

## Protection Against Over-Indebtedness: Appraising Suitability and Affordability Assessment in Malaysia and South Africa

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### Abstract

This study analyses mandatory suitability and affordability assessment embodied in the Guidelines on Responsible Financing issued by the Central Bank of Malaysia, focusing on conventional banks, Islamic banks and prescribed development financial institutions. It employed a doctrinal legal research methodology whereby relevant primary and secondary sources of law were meticulously analysed. This study also employed comparative legal research methodology whereby the approach adopted in South Africa was scrutinised and compared against the practice in Malaysia. This study found that the Guidelines on Responsible Financing play an essential role in ensuring responsible lending among the banks, Islamic banks, and prescribed development financial institutions in Malaysia. Based on the analysis conducted, several recommendations were proposed to bolster the existing regulatory approach in imposing suitability and affordability assessment. The outcome of this study is imperative in reducing the situation of over-indebtedness among Malaysians and reinforcing the responsible lending regime in Malaysia.

**Keywords:** Responsible lending, suitability and affordability assessment, consumer protection, consumer credit

### 1.0 Introduction

Globally, people acknowledge banks as the mainstream credit providers offering various financial products. According to the Central Bank of Malaysia (BNM), in the second half of 2022, loans for the purchase of residential properties became the main driver of household debt expansion (59.7%), followed by personal financing (12.8%) and



motor vehicle financing (12.7%) (Bank Negara Malaysia, 2022). From the positive perspective, banks assume an influential task in providing access to credit to satisfy various consumers' needs ranging from emergencies, education, expenditures, car purchasing and repayment of existing loans (The World Bank, 2012). However, it is also imperative for the authorities to consider the over-indebtedness of consumers since it will lead to damaging consequences resulting from irresponsible practices and uncontrolled use of retail credit products. In a systematic literature review on consumer over-indebtedness, Cesar Leandro & Botelho (2022) classified several antecedents of over-indebtedness, including creditor-related factors. Literature has confirmed that intense market competition can drive the financial industry to engage in irresponsible lending practices (Gutiérrez-Nieto et al., 2017). The appeal of low interest rates and expanded credit limits may entice customers initially but eventually make them become overburdened by debt (Gutiérrez-Nieto et al., 2017). Another study proved that low-annual percentage rate offers attract consumers who then transfer balances and use revolving credit (Murthi et al., 2019). However, some cannot pay off the balance after the promotional period, potentially leading to over-indebtedness (Murthi et al., 2019).

Chronically overindebted individuals exhibit a higher prevalence of depressive symptoms, followed by those with moderate to high debt levels (Hojman et al., 2016). Moreover, over-indebtedness worsens an individual consumer's financial health and decelerates economic growth (Goode, 2012). Grundmann et al. (2015) and Micklitz (2015) found that irresponsible lending practices can have detrimental external consequences, potentially causing disruptions in the consumer credit market. Such practices can potentially erode consumer confidence in financial markets, leading to financial instability (Cherednychenko & Meindertsma, 2019). Due to the negative impacts of reckless lending and excessive indebtedness, responsible lending practices, with varying levels of importance placed on mitigating over-indebtedness, have garnered significant attention among international regulators aiming to bolster financial consumer protection (Financial Stability Board, 2011).

In Malaysia, financial institutions providing consumer credit facilities can be divided into banks and non-bank institutions. However, this study is confined to institutions regulated by BNM, which imposes mandatory suitability and affordability assessment according to the Guidelines on Responsible Financing (GRF). The following diagram



illustrates the classification of credit providers offering credit or financing facilities:-

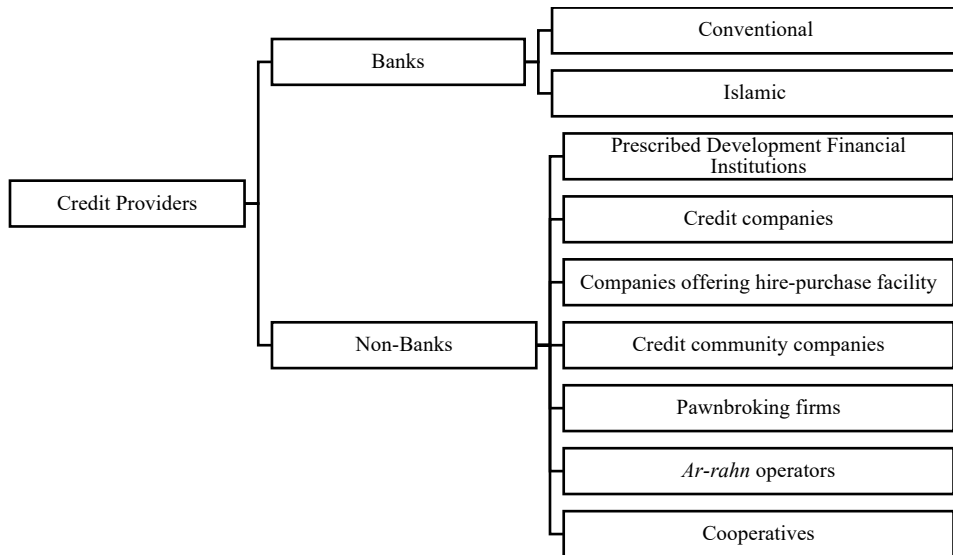


Figure 1 : Classification of Credit Providers in Malaysia  
Source: Author's own

In this context, this study aims to analyse the existing suitability and affordability assessment imposed by BNM as part of regulatory approaches in regulating responsible lending among conventional banks, Islamic banks, and prescribed development financial institutions (PDFIs), which are the leading consumer credit providers in Malaysia. To achieve the objective, this study employed a doctrinal and comparative legal research methodology whereby the approach adopted in South Africa was examined and compared against the practice in Malaysia for benchmarking purposes.

## 2.0 Literature Review

### 2.1 Credit, Debt and Over-Indebtedness in Malaysia

The prevailing legal repercussion resulting from excessive indebtedness culminates in an individual being declared bankrupt. As illustrated in Figure 2, it becomes evident that the primary catalysts behind the elevated incidence of bankruptcy cases in Malaysia are rooted in consumer credit, specifically in the forms of hire-purchase agreements and personal loans. One of the factors attributed to this surge is the relative ease with which individuals can secure personal



loans, coupled with the eagerness of banks to extend credit to individuals whose financial capabilities are substantially exceeded by their borrowing requirements (Mohd Nazari, 2020).

Figure 3 illustrates a declining trend in bankruptcy cases. This phenomenon can largely be attributed to several legislative amendments in 2017 and 2020. Specifically, the Bankruptcy (Amendment) Act 2017 raised the minimum debt threshold for initiating bankruptcy proceedings from RM30,000 to RM50,000. Furthermore, the Insolvency (Amendment) Act 2020, which took effect on 22 October 2020, raised the minimum threshold for creditors to file a bankruptcy petition from RM50,000 to RM100,000. According to the Malaysian Department of Insolvency (MDI), this amendment is a pivotal factor in reducing the incidence of bankruptcy (New Straits Times, 2023).

