

A CASE FOR CONSUMER CREDIT LAWS IN PAKISTAN

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MASTER OF LAWS (Faculty of Shariah and Law)

By

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3-FSL/LLMCL/F-04

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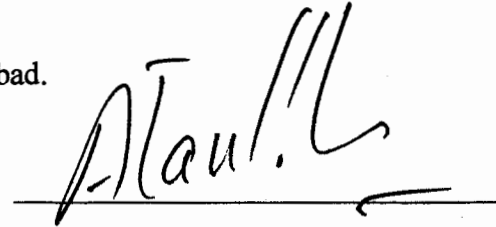
“A Case for Consumer Credit Law in Pakistan”

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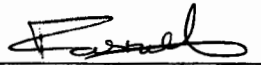
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DECLARATION

I, Farrukh Abbas, hereby declare that this dissertation is original and has never been presented in any other institution. I, moreover, declare that any secondary information used in this dissertation has been duly acknowledged.

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TABLE OF CONTENTS

DEDICATION _____	vii
Chapter 1: INTRODUCTION _____	2
A. What is Consumer Credit? _____	3
B. Rational behind Consumer Credit _____	8
C. Classification of Consumer Credit _____	9
1. Credit Cards _____	9
2. Auto Financing _____	11
3. House Financing _____	12
4. Personal loans _____	13
D. Idea behind Consumer Credit Law _____	14
E. Payday Lending _____	16
F. Fringe Lending _____	17
G. Financial Exclusion _____	18
H. Non Performing Loans _____	19
I. Status of Consumer Credit in Pakistan _____	21
Chapter 2: INTERNATIONAL EXPERIENCE _____	26
A. NewZeland _____	26
B. United States of America _____	28
C. United Kingdom _____	30
D. EU Status _____	33
E. Conclusion. _____	38
Chapter 3: CONSUMER CREDIT IN PAKISTAN _____	40
A. History of Consumer Credit in Pakistan. _____	41
1. Privatization _____	41
2. De-Regulation _____	43
3. Mergers and Acquisitions _____	44
B. Brief Description of Banking Laws _____	44
1. State Bank: _____	44
2. Laws Relating to Banking: _____	45
3. Banking Courts: _____	45
4. Laws Creating Specialized Banks: _____	45
5. Rules: _____	46
C. Sector Analysis and Regulator. _____	47
1. Banks: _____	47
2. Leasing Companies: _____	51
3. NBFIs: _____	53

D. Brief of Each type of Consumer Financing in Pakistan.	54
1. Car Financing.	55
2. Credit Cards.	55
3. Housing Sector	56
4. Personal Loans.	57
Chapter 4: PRUDENTIAL REGULATION ON CONSUMER FINANCING	59
A. Overview of regulation for banking sector & NBFIS	59
1. Credit Cards:	63
2. Auto Loans:	64
3. Housing Loans:	65
4. Personal Loans:	66
B. Banking Mohtasib	67
C. Current Legal and Regulatory Regime	69
D. Pitfalls in present scenario	72
Chapter 5: CONCLUSION	78
A. What should the Law focus on?	78
B. Recommendations	82
BIBLIOGRAPHY	84

LIST OF ABBREVIATIONS

BCO	Banking Companies Ordinance 1962
CIB	Credit Information bureau
EU	European Union
HBFC	House Building Finance Corporation
MAP	Mudarabah Association of Pakistan
NBFI's	Non-Banking Financial Institutions
NBFCs	Non-Banking Finance Companies
PBA	Pakistan-Banks Association
PLS	Profit And Loss Sharing
PR	Prudential Regulation
SBP	State Bank of Pakistan
SECP	Securities and Exchange Commission of Pakistan
SLP	Statutory Liquidity Requirement
CRR	Cash Reserve Ratio
NPL	Non Performing Loan

DEDICATION

I dedicate this thesis to my entire family, especially to my brothers. Thank you all people for your constant encouragement. Also this thesis is dedicated to all of my friends who have been very supportive during my entire educational career.

ABSTRACT

A CASE FOR CONSUMER CREDIT LAWS IN PAKISTAN

By

Farrukh Abbas

Chairperson:

It goes without saying that laws are enacted to protect the society to bring about an orderly and smooth functioning of system. The legislative arrangements are introduced to bring harmony between rights and corresponding liabilities. This in turn ensures a peaceful and properly functioning society. The public at large upon fulfilling their liabilities are entitled to get their rights protected by way of legislative cover. This dissertation is an attempt to highlight the reasons rendering it necessary to have a legal frame work in place for the redressal of hardships and problems being faced by people availing consumer credit facilities offered by the banking system in Pakistan.

The country today has a very vibrant and fast growing banking sector. During the last few years the sector has experienced enormous growth with consumer credit products being the driving engine in it. The favorable economic indicators such as lower budgetary deficit, single digit interest rates and rise in the income of lower and upper middle class has proved to be a catalyst in the boom of the sector. The consumer driven growth has attracted the local and major players in the global economy who have entered into the bustling banking sector. The situation has led to a very competitive environment where every player has lured the developing urban middle class to a luxurious life style, unknown previously, by making money available at affordable rates.

The quantum of the spread in credit can be gauged from the fact that in the FY 2004-05 the lending of the banks grew up to 70% of their total deposits and after providing 25% for SLR&CRR with the SBP, only 5% was left to maintain the cash flows. The cheap credit facilities prompted people to avail themselves of automobiles, mobiles, electronic appliances etc. With the tightening of monetary policy by the SBP to arrest the inflationary pressure in the economy from FY 2006-07 through raising interest rates, the affordability of credit started becoming difficult. The upward movement of interest rates forced the banks to curtail their credit flows thereby making it increasingly difficult to get credit. The rising commodity prices have caused an imbalance in the public income and expenditure thereby making it difficult for people to pay what they owe to the banks. The bleaker prospect of recovery of debts prompted banks to invoke the stiff conditions of the terms of credit which in turn complicated the woes of the lenders. At the time of agreement neither the debtor fully analyzed the capacity of the consumer nor did the later fully realized the consequences of the downturn.

It is worth mentioning that SBP which is the regulator of banking sector couldn't provide respite to the general public because the laws in force do not provide for it to interfere in the internal matters of the banks. The advisory role of the regulator ensured the implementation of liberalized environment vital for banking growth on one side but on the other exposed general public to the whims of different practices being followed by banks. The various hidden charges being levied by banks in the name of service charges, commission and late collection charges necessitate the need for having laws ensuring consumer's right to know the consequences of any transaction he/she makes with the banks.

The gravity of the situation can further be gauged by the fact that the consumers don't have any forum to get their grievances redressed. The advisory role being assigned to the SBP restricts its ability to enforce the various policies being pursued by the banks. Even the promulgation of Prudential Regulations did not provide the protection of consumer rights. The regulations do not have binding conditions regarding foreclosures, the detail of losses write-offs by the boards of the banks, and the issue of hidden charges.

The thesis elaborates the need for a law to address consumer related issues in credit banking. It entails in detail the post and pre-contractual situations wherein the consumer could suffer due to unjustified terms and conditions of the credit contract. The introduction of various forms of credit available for various classes is given for ease of understanding the credit base, in the first chapter. A brief analysis of consumer credit laws in place in New Zealand, UK, USA and EU Zone is done in second chapter. An overview of present day Pakistan's banking sector is made with the view to classify the creditor in the third chapter. A thorough analysis of the Prudential Regulation on Consumer Financing and their status is made to identify the grey areas requiring attention in the fourth chapter. Lastly an attempt is being made to suggest various measures for the resolution of the issue. Keeping in view the modern banking practices being followed in developed countries and ensuring transparency and protection of the rights of the people availing themselves the various facilities offered by banks, it would be in the interest of justice to introduce such measures for domestic banking sector as well.

Chapter 1: INTRODUCTION

Consumer Credit products are an addition to products list introduced by banking sector in Pakistan. Two decades ago there was no concept of credit or lending to the consumers. Internationally these consumer credit transactions were popular much before that and it is noticeable that developed countries introduced legislation even before that. United States of America was the first to introduce consumer credit legislation in 1968 followed by the United Kingdom in the shape of Consumer Credit Act of 1974. The concept of consumer credit was first introduced via credit cards in Pakistan in year 1985 and afterwards such consumer credit transaction became popular in years following 2001 and people were encouraged to avails those products due to competition amongst the sector players. There is no comprehensive legislation in this area but there are prudential regulations issued by the State Bank of Pakistan, which are of suggestive nature, and they only address the banks on how to formulate their consumer credit transaction approval policy, but are silent as to consumer problems and their solutions.

If coupled with sound financial planning, consumer credit can greatly improve the living standards of poor and middle classes. There are different generic products, and although named differently, fall into one of the following types; credit cards, personal loan, vehicle financing, and home leasing. This thesis is primarily intended to help create a better understanding and to create awareness about consumer credit transactions and to suggest some issues which require legislation, following which the banks can enter into the consumer credit business without having a negative impact on society. With the Hidden fees,

penalties and unfair actions against consumers, banks have become far less consumer friendly. The thesis intends to elaborate the pitfalls and suggest the remedies to avoid those. This thesis also analyzes the practices being followed and those that are suggested by the Prudential Regulation and to what extent have they been successful in achieving their goals in terms of public-policy implications.

The main purpose of study in this chapter is to explain what is consumer credit; distinguish consumer credit for other forms of credit. Further consumer credit is divided into four classification based on its utilization in order to facilitate the reader's understanding of credit and its usage. The usage of credit is a distinguishing factor in deciding whether the credit come under consumer credit or not and if so, what class it falls under.

A. What is Consumer Credit?

The term consumer credit refers to credit facility provided to the individual customers. The word has not been defined in any legal document so far. In order to better understand the term and its usage, we will consider "consumer" and "credit" as different words and will try to explain them separately in order to have better understanding of consumer credit transaction.

Consumer:

In Pakistan different definitions are used for consumer in different laws.

"The Punjab Consumer Protection Act 2005" define consumer as follow:-

"Consumer" means a person or entity who-

- (i) Buys or obtains on leases any product for a consideration and includes any user of such product but does not include a person who obtains any product for resale or for any commercial purpose; or
- (ii) Hires any services for a consideration and includes any beneficiary of such services.

Explanation:- For the purpose of sub-clause (i), “commercial purpose” does not include use by a consumer of products bought and used by him only for the purpose of his livelihood as a self employed person.¹

The definition under Islamabad Consumer Protection Act, 1995 is as follow:-

“Consumer” means any person who:

- a. Buys goods for a consideration which has been paid or partly paid and partly promised to be paid or under any system of deferred payment or hire purchase and includes any user of such goods, but does not include a person who obtains such goods for re-sale or for any commercial purpose; or
- b. Hires any goods or services for a consideration, which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes beneficiary of such services.²

¹ The Punjab Consumer Protection Act, 2005, Sec. 2(c).

² Islamabad Consumer Protection Act, 1995, Sec. 2(3).

Generally speaking all persons are consumer regardless of goods or services required, but the only condition is that the goods or services should be for personal use and not for resale or manufacture or business usage.

Credit:

Credit as a financial term, refers to the grant of a loan and the creation of debt. Credit in commercial trade is used to refer to the approval for delayed payments for goods purchased.³ Credit can also be defined as an amount of money being borrowed. It can be cash loan, credit sale or use of credit card. All of these fall under the definition of credit. Technically it is an agreement in which one party receives its part of the consideration and the other party shall receive consideration as per terms on contract after the passage of a stipulated period of time.

Another definition of credit is a contractual agreement, in which a borrower receives something of value now and agrees to repay the lender at some later date.⁴ Broadly therefore, credit is a deferred payment facility.

Consumer Credit:

Consumer Credit is deferred payment facility to be availed by the consumer for personal use. Every person is a consumer and whenever he uses credit in personal capacity

³ General Definition given on Wikipedia, Retrieved May 21, 2009, online from [http://en.wikipedia.org/wiki/Credit_\(finance\)](http://en.wikipedia.org/wiki/Credit_(finance)).

⁴ Debt Assessment Scheme, Govt. of Scotland definition of credit, Retrieved online May 21, 2009, from http://www.moneyscotland.gov.uk/das/das_display.jsp;jsessionid=5A09AFBCD48F5896889A821CDFE83A1F?pContentID=102&p_applic=CCC&p_service=Content.show&#c1.

irrespective of the form of credit, it will be consumer credit. Encyclopedia Britannica defines consumer credit as “short and intermediate term loans used to finance the purchase of commodities or services for personal consumption or to refinance debts incurred for such purpose.”⁵

The Webster dictionary defines consumer credit as credit that is granted to an individual especially to finance the purchase of consumer goods or defray personal or family expenses and is usually repaid in installments.⁶

The Prudential Regulations (PR) define consumer credit as follow:

“Consumer Financing means any financing allowed to individuals for meeting their personal, family or household needs. The facilities categorized as Consumer Financing are given as under:

(i) Credit Cards mean cards which allow a customer to make payments on credit. Supplementary credit cards shall be considered part of the principal borrowed for the purposes of these regulations. Corporate Cards will not fall under this category and shall be regulated by Prudential Regulations for Corporate / Commercial Banking or Prudential Regulations for SME’s Financing as the case may be. The regulations for credit cards shall also be applicable on charge cards, debit cards, stored value cards and BTF (Balance Transfer Facility).

