

SUITABLE AND AFFORDABLE: REGULATING RESPONSIBLE LENDING AMONG BANKS IN MALAYSIA

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I. INTRODUCTION

In Malaysia and globally, banks play a crucial role in providing access to credit in order to satisfy various consumers' needs ranging from emergency, education, expenditures, purchasing a car and paying existing loan.

Banking institutions are generally required to meticulously assess the creditworthiness of the consumers in view of mitigating their credit risks, however financial enticements may stimulate creditors to extend credit to consumers who they expect to be profitable notwithstanding that these consumers are at high risk of suffering considerable harm.

While the creditors are expected to exercise caution in mitigating their credit risk, this motivation does not offer adequate protection against irresponsible lending and resulting consumer detriment.

One of the foreseeable detriments is in the form of overindebtedness.

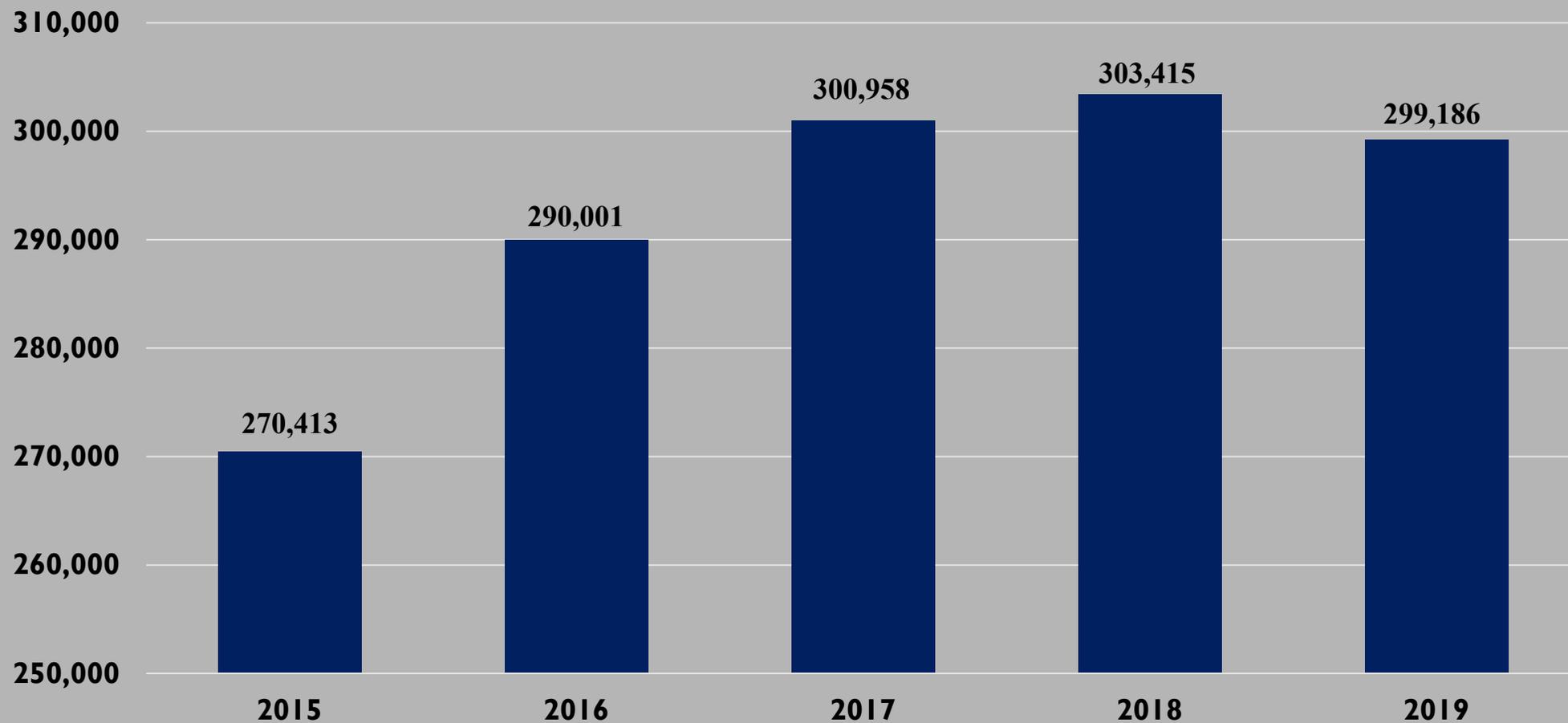


Figure 1: The Total Number of Bankruptcy Cases in Malaysia from 2015 to 2019.

