

2012

MARKET CONDUCT AND CONSUMER EMPOWERMENT

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MARKET CONDUCT AND CONSUMER EMPOWERMENT

The Financial Services Act 2013 (FSA) and Islamic Financial Services Act 2013 (IFSA) accord the Bank with a clear mandate to foster fair, responsible and professional conduct by financial service providers (FSPs) that are regulated by the Bank. The Bank discharges its mandate by setting expectations and requirements for regulating the conduct of FSPs towards consumers and assessing the behaviour of FSPs against those expectations; promoting transparency to consumers; taking enforcement actions against breaches of conduct; and equipping consumers with the financial knowledge, skills and access to effective redress avenues to better protect their own interests. While it would not be possible to completely eliminate the potential for FSPs to act in a way that may not be in the best interests of consumers, the Bank commits to providing a credible deterrent against unfair practices towards consumers through its supervisory and enforcement activities, and ensuring that when there is unfair treatment, there are effective avenues through which consumers can seek remedy. This will allow for healthy competition and innovation in the financial industry which ultimately benefits consumers, while mitigating moral hazard in the longer term by also advocating the responsibility of consumers to take appropriate measures to protect their financial interests.

KEY TRENDS AND DEVELOPMENTS

The Bank's strategic priorities in the area of market conduct are guided by developments and conditions in the operating environment and the key risks that they present to consumers. To a large extent, developments in the retail financial markets in the recent period have been substantially influenced by the low interest rate environment, increasing competition including from non-bank FSPs and the strengthening of prudential requirements that have had an important bearing on the structure, design and distribution of financial products in the market. Since 2006, the general insurance industry has also been confronted with considerable challenges in the motor insurance sector as claims costs continue to escalate beyond sustainable levels that are not supported by premiums, leading to

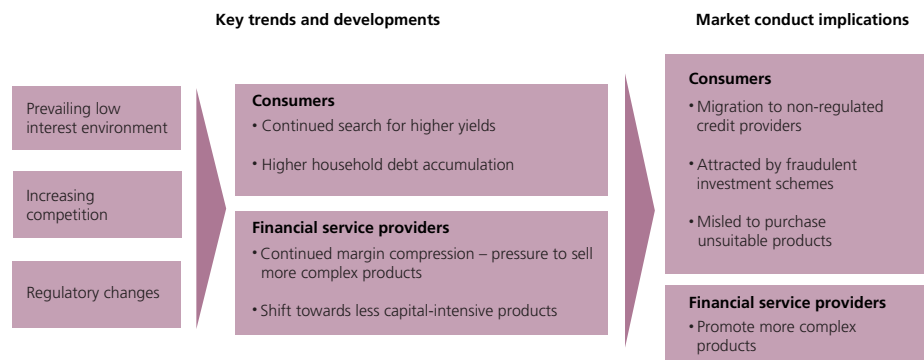
fundamental reforms that are set to significantly change the motor insurance landscape. In turn, these conditions influence the behaviour of FSPs and consumers, sometimes in ways which can affect the interests of consumers (Diagram 4.1). The Bank closely monitors such conditions and takes action to mitigate identified risks to consumers.

Against this backdrop, the Bank's oversight activities in 2012 continued to focus on managing the following key risks to consumers:

- **In search for higher yields**, more consumers may seek out investment alternatives without sufficient understanding of the risks involved or making adequate enquiries on the legitimacy of the service providers. The relatively low appreciation of financial risk management among consumers further increases the risk of making ill-informed financial decisions. A study undertaken by the Organisation of Economic Co-operation and Development (OECD) in 2011 observed that while financial literacy levels of Malaysia's financial consumers are comparable to those in developed economies, Malaysian consumers pay little attention to risk reduction in managing their finances;
- **The accumulation of higher debt by low income households** in response to lower borrowing costs. Households become overly burdened when borrowing decisions are made without due regard to the ability to service the debt over the longer term. The risks are increased when borrowers have no financial buffers to meet contingencies. This has been compounded by an increasing trend in borrowings by lower-income households from non-bank credit providers, which are not subject to underwriting standards imposed by the Bank;
- **Continued pressure on FSPs' margins**, resulting in the promotion of more complex products with higher expected returns without considering whether the products are suitable for the targeted consumers. Some of these products are also being bundled together and sold through alternative and multiple distribution channels without proper training

Diagram 4.1

Key Trends and Developments, and Market Conduct Implications



- of sales staff. This in turn can lead to poor sales practices and behaviour; and
- **The offering of less capital-intensive structured products by FSPs with greater risks borne by consumers**, partly in response to the increasing demands of prudential regulation which are necessary to ensure that FSPs are financially sound and have the ability to meet their obligations to consumers, including under adverse market conditions.

The Bank's priorities in 2012 were directed at strengthening the legal foundation for the oversight of market conduct, implementing an enhanced market conduct supervisory framework, increasing the scrutiny of insurance intermediaries and empowering consumers through targeted financial education programmes

In managing these risks, the Bank's priorities in 2012 were directed at strengthening the legal foundation for the oversight of market conduct, implementing an enhanced market conduct supervisory framework, increasing the scrutiny of insurance intermediaries and empowering consumers through targeted financial education

programmes. The Bank also significantly increased its engagements with other authorities and agencies, and continued to maintain constructive dialogue with consumer associations on the issues confronting consumers.