⁵ Consumer Credit. (2009). In Encyclopedia Britannica. Retrieved May 21, 2009, from Encyclopedia Britannica Online: <http://www.britannica.com/EBchecked/topic/134539/consumer-credit>

⁶ Consumer Credit. (2009). In Merriam-Webster Online Dictionary. Retrieved May 21, 2009, from [http://www.merriam-webster.com/dictionary/consumer credit](http://www.merriam-webster.com/dictionary/consumer%20credit)

(ii) Auto Loans mean the loans to purchase the vehicle for personal use.

(iii) Housing Finance means loan provided to individuals for the purchase of residential house / apartment / land. The loans availed for the purpose of making improvements in house / apartment / land shall also fall under this category.

(iv) Personal Loans mean the loans to individuals for the payment of goods, services and expenses and include Running Finance / Revolving Credit to individuals.”⁷

It is very difficult to differentiate consumer credit from other types of credit transactions but if any credit transaction fulfills the following condition, it is a consumer credit transaction.

1. Short term loan
2. To finance goods or services
3. For personal use only

Formulation of Consumer Credit Transaction:

The phases involved in a consumer credit transaction differ from those of corporate financing. The consumer credit transaction can be divided into five phases⁸.

1. pre- negotiating phase.
2. negotiating phase

⁷ State Bank of Pakistan, Banking Policy Department, Prudential Regulations For Consumer Financing. Part A: Definitions. Page 5.

⁸ Barbara A Curran, Trends in Consumer Credit Legislation, (University of Chicago Press, 1965).

3. formalizing phase
4. performing phase
5. terminating phase

In consumer credit transaction the transaction begins with pre-negotiating phase, in this phase a generic product is designed for the all consumers and launched whereas in case of corporate financing the credit transaction can be designed for a specific corporate entity after negotiation.

B. Rational behind Consumer Credit

In past, it has been a practice that people used to carry money with them for their personal expenditures. Such activities were called cash and carry transaction but things have gradually changed and for one reason or other, the trend of carrying money for shopping is gradually diminishing. Now a new dimension in purchasing has emerged whereby you buy a thing now and pay for it latter. In past, in Pakistan only home financing transaction were available as an example of consumer credit, but with time things changed and now more and more transaction are done on revolving credit basis. The total consumer credit in Jun 2004 was 103,752.9 millions rupees which grew to 208,911.9 million in Jun 2005 rupees and in Jun 2007, total consumer credit was 345,584.2 million rupees⁹. People go for shopping or dinning but the credit allows them to pay for such expenses after a reasonable duration of time, thus giving them a degree of flexibility in managing their resources. Some examples of

⁹ State Bank of Pakistan, Statistical Bulletin- February 2008, Retrieved May 21, 2009, from http://www.sbp.org.pk/reports/stat_reviews/Bulletin/2008/Feb_08/Banking_system.pdf, P. 57 & 61.

such transaction are that people will purchase a product but they will pay later. Likewise, for personal spending people take loans which are easy to secure but they are to be paid in instalments and in the same manner the petrol to be consumed will be paid in next bill of credit card without any extra charges. The consumer credit enables consumers to afford better standards of living by providing flexibility in money matters.

Generally, the middle class tends to use more credit transactions than the richer ones. Their longing for a better life tends to involve them in credit transactions which otherwise are not possible for them.

The banks prefer consumer loans for their propensity of higher interest rates, small value of consumer loans with low risk involved and short period as compared to risky corporate loans.

C. Classification of Consumer Credit

“The facilities categorized as Consumer Financing are given as under:¹⁰

- (i) Credit Cards
- (ii) Auto Financing.
- (iii) Housing Finance
- (iv) Personal Loans

1. Credit Cards

¹⁰ State Bank of Pakistan, Banking Policy Department, Prudential Regulations For Consumer Financing. Part A: Definitions, Page 5.

Credit cards transactions are gradually replacing cash transaction and also referred as plastic money due to more and more usage. Credit cards have become a most convenient means to get services and goods and even cash can be withdrawn using credit cards. Credit cards have replaced cash and are globally accepted currency. The increasing use of credit cards is due to the convenience of avoiding cash carrying bundled with credit facility which means that while the consumer is spending now, actual expense will be incurred after a month when consumer has to pay his Credit Card bill. Credit card is plastic cards issued by banks, having card holder's name, signature and account numbers, and such cards can be used repeatedly.

Credit card is defined in the Blacks Laws Dictionary (sixth edition) as "Any card, plate, or other like credit device existing for the purposes of obtaining money, property, labor or service on card. The term does not include a note, cheque, draft, money order or other things like negotiable instrument. Federal and often State statutes regulate the issuance and use of credit cards".¹¹

The definition of Credit Cards given by PR is as follow:

"Credit Cards mean cards which allow a customer to make payments on credit. Supplementary credit cards shall be considered part of the principal borrower for the purposes of these regulations. Corporate Cards will not fall under this category and shall be ({} regulated by Prudential Regulations for Corporate / Commercial Banking or Prudential Regulations for SMEs Financing as the case may be. The regulations for credit cards shall

¹¹ Blacks Laws Dictionary (sixth edition)

also be applicable on charge cards, debit cards, stored value cards and BTF (Balance Transfer Facility).”¹²

In order to get cards worldwide acceptance the Credit Cards are issued by bank under licence from large organization like Visa, MasterCard, American Express and Diners Club. The card is issued by banks with a certain limit set, and organizations like “Visa” conduct clearing and settlement of Credit Cards transaction. . Upon becoming a member of Organization like “Visa”, banks are issued a license using which bank can issue cards to its account holder.

In credit cards there is an agreement between holder, card issuer and the issuing bank. A credit card being issued is an indication for the person where cards is used that the issuer of the card will make sure that the amount used by consumer is paid by issuing bank. The transaction process goes like this; the customer purchases goods or services from the merchant. The merchant transmits the transaction to the acquirer, who submits the ticket electronically to the issuer for payment via clearing. The acquirer credits the merchant for deposits. The issuer bills the customer.

2. Auto Financing

Arrangements which are made to get a vehicle in which more cost is to be borne by the bank is termed as Auto financing or car financing. Auto financing is defined in PR as

¹² State Bank of Pakistan, Banking Policy Department, Prudential Regulations For Consumer Financing. Part A: Definitions, Page 5.

“the loans to purchase the vehicle for personal use.”¹³ Whenever the type of vehicle, if secured for personal use without any commercial usage, it will be termed as Auto Financing.

Auto financing is responsible for introducing consumer credit to the masses because although Credit Cards were in use before auto financing, only a limited number of people were using Credit Cards whereas auto financing products became famous in middle class and poor people which has led to the banking sector boom. The bank pays for the vehicle and such payment can be under leasing or financing, but the transaction comes under the definition of Consumer Credit in both instances. The only difference between the leasing and financing is that in financing, consumer gets ownership of the vehicle but such vehicle is secured by way of hypothecation or charge, whereas in leasing, ownership of the vehicle remains with the creditor throughout and after the term of the lease is completed then the vehicle is transferred on name of lessee. Hypothecation is a way by which the vehicle is used as security for the car loan in which possession is with the consumer.

3. House Financing

House financing is a loan against which a property to be used for residential purpose is acquired. House financing can be for both land and structure or only structure. House financing can also be for the purpose of construction of building, a new structure, or for renovation. The PR defines House Financing as “loan provided to individuals for the

¹³ State Bank of Pakistan, Banking Policy Department, Prudential Regulations For Consumer Financing. Part A: Definitions, Page 5.

purchase of residential house / apartment / land. The loans availed for the purpose of making improvements in house / apartment / land shall also fall under this category.”¹⁴

House financing is a long-term loan as compared to other types of consumer financing and can extend up to 15 years. The House financing loans is secured by way of mortgage on property. Mortgage is a contract in which the lender is given assurance that the consumer will re-pay the amount secured as credit, otherwise the title will pass on to the mortgagor.

4. Personal loans

Personal loans are short or medium term credit arrangements which are secured in the form of cash or to pay for services, goods or consumer items. Personal loans are short term consumer credit agreements and the credit which is given is not considerate as compared to other types of consumer credit transaction. The PR defines personal loans as follow:

“Personal Loans mean the loans to individuals for the payment of goods, services and expenses and include Running Finance / Revolving Credit to individuals.”¹⁵

The terms and conditions of a personal loan, amongst other basic details refer to the purpose for which the loan is to be utilized. Personal loans can either be secured or unsecured. Secured loans are against fixed deposits, shares and property and have low interest rates. It is granted to individuals depending upon their borrowing history, current cash flows whereas in case of unsecured personal loans there are no such surety arrangements. There is risk in unsecured personal loans for bank, because in case of inability

¹⁴ State Bank of Pakistan, Banking Policy Department, Prudential Regulations For Consumer Financing. Part A: Definitions, Page 5.

¹⁵ State Bank of Pakistan, Banking Policy Department, Prudential Regulations For Consumer Financing. Part A: Definitions, Page 5.

to pay back the loan due to bankruptcy or death or reasons of job or business losses, there is no other course left to bank other than to write off personal loans. The person loan can be secured by way of mortgage, pledge, hypothecation, and lien.

Due to the aforesaid reasons, unsecured personal loans usually carry higher interest rates and they are short term as compared to secured personal loans. The consumer is at ease in unsecured personal loans because they are easy to get, in some cases it only takes a day.

D. Idea behind Consumer Credit Law

In Pakistan there has been a fundamental change in the financial system. Although there existed informal credit institutions in pre-partition India, subsequently the banking institutions have gained control over the financial sector especially the credit side. After 1990 the banking sector has gone through comprehensive privatisation process and there seems to be a need for a mechanism to control the changing conditions and forms of consumer credit. A Consumer credit transaction is basically a contract and like any other contract it creates right and liabilities for both parties to the contract i.e., consumer and creditor. Whenever there is a service provided to the consumer, some sort of regulation and protection must be there so that the creditor involved does not exploit the public at large. The regulation and legislation will provide better information to the consumer about the terms of the contract and facilities which they can avail and there will be fewer chances for the consumer to be misled and exploited by the oppressive conduct of the creditors.

The idea of consumer credit laws is a relatively new field of law. Consumer Credit law defines right of both creditor and consumer in any given case. After the advent of plastic money in last century, the governing law in Pakistan regarding consumer credit has been statutory laws dealing with contract, negotiable instruments and bankruptcy. There has been no specific law on this issue and this means that the rights and liabilities of both the lender and the consumer are not demarcated. If somebody has a vague idea about his right and liabilities, he is not sure where he stands and rights are bound to be violated in such a situation, and the law therefore needs to ensure protection of such rights. The prudential regulations were the first step involved, and further on there seems to be a need of a law for the safety and soundness of the consumer credit sector besides protecting the interests of users of financial services. As far as the PR on consumer financing are concerned they are not formulated in a comprehensive way covering all the aspect of consumer credit as they are formulated by a banking institution not involving any second party. This is a major flaw since the regulations have been framed without consultation with the most important second party, i.e. the representatives of the consumers.

The main thrust of consumer credit laws should be to protect consumers and also to promote a fair and accessible credit industry in a given market economy, ensure safe consumer credit products and increase access to justice. This is to be achieved through protection against unfair practices like high and un-managed interest rates, discrimination by creditor, unfair credit terms, deceptive terms and lack of disclosure of terms, and unfair and unmanaged debt collection mechanism.

E. Payday Lending

Payday lending generally is a source of finance for the consumer with low income. In a payday lending transaction the consumer is bound to pay back credit on the day of pay with interest or finance fee. The payday lending facilities are availed mostly by those consumers who are unable to get bank credit for a short duration in quick time. The payday lenders give a small cash loan and in exchange the consumer hands over a post dated cheque of original amount plus interest amount, and these are to be encashed upon a stipulated time. Different definitions are forwarded for payday lending but the most and simple and comprehensive is as follows:-

“Payday loan” means a supervised loan or other credit transaction in which a Cash advance is made to a consumer in exchange for the consumer’s personal cheque, or in exchange for the consumer’s authorization to debit the consumer’s deposit account, and where the parties agree either that the cheque will not be cashed or deposited, or that the consumer’s deposit account will not be debited, until a designated future date.¹⁶

Payday lending has been discouraged as it is a form of informal credit. Some countries even have special legislations to stop Payday loans as they are expensive loans with very high interest rate and failure of the consumer to pay back leads to debt trap as such loans are repeatedly rolled over. “Payday lending has become controversial because of concerns that the loans are expensive; that the structure of the product—a short term loan with a balloon payment and high fees—leads to defaults or borrowers falling into a “debt

¹⁶ Deferred Deposit Loan Act 2005, People States of Maine, USA, Section 6185(3), Chapter 80-B.

trap” as they repeatedly “roll over” the loan; and that payday lenders use misleading disclosures and aggressive collection”.¹⁷

Despite the fact that the cost is great, Payday lending business still exists and this is due to the fact they are loans with simple calculation procedures, easy to secure and less complicated as compared to formal consumer credit transaction. Such credit transactions are popular as small cash loans are available in a short time to consumers.