Regarding this, financial expert Professor Dr Mohamad Fazli Sabri has raised concerns about individuals carrying debts in the range of RM100,000 to RM499,000 and emphasised the importance of a thorough assessment of their ability to manage loan repayments before taking on additional debt (New Straits Times, 2023). Moreover, the worrying prevalence of over-indebtedness among Malaysians was further highlighted by the approval of 23,711 applications for the Debt Management Programme (DMP) provided by the Credit Counselling and Debt Management Agency (AKPK) in 2021 (Credit Counselling and Debt Management Agency, 2021). The DMP serves to reconfigure cash flow, delay bankruptcy proceedings, establish equitable repayment schedules based on the most up-to-date financial circumstances, and safeguard individuals from harassment by debt collectors (Ilias et al., 2023).



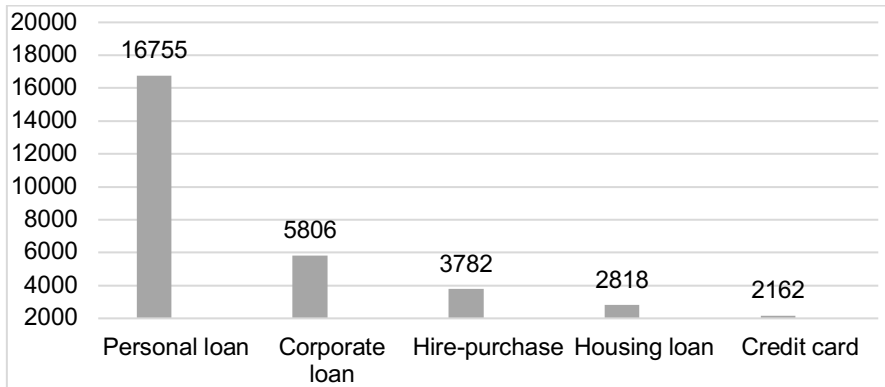


Figure 2 : The Top Factors of Bankruptcy in Malaysia from 2019 – April 2023

Source: Malaysian Department of Insolvency

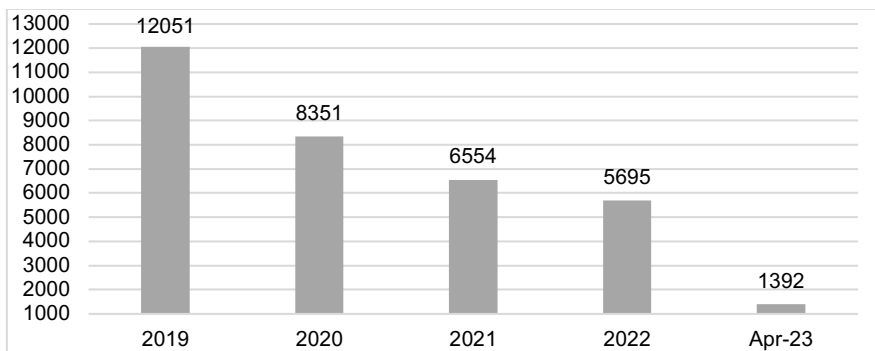


Figure 3 : The Total Number of Registered Bankruptcy Cases in Malaysia According to Year from 2019 to April 2023

Source: Malaysian Department of Insolvency

Furthermore, as seen in Figure 4, Malaysia's overall household debt-to-GDP ratio is considerably high, albeit slightly declining to 81.2 per cent as of December 2022 (Bank Negara Malaysia, 2022). Previously in 2020, it soared to a new high of 93.3 per cent primarily owing to the country's GDP lingering below pre-Covid-19 crisis levels, with household debt growth returning to pre-pandemic levels in the second half of 2020 when the government eased movement restrictions (Zainul, 2021).



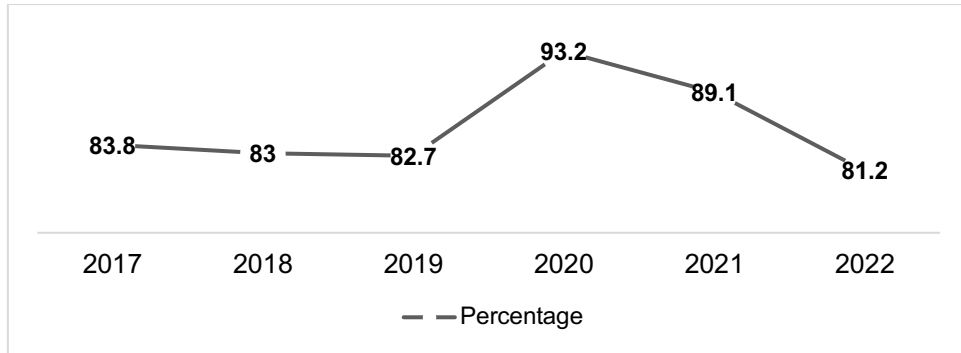


Figure 4 : Percentage of Malaysia's Household Debt to GDP 2017-2022  
Source: Bank Negara Malaysia

## 2.2 The Concept of Responsible Lending

The emergence of responsible lending as a concept can be directly attributed to the global financial crisis, which starkly illustrates the widespread damage caused by reckless lending practices in numerous consumer credit markets globally (Odayappan, 2022). It is undeniable that consumers are expected to exercise responsible credit usage. Conversely, credit providers bear a significant responsibility to prevent consumers from falling into over-indebtedness. Credit companies' marketing strategies often take precedence over consumers' rational decision-making, psychologically influencing them to purchase items or services that exceed their financial capabilities (Musa, 2015). Despite stringent requirements on banking institutions to meticulously assess consumers' creditworthiness as a measure to mitigate credit risk, the allure of financial incentives often outweighs the consideration of risk, leading to the approval of credit for high-risk consumers (Cherednychenko & Meindertsma, 2019).

There are multiple perspectives on understanding responsible lending. According to the Financial Stability Board (2011), various regulatory approaches have been adopted in setting responsible lending standards. Some jurisdictions concentrate principally on regulating information disclosure where the consumers must exercise their prudent judgement and make appropriate decisions. Certain regulators place a responsibility on lenders to ensure responsible lending, requiring them to analyse the loan's eligibility for each customer. Other countries have enacted more robust measures, such as setting interest rate caps, capping maximum debt-to-income or loan-to-value ratios, and imposing maximum penalties and late fees.



Despite the lack of universally accepted standards on responsible lending, the Financial Stability Board (2011) explained that the common objectives of responsible lending practices are to prevent over-indebtedness, ensure that consumers can repay their loans and protect consumers from unfair selling practices.

### 2.3 Suitability and Affordability Assessment

In a global context, the World Bank (2012) acknowledges that the affordability assessment is widely recognised as a critical component of responsible lending practices. In Malaysia, several past studies attempted to examine the affordability assessment through the GRF. Within the GRF framework, suitability and affordability assessment refers to a regulatory requirement to guarantee that credit facilities are only offered to consumers who are both suitable and able to afford them (Ilias et al., 2019). Credit providers must gather an adequate amount of information regarding a consumer to assess the appropriateness of credit products based on the consumer's requirements and financial capabilities (Ilias et al., 2019). Essential prerequisites that credit providers must adhere to encompass evaluating the consumer's repayment history, credit scores, and borrowing behaviours (Ilias et al., 2019).

