

The Institutional Framework of Financial Consumers in Malaysia: A Legal Study

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Abstract: Financial consumer protection is essential in the contemporary financial market. Financial consumers in the financial transaction contribute vastly in developing the economy of a country. Sound and effective legal and institutional framework premised the fair treatment of a robust and resilient financial system. The objective of this study is to examine the extent of financial consumer protection in the Malaysian financial system. The study adopted qualitative method with comparative approach between 2 groups of financial consumers, their institutions, governing laws and avenue for help and redress. Findings of the study showed that the unbanked financial consumers are in a disadvantaged status, as there is no law protecting them. On the other hand, the banked consumers are well protected with the enactment of the Financial Services Act 2013 and Islamic Financial Services Act 2013. Finally, it is recommended that the legal framework be reviewed for the enhancement of financial consumer protection.

Key words: Financial consumers, consumer protection, financial services, legal framework, banked consumers

INTRODUCTION

Financial consumer protection is not about protecting consumers from bad decision but about enabling them to make informed decision in a marketplace that is free of deception and abuse. Financial education, financial literacy and consumer protection framework creates the foundation of the regulatory and supervisory framework for protecting personal borrowers and the financial inclusion effort by reaching the unbanked consumers. The study aims to examine the extent of financial consumer protection in the Malaysian financial system by analysing the relevant laws and institutions.

WHAT IS FINANCIAL CONSUMER PROTECTION?

In describing the meaning of financial consumer protection, researchers have to consider few situations like the nature of the countries; either developed or developing; affluent or not highly educated or not. This is due to the fact that consumers are heterogeneous (Cartwright, 2011) and not some endangered species in need of protection. The issues of consumer protection are not limited to specific acts of consumption but extended to the needs and wants. The consumer as depositor, saver and borrower is the central actor in the financial marketplace and the most infected by the ill-effects of

macro and micro-economic problems that have challenged the financial sector (Chakrabarty, 2013).

The financial services like banks, building societies, pawn broking, pensions, insurance policies and loan are essentially driven by commercial intent and the actions in the issue of consumer protection should be taken care of by competitive market forces. This is due to the fact that a competitive market force provides barriers to entry for the service providers. For instance, banking institutions requires stringent conditions for qualified borrowers. Thus, the consumers have limited services from a limited set of service providers.

WHO ARE FINANCIAL CONSUMERS?

Financial dealings are vital part of the contemporary society. In the words of Galbraith (1984): The process of persuading people to incur debt and the arrangements for them to do so are as much a part of modern production, as the making of goods and the nurturing wants. Accordingly, the Islamic Financial Services Act 2013 identify financial consumer, as any person who uses has used or may be intending to use, any financial service or product inter alia for personal, domestic or household purposes or in connection with a small business by the central bank (Part VII of Financial Services Act 2013 and Part VIII of Islamic Financial Services Act 2013). In the broader context, it is submitted that financial consumer

includes any individual who do financial transactions with financial institutions govern by the central bank, pawnbrokers, licensed moneylenders and unlicensed moneylenders.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF FINANCIAL CONSUMERS PROTECTION IN MALAYSIA

Figure 1 shows that the legal and institutional framework for financial consumers depends on the nature of financial institutions. In general, there are 2 groups of financial consumers; the banked and unbanked. The banked consumers refer to those who obtained financial services from the banking institution, such as commercial and Islamic banks. Alternatively, unbanked consumers consist of those who do financial transactions with the licensed moneylenders, pawnbrokers and unlicensed moneylenders. These groups related to the relevant institutions suitable to their need. Hence, the unbanked financial consumers resort to the licensed moneylenders, pawnbrokers and unlicensed moneylenders. On the other hand, the banked consumers will resort to the licensed banking institutions and licensed insurance companies and takaful operators.

The Central Bank of Malaysia: Financial institutions landscape in Malaysia primarily focused on the central bank. The Central Bank of Malaysia plays the major role

in ensuring the prudent conduct of monetary policy and bringing about financial stability for a sound and progressive financial sector. In addition, the bank also plays developmental role in developing comprehensive, robust and resilient financial system structure. It also actively promotes financial inclusion in support of the balanced economic system. Finally, the bank acts as a banker and adviser to the government and contributes in advising on macroeconomic policies and managing the public debt.