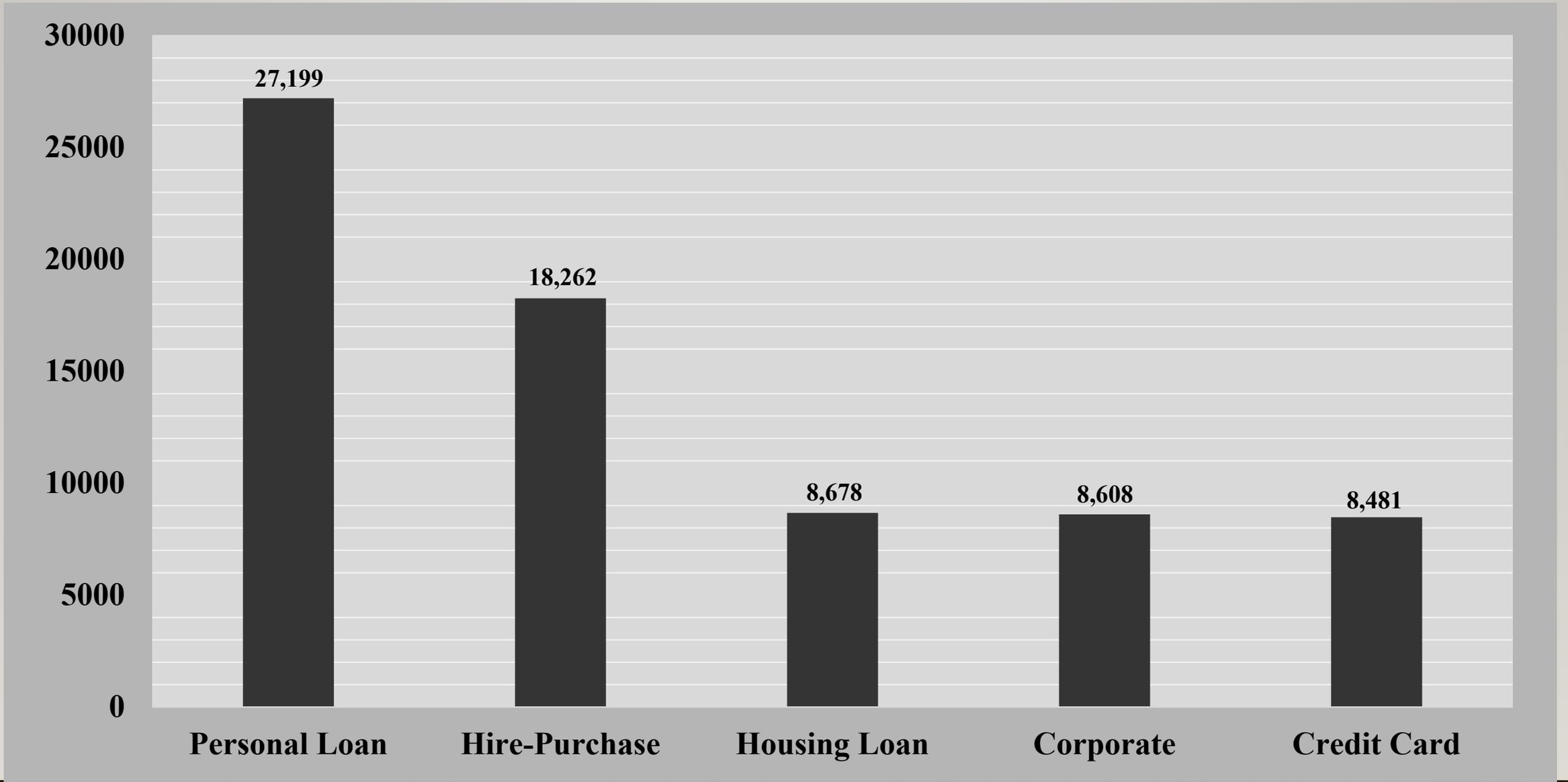


Figure 2: The Top Factors of Bankruptcy in Malaysia from 2015-2019

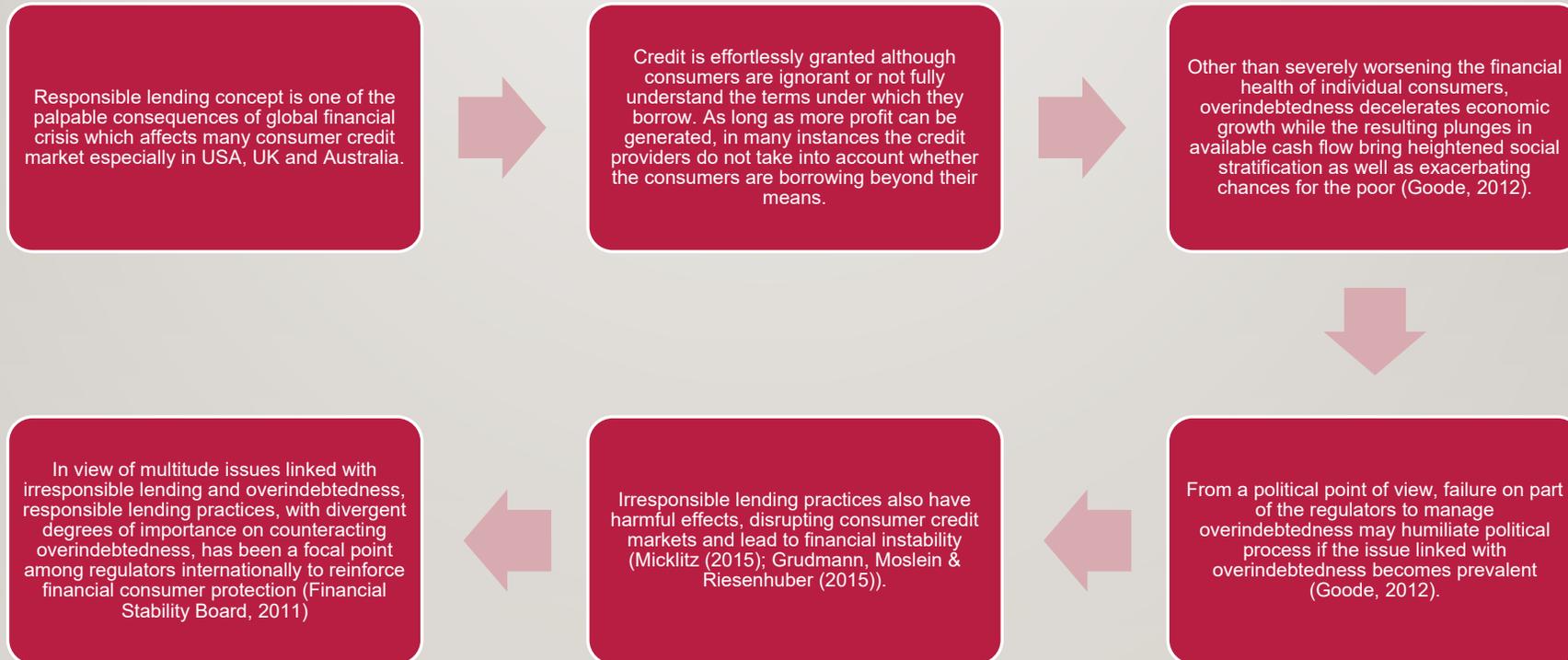
2. METHODOLOGY

This study employs doctrinal legal research methodology relying on both primary and secondary sources of law. Accordingly, the relevant provisions of the Financial Services Act 2013 (FSA) and Islamic Financial Services Act 2013 (IFSA) are examined.