Musa (2015) discussed the role of BNM in promoting prudent lending practices. The study found that the GRF curtailed the expansion of household borrowing and consumer loans/financing and asserts that BNM plays an influential role in mitigating the adverse consequences of reckless consumption. Isa and Mohd Hussin (2016) focused on the impact of the GRF on household loans in both commercial and Islamic banks during its early implementation. The study revealed that from 2013 to 2015, there was a decrease in the growth of household loans, indicating the effectiveness of the GRF imposed by BNM to control household loans.

According to one empirical study that investigated the implementation of responsible lending practices among selected banks in Malaysia, bankers adhere to the GRF when evaluating the suitability and affordability of potential customers (Rosli et al., 2021). Respondents unanimously concurred that they routinely perform assessments of suitability and affordability before granting any loan or financing application. This procedure is deemed of paramount importance to safeguard against potential financial hardships for consumers resulting from approved credit. The primary emphasis is



placed on verifying customers' capacity to fulfil their payment obligations within the agreed-upon timeframe.

Rafie & Ilias (2022) assessed the Malaysian consumer credit industry's current responsible lending policy which includes banking, pawnbroking, hire-purchase, moneylending, credit sale, and cooperatives, as industries are regulated separately. The applicable laws which were scrutinised included the Financial Services Act 2013 (FSA), the Moneylenders Act 1951, the Pawnbrokers Act 1972, the Hire Purchase Act 1967, the Consumer Protection (Credit Sale) Regulations Act 2017, the Cooperative Society Commission Act 1993, the GRF and the Guidelines on Credit Facility for Cooperatives. This study identifies an inconsistency in the Malaysian consumer credit industry's approach to responsible lending, as banking institutions supervised by the Central Bank of Malaysia are required to adhere to the GRF, while others are not legally required to conduct mandatory suitability and affordability assessments.

#### 2.4 Affordability Assessment in South Africa

The South African National Credit Regulator has been entrusted with the responsibility of overseeing the implementation of the National Credit Act 2005 (NCA) (CM van Heerden & Steennot, 2018). This legislation is designed to foster a fair and non-discriminatory environment in the credit industry, ensuring that consumers have equitable access (Mnxuma, 2022). The NCA not only prohibits the irresponsible granting of credit but also mandates that credit providers conduct pre-agreement assessments before entering into credit agreements with consumers (Rayi, 2016). Later on, Regulation 23A was enacted to fill in the lacunae of the NCA, specifically the gap in sections 81 and 82 of the said Act (Rayi, 2016).

#### 2.5 Conclusion

A review of past literature exposes that despite numerous studies that have been conducted concerning responsible lending, as well as suitability and affordability assessment in Malaysia, none has carried out an extensive comparative study with South Africa. This study closes the gap in the existing literature and offers a novel contribution to the consumer law study.





### **3.0 Methodology**

This study employed doctrinal legal research methodology to achieve the research objectives. According to Jain (1975), doctrinal legal research involves “analysis of case law, arranging, ordering and systematising legal propositions and the study of legal institution through legal reasoning or rational deduction”. The study began with a review of relevant literature on credit, debt and over-indebtedness, the concept of responsible lending and suitability and affordability assessment. Jesson et al., (2011) emphasise the significance of a literature review as a means to grasp the existing research on a given subject, gain insights into the methodologies employed in previous studies, and identify the central issues within the field.

In line with doctrinal research methodology, both primary and secondary sources of law have been analysed. The latter is vital to highlight the current development in the respective area of law. Both sources have been accessed primarily from online database resources such as Lexis Legal Research for Academics, LawNet, CLJ Law, Springerlink, and HeinOnline, as well as websites of relevant institutions such as BNM, AKPK and MDI.

The primary sources of law that have been rigorously evaluated were the FSA, Islamic Financial Services Act 2013 (IFSA), Development Financial Institutions Act 2002 (DAFIA), GRF, NCA and Affordability Assessment Regulations (AAR) or Regulations 23A. Analysis of the primary sources of law is supported by secondary sources of law, including textbooks, journal articles, reports, working papers, seminar papers, thesis and newspaper articles concerning the position in Malaysian and South Africa.

Additionally, the study utilised a comparative law analysis to draw comparisons between the responsible lending frameworks in Malaysia and South Africa. In essence, comparative law involves the practice of juxtaposing the legal systems of one nation against those of another for examination and evaluation (Eberle, 2011). South Africa is selected because this country is among the earliest to introduce comprehensive consumer credit laws namely the NCA (De Wet et al., 2015; Schraten, 2014) and specific regulations to curb reckless lending (Migiro, 2017; Rayi, 2016; Van Heerden & Renke, 2015). Green & Sewnunan, (2015) highlight that the introduction of NCA has greatly improved consumer protection in South Africa.



## **4.0 Findings**

### **4.1 Suitability and Affordability Assessment under the GRF**

The importance of responsible lending or financing is demonstrated by section 123(2) of the FSA, section 135(2) of the IFSA and section 42C of the DAFIA, which empower BNM to establish standards and provide recommendations or advice relating to assessments of the suitability and affordability of financial services or products offered to financial consumers. In fact, before the implementation of the FSA and the IFSA, BNM proactively introduced measures to protect financial consumers against over-indebtedness via the GRF, which was issued on 18 November 2011 and came into effect on 1 January 2012. The GRF applies to entities regulated by BNM, including conventional and Islamic banking institutions, as well as PDFIs. Apart from evaluating consumers' suitability and affordability, there are five other policy requirements provided in the Guidelines: marketing and disclosure, fees and charges, monitoring and recovery and avenues for redress and compliance. Nevertheless, this study only evaluates the policy requirements relating to the suitability and affordability assessment of consumers.

Thus, one of the vital regulatory mechanisms provided in the GRF is the mandatory suitability and affordability assessment. The GRF mandates that all financial service providers must conduct suitability and affordability assessment for every financing facility they offer, irrespective of whether it involves new or additional credit services. Intermediaries working with financial service providers are also obligated to adhere to these guidelines, and non-compliance may lead to corrective measures. Specifically, banks are required to assess consumer applications for various financing products, such as home financing, personal financing, overdraft facilities, vehicle financing, credit and charge cards, and financing for securities purchases, except for share margin financing, which falls under the jurisdiction of Bursa Malaysia's rules.

