification stipulated by the GRF are commendable to prevent erroneous assessment outcome. The need for a sufficient buffer for expenditures and contingencies in establishing a prudent level of DSR, reliance on the DSR despite the availability of collateral and restriction on loan tenure can be viewed positively to prevent over-indebtedness.

Nevertheless, several shortcomings are identified in the present GRF. Determining overall debt obligation for the calculation of prudent DSR level according to the GRF cannot be ascertained from CCRIS since the system does not incorporate data on debt obligation from institutions outside its coverage. Though information can be obtained from the consumer, its accuracy may sometimes questionable. Furthermore, as a regulatory instrument, the compliance with the GRF relies heavily on the enforcement agency, namely BNM. Moreover, the GRF delegates the duty to ensure compliance to the senior manager and board of each financial service provider. No remedy is available in favour of financial consumer who suffers from the detrimental consequences of irresponsible lending. The power of the court or alternative dispute resolution bodies in respect of agreement and obligation of financial consumers pursuant to irresponsible lending is also not specified in the existing legal framework.

Reference to the practice adopted by several jurisdictions is worth considering. Suitability assessment is mandatory to be performed by all regulated credit providers prior to credit granting in Australia, the United Kingdom (UK) and South Africa. This is mainly attributed to the presence of a unified legal and institutional framework governing consumer credit in those countries. In Australia, the mandate to oversee consumer credit is given to Australian Securities and Investment Commission in accordance with the National Consumer Credit Act 2009 while the UK Financial Conduct Authority holds similar responsibility pursuant to the Financial Services Act 2012. The National Credit Act 2005 appoints the National Credit Regulator to regulate consumer credit in South Africa. Thus, breach of responsible lending obligations entitles the regulators to proceed with appropriate enforcement actions.

In Australia, the aggrieved consumer can apply for several remedies including an injunction to prevent the credit provider from collecting interest payments; compensation for any loss or damage; or an order to vary the contract or declare all or part of the contract void. In South Africa, the court or the National Credit Tribunal are empowered to declare the credit agreement as reckless. Moreover, a hefty administrative fine can be imposed and registration as a credit provider may be cancelled in the event of contravention of the applicable provision. Pursuant to the finding that the agreement is reckless, the court or the National Credit Tribunal is empowered to set aside all or part of the consumer's rights and obligations under the reckless credit agreement, depending on what they determine to be just and reasonable in the circumstances or suspend the force and effect of that credit agreement or restructure the consumer's obligations under any other credit agreements.

## 7. CONCLUSION

Responsible lending is another mechanism introduced to protect financial consumers from the trap of over-indebtedness. Unfortunately, in Malaysia, this obligation is not uniformly imposed on all credit providers due to the piecemeal approach in regulating consumer credit. This is evident when only banking institutions are required to perform pre-contractual affordability assessment while a similar requirement is absent in respect of non-bank institution. In view of the significance of this provision as demonstrated in other jurisdictions renowned for strong consumer protection regimes, its extension to other credit providers is strongly recommended. To achieve this objective, it is suggested that the core issue of uniform legal and institutional framework should be first established. The new single law will incorporate the responsible lending obligation with enhanced features such as remedies for consumers in the event of a breach and the power of the court or alternative dispute resolution bodies in respect of agreement and obligation of financial consumers should be specified. The CCRIS data should include the debt obligation from non-bank institution whilst the credit providers should have adequate systems and process in place to enable effective suitability assessment.

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