F. Fringe Lending

Fringe Credit is offered to consumer by those informal institutions of credit like, banks, leasing companies and Non-Banking Financial Institutions (NBFI) and the following description may better explain fringe lending. “*The fringe market* includes the products and services offered by businesses that are not considered to be mainstream institutions. Products and services are offered on profit basis, but often at a higher cost and/or more onerous terms than those offered by mainstream market. The products in this market can also be more specialized and flexible, and include small, short-term loans, payday loans, rent-to-own arrangements, and other products.”¹⁸

Fringe lending is attractive because it offers following features:

- Getting loan is effortless
- Speedy processing

¹⁷ Michael S. Barr, Banking the Poor; University of Michigan Law School, Retrieved May 21, 2009, from <http://law.bepress.com/umichlwps/olin/art49>, p 31.

¹⁸ Nicola Howell, High Cost Loans: A Case for Setting Maximum Rates? p 9

- Anyone can get loan irrespective of the purpose of utilization
- Less paperwork in securing loans

The people who are unable to borrow from banks and or other institutions chose fringe lenders. This inability can be due to different reasons such as absence of security for the loan, or good credit history, and regular source of income.

G. Financial Exclusion

Non availability of credit for certain class of people due to any external factor constitutes financial exclusion. The external factor may be due to their economic standings or their geographic location and failure to provide consumer credit. Financial Exclusion leads consumers to non conventional form of banking and credit which may be more costly in terms of interest, have un-regulated commission, and such unconventional credit schemes are, mostly exploitative.

Two important phenomenon which constitute Financial Exclusion are

- Availability of credit
- Practices of lenders.

If any of the above is negative, it will result in financial Exclusion. In simple words Article 38 of the Constitution of Pakistan 1973 provides that the state shall secure the well being of the people, irrespective of sex, caste, creed or race. The article ensures that there shall be no discretion on social grounds. Refusing to provide credit services based on any factor to any specific class of people tantamount to the violation of the article.

Financial Inclusion as a term stands for everybody who can open a simple bank account with all basic facilities and practically the financial inclusion is to be achieved through banking industry and not through direct government intervention where as financial exclusion is a term related to credit transaction. Consumer credit laws deals with financial exclusion to promote access to fair and affordable credit products which are governed by a law which is more secure and provides cost effective solutions for the consumer.

H. Non Performing Loans

Non-Performing loans are defined as a loan (including principal amount and accrued interest) which remains unpaid for duration of more than 90 days. In past, the non-performing loan ratio has been very high which was brought down using different ways, including writing off bad credit agreements. In past there have been cases in banking history where people disappeared after securing credit from banks. The situation arises due to the lack of proper documentation. In Pakistan, non-performing loans have a long history. If one looks at the history of consumer credit in Pakistan, the Yellow Cab Scheme comes across as a case where there were very high default rates. The political involvement and the operational irregularities on part of the banks were the main reasons, which resulted in NPL's.

The largest number of default cases in consumer credit are taking place in credit cards, and this is mainly due to high interest rates coupled with variety of charges levied by the banking sector like annual fees, processing fee, collection charges, late payment charges, over limit fee, transaction charges etc. The interest rates are high and the bank charges

accrue monthly whereas the principal remains unpaid. This ultimately results in consumer default. It is thought that the interest rates are high due to the risks involved in lending, as the credit card facility is given to the consumer based on consumer's personal surety looking at the consumer's personal credit history. The risk in credit card is more from the lender prospective as there is no re-course available to the creditor in case of default of credit cards. Incase of default of car financing, the bank has right of lien where as incase of home loans, there is mortgage in which summary remedy is available to bank as they can go the banking court under the Financial Institution (Recovery of Finances) Ordinance, 2001 whereas no such proceedings can be commenced for credit cards.

The analysis of the data as at on March 31st 2008 reveals that the non performing loans of banking sector were 231,423 millions as compared to 216,447 on 31st December 2007, an increase of 7%.¹⁹ The data includes all the financing activities like corporate financing and S.M.E. financing.

20

¹⁹ State Bank of Pakistan, Non Performing Loans, Based on data submitted to SBP by Banks and DFI's Retrieved April 15, 2009, from <http://www.sbp.org.pk/ecodata/NPL.pdf>

²⁰ State Bank of Pakistan, Non Performing Loans, Based on data submitted to SBP by Banks and DFI's Retrieved April 15, 2009 from <http://www.sbp.org.pk/Ecodata/NPL.pdf>

NON-PERFORMING LOANS

(Domestic and Overseas Operations)

(Rs. in million)

BANKS/DFIs	As of 31-03-2008			As of 30-06-2008		
	NPLs	NET NPLs	NET NPLs TO NET LOANS (%)	NPLs	NET NPLs	NET NPLs TO NET LOANS (%)
All Banks & DFIs	239,565	37,803	1.25	250,594	35,306	1.20
All Banks	231,432	36,195	1.18	241,334	33,336	1.14
All Commercial Banks	199,200	25,561	0.83	212,365	25,782	0.91
Public Sector Banks	52,588	6,588	0.97	57,396	8,255	1.55
Local Private Banks	145,041	19,620	0.87	153,372	18,068	0.81
Foreign Banks	1,572	(647)	-0.86	1,597	(540)	(0.59)
Specialized Banks	32,232	10,634	13.84	28,969	7,554	9.95
DFIs	8,133	1608	6.62	9,259	1,969	5.57

I. Status of Consumer Credit in Pakistan

Consumer Credit is a new term for most of the people; hence the understanding of situation arising out of a consumer credit transaction is not as it should be. The public at large is suffering due to the lack of understanding of the issues involved and regulation of the consumer credit. Consumer Credit is an issue that concerns a large majority of people in society i.e. poor and middle class, as the upper class do not need to turn to consumer credit to fulfill their daily needs. The upper class enters into consumer credit transaction as a part of luxury whereas the middle and lower class enter into consumer credit transactions due to necessity. It would therefore be correct to assume that to ignore the issue of legislation for regulation of consumer credit will be to the detriment of the majority of people in the country.

The story of a common man from Karachi, Muhammad Tufail, who belonged to New Karachi Police Station area came to prominence recently, with coverage by all major media

outlets. The story brought to fore the urgent need for legislation to ensure consumer protection. Muhammad Tufail, aged 27 was in Liquid Petroleum Gas Business. He secured personal loan from Muslim Commercial Bank. He was faced with financial losses in his business and consequently failed to pay installments of his personal loan. The recovery staff of MCB got into action due to delay in payment of installment. They visited his home frequently and also directly contacted him on his phone. Tufail was threatened time and again. On 27th April, 2008 the recovery staff of MCB, on Sunday visited the house of Tufail. Although, it was Sunday, but the recovery staff was taking the recovery matter as a personal issue and visited a client on a public holiday. The again threatened Tufail and after the recovery staff had left, the poor man committed suicide due to continuous pressure and humiliation he had to face at the hands of the recovery staff in front of his family member and neighborhood. If, Tufail was aware of the concept of un-secured personal loans, he might not have committed suicide. It can be rightly said that the absence of law and lack of a specific procedure for recovery of unsecured personal loans were factors which contributed to the death of a common man.

Legal understanding of the Consumer Credit in Pakistan can be judged from a recent judgment of the Lahore High Court. In the instant case, consumer got a car on lease from a bank and failed to pay four installments. Due to default of four installments, the car was confiscated by the bank. The consumer filed a Writ Petition in L.H.C. as there seemed to be no suitable alternate remedy available. Whereas the bank claimed in reply that for confiscation of vehicle, an alternate remedy is available to the consumer which is by way of filing a civil suit. The bank also claimed that the high Court has no jurisdiction to deal with

the matter as no right has been infringed, the controversy is factual in the case as the matter is not only payment of some installments. The creditor was at wrong and it had no defense to its action other than that on technical grounds, so the creditor tried to bring technicalities of law in action to deprive the consumer of its lawful rights. The learned Judge Khawaja Muhammad Sharif arrived at the following conclusion:

“As far as filling of suit before the learned Banking Court in concerned, it would take years and years and the car, which has been taken into custody by the respondents, would be damaged. The petitioner is ready to pay outstanding installments to the Bank. No factual controversy is involved in the case, therefore, the petitioner is directed to pay four outstanding installments to the Bank within two days and the Bank thereafter would release the car forthwith to the petitioner. It is made clear that in case in future any default is made in payment of installments by the petitioner, the Bank has a right to confiscate the car”²¹.

Although the consumer got relief in the above mentioned case as if was felt by the court that some wrong was committed by the bank but more could have been done in the above case to protect the rights of the consumer, if the petitioner and the legal community was aware of the rights available to them under any regime where there are consumer credit laws.

In another case, the learned Judge arrived on a conclusion in which he specifically expressed need for legislation on the subject. It was also directed by the His Lordships that until, new laws are passed, the State Bank of Pakistan should give more comprehensive

²¹ 2007 CLD 1352 [Lahore] SHAUKAT ALI Versus STATE BANK OF PAKISTAN and 2others, Writ Petition No.5693 of 2007

regulations so that the right and liabilities of the parties to a consumer credit transaction may be regulated. The facts giving rise to issue in controversy was that the consumer contended breach of contract by the bank and the consumer filed suit for damages and compensation. The consumer got a Credit Card from Union Bank. The card was said to be acceptable worldwide but when the consumer traveled abroad, the card was not accepted. The bank claimed that consumer or their bank agent i.e. Union Bank of Pakistan didn't pay the renewal charges in time. It was held that if the card was valid then the bank was liable to pay the damages however in the instant case, the card is not valid as renewal charges are not paid. Statement showed that the renewal fee was claimed in April but it was not paid in time, therefore performance cannot be claimed as reciprocal obligation of paying renewal fee in time is not fulfilled. The appeal was disallowed based on the principle that when a person himself failed to perform his part of the obligation, he could not compel reciprocating party to discharge its part of duty, however the following statement elaborated the need for consumer credit legislation.

“Controversies arising out of blockage, freezing, misuse, excessive billing, over charging, dishonoring of cards are but few instances that are subject matter of litigation worldwide and Pakistan is no exception. There is no reason why damages or injury that may arise out of breach of agreement to honor the card may not be considered as naturally arising according to the usual course of things from the breach of contract and thus could be recoverable in the ordinary circumstances. Likewise, a party to contract of credit card may also recover special damages provided a case is made out. Special damages are awarded in

cases, as may reasonably be supposed to have been in contemplation of both parties at the time of contract. Burden is on the person alleging loss, damages or injury.

Unlike other countries (Consumer Credit Act, 1974. in United Kingdom) relationship, between the card holder, card issuer and the retailer of service or goods is not yet formally regulated in Pakistan under any statute. However, the State Bank of Pakistan has issued Prudential Regulations for Consumer Financing (2003). Regulations 0-1 to 0-5 and Regulations R-7 to R-8, deal with credit card. The embryonic Prudential Regulations hardly provides a sufficient matrix to deal with complex situation that may arise out of issuance and use and dishonour of such cards, it is high time to legislate on the subject. Until legislation is made, State Bank may at least consider framing more comprehensive regulations regulating rights and obligations inter se the card holders, issuers and goods or service providers.”²²

²² 2007 C L D 1022 [Karachi] AZIZULLAH SHAIKH, BAR AT LAW and another Versus UNION BANK LIMITED, Spl. H.C.A. No.92 of 2006

Chapter 2: INTERNATIONAL EXPERIENCE

Consumer Credit legislation is not a novel idea as evidence by the first consumer credit legislation, the Consumer Credit Protection Act of United States of America which is almost half century old and its has been modified from time to time with the advancement in credit products. As Pakistan is a Common law country, this chapter will give brief description of Consumer Credit law of some other Common law countries like New Zealand, UK and USA, followed by a description of EU directives on Consumer Credit, as they are of suggestive nature and are meant to harmonize EU member states Consumer Credit law.

A. NewZeland

The first legislations on consumer credit in NewZeland was the Money Lenders Act of 1931 which was replaced by the Credit Contract Act of 1981. The Act of 1981 had, among other things, dealt with disclosure and reopening of contract. The creditors were under disclosure obligation to give calculation details. Courts had the power to re-open contract which seemed to be oppressive and edit the contract. The Act also empowered the courts to impose penalties on the creditors. The Credit Contract Act of 1981 was repealed by the Credit Contract and Consumer Finance Act of 2003²³. The Act was passed in October 2003 and it came into force from 1st April 2005, and it set out new rules for credit transaction. The purpose as given in section 3 of the new Act is to improve the level of protection of consumers as previous law Credit Contract. Act of 1981 was disregarded by

²³ New Zealand Legislation website, Retrieved May 21, 2009 from <http://www.legislation.govt.nz/act/public/2003/0052/latest/DLM211512.html>

creditors because it didn't provided any means to redress consumer problems and the disclosure of financial obligation laid in the Act was not sufficient.