The GRF defines "affordable" as the ability to meet repayment obligations throughout the financing period without needing debt relief or facing significant hardship. It also outlines several factors to assess if a financial product suits a consumer's financial situation and ensures affordability. These factors are detailed below:



#### 4.1.1 Prospective Consumer's Repayment History and Credit Scores

The GRF does not provide a detailed explanation of these two elements, namely repayment history and credit scores. It is submitted that these two elements are incorporated in the credit risk policy of each bank, Islamic banks or PDFIs (BNM Policy Document on Credit Risk (BNM/RH/PD 029-22)). Thus, financing applications submitted by consumers with lousy track records, including late payments, missed payments and adverse information such as bankruptcy suits, legal action, collection and delinquencies, will likely be rejected. On the contrary, consumers who demonstrate a good payment history would obtain smooth financing approval.

#### 4.1.2 Credit Score

Another paramount factor in assessing suitability and affordability is by looking at credit scores. According to Experian (2021), a credit score is a number between 300–850 that depicts a consumer's creditworthiness. Consumers with higher credit scores will generally be regarded as suitable and can afford the financial obligation arising from the financing application promptly. Factors that may affect one's credit score are, among others, credit history, number of open accounts, total levels of debt, and repayment history (Experian, 2021).

#### 4.1.3 Debt Service Ratio

A complementary method of assessing affordability provided in the GRF is to observe the prudent Debt Service Ratio (DSR) computed using the following formula:

$$\frac{\text{all outstanding debt repayment obligations from banks and non-banks (including those not covered by Central Credit Reference Information System)}}{\text{Income after statutory deductions (i.e. tax, Employees Provident Fund, Social Security Organization)}}$$

The GRF emphasises the need to determine DSR prudently to screen consumers' eligibility for a financing application. To accomplish this goal, two factors must be considered: total outstanding debt repayment from banks and non-bank creditors, as well as income after statutory deductions. Given that there are various income categories, the GRF accentuates the need for verification by a credible party to ensure the consumers furnish reliable documents to the credit



providers. Irrespective of the GRF, BNM provides considerable flexibility for the banks to determine income sources and the appropriate DSR that the borrowers can reasonably sustain (Ying, 2018). Most Malaysian banks rated by Moody's adopt a DSR of 50%-70% (The Edge, 2013). To increase affordability, Malaysian banks such as Maybank, CIMB, Public Bank, RHB, AmBank, Hong Leong Bank, Affin Bank, and Bank Islam have allowed a spouse or family member to be a joint borrower on a housing loan (Ying, 2018). Thus, it can be seen that BNM is providing flexibility to banks, Islamic banks and PDFIs to determine their respective DSR depending on their risk appetite.

#### 4.1.4 Income Assessment

Regarding income assessment, the financial service providers must inquire with the consumers about their sources of income and the amount to determine the DSR. If consideration is given to various sources of income such as overtime, allowance, commission and contractual bonus payment; variability of such income for at least three months, which only includes a prudent portion of the average amount, should be regarded as their income in assessing affordability. The financial service providers must take into account a month-to-month variance of income as well.

If a high month-to-month variance is observed, a longer period of proof of variable income should be obtained to establish the amount that should be regarded as the financial consumer's stable income. One-off variable income such as bonuses should be excluded in the assessment of income. In respect of consumers who are not permanently employed or self-employed, an evaluation should be conducted on the stability of the primary sources of income by requiring them to provide proof of income for at least six months. Verification of income is also important to ensure the authenticity of the evidence of sources of income. Income should be verified using reliable sources 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 not allowed.

#### 4.1.5 Debt Repayment Obligation

As stipulated in the DSR formula, the banks must extensively examine consumers' overall indebtedness, including secured and



unsecured financing from all financial service providers, including non-bank entities that provide credit facilities in determining debt repayment obligations. For this purpose, reference must be made to the Central Credit Reference Information System (CCRIS), a computerised database that stores credit information from participating institutions. In respect of financial obligations arising from credit transactions with entities that CCRIS does not capture, the bank must obtain such information directly from the consumers. Consumers should be informed of their responsibility to reveal relevant and error-free information during the respective financing application. Besides that, the consequences of providing inadequate or false information must be made known to the customer. CCRIS processes data automatically and synthesises it into credit reports that are available upon request to financial institutions and borrowers.

The amount included in the debt repayment obligations should reflect the scheduled repayment of both principal and interest/profit, including any fees and charges included in the financing amount. In respect of instalments payable for home financing during the construction period of new housing development project where the consumers are only required to serve the interest/profit, the amount to be considered for calculation of debt repayment obligations shall include both the principal and interest/profit applicable at the end of the interest/profit-only period.

Discounted interest/profit rates may apply in the early stages of a financing arrangement in some cases. In this instance, the maximum appropriate rate of interest/profit should be adopted (based on the applicable base lending rate/base financing rate at the time of assessment). Even with the collateral promised by consumers, the DSR must be used to ascertain affordability. Financing should not be granted to consumers who are deemed unqualified without the collateral. High net-worth consumers, on the other hand, can be afforded more flexibility than vulnerable consumers, with their deposits or assets being taken into account when determining repayment capacity.

#### 4.1.6 Buffer for Expenditures

It is a prerequisite that adequate buffers for expenditures and contingencies to determine a prudent level of DSR to take into account several circumstances of consumers. The circumstances include the nature of employment, the number of dependents, the location of



residence and other factors that may affect the expenditure amount of the consumers.

#### 4.1.7 Financing Tenure

A more extended financing tenure merely provides a short-term benefit to consumers as it may expose them to higher risks due to the overall debt burden in the long run. The GRF specifies the maximum loan tenure for vehicle financing, which is nine years. Additionally, another measure adopted by BNM to strengthen prudent lending practice is by way of restricting the loan tenure for the purchase of residential properties and personal financing to 35 years and 10 years, respectively.

Once proper evaluation has been conducted, the banks are required to prepare adequate documentation concerning financing decisions. The reason for financial decisions must be properly recorded and supported by information. The grounds for approval or rejection must be stated not only to justify the decision made but also to assist internal risk management and supervisory inspection of the banks' compliance with the GRF by the regulator.

For compliance with the GRF, the banks are obligated to reflect the effectiveness of existing programs and procedures which include risk management and internal control review mechanisms. The senior management as well as the board of directors of the financial institutions is mandated to ensure that proper procedures are in place. Therefore, any non-compliance must be reported to them for rectification based on the prescribed action plans. Finally, the Board is accountable for ensuring that appropriate steps have been taken to address any non-compliance in the conduct of retail finance that could expose them to financial and reputational risks.

#### 4.2 Responsible Lending in South Africa

The promotion of responsible lending and prohibition of reckless credit granting has become the leading agenda of the enactment of the NCA. Section 3(c) of the NCA summarises the primary objective of the legislation, namely promoting responsibilities of both credit providers and consumers in the credit market. Credit providers are discouraged from reckless lending, while consumers are required to practise prudent borrowing, avoid excessive debt, and fulfil their financial commitments. Additionally, as expressed in section 3(g) of the NCA, its



cardinal focus is on preventing over-indebtedness and developing methods to remedy it. In addition to the NCA, the AAR is crucial in regulating credit provision as it offers more detailed affordability assessment procedures.