STRENGTHENING THE LEGAL AND SUPERVISORY FRAMEWORK

Specific provisions in the FSA and IFSA have significantly strengthened the preconditions for an effective regulatory and supervisory regime for business conduct and consumer protection. The new legislation provides explicit and expanded powers for the Bank to set and enforce business conduct standards on FSPs in areas that include disclosure requirements, fairness of contract terms, financial promotion, provision of advice and complaints handling. In addition, the legislation clearly identifies prohibited conduct that is inherently unfair to consumers, enhances the legal protection provided to consumers in relation to dealings with insurance and takaful companies and intermediaries, and provides for the evolution of avenues for consumer redress. Key features of the new legal framework are further described in Table 4.1.

Implementation of market conduct supervisory framework

The implementation of the risk-based market conduct supervisory framework continued to be a priority in 2012. This entailed moving towards a more pre-emptive, risk-based, and outcome-focused framework, with an emphasis on conduct risks that have the highest potential of causing widespread detriment to consumers or a loss of confidence in the financial system.

Table 4.1

Key Features of the New Legal Framework

Wider market conduct powers	<ul style="list-style-type: none"> • Powers for the Bank to specify standards on business conduct • Clear identification of prohibited conduct by FSPs <ul style="list-style-type: none"> – Engaging in misleading or deceptive conduct – Making false, misleading or dishonest representation – Exerting undue pressure when marketing financial products or in seeking payments – Demanding payments for unsolicited financial products or services – Coercing consumers to purchase a financial product as a condition of purchasing another financial product – Colluding to fix or control the features or terms of financial products or services to the detriment of consumers • The Bank may provide guidance on prohibited conduct
Strengthened provisions for insurance and takaful business	<ul style="list-style-type: none"> • Enhanced protection for consumers with respect to their pre-contractual disclosure obligations. Among others, an insurer or takaful operator must pose specific questions to consumers for its underwriting purpose. Remedies available to insurers or takaful operators for careless or innocent misrepresentations by consumers shall also be proportionate to the action that would have been taken by the insurer or takaful operator had the consumer not made the misrepresentation • New provisions on family takaful certificates that require a person to have a permissible takaful interest on a person covered to avoid moral hazard or manipulation of the takaful contract • New provisions on compensation on claim amount to expedite the payment of family takaful benefits • New provisions on nominations, including a provision on conditional <i>hibah</i>, to provide greater clarity on the nomination process
More efficient regulatory framework for insurance and takaful intermediaries	<ul style="list-style-type: none"> • Introduction of an approval and registration regime for insurance and takaful intermediaries which is more reflective of the risks presented by such entities • Recognition of Islamic financial advisers as a new distribution channel for family takaful products • New requirement to have in place professional indemnity insurance or takaful cover to protect clients' interests • New requirement to maintain separate accounts to ensure ring-fencing of clients' monies
Enhanced avenues for consumer redress	<ul style="list-style-type: none"> • Enabling power for the Bank to approve financial ombudsman schemes aimed at ensuring effective and fair handling of complaints and resolution of disputes • The Bank may prescribe the function, duties and scope of the scheme • Obligations on FSPs to be members of an approved financial ombudsman scheme and to comply with the awards granted under the scheme
Strengthened enforcement powers	<ul style="list-style-type: none"> • Monetary and non-monetary administrative actions in addition to civil and criminal penalties • Includes public reprimand, orders to remedy a breach and for the FSP to make restitution to any person aggrieved by the breach
Cooperation with other regulatory agencies	<ul style="list-style-type: none"> • The Bank to: <ul style="list-style-type: none"> – coordinate with Securities Commission Malaysia on the regulation of business conduct relating to capital market activities conducted by FSPs under the purview of the Bank – consult the Malaysia Competition Commission (MyCC) on the development of guidance on tied selling and collusive actions, and to refer complaints related to these actions to MyCC

The supervisory approach combines thematic issue specific and individual firm reviews based on an identification of key conduct risks over the period of review. During the year, three thematic reviews and 19 individual firm reviews were conducted by the Bank, the outcomes of which are discussed in the next section on 'Addressing Consumer Issues'. The Bank is in the process of developing baseline conduct risk assessments for institutions with significant retail business segments in each regulated sector. This involves an assessment of the risks present in an institution's main retail activities and the manner in which these risks are controlled through its operational management and oversight activities. The assessment covers (i) product development and governance; (ii) fairness and transparency of contract terms; (iii) sales and marketing practices; (iv) incentives and remuneration structures; (v) competencies of sales and marketing personnel; (vi) after-sales support; (vii) advisory and redress channels; (viii) protection of customer information; and (ix) handling of clients' monies. The Bank expects to complete the risk assessments for 15 institutions in the banking, insurance and takaful sectors by end-2013. These institutions account for about 30% of FSPs with significant operations in the retail market segment in the respective subsectors. The assessment of the remaining institutions is expected to be completed by the end of 2015. Once completed, the risk assessments will be updated regularly and will be used as a basis to prioritise supervisory activities, including thematic and institutional reviews.

Generally, the supervisory reviews in this recent year showed that FSPs have a higher level of awareness of the impact that consumer issues have on their business and risk strategies. This was observed with some consistency at the senior management level but less at the board level, which suggests that processes within FSPs for escalating conduct issues to the attention of the board still requires improvement. Beginning 2013, the Bank will start to include conduct assessments in its annual supervisory meetings with the boards of FSPs which discuss the Bank's risk assessments of individual FSPs. This is to encourage a broader deliberation of conduct risks at the boards of FSPs and to facilitate the prioritisation of management attention and resources towards addressing key conduct issues facing an FSP.