The Credit Contract and Consumer Finance Act of 2003 improved regulation of disclosure of information, interest rate determination method and its payment. The credit fee and charges are also fixed in the law. Section 17 of the Act deals with disclosure and it is stated that the creditor must disclose all information to consumer. The information includes giving a right of recession, interest rate and applicable fee and charges. Such disclosure is required to be made before entering contract or within 5 days of contract being made. The failure to disclose key information is a criminal offence. Section 51 and 52 deals with early repayment and consumer are given a rebate even in the insurance premium in case of early repayment. The Act also gives a period of 3 days as cooling off period.

The law facilitates the consumer and in case of unforeseen hardships, the consumer credit contract can be changed. Likewise in case of a contract giving unfair advantage to the creditor, it can be called in question at any latter stage under the oppression provision. Section 98 deals with operative contracts and their reopening. The Act contains a hardship provision in which a consumer who is facing difficulties to meet his obligations under a consumer credit transaction may request for change in credit contract. In case the creditor fails to change the contract, the consumer is given the right to go to court and get the contract modified.

The Commerce Commission was given the role of enforcing compliance with the Act. The main responsibilities of the Commission include monitoring credit market,

consumer guidance and ensuring compliance with the Act. The oppressive contract reopening is also regulated and enforced by Commerce Commission.

B. United States of America

Consumer Credit is regulated by both Federal and State law in USA. The Consumer Credit Protection Act is federal law. States have their own laws dealing with Consumer Credit transactions. There has been an effort to harmonize the consumer credit laws of all the states in Uniform Consumer Credit Code. It has been adopted by nine states so far and other states have laws similar to it.

The first law introduced generally to control the interest rates was The Small Loan Laws 1916. The United States Code is the collection of all the laws. The Title 15 of the code and chapter 41²⁴ dealt with the Consumer Credit Protection in USA. The Sub-chapter 1, which is Consumer Credit Cost Disclosure, lays down the substantive laws in details. The main legislation which constitutes the Consumer Credit laws of USA is as follows;

Consumer Credit Protection Act 1968

The Consumer Credit Protection Act of 1968 is a bundle of legislation in which the main law is Truth in Lending Act.

Truth in Lending Act

²⁴ United States Code title 15, Law Revision Counsel, Retrieved May 21, 2009, from <http://uscode.house.gov/download/pls/15C41.txt>

TH-6364.

The law United States Truth in Lending Act was the first special law for consumer credit which came into force on July 1st 1969. All the other consumer credit laws in different countries have derived their basics from the Truth in Lending act. The Truth in lending Act is applicable to all types of consumer credit transactions and it grants new rights to the consumers in obtaining credit and regarding credit cost information. It makes incumbent upon the creditors to make detailed disclosure about the credit and its direct and indirect costs in written form. The law gave a Standard method for calculating and disclosing the finance charges. The law gave a cooling off period of three days to the consumer in case the credit transaction-relates to a security involving consumer residence. The law mentions penalties against creditor for different type of breaches.

Fair Credit Billing Act.

The Fair Credit Billing Act amended the Truth in Lending Act and it imposed some conditions on the creditors regarding billing. This Act dealt with correction in billing. This Act introduced the length of billing period in credit statement for imposition of charges to be 14 days. Further more, it imposed a duty on creditor to promptly credit off payments received from the consumer.

Consumer Leasing Act.

The Consumer Credit Leasing Act required the creditor to disclose certain information to the consumer mentioning the description of lease subject, amount to be paid at inception, the amount to be paid as office fees and title fees or transfer fees, the amount,

number, and due dates of payment under the credit transaction, and the total number of such payments. All these disclosures are required to be mentioned in the written lease contract to be signed by the consumer.

C. United Kingdom

The Consumer Credit Act of 1974²⁵ regulates the consumer credit transaction in the United Kingdom. The Act deals comprehensively with form of the agreement and its content, rules relating to unfair advantage to creditor, advertising of credit products, default procedure, termination of credit and early settlement of credit contract. The Consumer Credit Act of 1974 had provisions relating to licensing of creditors, disclosure of cost of credit and also a period known as cooling off, in which the consumer can cancel the contract within 7 days on certain conditions. This Act applied to transaction up to £ 25000. Section 17 of the 1974 Act exempts from regulation those consumer credit arrangement where the credit to be made exceeds £25,000. This Act of 1974 also does not apply to home financing, but both of these things were again dealt in amended Act of 2006.

In case a creditor serves the consumer a default notice, it was to be given in the prescribed form under section 87 or if he wishes to terminate the agreement, demand earlier payment of a sum, recovers possession or to enforce any security of default, notices was required under the same section. A consumer could apply for time order under section 129 of this act. A time order is an order in which the court may reschedule any payments due under any consumer credit contract

²⁵ Available at Finance Industry Standards Association, Retrieved May 21, 2009 from <http://www.fisa.co.uk/downloads/CCA%201974.pdf>

It was the first law that enabled the courts to reopen the contracts, which have been settled down, and the court was given discretion to settle the accounts or repay the consumers who had been excessively charged, or which were contrary to general principles of fair dealings under sections 137-140. The term used for such contracts was 'extortionate credit bargain'.

The consumer credit Act of 1974 was further facilitated by following regulations:

- Consumer Credit (Advertisements) Regulations 2004
- Consumer Credit (Agreements) (Amendment) Regulations 2004
- Consumer Credit (Disclosure of Information) Regulations 2004
- Consumer Credit (Early Settlement) Regulations 2004
- Consumer Credit (Miscellaneous Amendments) Regulations 2004
- Consumer Credit Act 1974 (Electronic Communications) Order 2004
- The Consumer Credit (Enforcement, Default and Termination Notices) (Amendment) Regulations 2004

Consumer Credit Act 2006

The Consumer Credit 2006²⁶ Act amended the Consumer Credit Act 1974 which dealt with the statutes governing the licensing, control and regulation of credit or hire-purchase to consumer. The aim of the acts was to amend the Act of 1974 so that it covers all consumer credit agreements, and to deal with the licensing for consumer credit business. It also provided the ombudsman with jurisdiction in matters relating to consumer credit. The

²⁶ Available at Office of Public Sector Information, Retrieved May 21, 2009, from http://www.opsi.gov.uk/acts/acts2006/ukpga_20060014_en_1

Consumer Credit Act of 1974 lacked on matters relating to unfair credit relationship, licensing, limit of credit and consumer complaints redressal which were dealt in consumer credit Act of 2006. The Act was passed on 20th March 2006 and it came into effect in March 2008.

Section 2 of the Consumer Credit Act of 2006 removes upper limit for consumer credit which was fixed in 1974 Act as £25,000. It is said under this Act that all consumer credit, irrespective of the limit will be dealt under Act of 1974. Under section 6 it was made compulsory upon the creditor to provide the consumer with annual statements in fixed sum credit agreement and in case of non compliance, the creditor could not enforce the agreement and consumer was not bound to pay the interest or other default payments for the period in which statement has not been sent. The fixed sum credit includes loans for a fixed term or for a fixed amount.

The creditor was bound to give early warning notices to the consumers who have started to fall in arrears. Such early warning notices will be due when two consecutive payments are not made. Failure to give the notice means that creditor will not be able to enforce the agreement unless such notices are served. Likewise the Office of Fair Trading (OFT) was required to publish a sheet for creditors and consumer about arrears and default. Other important changes brought about by the Act were that the courts were given wide discretion to re-write consumer credit contracts which were unfair.

A definition of default sum was introduced in Act of 2006 default sum does not include the sum which become payable as a consequence of breach of agreement. All the creditors were bound to give the notice of default to the consumer and failure to serve notice

meant that agreement could not be enforced and that the interest of non compliance period of default notice will not claimed from the consumer.

The Consumer Credit Act of 2006 defines unfair agreements. An agreement is unfair, if the relationship is unfair under any term of the credit agreement but in such case, the consumer had to prove that the agreement is unfair. The discretion to declare a contract unfair is with the courts, which can order the return of amounts paid or reduce them. The court can also alter the terms of the credit agreement. Section 27 deals with licensing and the Ombudsman

D. EU Status

Currently all the states in EU have harmonized basic consumer credit rules based on EU legal system. The states comprising EU have both common law and civil law systems. EU member states have their own separate laws governing contract of all types. In case of the EU, European Commission and Council of Ministers enact legislation, which is in the form of directive. These directives are binding on the member countries. The directives are binding in term of achieving the goal of directive, and the means by which the result may be achieved vary from state to state. "The Council and the Commission may:

- Make regulations - These have general application, are binding in their entirety and are directly applicable in all Member States;
- Issue directives - These are binding as to the result to be achieved by the Member States to which they are directed. However, the national authorities may decide upon the method and form of implementation;

- Take decisions - These are binding in their entirety upon those to whom they are addressed (e.g. governments, companies etc);²⁷

The consumer credit law in any given country in EU is based on the following different directives of European Union;

- **93/13/EEC** of 5th April 1993 on Unfair Terms in Consumer Contracts
- **87/102/EEC** of 22nd December 1986 for the approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit
- **90/88/EEC** of 22nd February 1990 amending Directive 87/102/EEC
- **98/7/EC** of 16th February 1998 amending Directive 87/102/EEC
- **98/27/EC** of 19th May 1998 on injunctions for the protection of consumers' interests
- **2002/65/EC** of 23rd September 2002 concerning the distance marketing of consumer financial services and amending Council Directive 90/619/EEC and Directives 97/7/EC and 98/27/EC
- **2008/48/EC** of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC

Directive on Unfair Terms in Consumer Contracts

The European Economic Committee on 5 April 1993 issued directives regarding unfair terms in consumer contracts. It was called Directive on “Unfair Terms in Consumer

²⁷ EU Legislation and Scrutiny Procedures, Retrieved May 21, 2009, from <http://www.parliament.uk/documents/upload/111.pdf>

Contracts”²⁸ (93/13/EEC) and it was required that members should enact legislation to stop usage of unfair terms in consumer contracts, otherwise such agreements should not be binding upon the parties to consumer contracts. Although this directive was not consumer credit law specific and was generic, it brought awareness regarding the consumer contract issue that such contracts would not be binding if they had unfair terms.

Directive on Consumer credit²⁹:

This directive is called directive 87/102/EEC of 22 December 1986 for the Approximation of the Laws, Regulations and Administrative Provisions of the Member States Concerning Consumer Credit. The directive came into force on 12 January 1987 and the deadline given to member states to implement it was 1st January 1990. It harmonized the EU consumer credit rules by fixing annual percentage rate of charge on credit and the total amount to be paid in case of default. The directive created a common credit market, which also covered cross border credit transaction.

This directive does not apply to all types of credit. The home loans, credit free of interest, credit to be paid in one installment without interest, Credit cards, and credit less than 200 Euro or more than 20,000 Euros were expressly not covered by this law. Under the directive all consumer credit agreements were to be compulsorily made in writing mentioning expressly the annual percentage rate of interest. It was expressly mentioned in the directive that if a consumer can discharge his debt prematurely then in such a situation consumer shall be give rebate.

²⁸ European Commission website, Retrieved May 21, 2009, from http://ec.europa.eu/consumers/policy/developments/unfa_cont_term/uct01_en.pdf

²⁹ European Commission website, Retrieved May 21, 2009, from <http://europa.eu/scadplus/leg/en/lvb/l32021.htm>

It was made mandatory upon the member states of EU that they should issue license to creditors and they were liable to monitor licensed creditors and additionally, it was made mandatory for member states to constitute bodies providing consumer information and advice in matters relating to consumer credit and handling of complaints afterwards.

The directive also allowed the member states to make stricter rules than the directive. The amended directive 90/88/EEC gave a formula for the calculation of the rate of charge and setting out the cost item would also be included in calculation. The amended directive 98/7/EC gave a formula for calculation of annual percentage rate of credit interest. In general the directive set requirement of minimum disclosure by compulsory written contract mentioning the condition, cost, right and obligation of both parties.

Directive for the protection of consumer's interests

This directive is called Directive 98/27/EC of 19 May 1998 on Injunctions for the Protection of Consumers' Interests³⁰. The injunctive directive aims at protection of consumer interest by providing means to bring an action for cessation of contract infringing their rights. Under the directive the consumer of one state can bring action against creditors of other member states. If an injunction is to be sought under this directive, only notified bodies can bring an action and individual or consumer cannot bring an action, but such bodies can include governmental and non governmental organization.

Directive on distance marketing of consumer financial services

³⁰ EUR-Lex, Retrieved May 21, 2009, from <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31998L0027:EN:HTML>

This directive is called Directive 2002/65 of 23 September 2002 Concerning the Distance Marketing of Consumer Financial Services and Amending Council Directive 90/619/EEC and Directive 97/7/EC and 98/27/EC³¹. The directive came into effect on 9th October 2002 and member states were required to implement it by 9th October 2004.

The directive's main purpose was to enable smooth functioning of internal market coupled with high consumer protection, enhance consumer confidence in distance marketing of financial services and harmonization of the laws, regulations and administrative provisions of the member states for credit for consumers³².