The NCA is a major piece of legislation that regulates the consumer credit business on a broad scale, involving both banks and non-bank credit providers. The National Credit Regulator (NCR) controls credit providers such as banks, automobile financiers, apparel retailers, furniture dealers, and cooperatives. The NCA describes a credit provider as ‘the party that supplies goods or services pursuant to a discount transaction, incidental credit agreement, or instalment agreement; the party that advances money or credit pursuant to a pawn transaction; the party that extends credit under a credit facility; the mortgagee under a mortgage agreement; the lender under a secured loan; the lessor under a lease; and the party to whom credit is extended under a credit facility.’ The advantage of having a single regulator to supervise all credit activities is that it ensures a uniform legal and institutional framework, including the responsible lending regime, by imposing mandatory affordability assessment. The majority of credit providers must pre-evaluate the prospective consumers’ creditworthiness (except for some types of credit contracts that are exempted). Classification of credit providers in South Africa is depicted in Figure 6:-

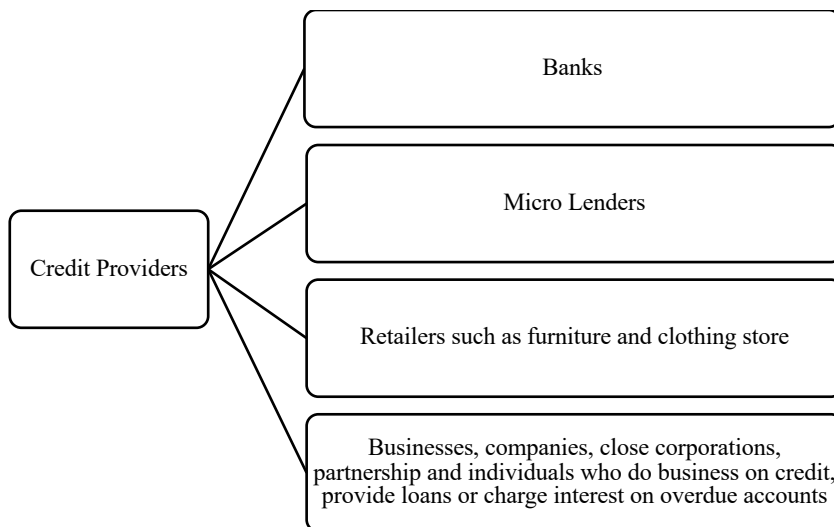


Figure 5 : Classification of Credit Providers in South Africa  
Source: Author’s own

### 4.3 Prevention of Reckless Lending Under the NCA

To address reckless lending concerns, the NCA imposes a prohibition on reckless credit under section 81(2)(a), which mandates the conduct of a pre-agreement evaluation. However, certain types of loans made under section 78 are exempted from such criteria, including educational loans, emergency loans, public interest credit agreements, pawn transactions, incidental credit agreements, and temporary increases in the credit limit under a credit facility. It is viewed that these exemptions are introduced given the nature of these credit facilities. For example, it is not feasible to conduct an affordability assessment for school loans as the borrowers are the students. It is also viewed that affordability assessment for emergency loans will defeat the purpose of granting the loan as it is for an urgent need; hence, the process may cause unnecessary delay.

Section 81(2)(a) makes it unlawful for credit providers to enter into a credit arrangement without taking proper steps to ascertain the following:

1. the consumer's overall understanding of the risks and costs associated with the proposed credit, as well as the rights and obligations under a credit agreement;
2. the consumer's credit agreement debt repayment history; and
3. the consumer's existing financial means, prospects, and commitments.

Moreover, the law stipulates the consumers' need to cooperate in preventing reckless lending as set down in section 81(1) of the NCA, where the potential consumer is required to completely and truthfully respond to any information request made by the credit provider as part of the assessment. Failure on the consumers' part to give accurate and comprehensive information during the pre-agreement assessment might result in serious harm. Section 81(4) provides that such failure constitutes a complete defence to an allegation that a credit agreement is reckless if the credit provider establishes that the consumers fail to provide complete and truthful information to the credit provider and a court or tribunal determines that such failure materially impairs the credit provider's ability to make an accurate assessment. However, as declared in *Absa Bank v COE Family Trust* 2012 (3) SA 184, section 81(4) must be read in conjunction with section 81(2). In this case, Davis J ruled that because there was no evidence that the credit provider





completed a proper assessment as required by section 81(2), the defence under section 81(4) of the NCA is irrelevant. This provision is critical because it establishes a legal requirement on consumers who are collectively responsible for averting over-indebtedness.

#### 4.4 The Consequence of Reckless Lending under the NCA

The NCA explicitly states that reckless lending is forbidden, and the NCR's responsibility is to oversee that credit providers adhere to legal requirements. This is accomplished through the NCR's investigative and enforcement power, which includes the power to issue a compliance notice. Complaints alleging imprudent credit may also be filed with the NCR. For example, in 2012, in response to consumer concerns, the NCR opened an investigation into about 669 irresponsible loans made by African Bank (Motshegare, n.d.). As a result of the settlement, the African Bank agreed to pay an R20 million fine and implement corrective measures.

Apart from NCR, the National Credit Tribunal (NCT) also plays a key role in discouraging irresponsible lending, with the competence to evaluate whether a credit agreement is reckless. Additionally, it has the right to levy a substantial administrative fee or revoke a credit provider's registration for violating the applicable provision. If the NCT determines that an agreement is reckless, it has the authority to invalidate all or a portion of the consumer's rights and responsibilities under the reckless credit agreement, depending on what the court determines is appropriate and reasonable in the circumstances. Alternatively, in accordance with section 87 of the NCA, the NCT may postpone the performance of that credit arrangement or restructure the consumer's obligations under any other credit agreements (Stoop, 2009). As a result, it is clear that non-performance of pre-agreement evaluation could have a grave effect on credit providers.

#### 4.5 Affordability Assessment Under the AAR

According to the National Credit Amendment Act 19 of 2014 (Amendment Act), the AAR was embedded into the National Credit Regulations 2005. The importance of the AAR is the inclusion of 'Criteria to Conduct an Affordability Assessment'. The AAR does not prohibit individual credit providers from relying on their mechanisms to assess affordability provided that it is consistent with the AAR. It is agreed that the AAR was introduced to fill the lacuna in the NCA,



specifically on the gap found under sections 81 and 82 by enhancing the existing assessment procedures which are too general. Due to these undetailed procedures, inconsistent assessment practices are evident among credit providers. The AAR prescribes the affordability assessment procedures that apply to all credit providers and the requirements that need to be complied with for the credit agreements before approving any loan to the financial consumers. Matters that need to be considered include: -

#### 4.5.1 Applicability

It must first be highlighted that the AAR is only applicable to particular credit transactions. In general, the AAR applies to current, prospective and joint consumers, as well as to all credit providers and all credit agreements to which the NCA applies. The AAR also provides a list of credit transactions being excluded from the requirement to conduct a mandatory pre-agreement assessment, namely, development credit agreement, school or student loan, public interest credit agreement, pawn transaction, incidental credit agreement, emergency loan, temporary and unilateral credit limit increase (following sections 119(1)(c);119(4); and 119(5) of the NCA under a credit facility), changes to the pre-existing agreement according to Schedule 3 Item 4(2) of the NCA, any change to a credit agreement and/or any deferral or waiver of an amount under an existing credit agreement (in accordance with section 95 of the Act), and finally, a mortgage that is qualified under the Finance Linked Subsidy Programs developed by the Department of Human Settlements and credit advanced for house purchase that falls within the threshold set from time to time. Referring to the exempted list provided under section 78, the AAR provides an additional list of credit transactions that are exempted from conducting the affordability test.