Few FSPs have set a strong and consistent 'tone at the top' on how the board and management expect the FSP to treat its customers. Conduct obligations are often viewed as a compliance requirement, rather than a core value proposition of the FSP. This is slowly changing with some FSPs placing fair and responsible practices towards consumers at the centre of their growth strategies. These FSPs have made the consumer experience a key focus of their business plans and are strengthening the alignment between growth and performance targets, with a clear focus on consumers. The Bank also continues to observe improvements in the level of transparency and disclosure in FSPs' marketing and sales materials following previous interventions by the Bank. However, the Bank believes there is scope to further improve the level of comparability and reduce the complexity of information provided by FSPs, which is important to help consumers compare and understand the disclosures made. The Bank plans to undertake research in 2013 regarding the use of information that is made available by FSPs as a basis for more specific improvements to current disclosure requirements and practices.

Business practices that promote positive consumer outcomes not only serve to protect individual consumers from excessive risks, but also protect individual institutions from losses that can threaten their safety and soundness

Since the Global Financial Crisis, the nexus between conduct risks and prudential outcomes has become more pronounced. Business practices that promote positive consumer outcomes not only serve to protect individual consumers from excessive risks, but also protect individual institutions from losses that can threaten their safety and soundness, thus reducing the risks to financial stability. Within the Bank, supervisory reviews of market conduct practices, while serving on their own to promote and reinforce fair and responsible practices among the FSPs, also provide important inputs into the overall risk assessment of banks, insurers and takaful operators.

Significant conduct developments which can have implications on financial stability are deliberated by the Bank's Financial Stability Committee. More work is being undertaken by the Bank to better understand the primary ways in which conduct issues can manifest into increased risks to the safety and soundness of institutions. This will also contribute to the development of more robust approaches by the Bank to account for conduct risks in the overall supervisory risk ratings of FSPs.

ADDRESSING CONSUMER ISSUES

Responsible lending practices

While sustained income growth and favourable employment conditions have strengthened the capacity of consumers to borrow, lower-income households continue to be highly leveraged, increasing this group's vulnerability to income shocks and adjustments to borrowing costs. The Guidelines on Responsible Financing, which was implemented in January 2012, requires FSPs to focus on affordability assessments and their obligations to ensure that borrowers have the capacity to take on additional financing, based on more robust income verifications and prudent debt service ratios that take into account the circumstances of the borrowers. Since the implementation of the Guidelines, most FSPs have adjusted their internal underwriting standards, notably to strengthen documentation requirements for verifying income, and to provide more prudent buffers in setting the debt service ratio for borrowers to meet essential and contingency expenditures. FSPs have also been more circumspect on lending into retirement. These changes have contributed to improvements in the level of engagement between FSPs and potential borrowers as part of efforts by FSPs to obtain a better understanding of borrowers' financial circumstances before loans are made.

Public concerns that the Guidelines would significantly constrict access to financing by households proved to be unfounded. Annual growth in outstanding loans to the household sector by the banking system remains strong, and consumers who can afford to take on new debt continue to have access to financing. However, consistent with the objective of the Guidelines, new borrowings by households have started to moderate towards more sustainable levels, with growth recorded at 11.6% as at end-2012 (12.9% at end-2011). Approval rates for housing loans and vehicle financing which account for

the bulk of household loans declined marginally in line with more robust affordability assessments and measures by the Bank to curb borrowing for speculative property purchases. The approval rate for credit cards similarly continued to decline following the measures implemented in 2011 that raised the minimum income eligibility for owning a credit card, and imposed limits on the number of credit cards that can be issued to individuals earning annual incomes below RM36,000. The requirement for FSPs to perform their own affordability assessments rather than to rely on the possession of a credit card from another FSP as proof of affordability, also contributed to lower approval rates for credit cards.

Approval rates for personal financing however, continued to rise. The Bank has intensified its review of lending practices in this segment to ensure compliance with the Guidelines on Responsible Financing. With higher expectations being imposed on FSPs to conduct proper affordability assessments, there has been some migration of borrowers to other credit providers to obtain financing. This had been observed in the growth in personal financing offered by non-bank lenders in 2012, following the implementation of the Guidelines for banks. The uneven practices of responsible financing by the non-bank lenders have contributed to the increase in indebtedness among lower-income groups. As these institutions are not directly regulated by the Bank, the Bank has intensified its engagements with the relevant oversight authorities and government agencies during the year to promote a more consistent implementation of responsible financing practices for the household sector. As a result of these engagements, the Malaysia Co-operative Societies Commission (Suruhanjaya Koperasi Malaysia, SKM) issued formal requirements on responsible financing practices for credit co-operatives in December 2012.

Product suitability and appropriate advice to consumers

Improving the quality of advice provided to consumers continued to be a key focus of conduct regulation and supervision. Particular attention was accorded to the insurance and takaful industry to ensure that in the persistent low interest rate environment, insurers which were taking steps to improve their portfolio mix between new and previous policies that were priced with much higher interest rates did so responsibly. During the year, the Guidelines on

Proper Advice Practices for Life Insurance and Family Takaful Business were revised to further strengthen expectations for insurers and takaful operators to conduct sufficient enquiries to better understand consumers' financial needs and priorities. The Guidelines, which have been extended to insurance brokers and financial advisers, also require intermediaries to disclose any conflicts of interest that may affect the advice they may provide to consumers.

