

1. Introduction

1.1 This paper deals with consumer credit law and practice in Malaysia and the need for changes in these.

CONSUMER CREDIT THE NEED FOR CHANGES IN LAW AND PRACTICE

Dr. S. SOTHI RACHAGAN
Associate Professor
Faculty of Arts and Social Science
University of Malaya

1.2 The paper first deals with the rationale for consumer credit legislation. It then presents a critique of current legislation and focuses in particular on the issue of credit cost. The changes introduced by the United Kingdom and Australia are then briefly outlined. The final section provides a summary and concludes with a call for a review and changes in Malaysian consumer credit law.

2. Rationale for Consumer Credit Legislation

2.1 Consumer credit legislation has been introduced in the

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1. Introduction

1. 1 This paper deals with consumer credit law and practice in Malaysia and the need for changes in these.
1. 2 Previous sessions in this seminar have already dealt with different forms of credit and the law and practice pertaining to them (eg. moneylending, pawnbroking, hire-purchase, leasing, etc.). This paper will, therefore, not again deal with each of these separately. Rather, the paper will deal with consumer credit law as a whole.
1. 3 The paper first deals with the rationale for consumer credit legislation. It then attempts a critique of current legislation and focuses in particular on the issue of credit cost. The changes initiated in the United Kingdom and Australia are then dealt with briefly. The final section provides a summary and concludes with a call for a review and changes to Malaysian consumer credit law.

2. Rationale for Consumer Credit Regulation

2. 1 Consumer credit transactions have increased over the years. They have served to increase demand and consumption of goods and services, and in this way stimulated the growth of our economy. The overall benefits filter down to individuals and permit them to enjoy a better standard of life. However, consumer credit can have adverse impacts on the economy. It can result in

inflationary pressures and adversely affect the volume of savings. Unchartered growth can affect not only the credit industry but the economy in general.

2. 2 To the individual consumer, there are several advantages in using credit. Credit permits the consumer to raise his standard of living for if cash were needed for all transactions many could not afford the luxuries and even some of their necessities until they have saved the total amount. Credit gives flexibility to money management, offers safety and convenience to those who do not wish to carry cash, tides people over emergencies and can even ensure easier returns to and better service from vendors.

2. 3 Buying on credit can also pose distinct disadvantages to consumers. There is the temptation to buy on impulse or overspend. Credit costs money. Using credit ties up future income and can be an inconvenience, especially in the case of billing disputes. When there is a dispute with one's creditor or failure to meet credit obligations the consumer may lose not only his merchandise but also his ability to obtain any further credit.

2. 4 Low income families face additional problems regarding credit. They are frequently ineligible for credit or where eligible, pay more for their credit, far in excess of what is paid by more wealthy and larger borrowers.

2. 4 Especially in low income communities, shoddy goods at high prices are often the only merchandise available in places that offer credit, and this adds to the price of credit. The higher cost of credit for the poor is yet further evidence of the principal concern of consumerism that the POOR PAY MORE, and places out of reach of the less well-to-do a range of essentials that they could have availed themselves if the cost of credit was less exorbitant.
2. 5 Perhaps the greatest danger is that individual consumers will be tempted to enter into excessively burdensome commitments. A practical indication that an individual borrower has over-reached himself at any time would be actual default or near default of his contracts.
2. 6 The traditional view is that people get into debt because they are feckless or incompetent. Others have taken the view that people get into debt largely or mainly because they do not have enough money to live on. Neither of these views is entirely without substance. A low income on its own does not cause debt, however, there is no doubt that most debtors are on low incomes.
2. 7 A very significant portion of debtors are people who have suffered an unexpected drop in income - for such reasons as redundancy, short time working, illness, a death in the

family, or marriage break-up. In other words income has gone down since they took on commitments which they are now unable to meet. Many such people have difficulties with more than one bill at the same time, so that rigorous collection action by one creditor often makes things worse for other creditors, and forces the debtor into worse difficulties.

2. 8 Although defaulters are relatively a very small group, they represent a very significant social problem, for in actual terms many thousands of human beings have their lives blighted by financial disaster. It would be callous to dismiss their difficulties as a trivial matter which social policy can afford to ignore. Legislation must adequately provide for the protection of these persons.