Table 1 and 2 showed that there are 65 licensed banking institutions and 58 licensed insurance and takaful

Table 1: List of licensed banking institutions

Name of licensed banking institutions	Numbers
Commercial banks	21
Islamic banks	16
International Islamic banks	5
Investment banks	15
Other	2
Total	65

Table 2: List of licensed insurance companies and takaful operators

Name of licensed insurance companies and takaful operators	Numbers
Life and general business	6
Life business only	9
General business only	20
Life and general reinsurance business	1
Life reinsurance business	1
General reinsurance	5
Takaful operator	12
Retakaful operator	4
Total	58

Central Bank of Malaysia

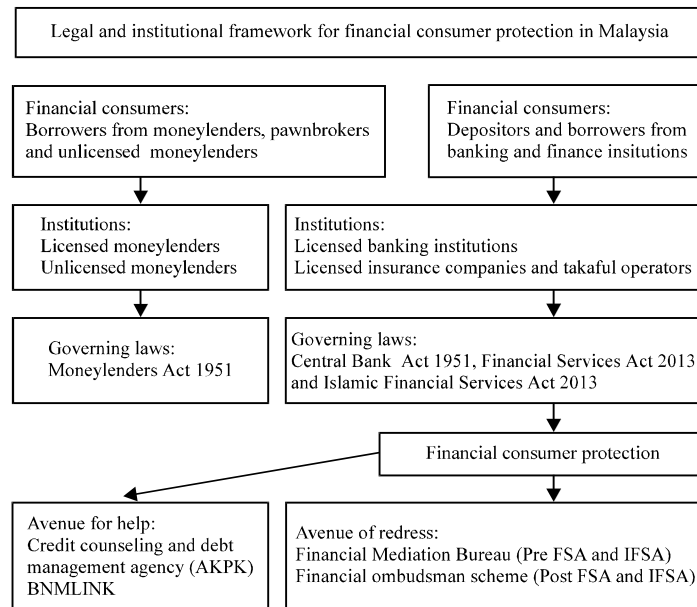


Fig. 1: The legal and institutional framework

operators under the central bank. Both commercial and Islamic banks have 21 licensed institutions. Indirectly, it shows that Malaysia offers both conventional, as well as Islamic financial services to the consumers. In contrast, the takaful industry is still developing compared to the insurance due to the fact that there are 42 insurance companies and 16 takaful operators.

The central bank is governed by the Central Bank Act 2009. It is an act which provides for the continued existence of the Central Bank of Malaysia and for the administration, objects, functions and powers of the bank for consequential or incidental matters. Furthermore, the Financial Services Act 2013 (FSA) and Islamic Financial Services Act 2013 (IFSA) to provide for the regulation and supervision of financial and Islamic financial institutions, payment systems and other relevant entities and the oversight of the money and foreign exchange market to promote financial stability and for related, consequential or incidental matters.

Both the FSA and IFSA confer power on central bank to specify standards on business conduct to a financial service provider to ensure that a financial service provider is fair, responsible and professional when dealing with financial consumers.

Section 124 of the FSA and Section 136 of the IFSA prohibit a financial service provider from engaging in any business conduct set out in Schedule 7 of the FSA and IFSA. Examples of prohibited business conduct include misleading and deceptive conduct, exerting undue pressure in relation to the provision of any financial service, demanding payments from a financial consumer for unsolicited financial services or colluding with any other person to fix or control the features or terms of any financial service or product to the detriment of a financial consumer, other than any tariff or premium rates or policy terms which have been approved by the Central Bank.

Interestingly, Schedules 8 and 9 of the FSA highlight specific matters relating to insurance business in the context of consumer protection, such as pre-contractual duty of disclosure for consumer and non-consumer insurance contracts. Similar provisions are found in Schedules 8 and 9 of the IFSA in relation to contracts for consumer and non-consumer takaful contracts.