#### 4.5.2 Income Assessment

When an affordability test is required to be exercised, the second stage is to assess the prospective consumers' current financial means and prospects. The AAR imposes an obligation on the credit provider to take reasonable steps to evaluate the consumer's discretionary income to determine whether that consumer has the financial means and prospects to repay the proposed credit instalments. Discretionary income is defined under the Amendment Act



as the consumer's gross income less statutory deductions, necessary expenses and all other committed payment obligations as disclosed by the consumer, including obligations disclosed in the consumer's credit record as held by credit bureaux.

#### 4.5.3 Validation of the Gross Income

Following that, credit providers must take appropriate measures to verify a consumer's gross income produced in various scenarios under rule 23A (4). Gross income is defined under the Amendment Act as all income obtained from any source without deductions. In the case of consumers who get a salary from their employer, the credit provider must verify such gross income using the consumer's most recent three salary slips or bank statements showing the consumer's latest three salary deposits. Consumers who do not earn a wage must submit the credit provider with the most recent three written proofs of income or three months' bank statements. In the case of consumers who are self-employed, informally employed, or employed in a way that does not require them to receive a payslip or other form of proof of income, the credit provider must validate such gross income using the consumer's latest three months' bank statements or financial statements. The consumers are obliged to declare all financial commitments to the credit provider precisely and to submit authentic documentation for the credit provider to undertake the affordability assessment.

However, in *Truworths & others v Minister of Trade and Industry & Others*, (4375/2016) [2018] ZAWCHC 41; 2018 (3) SA 558, this income validation process specified in the AAR was criticised. The plaintiffs in this lawsuit were three of South Africa's top retail clothing companies. Based on their internal regulations, the customers were allowed to pay for their purchase either by cash or credit. If the customers choose to pay using credit, they must apply for a store card and open an account. The issue that arose was that the customers of these retail companies were mostly unbanked and informally employed, as such they were not able to provide their proof of income as required by regulation 23A(4). Plaintiffs argued that it was adequate to assess their customers' repayment ability based on their affordability assessments. The plaintiffs also submitted that the new regulations discriminate against the employee who does not have any payslip and bank statement as the AAR does not allow any substitute means to prove his or her sources of income. Plaintiffs argued that regulation 23A (4) should be set aside.



The court found in favour of the apparel manufacturers and struck down regulation 23A. (4). The primary reason for revoking regulation 23A (4) was that it discriminates against unbanked, informally employed, and self-employed persons. The court further held that it was 'reasonable for this category of employment to provide a financial statement to calculate their gross income because they surely cannot comply with this condition which subsequently blocks them from accessing the credit from the creditors'. The financial statement was also defined by the court in this case as a specific document that is produced annually by an accountant which regulation 23A (4) defines 'latest financial statement' to mean a regular document and not only a single document from the employer.

Additionally, the court opined that the initial design of regulation 23A (4) was more adaptable than the existing AAR, which requires credit providers to take reasonable steps to verify gross income by referring to:

- a) the consumer's most recent three months' payslips
- b) bank statements for the last three months
- c) any additional convincing proof of a comparable nature

The AAR may help to reduce reckless lending but indirectly discriminates the informal and self-employed individuals from accessing credit (Mhaka & Osode, 2019). In light of the decision in *Truworths's* case, the NCR proposed new guidelines specifically to fill the loophole in assessing the gross income of an individual. Under the proposed guidelines, the gross income of an employed individual should be validated by using the consumer's payslip. In addition, if the consumer has a bank account for receiving his salary, their net income will be validated using the bank statement and thereafter deduction on living expenses and debt repayment will be made to determine the discretionary income.

Meanwhile, consumers with less than three months of employment history should give their most recent payslip or a letter of employment confirmation from their respective company detailing the salary and frequency of payment, or a bank statement indicating the most recent salary deposit. Secondly, credit providers should analyse informally and self-employed individuals, including those who have income but do not have a payslip or bank statement, using alternative methods of verification.



Apart from the above, the credit providers are also required to submit their affordability assessment models and the process and procedures adopted by them in the credit assessments on this group of employees. In addition, credit providers should also determine if the consumer has a bank account or otherwise to ascertain their income flows. The proposed guidelines for credit providers prepared by the NCR were issued for public consultation on 18 April 2018. It is submitted that the court has pronounced a sound judgement as the mechanism laid down in the AAR is discriminatory and irrational which restricts the prospective consumers' access to credit. It is also hoped that the proposed guidelines will be implemented soon as they offer a more flexible approach to validate the prospective consumers' income.

#### 4.5.4 Calculation of Existing Financial Obligations

The other scope of affordability assessment is in relation to the consumers' existing financial obligations. A credit provider is required to assess the consumers' existing financial means, prospects and obligations as required under sections 78(3) and 81(2)(a)(iii) of the NCA. The AAR provides a minimum expense norms table which is broken down by monthly gross income for reference by the credit provider when calculating the existing financial obligations of a consumer. The calculation method prescribed requires credit providers to ascertain gross income, statutory deductions and minimum living expenses to be deducted to arrive at a net income whereby it will be allocated for payment of debt instalments.

After considering the existing debt obligations of a consumer, the credit provider must calculate his discretionary income to assess the consumer's ability to satisfy any new debt obligation. However, the credit provider may, on an exceptional basis, where justified, accept the consumers' declared minimum expenses which are lower than those set out in the minimum expenses table, provided that the questionnaire set out in the schedule is completed by the consumers. The credit provider is then required to calculate the consumers' discretionary income, take into account all monthly debt repayment obligations under all credit agreements as reflected in the consumers' credit profile held by a registered credit bureau, as well as maintenance obligations and other necessary expenses. Registered credit bureaus in South Africa store credit information from all registered credit providers in South Africa (Coetzee, 2021). The AAR defines necessary expenses as the consumer's minimum living expenses, including



maintenance payments but excluding monthly debt repayment obligations under credit agreements.

#### 4.5.5 Debt Repayment History

The fifth step of the affordability assessment requires the credit provider to take into account the consumers' debt repayment history under all previous credit agreements. This requirement must be met immediately before the initial approval of credit or the increase of an existing credit limit, and within 14 working days for mortgages.

#### 4.5.6 Avoiding Double Counting

The next step of the affordability assessment is only relevant when the credit agreement is entered into on a substitutionary basis to set off one or more existing credit agreements as provided under regulation 23A (14). In this instance, a credit provider must record that the purpose of the credit being applied is to replace other existing credit agreements and take reasonable steps to ensure that such credit is properly used for such purpose. Thus, when the consumer wants to repay their existing smaller debts by taking another loan with the credit provider, the credit provider must take note and record the purpose of the consumer taking the loan which is to repay the existing debt or for the purpose stated by the consumer (Rayi, 2016).