The relevant provisions of the Financial Services Act 2013 (FSA) and Islamic Financial Services Act 2013 (IFSA) are examined. The key regulatory instrument i.e. Guidelines of Responsible Financing (Guidelines) which is the main subject of the research is critically analysed in order to evaluate the suitability and affordability assessment imposed by BNM on banking institutions.

Reference is made to textbooks, journals, articles, online resources from the government website and non-government organisations, general and academic websites, newspapers, and database sources in order to gain an in-depth understanding on the background and fundamentals of responsible financing.

RESULT



There are no single standards in defining responsible lending.

Another way to understand this concept is by looking from the opposite perspective namely irresponsible lending which covers an array of predatory lending practices.

Notwithstanding the absence of universally accepted standards, Financial Stability Board (2011) explained that preventing overindebtedness, ensuring that the consumers have the capability to repay, and protecting consumers from unfair selling practices are the common objective of responsible lending practices.

From Shariah perspective, responsible lending is an emerging concept which has not been particularly discussed in traditional *fiqh* literature.

Banking industry in Malaysia is uniquely characterised by its dual banking system which is evidenced in the operation of conventional banking alongside Islamic banking system.

The significant role of the banks as credit provider has been clearly highlighted under section 2 of FSA under the definition of banking business since the provision of finance include lending of money.

The role of Malaysia as a pioneer in the development of Islamic banking and finance has gained worldwide recognition (Abdullah, 2019).

The definition of Islamic banking business in IFSA apparently reflects the primary role of Islamic banks in extending Syariah-compliant financing.

By virtue of the Central Bank Act 2009, the FSA and the IFSA, BNM plays a paramount role in regulating banking industry in Malaysia.

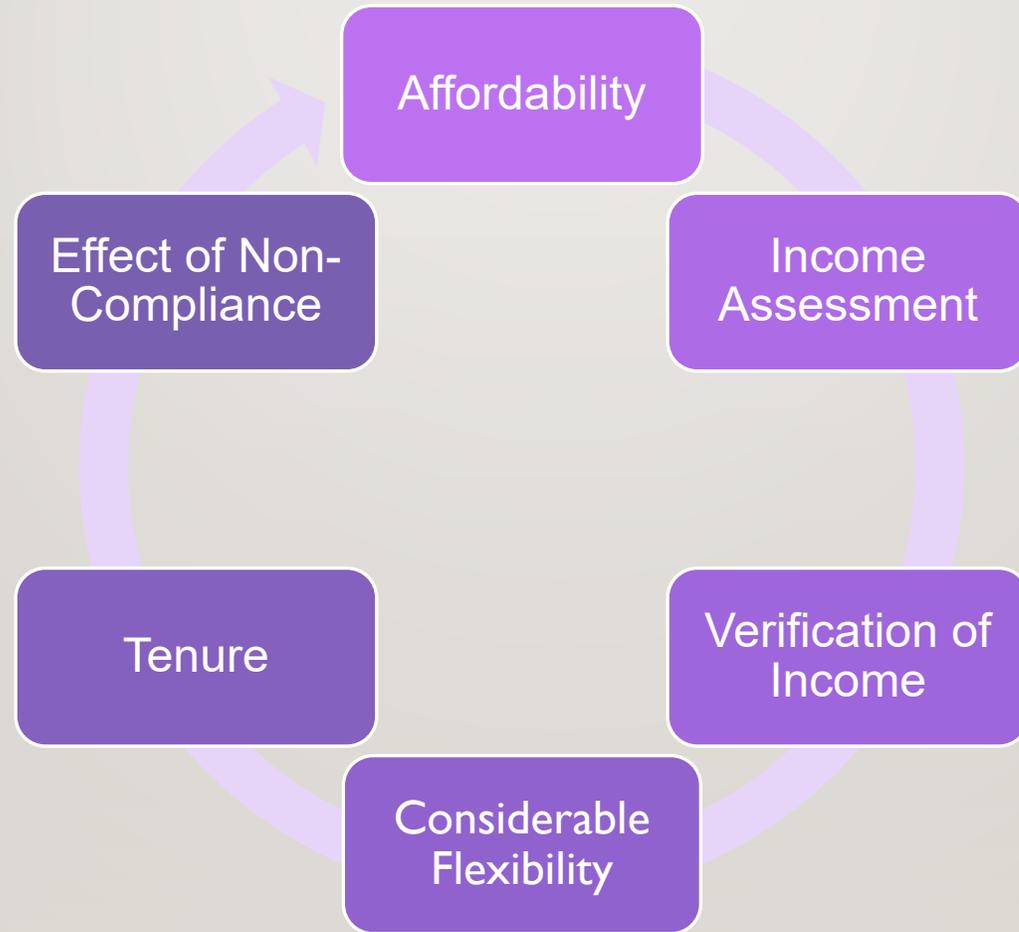
Equally mandated to protect financial consumers, BNM has established the Guidelines to ensure that the banks approve the loan or financing application responsibly and to protect the consumers against harmful repercussions of overindebtedness.