The Bank's ongoing surveillance and supervisory activities found mis-selling practices in the sale of insurance products by three institutions during the year. These incidents were attributed mainly to inadequate training and controls implemented by these institutions over the selling practices of their agents, as well as the use of misleading marketing materials by agents. The Bank required these institutions to take immediate actions to identify and suspend further sales by the errant agents, review all agent training materials, and strengthen controls over the use of marketing and sales materials by agents. The institutions were further directed to furnish over 1,400 affected policyholders with accurate product materials and information, and allow policyholders to review their decisions to purchase or retain their policies. Policyholders that chose not to continue with their policies were given the option to discontinue the policies with a full refund, or convert their policies to other products at no additional cost. As a result of the supervisory intervention, more than RM30 million in premiums were refunded to the affected policyholders. As part of the efforts to identify increased risks of mis-selling at an earlier stage, the Bank will be taking a closer look at the effects of incentive structures on the quality of insurance and takaful advice provided to consumers. The review will also include an assessment of whether controls within institutions are adequate to provide a countervailing influence on incentives that encourage sales staff to promote some products over others, or to churn existing policies.

Meaningful consumer disclosures

Meaningful disclosures to help consumers make informed decisions are primarily achieved through product transparency and disclosure requirements, the use of simple language in financial consumer contracts and comparative tables published by the Bank on financial product fees and charges. These efforts aim to provide consumers with the means

to better understand information on products being offered and to make informed decisions.

As part of its monitoring activities, the Bank reviewed more than 1,400 advertisements and promotional materials published by banks, insurers and takaful operators during the year to ensure compliance with the Bank's product transparency and disclosure requirements. Of these, over 30 non-compliant incidents were observed, with the respective FSPs directed to withdraw or modify the misleading disclosures with immediate effect. In addition, the Bank has prohibited insurers and takaful operators from making direct comparisons of returns between products with different features and risks in their product illustrations. Such comparisons are generally misleading to consumers, providing an imbalanced presentation of risks and returns on products with very different risk profiles. Insurers and takaful operators were further prohibited from illustrating returns based solely on optimistic scenarios and representing guaranteed benefit payments that have already been imputed in premiums paid by policyholders as additional income or investment returns.

The use of plain language in insurance contracts and takaful certificates facilitates consumers' understanding of their contractual rights and responsibilities and complements existing measures on product transparency and disclosure. At the industry level, the Life Insurance Association of Malaysia (LIAM), the General Insurance Association of Malaysia (Persatuan Insurans Am Malaysia, PIAM) and the Malaysian Takaful Association (MTA) continue to have an important role in driving the plain language initiative which is being implemented in stages. All houseowner and householder insurance policies have adopted plain language since March 2012. This is being followed by the translation of private car insurance and hospital and surgical insurance policies into plain language which is on track to be completed in the first half of 2013. The use of plain language has important benefits to both FSPs and consumers. It reduces gaps in expectations between FSPs and consumers and consequently reduces the incidence of disputes and litigation. In addition, the use of plain language facilitates consumers in ensuring that products are suitable for their specific needs. For FSPs, it can enhance the appeal of products to a wider market. The adoption of plain language for hospital and surgical insurance policies will be particularly significant for many

consumers given the important conditions and exclusions that consumers need to be aware of when purchasing such products and the technicalities that can often obscure the visibility of important information to consumers.

At the industry level, the Life Insurance Association of Malaysia, the General Insurance Association of Malaysia and the Malaysian Takaful Association continue to have an important role in driving the plain language initiative

Similarly, the Association of Banks in Malaysia (ABM), in consultation with the Bank and the Government's Special Task Force to Facilitate Business (Pasukan Petugas Khas Pemudahcara Perniagaan, PEMUDAH), has developed a template to standardise and simplify the description of key terms and conditions for housing loans and home financing agreements to ensure that they are presented in a manner that is clear, consistent between institutions offering similar products and easy to understand. The template is applicable to loan and financing agreements involving a principal sum of RM500,000 and below, which covers 80% of straightforward housing loans extended by banks. This initiative is expected to reduce the length of housing loan or financing contracts, making it easier for consumers to read and understand the terms and compare them across institutions. While banks remain free to compete on the terms that they offer to consumers, consumers would be in a much better position to compare these terms as they are now presented in a consistent manner. The Islamic banking industry has embarked on a similar initiative to develop standardised key terms to cater for all Shariah contracts for home financing agreements involving a principal sum of RM500,000 and below.

Fair marketing and claims practices in motor insurance sector

While measures are progressing to reform the motor insurance sector, the Bank has been concerned with actions by some insurers during

the transition period to increase, through unfair practices, the balance of non-motor business in their portfolio as a means of cushioning the impact of continued losses experienced on the motor insurance business lines. A specific concern has been with the forced selling of personal accident insurance as a condition for obtaining motor insurance cover. The Bank took action in more than 50 identified cases of forced selling of personal accident products together with motor insurance covers. In all the cases, policyholders received a full refund.

The Bank also implemented several measures to promote fair motor claims assessments and reduce the time taken to settle claims. This included extending the requirement for loss adjusters to make reference to a centralised database on prices of motor parts and labour time operated by Motordata Research Consortium Sdn. Bhd. (MRC) for all motor claims, including third party claims. The standardised motor parts prices and labour time provided through the MRC database will support more transparent and objective claims assessments. Enhancements to the MRC system have also been made to facilitate the online submission of third party claims assessments directly to insurers, which is expected to improve the turnaround time for processing claims.