#### 4.5.7 Disclosure of Costs and Fees

It is crystal clear that the credit providers have the upper hand when it comes to the information to be made known to the consumers, including the fees and risks. Thus, regulation 23A (15) compels credit providers to disclose the total cost of fees to the consumers without any exception before signing the agreement. Regulation 23A(15)(d)(i)-(v) stated that the lender must disclose the cost to the consumer, including (i) principal debt, (ii) interest, (iii) initiation fee, (iv) service fee and (v) credit insurance. This provision is crucial to ensure that the consumers are well-informed regarding the costs and fees that they have to bear throughout the financing tenure.

If consumers are dissatisfied with the outcome of the affordability assessment, they may file a complaint with a credit ombudsman, consumer court, or alternative dispute resolution (ADR) agent, as specified in section 134 of the NCA. Alternatively, a complaint may be filed with the NCR following the provisions of section 136 of the



NCA. The credit provider is required to make a reasonable effort to resolve the complaint within 14 business days of the credit ombud notifying the credit provider of the complaint under section 134 of the NCA. If a credit provider does not respond to a consumer grievance within the specified timeline, the consumer may contact the NCR, which must resolve the complaint within seven business days.

## 5.0 A Comparative Analysis

The commendable inclusion of a suitability and affordability assessment within the GRF by BNM serves as a springboard for this paper to propose refinements, drawing inspiration from the regulatory practices of South Africa. Such proposals align with the tenets of paternalism theory, which espouses governmental intervention to ensure the diligent oversight and rigorous enforcement of laws, policies, or regulations designed to shield individuals from any harmful effect (Cvjetanovic, 2000).

Table 1 presents a comparative analysis between mandatory suitability and affordability assessment practised in Malaysia and South Africa.

Table 1 : Comparative Analysis

No	Themes/Elements	Malaysia	South Africa
1	Authority for mandatory suitability and affordability assessment	Guidelines on Responsible Financing enforced in 2012	<ul style="list-style-type: none"> <li>• NCA</li> <li>• AAR</li> </ul>
2	Types of legal instrument	Regulatory instrument established by the regulator	Legislation and regulation passed by Parliament
3	Regulator	BNM	NCR
4	Scope of credit providers subject to mandatory assessment under the Guidelines	<ul style="list-style-type: none"> <li>• Conventional banks, Islamic banks, and PDFIs regulated by BNM</li> <li>• Non-banks not regulated by BNM are not subject to the GRF</li> </ul>	All credit providers except those providing credit that are exempted under section 78 of the NCA.
5	Type of credit/financing requiring assessment	All types of credit/financing offered by the financial service providers	All types of credit except those exempted under section 78 of the NCA and AAR



No	Themes/Elements	Malaysia	South Africa
6	Assessment criteria	<ul style="list-style-type: none"> <li>i) Consumers' repayment history</li> <li>ii) Credit score</li> <li>iii) Debt repayment obligation (to determine DSR)</li> <li>iv) Income assessment (to determine DSR)</li> <li>v) Buffer for expenditure</li> <li>vi) Financing tenure</li> </ul>	<ul style="list-style-type: none"> <li>i) Income assessment (financial means and prospects, including discretionary income)</li> <li>ii) Existing financial obligations</li> <li>iii) Minimum living expenses</li> <li>iv) Debt repayment history</li> <li>v) Disclosure of cost and fee (the consumer's overall understanding of the risks and costs associated with the proposed credit, as well as the rights and obligations under a credit agreement).</li> <li>vi) Avoiding double-counting</li> </ul>
7	Disclosure of costs and fees	Dealt with by another provision in the Guidelines. There is also a specific Guidelines on Product Transparency and Disclosure issued by BNM	Required to be disclosed under the AAR and section 81 of the NCA
8	Income verification	Required	Required
9	Credit Information	<ul style="list-style-type: none"> <li>• CCRIS</li> <li>• CCRIS stores only credit data of consumers of institutions regulated by BNM and accessible by the regulated institutions</li> <li>• Other credit reporting agencies registered under the CRAs may gain access to the credit information of individual borrowers in the CCRIS with the borrowers' prior consent and accessible to other</li> </ul>	Registered credit bureaus store credit information from all registered credit providers





No	Themes/Elements	Malaysia	South Africa
		credit providers <ul style="list-style-type: none"> <li>• Credit information for non-BNM regulated credit providers such as moneylenders, cooperatives, and credit sale companies are not included in the CCRIS report</li> </ul>	
10	Avoiding double counting	No specific provision under the GRF	There is a provision that disallows double counting under the NCA
11	Consumers' right to complain about reckless lending	No specific provision under the GRF	Can complain to the NCR
12	Consumers' right to take legal action for non-compliance with mandatory assessment	No specific provision under the GRF	Can take legal action by filing a case at court or the NCT
13	Right of court or ADR body to decide cases on reckless credit granting	No specific provision under the GRF	NCT is competent to evaluate whether a credit agreement is reckless.
14	Remedies for consumers due to reckless credit granting	No specific provision under the GRF	<ul style="list-style-type: none"> <li>• All or a portion of the consumer's rights and responsibilities under the reckless credit agreement will be invalidated or</li> <li>• Performance of that credit arrangement can be postponed or</li> <li>• The consumer's obligations under any other credit agreements can be restructured.</li> </ul>
15	Effect of consumer's false disclosure	No specific provision under the GRF	Such failure constitutes a complete defence to an allegation that a credit agreement is reckless



No	Themes/Elements	Malaysia	South Africa
16	Enforcement action	BNM may exercise its enforcement power as a regulator whether administrative, civil or criminal action under the FSA, IFSA or DAFIA	<ul style="list-style-type: none"> <li>• NCR may exercise its investigative and enforcement power, which includes the power to issue a compliance notice.</li> <li>• NCT has the right to levy a substantial administrative fee or revoke a credit provider's registration for violating the applicable provision</li> </ul>

In light of the comparative table presented above, it is evident that when juxtaposed with South Africa, the responsibility of banks, Islamic banks, and PDFIs in Malaysia to perform suitability and affordability assessments relies on non-legislative instruments, specifically the GRF. This approach is associated with several shortcomings, primarily the absence of legislative influence that would compel compliance and establish punishment for non-compliance. The GRF simply stipulates that any instances of non-compliance should be addressed by the senior management and the Board. Additionally, there is a notable lack of provisions regarding consumers' rights to lodge complaints if they are granted credit without a proper affordability assessment. Furthermore, there are no remedies available to consumers who have been granted unsuitable contracts by credit providers and subsequently face financial hardships when it comes to repayment. The GRF also lacks the authority to empower the courts or ADR body to arbitrate disputes related to reckless credit granting. Notably, there is no specified course of action for cases involving false disclosures by consumers. It is viewed that this provision is significant to ensure a balance obligation on both consumer and credit providers to avert over- indebtedness issues. The absence of these legal provisions, which are explicitly outlined in the NCA and AAR, has the potential to undermine the effectiveness of the existing regulatory framework.