Affordability and Suitability Assessment

The significance of responsible lending or financing is acknowledged in section 123(2) of the FSA and section 135(2) of the IFSA where BNM is granted power to provide standards regarding provision of recommendations or advice including assessments of suitability and affordability of financial services or products offered to financial consumers.

The Guidelines makes it mandatory for the financial service provider to conduct suitability and affordability assessment for each new and additional credit facilities it offers.

Banks are required to carry out the assessment prior to granting home financing products; personal financing products, including overdraft facilities; vehicle financing products; credit and charge card products; and financing products for the purchase of securities except for share margin financing that is governed by Bursa Malaysia rules.



(A) Affordability

- Affordability in the context of financial product is when the amount and the terms of the said product enable the financial consumers to 'reasonably meet the repayment obligations in full throughout the course of the financing without recourse of the debt relief or substantial hardship'.
- Other than borrower's repayment history and credit scores, a complementary method of assessing affordability established by the Guidelines is by observing a prudent Debt Service Ratio (DSR).

(B) Income Assessment

- The financial service provider must enquire with 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.
- 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 six months.

(C) Verification of Income

- Verification of income is also crucial to ensure the authenticity of the evidence on sources of income.
- Income should be proven against reliable sources which are independent of the financial consumers such as an Employees Provident Fund statement, bank statement or tax return.
- Sole reliance on financial consumers' self-certification of income is non permissible.

(D) CONSIDERABLE FLEXIBILITY

- There must be sufficient buffers for expenditures and contingencies considering relevant circumstances of the financial consumers in establishing a prudent level of DSR for the purpose of deciding the approval or otherwise of the application.
- Such considerations include nature of employment, number of dependants, the location of residence and other factors affecting the financial consumer's level of expenditures.
- 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 reinforced by information that supports the decision.

(E)TENURE

- A longer financing tenure merely provides short-term benefit to financial consumers because, in the long run, it may expose the financial consumers to higher risks due to the overall debt burden.
- The Guidelines specify the maximum loan tenure for vehicle financing is nine years.
- In addition to the Guidelines, 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 ten years, respectively.

(F) EFFECT OF NON-COMPLIANCE

- 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.

ANALYSIS

- The role of the Guidelines in prescribing mandatory affordability and suitability assessments is crucial to prevent overindebtedness both in respect of the financing provided by conventional and Islamic banks.
- The Guidelines provide the meaning of affordable as when the amount and terms of the financing 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'.

ANALYSIS

- In determining prudent DSR, two elements must be determined namely all outstanding debt repayment from banks and non-banks and income after statutory deductions. With regards to the first element, a problem may arise in respect of debt from non-banks since the data is not covered by CCRIS.
- If the financial consumers do not truthfully supply the information, it will lead to inaccurate assessment.