With more complete information captured on motor claims assessments, the MRC database will facilitate monitoring of trends in the practices of the industry for approving and assessing motor claims, and to gauge progress in improving the efficiency of claims settlements. It will also enable the undertaking of broader industry analyses on trends in parts prices, trade discounts and labour costs, as well as facilitate more effective fraud detection and control.

Safeguarding customer information

FSPs and their employees have a statutory and contractual duty not to disclose customer information to any third parties unless express consent has been given by the customer. Banking institutions and payment instrument issuers in particular are specifically prohibited from giving out customer information except under legally permitted circumstances such as disclosure to law enforcement agencies for purposes of investigating or prosecuting an offence, or disclosure to regulatory authorities. FSPs must establish policies, procedures, and effective internal controls in respect of disclosure

of customer information to permitted external parties. FSPs are also required to ensure that any complaint on wrongful disclosure or detection of a breach of customer confidentiality is fully investigated and remedial actions are taken.

The supervisory review of FSPs includes an assessment of controls and practices for safeguarding customer information. During the year, the Bank conducted a thematic review covering the retrieval, access and disposal of customer information by selected banks. The Bank found that most FSPs have effective control measures to safeguard customer information, including promoting a high level of staff awareness on the importance of proper handling of customer information. A small number of FSPs were required to strengthen the controls associated with the sharing of customer information with affiliated companies or strategic partners for marketing and promotion purposes. The Bank was satisfied that the sharing of information in these situations did not include specific information on customer accounts, but was confined mainly to contact information. Nevertheless, the Bank required that the FSPs strengthen their controls by requiring a customer's permission for his or her contact information to be shared. The Bank was also generally satisfied with the procedures and practices for handling complaints on wrongful disclosures, and for ensuring that all complaints are investigated and addressed. In isolated instances where breaches were found to have occurred, mainly with fraudulent intent, the Bank has taken legal and supervisory actions against persons responsible for the breach, while FSPs also took swift disciplinary actions, including suspension or termination of the employees concerned.

Equitable fees and charges

The regulation of fees and charges in the financial services sector has two main aims (i) ensuring sufficient transparency to consumers on costs that they may incur in procuring a financial product or service; and (ii) preventing unfair or excessive fees and charges that are not reflective of the costs incurred by the FSPs.

FSPs have considerable flexibilities to determine the appropriate level of fees and charges to recover the costs incurred in providing a financial product or service, but in doing so, must demonstrate that the principles of fair

practice as set out by the Bank are observed. This includes ensuring that the charges for ad-hoc services reasonably reflect the costs incurred and not the passing on of charges to customers for activities that are part of an FSP's internal processes for managing its risks. At present, the introduction of new or upward revisions in fees by FSPs must be approved by the Bank. About 160 of such applications are received annually for the Bank's consideration. In 2012, about 22% of applications received by the Bank were not approved or required to be adjusted as the proposed fees were inconsistent with the principles established by the Bank under the Guidelines on Imposition of Fees and Charges on Financial Products and Services. Enforcement actions were also taken against seven FSPs for non-compliance with the Bank's Guidelines, which resulted in a total refund of about RM4.7 million in fees and charges to affected customers.

Over the years, the Bank has observed progressive improvements in the level of FSPs' compliance with the principles on fair practices in the imposition of fees and charges. This in turn has led to a progressive reduction in interventions on fees and charges, suggesting a better understanding of the Bank's expectations by FSPs. Furthermore, complaints received on unfair or excessive fees and charges have remained low. These developments provide the necessary conditions for the Bank to undertake a review of the current approval regime, with a view towards reducing compliance costs for banks and enabling competitive forces to work more effectively for the benefit of consumers. A key premise of the review is the increased responsibility of the board and senior management of FSPs to ensure that fees and charges are fair and commensurate with the quality of services offered and the costs of providing a financial product or service. This review will be in tandem with strong disincentives for unfair fee practices under the FSA and IFSA, including public sanctions and orders to remedy a breach or make restitution to any person aggrieved by the breach. Careful consideration will also be given to the safeguards that should be preserved which will include an outright prohibition against specific fees and charges that are clearly unfair to consumers. A concept paper on the Bank's review proposals will be published for feedback in 2013.

Table 4.2

Features of the Guidelines on *Ibra'* (Rebate) for Sale-Based Financing

Key Areas	Policy Requirement	Implementation Date
Eligibility of <i>ibra'</i>	<ul style="list-style-type: none"> <i>Ibra'</i> must be granted to customers of sale-based financing upon settlement prior to maturity (includes early settlement arising from prepayment, default cases and restructuring exercise) 	1 Nov '11
Disclosure on <i>ibra'</i>	<ul style="list-style-type: none"> Full disclosure on the Islamic financial institution's commitment to provide <i>ibra'</i>, the formula used to compute <i>ibra'</i> and its terms and conditions in relevant legal documentation at the inception of financing, during the recovery process and in connection with court litigations During the inception of the contract, Islamic financial institutions are required to provide customised illustrations comprising the application of the <i>ibra'</i> formula and an indicative payment schedule to enhance customers' understanding on the workings of <i>ibra'</i> 	1 Jul '12
Calculation on <i>ibra'</i>	<ul style="list-style-type: none"> Determination of <i>ibra'</i> shall be based on the prescribed methodology. The amount of <i>ibra'</i> is equal to the unaccrued profit net of early settlement charges 	
Early settlement charge	<ul style="list-style-type: none"> Imposition of early settlement charges is allowed to reflect a reasonable estimate of costs incurred by Islamic financial institutions as a direct result of settlement prior to maturity 	

In the Islamic financial sector, consumer interests are protected with the requirement to grant *ibra'* (rebate) to all customers upon early settlement of sale-based financing contracts such as *murabahah* and *bai' bithaman 'ajil*. The granting of *ibra'* by Islamic financial institutions provides equivalent financial effects as per conventional banking practices in which customers only repay the principal and accrued profits up to the date of early settlement. The Guidelines on *Ibra'* overcome problems previously associated with the discretionary nature of *ibra'*, the lack of clarity on the circumstances for granting *ibra'*, and insufficient disclosures in legal documentation which had resulted in varying outcomes for consumers and a common misconception that Islamic financing is more expensive than a conventional loan where early settlement is made by customers (Table 4.2).