As of 30 June, 2013 Schedule 8 of both the FSA and the IFSA has come into effect. These schedules set out the mandatory terms of insurance policies and takaful certificates. However, Section 129 and Schedule 9 of the FSA and all but 2 of the provisions of Schedule 9 of the IFSA have yet to come into operation. These provisions lay down the requirements in relation to pre-contractual

disclosure and representations for insurance and takaful contracts (Tan and Gumis, 2013).

It is submitted that the Central Bank do hold important regulatory role in the licensed banking, insurance and takaful industries in Malaysia.

Licensed moneylenders: Licensed moneylenders played important role of informal financing in facilitating private sector growth and for the living of community that falls beyond the monitor of formal financial system. The licensed moneylenders are governed by the Moneylenders Act 1951. Since the enactment of the Moneylenders Act in 1951, the institutional governance of the money lending business has evolved from a decentralized to a centralized structure. Initial administrative decentralization allowed local authorities to evaluate, administer and grant money lending licenses. The institutional governance and administration of the money lending industry was centralized under the Ministry of Urban Wellbeing, Housing and local government.

The uniqueness of the money lending industry is that it provides instant cash to the consumers. Despite the high interest rate imposed to the secured and unsecured loan in which the interest is capped at 12 and 18% per annum, respectively. Although, the law requires the moneylender to execute a formal agreement between both parties, the agreement only protects the moneylenders and none of the provisions indicates protection to the borrower. In fact, it is submitted that the title of the law obviously explain that the act is meant to protect the moneylenders interest and in the event of non compliance to the law, the moneylenders will be penalized accordingly. The act is silent on the protection to the financial consumers.

Credit counselling and debt management agency: With the robust growth in private consumption, consumer wealth and increased access to credit products, it has become essential for Malaysian consumers to understand how to manage their finances and debts prudently. In the last decade, the bank has observed an increase in the number of people who are unable to meet their financial obligations, either because of unexpected changes to their financial situation or overstretched finances. In response to this, the bank established the credit counselling and debt management agency in 2006. The consumers who approached the agency for assistance are from all walks of life. In most cases, the factors contributing to their indebtedness and inability to repay include poor financial

planning, ignorance and lack of financial discipline to live within their means. There are also borrowers who have been affected by unforeseen circumstances like health problems, death of a breadwinner loss of employment or business failure. For these consumers, the agency provides financial counseling and debt management services, including assistance with restructuring or renegotiating loans and teaches individuals basic money management skills and how to use credit responsibly. Since, the agency was launched in 2006 over 130,000 people have contacted the agency for counseling services and 35,000 have enrolled in the Debt Management Program (DMP). The agency, Consumer and Market Conduct Department (CMC) work closely together, sharing knowledge and information about ways to prevent financial stress and how to support consumers when it happens. In 2011, as part of an ongoing effort to help Malaysians become more financially savvy the bank introduced the power program. Power aims to equip individuals with practical knowledge and skills in money and debt management and targets new and prospective borrowers and young adults. The program focuses on practical applications of financial decisions and their consequences in real life situations (Di Castri, 2011).

BNMLINK

In instances of fraud or when consumer rights have been violated, customers can file a complaint directly with the bank's customer service centre called BNMLINK. BNMLINK assists the public and businesses with complaints and issues concerning financial products and services and advises Small and Medium Enterprises (SMEs) that need financing and verification of credit history and status. There are now 6 BNMLINK centers nationwide with the 1st BNMLINK established in Kuala Lumpur in January, 2005. There has been a significant upward trend in the number of consumers seeking information and assistance from the bank through BNMLINK with 155,711 individuals and businesses assisted in 2010. In 2007, BNMLINK became part of the Bank's Integrated Contact Centre (ICC) that aims to improve customer service and responses to queries about financial matters. The website, bankinginfo.com.my provides consumers with a variety of financial resources where the households can use portfolio management tools and borrowers and savers can comparative shop using tables that outline costs and key features of financial products. In addition, consumers are guided by the tutorials in financial planning.