ANALYSIS

- The banks are given considerable flexibility to determine income sources and the appropriate DSR that the borrowers can reasonably sustain (Ying, 2018).
- Reliance on DSR is compulsory despite the existence of collateral pledged by financial consumers, however, flexibility can be given to high net-worth financial consumers whereby their deposit or asset can be taken into account in assessing repayment capacity.
- Another significant feature of the Guidelines to ensure consumers are not overburdened with debt is by specifying the limit of financing tenure for major types of financing namely 9 years for vehicle financing, 10 years for personal financing and 35 years for home financing.

ANALYSIS

- A rigorous evaluation process prior to approval may substantially affect the financing application and the risk of rejection (Isa & Hussin, 2016).
- Nevertheless, it is submitted that the accumulated debt liability may affect borrower's ability to repay in the long due to changes in interest rates or profit rate in case of floating rate Islamic financing or unforeseen events such as loss of job.

ANALYSIS

- Strict lending policy has likewise been adopted by several Asian countries with the objective of deterring irresponsible lending practices.
 - Singapore enforces LTV limits and prohibition of certain types of mortgage products such as interest-absorption, interest-only so as to encourage financial prudence among property purchasers in a rising property market.
 - Hong Kong also imposes prudential requirements on residential mortgage lending.

ANALYSIS

- Although the Guidelines are in the form of non-legislative regulatory instruments and issued prior to the FSA, non-compliance entails similar consequence of breach of the FSA itself as stated in section 272(2)(b) of the FSA and section 283(b) of the IFSA.
- Thus, BNM may pursue with administrative or civil action in the event of breach as laid down under section 234 of the FSA and section 245 of the IFSA.
- Nevertheless, only BNM as a regulator has a locus to take action for contravention and the burden to ensure the guidelines are properly observed lies on BNM.

ANALYSIS

- Currently, no enforcement action has been reported on non-compliance with the Guidelines.
 - One possible factor is the absence of complaints from consumers due to lack of awareness on the issue of irresponsible lending.
- In this regard, Credit Counselling and Debt Management Agency can proactively play its role in enhancing consumers' knowledge in this aspect of consumer protection apart from providing financial education, financial counselling and debt management.
- Furthermore, it may also be attributed to the fact that under the present regime, there is no legal basis for consumers to take action against banks because the Guidelines is merely a regulatory instrument which only permits the regulator to take action for non-compliance.

ANALYSIS

- It is suggested that the affordability and suitability assessment requirement should be set out in legislation.
 - In Australia, the National Consumer Credit Protection Act 2009 (NCCP) mandates suitability assessments on consumers' abilities to repay and alignment of the product with the objectives of the consumer.
 - Not only can the Australian Securities & Investment Commission (ASIC) pursue with civil, criminal or administrative action if a consumer credit provider breaches the provisions of the NCCP, the said Act also lists down remedies available if a consumer is granted an unsuitable contract by a credit provider (Pearson & Batten, 2010).
 - *Australian Securities & Investments Commission v Thorn Australia Pty Ltd* [\[2018\] FCA 704](#) illustrates one of the historic cases on breach of responsible lending obligation.

ANALYSIS

- 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 reckless lending practice (Rayi, 2016).
 - For instance, in 2012, pursuant to complaints received from consumers, the NCR initiated an investigation on approximately 669 reckless loans by African Bank (Motshegare, n.d.). 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 a credit agreement is reckless.

ANALYSIS

- Accordingly, it is viewed that affordability and suitability assessment should be incorporated in a specific financial consumer protection legislation prescribing remedies 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 should also be specified..

CONCLUSION

The discussion reveals some areas for improvements which are worth to be considered as practised by some jurisdictions reputable for advanced consumer protection regime.

Strengthening responsible lending regime is crucial to prevent overindebtedness which, not only affect the individual financial consumers but the society and the country as well.

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