Combating financial scams

The Bank continued to strengthen its efforts to ensure that consumers do not fall prey to fraudulent financial schemes or scams. The proliferation of scams – particularly get-rich-quick schemes, internet investment schemes and fake

lotteries – continues to affect people of all backgrounds, ages and income levels.

As financial scams evolve in form and sophistication over time, it is vital for consumers to remain vigilant and to come forward to the authorities when offered suspicious investment schemes that promise unrealistically high returns with low risks

During the year, 11 illegal schemes which involved breaches of the laws administered by the Bank were investigated, of which one case was successfully prosecuted with jail sentences meted to the accused, two cases have been brought to court for prosecution, three are pending charge,

and investigations on five cases are expected to be completed during the first quarter of 2013. Given that enforcement activities on illegal financial schemes involve numerous enforcement agencies, a White-Collar Crime Taskforce was established in 2012 comprising the Bank, Securities Commission Malaysia, the Companies Commission of Malaysia, the Malaysian Communications and Multimedia Commission, the Royal Malaysia Police, the Ministry of Domestic Trade, Co-operatives and Consumerism, and the Inland Revenue Board. This Taskforce provides a platform for coordinating joint enforcement actions. In October 2012, the Taskforce conducted joint raids and investigations against four companies suspected of conducting illegal financial schemes based on gold trading.

As financial scams evolve in form and sophistication over time, enforcement activities alone are not enough to protect consumers from these fraudulent schemes. It is vital for consumers to remain vigilant and to come forward to the authorities when offered suspicious investment schemes that promise unrealistically high returns with low risks. During the year, significant resources have been directed at generating wide publicity on the dangers of such illegal schemes. In addition to wide mass media coverage, educational materials (including booklets, posters and leaflets) on financial scams entitled *Awas Penipuan Kewangan* have been distributed nationwide through the Bank's LINK and MobileLINK channels and strategic partners. To reach a wider audience, the Bank also utilises social networking platforms, such as Facebook and Twitter, to publish alerts and create interactive discussion forums. Consumers are also advised to refer to the Financial Consumer Alert List available on the Bank's website, which provides information on the modus operandi of different financial scams, as well as the names of companies and websites which are not authorised or approved under the laws administered by the Bank.

Preventing online fraud

In efforts to combat online fraud, banking institutions have implemented strengthened security measures for electronic banking, which include the deployment of customised picture or word verification to authenticate electronic banking users. This is in addition to the use of user identities and passwords, additional authentication mechanisms for high-risk transactions, and more stringent controls on the registration of electronic banking accounts.

Despite persistent electronic banking fraud attempts, actual electronic banking fraud cases have continued to decline dramatically from 4,380 cases in 2010 to 1,992 cases in 2012, reflecting the effectiveness of measures taken. Monetary losses due to electronic banking fraud accounted for only 0.0002% of the RM2.8 trillion worth of online transactions recorded last year. The primary modus operandi of online fraud remained largely unchanged, and mainly involved phishing (the use of fake e-mails or short message services purportedly sent from financial institutions to deceive unsuspecting customers into divulging login credentials and personal details), fraudsters masquerading as persons in authority to direct users to transfer funds to the fraudster, and spoofing (where fraudsters contact users online anonymously and trick them into revealing their account information). These methods are reliant on account holders voluntarily giving their personal information and account details, without which the fraud attempts would not succeed. Hence, in an effort to raise consumer awareness, banking institutions have further increased the visibility of consumer alerts on the modus operandi of online fraud and on the importance of not responding to requests to divulge personal information.

Cohesive supervision of consumer credit activities

The regulatory framework governing the provision of consumer credit in the country remains fragmented given the involvement of multiple authorities in regulating consumer credit activities and the diversity of credit providers in the market, including banks, credit co-operatives and non-bank credit providers. This invariably gives rise to inconsistent expectations and enforcement of fair and responsible financing practices which can increase risks to consumers as elaborated earlier in this Chapter. The Bank sees important benefits to be gained from enacting a consumer credit law that will provide a more comprehensive and consistent framework for regulating consumer credit activities in Malaysia. This should address important protections for consumers in areas that include disclosures, responsible lending, fair debt collection practices, and debt restructuring. With this in view, the Bank will be collaborating with the relevant Ministries and Government agencies towards the enactment of a national credit law. An inter-agency platform will be established to conduct a comprehensive review of the gaps in the existing regulatory regime for credit providers in Malaysia and recommend

appropriate measures for a more cohesive legal framework to address the gaps, including gaps associated with major credit transactions and providers that are currently unregulated.