Learning from South Africa, it is suggested that the suitability and affordability assessment should be incorporated into legislation to make it a legal obligation of all credit providers. Failure to conduct such affordability and suitability assessment should be made as an offence



that carries appropriate sanctions. Secondly, civil remedies in favour of consumers who successfully prove that they become over-indebted due to irresponsible lending practices should be provided. For instance, the court may set aside all or a portion of the consumer's rights and responsibilities under the irresponsible credit arrangement, depending on what the court finds is just and reasonable in the circumstances. Other possible remedies include suspending the credit agreement's performance or modifying the consumer's obligations under any other credit agreements. Specific enforcement actions related to irresponsible lending should also be incorporated.

Furthermore, it is also recommended that legal consequences on the consumers for not providing or disclosing truthful information be spelt out in the said legislation. By following the NCA's approach, such failure will constitute a legal defence to the charge that a credit agreement is imprudent. This is subject to two conditions: first, the credit provider must establish that the consumer fails to provide or disclose complete and accurate information to the credit provider; and second, a court or other dedicated redress mechanism body must determine that such failure materially impairs the credit provider's ability to make an accurate assessment. Disclosure of all material facts relating to the financing, including the financing or interest rate, the monthly instalment amount, as well as the relevant cost and applicable fees should be stipulated in the agreement. Moreover, the right to complain to the regulator, a court, or any dedicated redress mechanism body should be accorded to consumers who are aggrieved by the result of the affordability assessment.

Also, in contrast to the NCA and AAR which apply to all major credit providers, (except certain types of credit that are exempted), GRF is only applicable to the credit providers regulated by BNM. It is submitted that this shortcoming is also attributed to the absence of one dedicated law governing consumer credit in Malaysia. This fragmented approach exposes another loophole that allows those who are rejected by the banks for example to apply for loans from other non-banks that may or may not evaluate the affordability of their prospective borrowers. This situation arises from the lack of legal requirements for non-bank lenders to conduct such assessments (Rafie & Ilias, 2022). It is submitted that this shortcoming will defeat the objective of preventing over-indebtedness.

Hence, establishing a comprehensive responsible lending regime encompassing other non-bank credit providers is critical. This



holistic approach is necessary since consumers who fail to get financing applications approved by banks can always resort to non-bank credit providers which are not subject to the legal or even regulatory requirement of mandatory suitability and affordability assessment.

Concerning assessment criteria, it is submitted that both the GRF, the NCA and the AAR have stipulated relevant assessment criteria. Among the core elements considered are existing debt obligations, income, debt repayment history and basic expenditures. In Malaysia, credit score also plays an important role in determining affordability. However, it is suggested that GRF prescribe the provision on avoiding double counting to prevent unfair assessment of prospective borrowers. In both jurisdictions, some flexibilities are allowed in devising assessment policies or mechanisms as long as they are consistent with the fundamental principles prescribed in the regulation or regulatory instrument.

Another vital element to ensure valid and reliable assessment is to have an integrated and comprehensive credit reporting system. There is a need to have a comprehensive credit database that captures consumers' indebtedness from all credit providers to facilitate a more accurate affordability assessment as implemented in South Africa whereby registered credit bureaus store credit information from all registered credit providers.

In Malaysia, the list of CCRIS's participating financial institutions (PFIs) is as follows:-

Table 2 : List of CCRIS's PFIs

No	Types	Details
1	Commercial banks	All
2	Islamic banks	All
3	Development financial institutions	All
4	Insurance companies	All
5	Payment instrument issuers	<ul style="list-style-type: none"><li>• AEON Credit Service (M) Sdn Bhd</li><li>• Diners Club (Malaysia) Sdn Bhd</li></ul>
6	Rehabilitation institution	<ul style="list-style-type: none"><li>• Prokhas Sdn Bhd</li></ul>
7	Credit or leasing companies	<ul style="list-style-type: none"><li>• BMW Credit (Malaysia) Sdn Bhd</li><li>• TC Capital Resources Sdn Bhd</li><li>• Toyota Capital Malaysia Sdn Bhd</li></ul>
8	Building societies	<ul style="list-style-type: none"><li>• Malaysia Building Society Berhad</li></ul>



No	Types	Details
9	Government agencies	<ul style="list-style-type: none"><li>Perbadanan Tabung Pendidikan Tinggi Nasional</li></ul>

Source: Bank Negara Malaysia

Non-PFIs may subscribe to credit reporting agencies (CRAs) to get the credit reports of their potential borrowers. At present, there are six credit bureaus operating subject to the Credit Reporting Agencies Act 2010. Subject to the approval by BNM, CRAs can access the credit information of borrowers in CCRIS, with prior consent from the borrowers. Presently, three CRAs have been approved namely Credit Bureau Malaysia Sdn Bhd, CTOS and Experian Information Services (Malaysia) Sdn Bhd. PFIs that subscribe to these CRAs may request credit reports of an applicant or borrower, directly from the CRAs to facilitate their lending decisions.

It is argued that the credit report generated by CRAs is limited for two reasons; firstly, only three CRAs have been approved by BNM to access the CCRIS data and secondly, subscription by credit providers is not mandatory. Moreover, CCRIS only includes specified financing and borrower information from PFIs. Furthermore, the imposition of fees may constitute an obstacle to subscription, especially among small-sized credit companies. Eventually, these shortcomings may affect the accuracy of the assessment.

Finally, it is argued that the sole crafting of a rhetorical piece of legislation may not be adequate. A proactive instead of reactionary regulatory approach is incumbent (Van Heerden & Renke, 2015). Furthermore, financial awareness should be heightened, and financial education programs should be aggressively conducted. Consumers should be informed of the impending destructive effect of ill-managed debt (Sebstad, Cohen, & Stack, 2006). Regarding this, the regulators' function in designing and implementing effective financial education programs is substantial.

## 6.0 Conclusion

The discussion above shows that promoting responsible lending is a delicate task to be carried out by the regulators. It is indispensable to achieve a balance between two conflicting interests, namely those of consumers and credit providers. Assuming paternalistic role, regulators must protect the consumers, especially against the repercussions of over-indebtedness. On the other hand, an extremely



stringent regulation may render an unproductive credit market and affect economic growth. Malaysia has positively responded to the vision of minimising over-indebtedness through the imposition of mandatory suitability and affordability assessments. Nevertheless, the discussion reveals some areas for improvement that are worth considering as practised by South Africa. Malaysia may consider establishing a reformed legal framework governing responsible lending, especially concerning suitability and affordability assessment as in South Africa. Strengthening a responsible lending regime is paramount to curb over-indebtedness which affects the individual financial consumers, society and the country. While this research is confined to secondary data, future research may engage an empirical study to investigate the practice of affordability assessment among various financial institutions in Malaysia.

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