Financial Mediation Bureau: Another important way to empower consumers is to provide them with cost-effective mechanisms for timely redress when they encounter a problem with a financial institution. The Consumer and Market Conduct Department (CMC) has required financial institutions to set up complaint desks to respond to customer concerns. Conventional and Islamic banks, insurance companies and takaful operators have all established a complaint unit. The bank actively promotes public awareness of the redress mechanisms customers can use to lodge complaints against financial institutions. The bank has realized that a cost-effective, simple and easily accessible dispute resolution process is essential for treating customers fairly. The Financial Mediation Bureau is an independent body dedicated to providing customers with objective and timely resolution of disputes, claims and complaints about services from financial institutions. An alternative to the courts this service is free of charge and promises to address disputes within 3 months.

Financial ombudsman scheme: One of the key changes to strengthen consumer protection under the FSA and IFSA is the establishment of a financial ombudsman scheme to ensure effective and fair handling of complaints and to resolve disputes in connection with financial services or products. Each financial service provider is required to be a member of the financial ombudsman scheme and to comply with the terms of its membership. The operational details of the scheme, including the type of disputes that may be referred, eligible complainants, membership requirements, procedures, fees charged and awards are to be set out in regulations. The FSA and IFSA expressly prohibit a dispute that has been referred to the financial ombudsman scheme from being lodged with the Tribunal for Consumer Claims under the Consumer Protection Act 1999. This demarcation of jurisdiction between the financial ombudsman scheme and the tribunal for consumer claims avoids multiplicity of claims and disparity between decisions.

ANALYSIS OF FINANCIAL CONSUMER PROTECTION FOR THE BANK AND UNBANK CONSUMERS

The legal and institutional framework of financial consumer protection in Malaysia is divided into 2 groups; the banked and unbanked group of consumers (Table 3).

Table 3: Analysis of financial consumer protection to the banked and unbanked consumers

Unbanked consumers		Bank consumers	
Strength	Weaknesses	Strength	Weaknesses
Instant cash	High interest rates	The licensed banking, insurance and takaful institutions are under the monitoring of Central bank which indirectly affects responsible lending to the financial consumers	There are procedures for loan and financing which takes time to be released to the consumers
No stringent requirement for a loan	No avenue for help and for redress	The licensed banking, insurance and takaful institutions are governed by the Central Bank Act 2009, the Financial Services Act 2013 and Islamic Financial Services Act 2013	The licensed banking, insurance and takaful institutions only approved qualified borrowers who satisfy their requirements of prudent banking
No ceiling amount of loan	The money lending agreement protect the moneylenders No laws protecting the unbanked consumers	There are avenue for help to the financial consumers like the AKPK and BNMLINK There are avenue for redress to the financial consumers such as the Financial Mediation Bureau and ombudsman scheme	Value of loan and financing, as well as interest rates are determined by the central bank There are special provisions in the Financial Services Act and Islamic Financial Services Act to protect consumers

CONCLUSION

Financial consumer protection regime is essential in ensuring fair dealings and treatment to the consumers, as well as enhanced informed participation while sustaining public confidence and trust in the financial system. In Malaysia, the banked groups of financial consumers are well protected by the governing laws and the avenue for help and redress. Furthermore, the licensed banking, insurance and takaful institutions are well regulated by the central bank guidelines. On the other hand, the unbanked groups of financial consumers interests are not protected. In areas where no laws exist to regulate the transaction, the consumer is at a very disadvantageous position. Where laws exist, the laws have weaknesses that work to the detriment of consumers. It is submitted that the Moneylenders Act 1951 on its own is ineffective and inefficient in protecting the interest of borrowers and maximizing the public's welfare as a whole. The regulatory approach exposes borrowers to an unfair marketplace, fail to deter loan sharking activities and compound licensed moneylenders to high compliance costs and risks. Alternative approaches, such as market-based instruments, co-regulation and information method should be integrated with the act to establish an equitable market for both the borrowers and the licensed moneylenders, de-motivates illegal activities, i.e., loan sharks, reduce compliance and enforcement costs, provides borrowers with access to information and empowers them to make informed decisions. Additionally, the Malaysian Licensed Moneylenders Association needs to be empowered to play a more active role. Only then can the interest of borrowers be effectively and

efficiently protected. Hence, the legal framework of financial consumer protection in Malaysia needs to be reviewed for the enhancement and empowerment of the financial consumers.

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