REGULATION AND SUPERVISION OF INSURANCE AND TAKAFUL INTERMEDIARIES

During the year, the Bank increased its scrutiny of insurance and takaful intermediaries. While agent activities have traditionally been an important focus of market conduct supervisory activities, the Bank's approach to the oversight of the activities of brokers and adjusters, given their limited direct interface with consumers, has generally been to rely more on other controls that have been put in place to protect consumers. These include the requirement for brokers to have adequate professional indemnity protection, proper disclosure of a broker's interests in an insurance or takaful transaction, and a system of checks and balances by insurers over adjusters through the panelling process. Recent developments, in particular the wide-ranging measures being undertaken to reform the motor insurance industry and weaknesses in controls of some insurers over the activities of intermediaries, have necessitated a review of this approach. The Bank's increased scrutiny of insurance intermediaries is also in preparation for changes in the legal regime governing intermediaries under the FSA which will introduce a more flexible regulatory framework for intermediaries commensurate with their risks, but with stronger ongoing supervision and enforcement by the Bank on the conduct of the intermediaries.

During the year, the Bank's regulatory and supervisory priorities for insurance intermediaries were focused on (i) the proper handling of clients' monies by insurance and takaful brokers; (ii) proper handling of introducers' arrangements and fees by insurance and takaful brokers; (iii) the proper submission of third-party property damage claims by loss adjusters (refer to previous section on 'Fair Marketing and Claims Practices in Motor Insurance Sector'); and (iv) strengthening the competencies of staff in the industry. During the year, supervisory actions, including the revocation or non-renewal of licences, were taken against three insurance brokers for various breaches of conduct. Steps were also taken in collaboration with the

Malaysian Insurance Institute (MII), Malaysian Insurance and Takaful Brokers Association (MITBA) and the Association of Malaysian Loss Adjusters (AMLA) to enhance the professional qualification standards for the brokers and loss adjusters and to better support existing professionals in the industry to meet those standards. The Bank also intensified its pre-licensing engagements with insurance and takaful brokers, including on-site reviews for larger intermediaries, prior to the renewal of licences to obtain further assurances of the intermediaries' compliance with the Bank's licensing and regulatory requirements.

COLLABORATION WITH OTHER AGENCIES

The Bank mainly coordinates its market conduct oversight activities with two regulatory authorities, namely the Securities Commission and the Malaysia Competition Commission (MyCC). This ensures that regulatory overlaps are effectively and efficiently managed, and that the authorities are working in a common direction to promote confidence in the financial system. During the year, the Bank together with the Securities Commission strengthened the Guidelines on Investor Protection, which was first issued in 2010 for FSPs carrying out capital market activities under the Capital Markets and Services Act 2007. The enhancements were aimed at providing greater clarity to FSPs on the scope and applicability of the Guidelines and introducing a new professional examination requirement for employees of FSPs who are involved in marketing and selling of structured products and unlisted debt securities. Joint working groups were also established to develop a mutual recognition framework for financial advisers and financial planners, and to improve and rationalise existing mechanisms for handling disputes against FSPs that fall under the remit of both the Financial Mediation Bureau (FMB) and the Securities Industry Dispute Resolution Centre (SIDREC).

The Bank also worked with MyCC during the year to address issues raised by the industry on the effect of the competition law and its supporting requirements on current practices in the financial industry. The Bank will continue to coordinate closely with MyCC on the development of guidance on tied selling and collusive actions in 2013.

WELL-INFORMED AND RESPONSIBLE FINANCIAL CONSUMERS

Financially empowered consumers are essential in exerting market discipline on FSPs, thus contributing towards the development of an efficient and competitive financial sector. There is growing recognition that empowering consumers through financial education is an important complement to market conduct and prudential regulation. In particular, financially literate and alert consumers remain the first line of defence against financial fraud. In this regard, initiatives to better equip consumers with knowledge, skills and tools to build, manage and protect their personal wealth continued to be a key priority of the Bank in 2012. An immediate focus has been to promote financial capability skills from an early age through the incorporation of financial education elements in school curriculum and to roll out financial

capability programmes based on the life event model for adults. As the goals of promoting financial literacy and empowering consumers are common across several agencies in Malaysia, the Bank is leading an initiative to provide a shared platform among the stakeholders to facilitate a more coordinated approach that would increase the reach and effectiveness of existing financial education efforts. Table 4.3 summarises the key achievements for financial education initiatives in 2012.

Encouraging progress was achieved during the year to integrate financial education into the formal school curriculum with the strong support of the Ministry of Education. In this regard, the Bank helped to develop materials and a structure for progressing financial learning outcomes for incorporation into the school curriculum. In the longer term, it is envisaged that financial

Table 4.3

Key Achievements for Financial Education Initiatives in 2012

Strategy	Achievements
Promote financial capability from an early age	<ul style="list-style-type: none"> Integration of key elements on saving and investing, spending, credit and debt management, financial risk management and consumer responsibilities into core school subjects, namely mathematics, languages, commerce and basic economics. Implementation of the new curriculum will be carried out in stages, beginning in 2014 for primary schools (<i>Kurikulum Standard Sekolah Rendah</i>) and in 2017 for secondary schools (<i>Kurikulum Standard Sekolah Menengah</i>) Financial education elements incorporated in year three Bahasa Malaysia and mathematics beginning 2013, ahead of the 2014 targeted implementation date Over 1,200 teachers at the teachers' training institutes completed training on money and debt management as part of the efforts to prepare teachers for the nationwide roll-out of financial education
Targeted financial capability programmes for adults based on significant events at life stages	<ul style="list-style-type: none"> More than 117,000 individuals benefited from the POWER! programme which provided young adults and first-time borrowers practical lessons and tools for effective debt and cash flow management Over 200 seminars conducted by AKPK on personal financial management, reaching out to about 22,000 tertiary students and employees Delivery of a customised financial capability programme for more than 1,500 1AZAM participants to help individuals better manage cash flows and encourage good savings habits. About 120,000 poor households are targeted to be reached through the programme by end-2015
Delivery of timely and useful financial education information	<ul style="list-style-type: none"> 20% increase in visits to <i>insuranceinfo</i> website Dissemination of financial management information and advisory services on financial-related matters through MobileLINK to over 15,000 individuals from rural communities in 45 sub-districts nationwide More than 1 million copies of <i>Buku Wang Saku</i> distributed to students, while <i>duitsaku.com</i> recorded more than 670,000 hits during the year as part of the outreach to children on basic money management skills