Under the directive the consumer was to be informed prior to the credit contract regarding the supplier, the financial services, the withdrawal of services and redressal mechanism for the consumer under Article 2. Additionally the consumer was given the right of withdrawal under article 6 in which 14 days were set as limit without assigning any reason for withdrawal for the consumer except in case of home loans. Article 10 of the directive forbade direct automated communication by the service provider to the consumer.

Directive on credit agreements for consumers, repealing Directive 87/102/EEC

A new Consumer credit Directive aiming at transforming the consumer credit market from national to a regional market to give consumers a choice and more competitive prices was approved by the EU member states after 6 year of negotiations. The directive is named

³¹ EUR-Lex, Retrieved May 21, 2009, from <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32002L0065:EN:HTML>

³² European Commission website, Retrieved May 21, 2009, from http://ec.europa.eu/consumers/rights/background_en.htm

as “**Directive on Credit Agreements for Consumers**”³³. In this Directive, the consumer will be given more access to facts and figures in advertisement mentioning the interest rate, amount and number of payments, insurance etc. The new directive on consumer credit is based upon Green paper on Retail Financial Services of May 2007. Under Article 9 of the directive, in case of cross border credit, each member state shall ensure access of creditor from other EU member states to databases for assessing the creditworthiness of consumer. Article 14 of the directive gives the consumer a right to withdraw from the contract within 14 days of contract formation. It is binding upon all 27 EU member states to implement this directive before 12th May 2010. The Directive mentions that the Directive 87/102/EEC is repealed with effect from 12th May 2008.

E. Conclusion.

If you look at all the legislation and Directive of EU, the following are the common features.

- **Unfair Marketing Practices:** All the laws prohibit the unfair and deceptive marketing practices to protect the interest of consumers.
- **Disclosure:** It is required that the terms of consumer credit be adequately disclosed in such a manner that the consumer is made aware of his obligation and liabilities and the implications of the transaction.
- **Cooling Period:** After the consumer has entered into consumer credit relationship with a creditor, the consumer is given period of 3-10 days so that

³³ EUR-Lex, Retrieved May 21, 2009, from <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:133:0066:01:EN:HTML>

he can re-think the terms and conditions and monitor the different consumer credit contracts.

- **Fees and Charges:** The interest charges and fee for services provided by the creditor are mentioned expressly so as to save the consumer from being charged on different head.
- **Hardship Provision:** Re-opening of contracts that are deemed to be oppressive by an adjudicative body and to provide the consumer a chance to change the consumer credit contract on basis of unforeseen hardship.
- **Default Procedure:** The process of giving pre-default, default notice and the procedure incase of actual default of a consumer.
- **Re-Possession:** All the law make specific provision for a process of re-possession.
- **Redressal Mechanism:** In case of complaint against a creditor, the means available to a consumer using which, the consumer can get redressal of his complaints.

Beside this, all the laws provide for a licensing authority, which will act also as a regulator of the consumer credit sector. If any laws address the above-mentioned issues, it can be said that it is a good law to regulate consumer credit sector in any given country from consumer protection perspective.

Chapter 3: CONSUMER CREDIT IN PAKISTAN

Pakistan is a developing country in which the banking sector and its products have not matured, as compared to developed countries. The banks had been serving government organization and large corporation and engage in trade financing. The budget deficit was high and banks were accustomed to lending to governments, and this was considered as a safe investment for banks, as well as being secure. Historically there was a political element in lending decisions. The consumers were not given any attention by the banking sector and the credit side of banking was long dormant. In 1992, first credit cards were introduced at large level followed by car financing scheme which was introduced by banks due to pressure by the government at that time. Then in the year 2000, the new political regime encouraged the banking sector. The Recent wave of development started in 2000 which lead the banking sector to new developments, in which banks designed new credit products to increase their profitability. There are two sources of credit available generally in less developed economies, such as Pakistan:

1. Institutional
2. Non-institutional (Informal)

The Non-institutional source includes moneylenders, landlords, traders, and friends. The formal sector includes commercial banks, regional development authorities, non-banking financial institutions and leasing companies. The informal sector is un-regulated and unchecked and therefore no statistical data is there to analyze this sector. The institutional

source of credit is regulated by either the State Bank of Pakistan, as in case of banks, or by the Securities and Exchange Commission of Pakistan, as in the case of leasing companies and NBFIs.

A. History of Consumer Credit in Pakistan.

In 1947, of the 99 commercial banks whose head office was located in Pakistan, only one bank (Habib Bank Ltd.) came to Pakistan. From 1947 onward private sector along with some foreign banks took part in growth of banking in Pakistan, but in 1974 nationalization took place, which resulted in merger of 13 banks into five nationalized banks.

Then in 1980's, the policy toward banking saw a shift and foreign banks were allowed again along with deregulation of interest rates. Citibank was amongst the first new foreign banks in Pakistan. Citibank started the trend towards consumer credit in Pakistan and then local banks followed suit. With time, the competition picked up and it became more intense, resulting in the interest rates were reduced.

1. Privatization

The banking sector in country in past was dominated by state owned banks. New entry to banking sector was not only closed but also branch expansion was not encouraged.

The government owned banks in past in which most of the staff worked like government employees, having nothing to do except to come, and check files, and leave in the afternoon.

The following are the main reasons which lead to privatization.

- overstaffing

- political interference
- un-profitable branches
- poor customer service
- High NPL's.
- Low recovery rates.

All the nationalized commercial banks were privatized except National Bank of Pakistan and this was done with one goal, i.e. to control inefficiencies in banking sector through private sector participation. The process of privatization of banks started in early 1990 but main steps were taken in 2002-03. The mainstream banks, United Bank Limited, Allied Bank Limited, Habib Bank Limited and Muslim Commercial Bank Limited were privatized during this time. Also in 1990 permission to setup new banks were granted and in 1991 10 new banks got licenses to start business. In 1992-93 Allied Bank Limited and Muslim Commercial Bank limited were handed over to the private sector, where as United Bank Limited in 2002 and finally in 2003 Habib Bank was privatized³⁴. By the end of 2003, compared to 5 nationalized commercial banks of 1974, there were 17 private commercial banks, 3 specialized banks, 6 development financial institutions, 4 micro finance banks and 11 foreign banks in Pakistan

The privatization process didn't bring any change in the sector by itself, however privatization improved the operations and allocation of resources, which helped in achieving

³⁴ Privatization Commission, Retrieved May 22, 2009, from [http://www.privatisation.gov.pk/about/Completed%20Transactions%20\(new\).htm](http://www.privatisation.gov.pk/about/Completed%20Transactions%20(new).htm)

maximum profits without changing market structure. The factor, which is considered to be the main reason for the boom of consumer credit after privatization, is that lending requires close monitoring of borrowers, and banks have achieved this after Privatization.

Over 80 % of the banking business is in private hands.

2. De-Regulation

Generally, in any given country, there are two types of systems in banking sector; regulated or de-regulated. Those who have any kind of fear regarding the market failure are in favour of regulation whereas those who have faith upon the market and also want an efficient and competitive market favour De-regulation. It is also contented that “freer markets need more rules³⁵”. But the choice of either regulation or de-regulations is more political than public interest based in practice. Main stress should be on regulating more effectively for the interest of public rather than on the debate of regulation or de-regulation. Since 2000, the banking sector has been de-regularized to such an extent that the bank are free to determine their services charges, only needing to inform the State Bank about the service charges change.

In the year 2000 and 2001, the interest rates were down to the low levels, due to which the consumer credit picked up pace. This gave growth to the consumer credit sector in an unprecedented manner in Pakistan’s history. The main focus of the State Bank of Pakistan has been liberalization of private banking sector without losing vigilant control over the

³⁵ Jonathan R. Macey , “The False Promise of De-regulation in Banking”, Yale school of law, bepress Electronic press, p-5”

sector. This liberalization process started firstly in 1991 when 10 new private commercial banks were allowed to commence business, followed by more new entries in 1990s.

3. Mergers and Acquisitions

In the recent year, another process of acquisition also picked up the pace and we have seen acquisition of Union Bank Ltd. by Standard Chartered Bank Ltd, Prime Bank Ltd. by ABN Amro Ltd. Likewise Habib Bank AG Zurich has bought the Metropolitan Bank Ltd. All this has been due to State Bank of Pakistan's policy of developing strong banks that can withstand business downturns. For this SBP has raised the minimum capital requirement in phases but all banks are required to reach 6 billion rupee minimum capital by the year 2009. The combined effect of Privatization, acquisitions, and deregulation has helped in improving the performance of banking sector and as the performance has improved the competition has also picked up.

B. Brief Description of Banking Laws

Following are some of the major banking laws and regulations, which amongst others regulate banks in Pakistan.

1. State Bank:

- i. The State Bank of Pakistan Act, 1956
- ii. The State Bank of Pakistan Banking Service Corporation Ordinance,
2001

The State Bank of Pakistan Act was enacted on 18th April 1956 and was given retrospective effect since 1947 and this Act has been amended in 1997, 1979, 1983, 1984, 1997, 2001 and 2002.

2. Laws Relating to Banking:

- iii. The Banking Companies Ordinance, 1962
- iv. The Banking Companies Rules, 1963
- v. The Bankers Books Evidences Act 1891
- vi. The Banking Companies (Recovery of Loans) Ordinance 1979
- vii. The Banking Companies (Recovery of Loans, Advances, Credits and Finances) Act 1997 (repealed by The Financial Institutions (Recovery of Finance Ordinance, 2001)
- viii. The Banks (Transfer of Assets and Liabilities) Ordinance 1973
- ix. The Banks (Nationalization) Act, 1974
- x. The Financial Institutions (Recovery of Finance Ordinance, 2001)
- xi. The Pakistan Banking (Prevention of Default and Evasion of Liabilities) Ordinance 1947
- xii. The Pakistan Banking and Finance Services Commission Act 1992.

3. Banking Courts:

- xiii. The Banking Tribunals Ordinance, 1984
- xiv. Offences in Respect of Banks (Special Courts) Ordinance 1984

4. Laws Creating Specialized Banks:

- xv. Agricultural Development Bank Ordinance 1961
- xvi. Agricultural Development Bank of Pakistan (Reorganization and Conversion) Ordinance 2002
- xvii. Industrial development Bank of Pakistan 1961
- xviii. Islamic Development Bank Ordinance 1978
- xix. Khushhali bank Ordinance 2000
- xx. Micro-Finance Bank (Amendment) Ordinance 2000
- xxi. National Bank of Pakistan Ordinance 1949
- xxii. Bank of Khyber Act 1991
- xxiii. Bank of Punjab Act 1989
- xxiv. Sindh Bank Act 1995
- xxv. Bank of Baluchistan Ordinance 2003

5. Rules:

- xxvi. The Banking Companies (Lahore High Court) Rules, 1973
- xxvii. The Banking Companies (Peshawar High Court) Rules, 1972
- xxviii. The Banking Companies (Sindh High Court) Rules, 1973
- xxix. The Banking Companies (Recovery of Loans) Rules, 1979
- xxx. The Banking Companies (Recovery of Loans) Rules, 1980
- xxxi. The Banking Companies Rules, 1963
- xxxii. The Banks (Nationalization)(Payment of Compensation) Rules 1974

Beside there Bank are bound to follow:

- SBP Circulars issued from time to time

- Code of Corporate Governance
- Prudential Regulations, issued by the SBP

C. Sector Analysis and Regulator.

Consumer Credit is a risky product and therefore it is required that all the Banks and NBFI's will establish have separate risk management unit under the banking manual. This risk management unit shall, for the purpose of consumer financing, prepare a credit policy and the bank of directors shall duly approve this policy. The policy should include the loan administration, including documentation, disbursement and appropriate monitoring mechanism. Consumer Credit is provided by Banks, leasing companies and NBFI's

1. Banks:

Banks differ from leasing companies and NBFI's. The fundamental feature of a bank is that the business of bank is generated through lending and deposit taking. Secondly the banks assets are invested in long-term instruments like loan to corporate sector while the liabilities are short like the current accounts in which checks are payable on demand.

Generally it is considered that financial sector and economic development are inter-related, and since banks constitute 95 % of Pakistan's financial sector, they play an important role in the economic growth of the country.

The banks have three sources of income; credit, government borrowing, and charges on banking services. The first source of income i.e. credit is very profitable for bank. The credit to corporate sector is less profitable business for banks so banks prefer to do business with

consumers. Such credit to consumer has only purpose behind it, i.e. maximization of bank profit.

The entire banks operating in Pakistan are classified into three groups.

- Public Sector Banks
- Private Sector Banks
- Foreign banks

I. Public Sector Banks:

Public banks are that Orgization which are incorporated in Pakistan and are controlled by governments units.

- National Bank of Pakistan
- The Bank of Khyber
- The Bank of Punjab
- First Women Bank Limited

Public Sector Specialized Banks:

Public Sector Specialized banks are those banks which are there to provide credit and assistance to special sector like SME banks, agriculture sector.

- Industrial Development Bank of Pakistan
- SME Bank Limited
- Punjab Provincial Co-operative Bank Limited
- Zrai Taraqati Bank Limited

- Khushhali Bank Limited

II. Private Sector Banks:

Private Banks are controlled by private sector

- The Royal Bank of Scotland Limited (formally ABN AMRO Bank (Pak.) Ltd.)
- Arif Habib Bank Limited
- Askari Bank Limited
- Atlas Bank Limited
- Bank Al Falah Limited
- Bank Al Habib Limited
- Bank Islami Pakistan Limited
- Crescent Commercial Bank Limited (CresBank)
- Dawood Islamic Bank Limited
- Dubai Islamic Bank Pakistan Limited
- Emirates Global Islamic Bank Limited
- Faysal Bank Limited
- Habib Metropolitan Bank Limited
- JS Bank Limited
- KASB Bank Limited
- Meezan Bank Limited
- Mybank Limited

- NIB Bank Limited
- Saudi Pak Commercial Bank Limited
- Soneri Bank Limited
- Standard Chartered Bank (Pakistan) Limited
- Barclays Bank Plc.

Following banks are privatized banks which were nationalized under The Banks (Nationalization) Act, 1974. Later on they were again privatized.

- Allied Bank Limited
- Habib Bank Limited
- MCB Bank Limited
- United Bank Limited

III. Foreign Banks:

Foreign banks are those banks which are incorporated abroad.

- Al Baraka Islamic Bank B.S.C. (E.C.), Pakistan
- Citibank N.A., Pakistan
- Deutsche Bank AG, Pakistan
- HSBC Bank Middle East Limited, Pakistan
- Oman International Bank S.O.A.G., Pakistan
- Bank of Tokyo Mitsubishi UFJ Limited, Pakistan

State Bank of Pakistan

Setup under the State Bank of Pakistan Act of 1956, being the central bank of country, has also responsibilities of regulation of monetary and credit system in the country. SBP core function is regulation of banking sector. The state bank of Pakistan has divided the banking sector and DFI's into four major segments based on operation which are Corporate, SME, Agriculture and Consumer Banking.

Prudential regulations in 1992 for banking sector/DFI

2. Leasing Companies:

Leasing is a concept in which the leased assets ownership remains with the leasing company and the lessee uses the assets and pays the rent to the leasing company where as in case of a bank, the ownership is transferred but hypothecation is involved. Generally speaking leasing can be termed as hire of asset for a long term.

As compared to other institutions, the only institutions dedicated for credit business are leasing companies as implied by name. The leasing companies faced severe competition from banks in credit sector in last decade, as banks have an edge over leasing companies, as cheap money of depositor is available to bank. Leasing companies have managed to survive though, through the aggressive marketing period by banking sector of credit products. The only advantage which brought the leasing companies business was the fact the credit was easy to obtain from leasing companies as compared to banks.

In Pakistan, the first leasing company was established in the year 1985 whereas during the period of 1985-97, 32 leasing companies were operational but due to increase in minimum capital requirement i.e. 100 million to 200 million, the number was limited to 26 as result of

mergers and acquisitions³⁶. The leasing sector is under the control and supervision of law and regulation made for Non-banking Financial Institution, and hence come under the supervision of SECP. Following are the leasing companies doing credit business in Pakistan.

- Al-Zamin Leasing Modaraba
- Askari Leasing Limited
- Capital Assets Leasing Corporation Limited
- Crescent Leasing Corporation Limited
- Escorts Investment Bank Limited
- First Dawood Investment Bank Limited
- First Fidelity Leasing Modaraba
- First Habib Bank Modaraba
- First Habib Modaraba
- Grays Leasing Limited
- IGI Investment Bank Limited
- International Multi Leasing Corporation Limited
- NBP Capital Limited
- Network Leasing Corporation Limited
- ORIX Leasing Pakistan Limited
- Pak Gulf Leasing Company Limited
- Pakistan Industrial & Commercial Leasing Limited

³⁶ Leasing Association of Pakistan, Retrieved May 22, 2009, from <http://www.pakistanleasing.org/>

- Pak Oman Investment Company Limited
- Saudi Pak Leasing Company Limited
- Security Leasing Corporation Limited
- Sigma Leasing Corporation Limited
- SME Leasing Limited
- Union (previously Standard Chartered) Leasing Limited
- Standard Chartered Modaraba
- Trust Leasing & Investment Bank Limited
- Universal Leasing Corporation Limited

3. NBFIs:

To add variety to the non-bank financial institution and to lessen dependence on banks for credit, a number of non-bank financial entities were allowed to operate.³⁷ The Securities and Exchange Commission (SECP) overlooks and regulates the operation of non-banking finance institutions in Pakistan. The non-banking Financial Sector includes non-banking finance companies, Modarabas, Leasing Companies, Investment banks, Mutual Funds and Development Finance Institution (DFI's). Modarabas companies are involved in business of financing and investment in accordance with Shariah. Modaraba companies are offering leasing products by name of Musharika and Morabaha finance.

³⁷ M. Nadeem Hanif, Restructuring of Financial Sector in Pakistan, Jan 2003, the Journal of the Institute of Bankers in Pakistan, page 7, Retrieved May 22
<http://unpan1.un.org/intradoc/groups/public/documents/APCITY/UNPAN026320.pdf>

In Pakistan, Pakistan Industrial Credit and Investment Corporation Ltd (PICIC) was the first DFI was formed in 1957. Industrial Development Bank of Pakistan (IDBP) and National Development Finance Corporation followed in coming years. Some development finance institutions focused on investment banking whereas others introduced financing.

SECP

The Securities and Exchange Commission of Pakistan (SECP) is regulator of NBFIs and leasing companies. The Development Finance Institutions come directly under purview of SBP whereas other types of NBFIs are regulated by SECP. Prudential Regulation for NBFIs was issued by the SECP in 2006. The NBFIs need a minimum paid up capital of Rs, 200 millions according to regulations of SECP to start business.

D. Brief of Each type of Consumer Financing in Pakistan.

Banks started focusing on the consumer financing as it was more profitable business for banks. Banks have a policy of aggressively focusing on consumer financing rather than corporate credit through attractive packages. The average rate of return on consumer financing is much more as compared to the corporate sector. The interest rate of bank vary from product to product and the banks have fixed plans for specific consumer product whereas in corporate financing it is not so. In corporate financing the markup rate can be negotiated based on external factors, which is not in case of consumer financing.

Technology has also driven the increase in volume of credit choices. Interest free products, credit card concessional schemes and other special promotions are common. There number of lending institution has increased and with diversified products, aggressive

marketing has helped to increase consumer credit transactions. Applying for consumer loans is very easy. Banks have products for which they have categorically specified list of documents. When you apply to a bank as a consumer, the bank will assess the application and then it will be conveyed to you that whether you are eligible for credit or not.

1. Car Financing.

Historically car financing was only carried out by leasing companies in Pakistan but post nineties, time this type of consumer financing became popular. Orix Leasing Pakistan Limited started car leasing in 1980's. This type of consumer financing is the most used facility by consumer as against the housing finance. The main scheme, which introduced vehicle financing in Pakistan, was the "Yellow Cab Scheme". Although under this scheme banks suffered a lot due to political involvement but this scheme created an impression of getting new vehicle on installment and repaying the amount was not a problem for those who could manage their accounts. Then in 1994 Citibank became the first bank to launch car financing. In the recent time, this mode has been most frequently used type of consumer credit. This has due to the aggressive marketing coupled with attractive products offered and almost all the banks offering auto-financing loans.

2. Credit Cards.

Pakistan, a developing country, has been a slow market for credit card operations for the international giants in Credit Card sector. Credit Cards replaced cash in developed economies but in Pakistan they were not that circulated and country was a strict cash society until the banks targeted this sector through extensive marketing and facilitation tactics.

Credit cards increased gradually in popularity due to their features like world wide acceptance, and personal security due to less cash transactions.

Credit cards were first introduced in Pakistan by Habid bank and United bank in early 1980's but they were not particularly popular or widely accepted. The credit cards were re-introduced by Citibank in 1992, which marked a beginning of new era for this sector, but at that time credit cards were offered to selected customer who needed them while traveling abroad. Afterwards, other banks also introduced multiple types of credit cards.

Due to competition, banks are offering credit cards on relaxed termed and condition to cover a wider section of public. Banks are marketing credit products aggressively and have attracted middle class segments toward it.

3: Housing Sector

The loans for buying, building and renovating house or buying land are classified as home loans. As compared to other types of consumer financing, the housing finance is long term in nature. The history of housing finance in Pakistan dates back to early year. To address the housing finance demand, House Building Finance Cooperation was established in 1952, which was a public sector organization. Housing finance though, has not been very popular among consumers and this has been due to lack of interest on the part of private sector. In 1992, housing sector was opened up for private sector but this effort also failed. However, with the promulgation of Financial Institutions (Recovery of Finances) Ordinance 2001, banks got encouragement from the steps taken and they marketed this type of consumer credit as well and introduced new products.

This type of consumer credit is given different names by different lenders.

1. house financing
2. house improvement loans
3. house renovation loans

Even in this period of unprecedented growth of the banking sector. The housing finance is the slowest one, as compared to other three types of consumer credit. This has got a few reasons behind it.

- Firstly, the banks are least interested in it because like corporate financing it is long duration investment by the bank.
- The rate of return of other types of consumer financing is much quicker than this type.
- The process involved in this type involves legal complication like mortgage which is a lengthy process as compared to hypothecation in car financing which is a quicker process.
- In case of default, the bank has to go to courts in housing finance and this take time during which the banks is stuck whereas the banks are more secure as they have got a pro-note signed in case of car financing which only involves 90 days litigation under order 39 Civil Procedure Code.

4: Personal Loans.

There are three types of personal loan products being marketed in Pakistan

1. Personal loan without any link to specific purpose

2. Personal loan for specific purpose
3. Personal loan secured with liquid asset.

The personal loans were first introduced in Pakistan by Citibank in 1999.

CREDIT/LOANS CLASSIFIED BY BORROWERS

(Outstanding position at the end of month)

(Provisional: Million Rupees)

Description	June 06	Jun-07	Jun-08
For house building	43,205	54,672	66,546
For transport i.e. purchase of car etc	97,777	105,444	104,996
Credit cards	33,538	42,822	44,427
Consumers durable	1,547	1,039	498
Personal loans	120,517	142,373	140,305

38

³⁸ State Bank of Pakistan, Retrieved May 22, 2009 from, <http://sbp.org.pk/reports/annual/arFY08/Vol2/index.htm>

Chapter 4: PRUDENTIAL REGULATION ON CONSUMER

FINANCING

The Prudential Regulations are the applicable set of regulations for all types of credit arrangements in Pakistan, introduced in 1992 by State Bank of Pakistan. These are the regulation introduced for the banking sector involved in credit business whereas there is separate set of Prudential Regulation dealing with Non-Banking Financial Institutions (NBFI's). The Non-Banking Financial Sector is regulated by the Securities and Exchange Commission of Pakistan (SECP). The regulations comprise of operational guidelines and various risk management measures that have to be adopted while initiating consumer financing.

Other than these regulations there are no rules of business for the credit business. As far as legislation is concerned under the Banking Companies Ordinance (1962) Section 7(1)(a), the banks are allowed borrowing and lending of money, receiving deposits and financing through permissible modes and leasing. There are no details of form of credit or leasing business or its regulation under Banking Companies Ordinance and there is no specific law on Consumer Credit Contracts and the applicable laws are general laws including the Contract Act, Transfer of Property Act, and Sales of Goods.

A. Overview of regulation for banking sector & NBFIS

There are have been a drastic change in the financial systems since 1990, and in turn leading to need for a mechanism of check and balance on credit agreements, and for ensuring

soundness of financial system by setting out the minimum requirements for consumer credit agreements. The regulations include comprehensive operational guidelines and various risk management measures and they do not go into details about post contractual and pre contractual circumstances.

The State Bank of Pakistan has divided the banking sector and DFI's into four major segments based on operation which are Corporate, SME, Agriculture and Consumer Banking. Prudential Regulations were first introduced by State Bank of Pakistan August 1991, effective from July 1992, after that these have been reviewed many times and currently there are five different types of Regulations.

1. Prudential Regulation for Consumer Financing.
2. Prudential Regulation for Corporate Financing.
3. Prudential Regulations for SME's.
4. Prudential Regulation for Agricultural Financing.
5. Prudential Regulation for Micro Finance Institutions.

The SBP has the responsibility of regulation of banking sector and credit system in Pakistan. The first four set of Regulations are issued by Banking Policy and Regulation department of State Bank of Pakistan where the last type regulation is dealt by the SME & Micro Finance Department of State Bank of Pakistan. As far as the applicability of Prudential Regulation is concerned, State Bank of Pakistan requires strict compliance by banks because these regulations involve risk management and operational instructions, however in exceptional cases relaxation/exemption may be allowed by State Bank of Pakistan from a particular regulations on the request of the bank/DFI, keeping in view the

given situation as these are merely regulatory guidelines. The current regulation are just aiming at controlling the interest factors and to regularize the credit market rather than comprehensively dealing with all aspects of consumer credit.