education will be fully integrated into the school ecosystem in a way that promotes action learning by students in planning and managing their finances on a day-to-day basis. The Bank has also supported programmes to elevate the level of financial understanding and capability among teachers and equip them with the necessary resources to ensure the effectiveness of financial education in schools.

Empowering consumers through financial education is an important complement to market conduct and prudential regulation

The focus for adult financial education continued to be directed at education for young adults and low-income households given their propensity to borrow and their relatively lower financial buffers. The Credit Counselling and Debt Management Agency (Agensi Kaunseling dan Pengurusan Kredit, AKPK) established by the Bank has put in place a targeted financial education programme to address specific risks and concerns associated with these target groups. The POWER! Programme continued to extend its reach during the year with its incorporation into the National Service Training Programme module and the nationwide roll-out of a customised version of the programme for highly-leveraged, low-income households with significant debt burdens. With an online learning portal introduced in 2011, more individuals will have access to POWER!. Building on the positive public reception to POWER!, the Bank, in collaboration with the Government's Performance Management and Delivery Unit (PEMANDU), implemented a financial capability programme customised for households earning below RM1,000 in October 2012 to complement the Government's poverty alleviation measures under the 1AZAM initiative.

Work also continues to progress on the development of a Financial Education Assessment Framework that measures financial literacy levels of consumers to identify priority areas for financial education interventions, and to assess the effectiveness of existing financial education measures. Building on the work done by the OECD on the financial capability of Malaysian households, the Bank expects to complete the Framework in time to undertake a baseline evaluation in 2014. This will be followed by

periodic assessments to track progress of the level of awareness, knowledge, skill, attitude and behaviour of consumers in making financial decisions. Findings from the assessment will aid the development of future financial literacy strategies to address identified gaps and target segments.

STRENGTHENING AVENUES FOR CONSUMER REDRESS

The number of consumers benefiting from access to financial information and consumer redress mechanisms provided by the Bank continued to increase. LINK received 400,971 enquiries from individuals and businesses in 2012, 25% higher than in 2011. A lower number of complaints (by 15%) was received by the Bank against FSPs during the year. For the banking sector, the complaints were mainly related to rejections of requests to reschedule and restructure loans, disputes over interest calculations and outstanding loan balances, and poor customer service. Meanwhile, for the insurance industry, common issues raised by complainants were in relation to delays in the processing of claims and dissatisfaction with the amount of claims paid. Through engagements between the Bank and FSPs on these issues, it has been apparent that a significant number of complaints received by the Bank were the result of ineffective processes within FSPs for communicating with customers and poorly trained staff who were not able to properly explain and clarify issues raised by customers. This has been highlighted to the FSPs concerned, which have since made improvements to their complaints and claims handling processes and the quality of their customer service resources. During the year, the Bank also continued to assist borrowers affected by abandoned housing projects by facilitating negotiations on revised financing repayment terms and providing support for efforts by financial institutions to revive the abandoned projects. While these efforts have helped affected borrowers to some extent, a holistic approach to address the issue of abandoned housing needs to be undertaken to prevent such problems from recurring in the future.

Since its inception in 2006, AKPK remains a key channel for assisting consumers through the provision of financial counselling and debt management services. To date, AKPK has provided credit counselling to 207,997 consumers, of which 85,994 or 41% received assistance under its debt management programme. During the year,

AKPK counselled 35,825 borrowers, of which 16,137 or 45% were further assisted through AKPK's debt management programme. Individuals falling within the 30- to 40-year-old age group continued to top the list of borrowers under the debt management programme, mainly attributed to poor financial planning.

In its role as the integrated dispute resolution centre for FSPs under the purview of the Bank, FMB handled 4,459 cases during the year, of which 1,919 were new cases. The number of new cases received by FMB declined by 13.6%, suggesting gradual improvements in the internal complaints handling processes of FSPs in resolving customer complaints. Consistent with previous years, insurance-related cases accounted for the largest proportion of complaints at 68.7%, with motor own damage claims contributing the highest number at 25.3% of the total number of disputes referred to FMB during the year.

To further enhance the oversight framework and effectiveness of the arrangements for consumer redress, work is in progress to transform the FMB into a financial ombudsman scheme (FOS) approved under the FSA and IFSA. In ensuring the FOS is fair, accessible and effective, the Bank may prescribe the functions, duties and scope of the scheme including the appointment of directors to strengthen the governance and oversight of the FOS. The scheme will be governed by rules which ensure adherence by members to the terms of membership of the scheme and compliance with the awards granted by the FOS. As part of the transformation, the scope of disputes that can be referred to the FMB will be expanded, along with the ability to determine a range of remedies or awards to consumers that have been treated unfairly. The proposed transformation will also involve a review of the existing membership fee structure to better reflect the utilisation of services of the financial ombudsman scheme by FSPs.