1. Prudential Regulation for Consumer Financing

The Prudential Regulation for Consumer Financing issued in 2003, consist of three parts, the first parts consists of definitions, the second part sets of minimum requirement for consumer financing, and the third part actually sets out the regulations, set of 28 guidelines.

Part A:

As the first part consists of 12 definitions including that of Bank, Borrower, Consumer Financing, DFI, Documents, Equity of Bank, Financial Institutions, Government Securities, Liquid Assets, NBFC, Secured and Tangible Security.

Part B:

This part mentions that minimum requirement for undertaking the consumer credit financing by a bank or DFI. It is mentioned in this part that the bank shall establish risk management policies. The bank shall prepare consumer credit policy duly approved by board of directors and banks shall make a specific program for each type of consumer financing. All the banks should implement computer based management information system (MIS) for reporting on loss and profit. Banks shall enroll with at least one consumer credit information system. Bank should develop their recovery procedures

The Prudential regulation does require bank to take report from Credit Information Bureau but they does not allow to deny extending credit based on this report, it is banks

decision based on the policy of the bank to approve the credit transaction or not. The regulation requires the banks to prepare standardized borrowing and recourse documents for each type of consumer financing. The regulation mentions that the consumer loan approval can be based upon four things.

- Source of repayment
- Consumer ability to repay
- Past dealings
- The net worth and CIB report

It is also required that at the time of financing, the banks shall obtain written declaration regarding already availed consumer credit facilities to ensure that the total exposure does not exceed the repayment capacity of the consumer.

Part C:

The part consists of actual regulations which are as follows:

Regulation 1: The banks financing to its director, share holders and employee shall be made at arm length basis and on normal terms and condition as applicable to other consumers.

Regulation 2: Limit on exposure against total consumer financing. The total consumer financing of a consumer shall not exceed 2 times of its equity at the end of first year and at the end of second year it should not exceed 4 times of equity.

Regulation 3: Total financing availed by a consumer should commensurate with the income. Repayment capacity is to be checked before allowing financing under any mode of consumer financing.

Regulation 4: Banks shall have general reserve against consumer financing which should be 1.5 % of its consumer credit portfolio.

Regulation 5: The banks shall not transfer one classification of consumer credit into another.

Regulation 6: Banks are free to determine the margin requirement on consumer credit according to their credit approval policy

1. Credit Cards:

Regulation 7: The Prudential regulation impose a maximum limit of Rs. 500,000 but with an exception of prime customer, in case of prime customer the limit can be extended to Rs. 2 million but in no case the limit can exceed this for unsecured.

Regulation 8: Incase of credit card, if the interest or principal amount is unpaid for 180 days after due data, such credit transaction should be marked as "Loss" by the bank.

The unsecured credit card transaction can be made secure by hypothecation with exception of hypothecation of house hold goods.

Following were the operation instructions given in the regulations to the sector.

O-1: Banks to ensure delivery of cards to card holder and advices the consumer to keep the card safe.

O-2: Consumer to be provided monthly statement of the cards or account

O-3: Banks should be liable for the transaction not being allowed by consumer i.e. if a consumer informs the bank that the card has been stolen or lost, then the transaction

after this information is conveyed are construed as un-authorized transaction under the prudential regulation.

O-4: Banks are under obligation to accept partial payment and to account such payment while charging interest.

O-5: Due date of payment must be mentioned to account or statement provided to consumer under regulation 2. Also the consequence of failure to pay, the penalty should be mentioned on the statement.

2. Auto Loans:

Regulation 9: The vehicle should not be utilized for commercial use, whereas Prudential Regulation for Consumer / Commercial Banking should apply on vehicle given for commercial purpose.

Regulation 10: The terms of auto loans cannot exceed 7 years.

Regulation 11: Minimum down payment shouldn't be less than 10 % of vehicle ex factory price.

Regulation 12: Hypothecation is also required along with proper insurance to cover loses. This regulation required that payment be made at time of delivery but in essence this is not being followed.

Regulation 13: Insurance of the vehicle is responsibility of bank during the term of consumer credit contract.

Regulation 14: Incase of auto financing, if the interest or principal amount is unpaid for 180 days after due data, such credit transaction should be marked as "Doubtful"

by the bank and if the period exceeds one year, the transaction will be marked at "Loss".

Following operational regulations were given regards to Auto-loans.

O-6: Default period and repossession of vehicle should be expressly mentioned in the contract along with the terms and cost of repossession in the consumer credit contract

O-7: Detail repayment schedule is to be provided to the consumer at the time of contract. Where the payment schedule is modified or revised, the revised schedule is to provided with 15 day

O-8: Vehicles more than 5 years old cannot be financed or re-financed and banks were required to formulate detail credit policy to used vehicles.

O-9: Creditors were asked to make sure that the authorized vehicle dealers were on their panel to eradicate chances of unethical practices.

3. Housing Loans:

Regulation 15: The Prudential regulation put the following condition in case of Housing Loans that the monthly payment of all loans including housing loan should not increase 50 % of the total income of the consumer. Banks were not allowed to sanction consumer credit transaction for purchase of land but where it was done so, it was duty of bank to ensure that the upto 50 % of credit is utilized to purchase land and rest utilized for construction.

Regulation 16: The credit equity ratio shall be 85:15.

Regulation 17: It was duty of bank to make sure that at any time the banks exposure should not exceed 10 % of their net advances.

Regulation 18: The term of financing should not be more that 20 years.

Regulation 19: The house financed should be mortgaged in favour of bank.

Regulation 20: The evaluation of property and genuineness of documents of title should be carried out be professional having relevant expertise.

Regulation 21: The banks were required to monitor market prices on quarterly basis to make sure that their policy is in lines with market prices.

Regulation 22: Banks were allowed to introduce floating inertest rate product in order to minimize the risk involved for the bank.

Regulation 23: Incase of house financing, if the interest or principal amount is unpaid for 180 days after due data, such credit transaction should be marked as "Substandard" by the bank and if the period exceeds one year, the transaction will be marked at "Doubtful" whereas the duration exceeds two year, such transaction will be marked as "Loss".

4. Personal Loans:

Regulation 24: The Prudential regulations limit the unsecured personal loan up to Rs. 500.000 and 1 million incase the loan is secured with duration of maximum 5 years. Incase of prime customers, the personal loan can not exceed 2 millions however secured personal loans can exceed this limit.

Regulation 25: The Prudential regulations require that if the personal loan is to be utilized for the purpose of purchase of consumer goods, then such loan should be secured one using hypothecation.

Regulation 26: The maximum tenure should not increase 5 years other than educational personal loans which can extend up to 7 years.

Regulation 27: Incase of Running / Revolving finance, the consumer should return at least 15 % of the maximum amount utilized for one week in a year.

Regulation 28: Incase of personal loan, if the interest or principal amount is unpaid for 180 days after due data, such credit transaction should be marked as “Doubtful” by the bank and if the period exceeds one year, the transaction will be marked at “Loss”.

B. Banking Mohtasib

The Mohtasib in Urdu stands for English word of Ombudsman, which is originally a Swedish word that stands for a representative of people. In 1809, first ever ombudsman was appointed in Sweden

In Banking Companies (Amendment) Act 1997, it was provided for appointment of a Banking Mohtasib who was to be appointed by President of Pakistan. The Banking Mohtasib is given jurisdiction under section 82 (A) BCO, in relation to following matter³⁹:

1. Enquire into complaint of banking malpractices:
2. perverse, arbitrary or discriminatory action;

³⁹ Banking Companies Ordinance 1962, section 82 (A)

3. violation of banking laws, rules, regulations or guidelines;
4. inordinate delays or inefficiency and
5. corruption, nepotism or other forms of maladministration.

The jurisdiction has been bared in regard directing a bank for giving loan to a complainant. This means that Mohtasib can not entertain complaints regarding financial exclusion and equal credit opportunity. Likewise complaints regarding charges and other policy matter of banks are kept out of authority of banking Mohtasib.

The banking Mohtasib office became functional on May 2nd, 2005. It is interesting to see that the banking Mohtasib is to be provided with a secretariat in consultation with SBP but the cost of banking Mohtasib secretariat are to be shared by the banks. In case any complaint is forwarded to banking Mohtasib, the Mohtasib is bound to facilitate parties to reach amicable resolution and incase such resolution is not possible then the Mohtasib can give its finding. But the first priority of the Mohtasib is to resolve the issue through mediation and amicable solutions. The complaint is to be made to Mohtasib in writing but only after giving a notice to bank that the consumer is going to file a complaint if the issue is not settled in forty five days. After the lapse of forty five days the consumer can approach the Mohtasib.

If a party to issue is not satisfied with the decision of the Mohtasib, it can appeal to the Governor, State Bank of Pakistan within 30 days of the decision of Mohtasib. Incase no appeal is filed from decision, period of implementation is given i.e. forty days, in which the order are to be complied with and the compliance report is to be sent to the Mohtasib.

In current setup if case of any complaint consumer has got three options;

- to approach banking Mohtasib

- to approach Redressal Division at consumer protection department established at SBP
- to approach the bank management directly to get redressal

C. Current Legal and Regulatory Regime

The consumers have two options currently in case they have any complaints or grievances against the credit institutions. The first one is to go to the regulatory body and complaint against the banks, i.e. to launch a complaint against the bank with the State Bank of Pakistan but before starting such complaints, it is required by the State Bank of Pakistan that consumer should first place the issue in internal complaints unit managed by the individual banks, if they are not satisfied with the decision on internal complaints units or not heard properly, they can approach the State Bank. The internal complaints units of banks are required to respond the complaints within 10 days.

The second option which is available to both the parties to a consumer credit transaction is to go to a court of law and get the issue settled. There are different laws which can be invoked like The Contract Act, 1872 or The Sales of Good Act, 1930, there is specialized law in the form of The Financial Institution (Recovery of Finances) Ordinance, 2001. Under this Ordinance, 29 banking courts are operational in Pakistan who mainly helps the banks in getting their issue settled with the defaulters; however the customer as well as the banks can file a complaint in the banking courts regarding violation of any financial obligation. The Financial Institution (Recovery of Finances) Ordinance, 2001 repeal The Banking Companies (Recovery of Loan, Advances, Credit and Finance) Act, 1997. This Ordinance was enacted to protect the banks and lenders:

“To tackle the problem of non-performing loans, a multi-task strategy was adopted by the SBP, which included enacting new laws, creation of institutions to pursue recovery of bad loans, and an incentive package for genuine cases (rescheduling of loans of those borrowers who were unable to pay due to economic constraints). Specifically, a new law, “The Financial Institutions (Recovery of Finance) Ordinance 2001” was promulgated. The new recovery law provided a mechanism for expeditious recovery of stuck up loans, e.g., the law provided a comprehensive procedure for the foreclosure and sale of mortgaged property without the interventions of a court of law, and automatic transfer of all cases pending in any other court to the bank courts for their early resolution”.⁴⁰

Under section 3 of the Ordinance, it was made a duty for the customer that he should fulfill his obligation to the financial institution and in case of default on the part of customer in discharge of obligation, the customer is made liable to pay for the period from the date of default till realization of the cost of the funds of the financial institution and beside that the customer was also liable to civil and criminal liabilities arising under the contract with the bank or any other relevant.

The customer was made to suffer twice for the same default, but the Ordinance is altogether silent as to the duties and responsibilities of the financial institution in regard of payment procedure and charges etc. There is no clear mentioning of any duty upon the bank in discharge of its obligation toward the consumer. Furthermore in order to extend the scope of application of the Ordinance to protect the financial institution the definition of customer

⁴⁰ Dr. Shamshad Akhtar, Governor of SBP. “Pakistan, banking sector-the need for second tier of reforms”, Address at the Pakistan Banking Association, London, 12 November 2006.

was given in such form that it included the surety and indemnifier. Likewise the Ordinance gives a special procedure for suits and proceedings. A suit is to be filed with complete accounts and the court is to issue the summons. On receiving the summons from the banking court, the defendant is entitled to only defend when he obtains leave to defend from the banking courts and such leave has to be obtained within 30 days of summons receiving otherwise the plaintiff's version is admitted and the Court may pass a decree in favour of the plaintiff. However, those cases in which leave to defend have been granted are to be settled within 90 days of granting the leave to defend.

The Ordinance gives another arbitrary right to the bank that they can sell the mortgaged property and even they can themselves buy the mortgaged property on such sale on giving the highest bid. The bank is to issue notice of default to the consumer for 14 days, the second and third notices of 14 and 30 days respectively are to be given then the banks get power to sell the property. Based on the given facts, it can be rightly stated that the Ordinance under discussion is practically giving only the post default procedure whereas pre default problems for the bank and lenders haven't been touched in the Ordinance and the consumer rights are altogether ignored in the current legislation.

The above mentioned discussion shows that there exist different types of mechanisms for the redressal of complaints of both parties, i.e., banks and the consumer however the mechanisms are not effective and there is a continuous increase in the complaints and problems being faced by the consumer. The regularity and legal framework needs complete overhauling keeping in view the current suffering of the consumer.

D. Pitfalls in present scenario

His lordships at the Sindh High Court have rightly felt that the current situation is against principle of public policy. Justice Muhammad Afzal Soomro and Justice Mushir Alam in case between *Azizullah Shaikh v Union Bank Limited* as shed light on the situation in the following manner:

“High Court observed that unlike other countries relationship, between the card holder, card issuer and the retailer of service or goods is not yet formally regulated in Pakistan under any statute---State Bank of Pakistan Prudential Regulations for Consumer Financing which deal with credit card hardly provide sufficient matrix to deal with complex situation that may arise out of issuance and use and dishonour of such cards---It is high time to legislate on the subject---Until legislation is made, State Bank may at least consider framing more comprehensive regulations regulating rights and obligations inter se the card holders, issuers and goods and service providers”.⁴¹

The most prominent problem in present situation is the regulation of rights and obligations as observed by the Judges in decision given about. The decision came in case of violation of rights of consumer in credit cards but actually the situation is same for all types of consumer credit transaction. The reason being that the creditors are at stronger footing as compared to consumer and they ensure that their rights are maximum and liabilities comparatively minimum. Consumer enter into the credit contract because they have the only one purpose at

⁴¹ 2007 C L D 1022 [Karachi] AZIZULLAH SHAIKH, BAR AT LAW and another Versus UNION BANK LIMITED, Spl. H.C.A. No.92 of 2006

time of contract, which is securing loan and they are kept ignorant or misguided as to what their liabilities will be.

The consumer credit regulation given by SBP are not as comprehensive as required, the regulation making process had active involvement of the Banks completely ignoring the consumer so these regulation are protection only the banking sector hence resulting in creating legal cover of irrational behavior of credit. These regulations are not formulated by SBP independently and are of advisory nature because the SBP can allow exemptions. The regulations do not regulate the negotiation, formation, terms and enforcement of credit agreements. The regulations are silent as far as rights of consumer are concerned and merely guiding the banks as to how the credit business is to be undertaken by the banks in a manner that the loss factor for banks is minimized. The regulations include comprehensive operational guidelines and various risk management measures. Each bank is allowed to make its own consumer credit policy. The different banks formulates their own polices keeping them on safe side so there is no uniformity in the procedure.

The regulation does not give any authority to monitor specifically the consumer credit business nor does it provides for any special licensing authority. The regulation does not have any term relating to the true cost of credit given to the consumer. Beside that the consumer are not communicated charges at the time of consumer credit contract. The present regulation are totally silent to the fact that what should be the situation when consumer prepays his loans, whether any plenty should be imposed on the consumer or what should be the situation, if at the end of credit duration, the consumer has some unpaid credit. So the termination of consumer credit transaction is not addressed

The recovery procedures in case of default may vary from product to product there is no standard and uniform recovery system proposed for the consumer credit services offered. Likewise there is no dispute resolution procedure and no authority given in the current mechanism for referral of disputes. There is no guideline as to how the repossession of good on credit is to be taken. In such a cases the lenders therefore even tend to use illegal means. There is law to address the default or the foreclosure but in case of repossession there is no law. The present regulations are silent as to the manner of recovery of loans. The unconventional practice of recovery by approaching the consumer directly is in practice in which recovery companies' employees, hired by banks, approach directly and threaten, insult and degrade the consumer. These recovery companies work on commission basis for the recovery of loans. They even take recourse to use of force, they visit the consumers at their homes or work place and humiliate person in front of neighbors and co-workers. The banks get signed from the consumer a contract of indemnity, by virtue of which consumer is bound to protect the banks from loss by his conduct, which is not required in case of secured loan.

His lordships at the Sindh High Court in a case of forceful re-possession of leased car without giving any notice to the lessee while the lessee was traveling on road in the car, by a recovery company person acting on behalf of the leasing company, used the following words:

“The matter is not to be left here as the situation coming out in this petition is alarming one as any company or body cannot be authorized to take law in its own hands on its own

justification without any notice etc. as, sometime, it can create serious problems if any resistance is offered by the borrower/customer⁴².

The cases mentioned in the instant document are few of those which have been followed by the consumer up to the High Court's and these have been decided based on public policy. Otherwise, most of the cases remain unnoticed and the consumer suffers because the litigation starts at the lowest level and the judges of lower court cannot adjudicate on basis of public policy. If there is a law, only then lower courts are empowered to adjudicate upon the matter. The only remedy available with customer is civil suit, and civil matters require long litigations and as there is financial obligation involved the remedy should be available in summary manner as it is available in case of negotiable instruments under C.P.C, otherwise the consumer are going to continue in their suffering as the banks get documents, like indemnity bonds signed by them. It has also been noticed in the case 2007 CLD 1365 [Karachi] that the company got signed form the consumer even the surrender certificate in case of re-possession. This re-possession certificate was also used but due to inconsistency between the statement of the leasing company director and its pleading, such certificate was proved to be signed at pre-mature level, otherwise most of the time the leasing companies and the banks get away while using such illegalities.

In another case in which nine identical petitions were decided by the his Lordships in which the recovery staff of banks with the help of police and private persons used illegal means to recover un-secured loans, they even raided the houses of the consumers and adopted illegal

⁴² 2007 CLD 1365 [Karachi] BABER SHEIKH Versus THE STATE, Criminal Miscellaneous Application No.118 of 2006

modes and means, causing harassment in front of the houses of the petitioner, created law and order situation with the aid and assistance of the local police. The Judges gave the following conclusions:

“As a consequence of order dated 30 April, 2008 Presidents of the Banks summoned have appeared in person. Controversy pertains to a delicate issue pertaining to the recovery of un-liquidated loan from the borrowers. Grievance of the petitioner is limited to the effect that those appointed by the authorities have resorted to illegal activities used all possible coercive measures for clearance of outstanding loan from the defaulters although persistently this Court is of the view as ordered in similar petitions that the mode and course provided under the law should be adopted for the recovery of the outstanding loan from the borrowers. It seems that the object of law as provided under Ordinance, 2001 as well as under the repealed Banking Laws has not been followed in letter and spirit.

On the contrary, it seems that the law has been flouted with the sole object of putting the borrowers, their lives and liberty at stake so much so that some of the borrowers in this Mega City were left over to commit suicide. We are of the view that the Presidents of the Banks present in Court should formulate a unilateral policy which should not cross the limits putting citizens at stake under the guidance of State of Pakistan which should be adopted in all the Provinces of the country to ensure that the criminal activities adopted by those appointed by the Banks for recovery must come to an end. Such report preferably be furnished by next date of hearing.’

Learned counsel appearing for Banks have candidly agreed that such policy would be formulated and would be implemented to secure the lives and liberties of the borrowers which may not in any way effect their status as guaranteed in the Constitution of Pakistan.

However, role of the police cannot be over-looked as they were also directed to take action against those at faults. Unfortunately, no substantive investigation has been conducted by the responsible in authority as they being the custodians of law are also entitled to play their role so that mischievous actives of the miscreants working for the Bank must be put to an end.”⁴³

⁴³ 2009 C L D 209[Karachi] ZAHEERUDDIN BABER Versus STATION HOUSE OFFICER and 3 others, Constitutional Petition No.D-1346 to D-1354 of 2008

Chapter 5: CONCLUSION

All the developed countries have advance credit products along with legal cover and protection mechanism for both consumer and creditors but this has not been so in case of Pakistan. Consumer credit transaction gained popularity in the recent past but the consumer protection mechanism has not been introduced practically. The consumer credit products are meant for middle class people and the society consists of mostly middle and poor class people so there is need to protect the majority of people comprising a society. Besides the law, there should be a strong regulatory framework, although the current one is good but it doesn't protect the consumer in any tangible way. It doesn't give any kind of dispute resolution mechanism and code of conduct for consumer credit business. This fact is evident by the observation of High Court, "The embryonic Prudential Regulations hardly provide sufficient matrix to deal with complex situation that may arise out of issuance and use and dishonour of such cards, it is high time to legislate on the subject"⁴⁴.

A. What should the Law focus on?

There are two kind of approaches followed in any given legislation, either negative approach or positive approach, in the first one law mentions misleading or deceptive practices and

⁴⁴ 2007 C L D 1022 [Karachi] AZIZULLAH SHAIKH, BAR AT LAW and another Versus UNION BANK LIMITED, Spl. H.C.A. No.92 of 2006

solutions to those whereas in second type law set a minimum standard for fair practices, the first one is easy to achieve but has narrow scope whereas the second approach is very difficult to legislate upon but has got a wider scope of application along with optimum consumer protection. Consumer Credit law should focus on setting the minimum standards for the consumer protection in any given consumer credit transaction.

But what ever approach is followed, the main thing is that the law should focus on both pre contract problem and post contract problems. Under Constitution of Pakistan Article 18, freedom of trade, business or profession is provided but in the first proviso it is also mentioned that the regulation of the profession can also be done⁴⁵. So the regulation of consumer credit under the constitution is also legal. Consumer credit law should focus promoting a fair, balanced and accessible credit market

It is considered that when law will be legislated, the role of SBP will be affected, but actually this will not be the case, because law will ensure accountability from the consumer credit providers, while maintaining regulatory control will be responsibility of the SBP.

The Law should cover the following part of a consumer credit transaction:

1. Advertisement, negotiations and disclosure: These mainly include pre-contract situation in which a consumer is attracted toward a credit transaction. Misleading

⁴⁵ Constitution of Pakistan 1973, Article 18. Freedom of trade, business or profession: Subject to such qualifications, if any, as may be prescribed by law, every citizen shall have the right to enter upon any lawful profession or occupation, and to conduct any lawful trade or business: Provided that nothing in this article shall prevent:-

- (a) the regulation of any trade or profession by licensing or system; or
- (b) the regulation of trade, commerce or industry in the interest of free competition therein; or
- (c) the carrying on, by the Federal Government or a Provincial Government, or by a corporation controlled by any such government, of any trade, business, industry or services, to the exclusion, complete or partial, of other persons.

advertisements only giving partial picture should be discouraged and disclosure requirement shall comprehensively cover disclosing the details of the transaction to the consumer, consumer should be made aware of all the details and calculation. The law should make it mandatory to disclose the following in a consumer credit transaction.

- a. Total credit amount
- b. Total credit charges
- c. Total amount including charges
- d. Number of installments mentioning the amount as well
- e. Insurance premium

2. Credit terms: The credit terms should at least focus on following:

- a. Contract terms including cost of credit, cancellation policies, early settlement procedures, partial payments polices
- b. Interest rate regulation and revising
- c. Payment schedule and rescheduling
- d. Default situation
- e. Penalties
- f. Consumer Privacy protection
- g. Change in credit contract terms by parties and under court order

3. **Prohibition of Financial Exclusion:** This is there to detail with discrimination in granting approval of consumer credit. There should be managed lending standards which should be followed strictly. Discrimination and discriminatory practices in the granting of credit lead people to informal form of credit such as payday loans. Legislation shall ensure that all qualified applicants have the equal opportunity to enter into consumer credit contract.
4. **Body to regulate consumer credit products and charges:** All lenders shall be monitored by regulator to determine compliance with the law. This is to ensure that the consumer pay a fair rate for the credit. The body shall be enforcement agency as well as licensing agency to ensure compliance with law.
5. **Regulation of Debt collection:** The law should focus on cases where the consumer fails to repay credit, in such a situation what method should be adopted or uniform procedure for the repossession, foreclosure and default declaration. Lenders should not be allowed to take direct steps to collect debts directly; for example, they cannot disclose collection information to third parties in order to harm a debtor's reputation.
6. **Consumer Remedies:** Consumers should be allowed to bring their own legal actions against lenders for violations of their rights and redressal should be dealt in detail. If successful, those consumers should be awarded their costs and attorney's fees.

B. Recommendations

The law should focus on all the stages of consumer credit separately, it should focus on pre-negotiation phase, where consumer is attracted, then the negotiating phase in which disclosure is important, then the formalizing phase, then performing phase focusing on re-financing and extension of credit of credit agreement and lastly the terminating step in which either two cases will be there, relinquishment of liability by the consumer or the default, repossession by the creditor. The law should make requirement for the creditor to send early warning notices to the consumer in case of default. The law should have default procedure, repossession regulation, and foreclosure sale as its ingredients. The un-conventional ways of recovery should be prohibited and specialized procedure for recovery of loans should be promulgated. Besides that the law should have a package that comprehensively deals with cases of deferral, re-financing of the credit and a mechanism to resolve the disputes arising between the consumers and banks. Speedy and summary mechanism for adjudication should be provided with comprehensive power to courts to set-aside and alter oppressive contracts.

The purpose of new legislation should be to create an efficient, fair and open market where consumers should be empowered to make fully informed decisions and the lenders ought to be able to compete on a fair and even basis. An efficient consumer credit market is essential to raise the level of economic growth.

Besides addressing the credit, the consumer credit law should also focus on the credit insurance, in which protection should be provided against over insurance, excessive premium, while also relinquishing the requirement of insurance as a condition of obtaining the credit transaction. The essence behind the relinquishment of this condition is that the

bank is seeking the cover for the loss, so it should be the bank who should pay for its price rather than the consumer because in such a case the consumer has to pay the interest on the loan to bank and the premium of insurance for banks safety along with the original amount.

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