2. 9 Bargaining power in consumer transactions lie with the supplier and this is especially so in the field of credit. The reasons for this inequality of bargaining power include:

2. 9.1 The borrowers need may be such that he is constrained to borrow on whatever terms offered.

2. 9.2 The acquisitive urge often overrides prudence especially when faced with expert salesmanship.

2. 9.3 The lack of information frequently results in the consumer not realising the drawbacks of the terms offered or the alternative sources of credit and terms available.

2. 9.4 The standard term contracts drawn are invariable one-sided and to the advantage of the creditor. They tend to impose maximum duties on the consumer and minimum responsibilities on the creditor.

2.10 The consumer is also subject to numerous trading malpractices on the part of lenders. The abuses are many, and take varied forms, and can arise before and after the conclusion of the credit transactions. These include: -

2.10.1 Deceptive advertising

2.10.2 False or misleading statements by salespersons, particularly in door-to-door sales.

2.10.3 The supply of defective goods.

2.10.4 The charging of sums for services which are either not performed at all or are minimal in relation to the amount charged.

2.10.5 The charging of excessive interest and other charges.

2.10. 6 The fraudulent concealment of material contract terms.

2.10. 7 The insertion of oppressive terms to govern default both on the defaulter and guarantors.

2.10. 8 The oppressive enforcement of contractual provisions.

2.10. 9 The tampering of items given as security.

2.10.10 The harassment of debtors in various ways, eg. threat of exposure to employers or neighbours, physical intimidation, etc.

2.11 The rationale of consumer credit legislation is therefore both economic and social.

2.12 Consumer credit legislation must

2.12. 1 Provide for the orderly growth of the industry.

2.12. 2 Be equitable as between the providers of the different forms of credit..

2.12. 3 Protect the legitimate interests of both lender and borrower.

2.12. 4 Redress the bargaining inequality as
between lender and borrower.

2.12. 6 Regulate the remedies for default.

3. Current Consumer Credit Law - A Critique

3. 1 The existing law lacks any functional basis and distinctions between one type of transaction and another are drawn on the basis of legal abstractions rather than on the basis of commercial reality. This is true not only of the general law but also of consumer protection legislation. For instance, the Moneylender Ordinance 1951 applies regardless of the size of the loan or the corporate nature of the borrower. The Hire-Purchase Act 1967 however excludes agreements entered into by a hirer who is engaged in the trade of selling goods of the same description of the goods let under the agreement. It further, only applies to goods specified in the First Schedule and the list omits a large number of commonly bought consumer goods.

3. 2 The law fails to extend consumer protection legislation to many forms of credit including leasing (except under the general provisions regarding bailment in the Contracts Act 1950), Credit and charge cards, instalment payments, revolving credit, etc.

3. 3 There is uncertainty as to what law applies to many consumer credit transactions. This confusion arises due to the failure of current legislation to provide specifically what law applies, inter alia, in the following situation:

3. 3. 1 Where existing legislation specifically provides that a particular Act does not or sections of it do not, apply to specified categories, for example:

(i) contracts of hire purchase for goods not covered by the Hire Purchase Act 1967;

(ii) the eight categories of moneylenders exempted from the Moneylenders Ordinance 1951;

(iii) pawnbroking transactions for all loans in excess of \$5,000 and loans between \$1,000 and \$5,000 where the interest rate is less than 10% per annum which are exempted from the provisions of the Pawnbrokers Act 1972.

3. 3. 2 Where there exists no specific Malaysian legislation to regulate a particular form of credit but there exists legislation or common law in the United Kingdom regulating these forms. The confusion arises

3. 3 The failure to provide for a single agency to enforce consumer credit has meant inconsistent application of the provisions of the Civil Law Act 1956 stipulating the applicability of English mercantile law. The confusion is further compounded by the fact that the incorporation of English law varies according to whether it is being applied in the Malay states or the states of Penang, Malacca, Sabah and Sarawak.

3. 4 Failure to distinguish between consumer and commercial transactions and where there is a distinction made (as in the Hire Purchase Act 1967) doing so in a wholly unsatisfactory manner.

3. 5 The lack of consistent policy in relation to sanctions for infringement - in instances the law provides criminal sanctions and in others offers only civil remedies. Where it does provide criminal sanctions the penalties provided for are inconsistent.

3. 6 Excessive Technicality - Virtually all the Acts governing consumer credit have amassed a considerable amount of case law concerned with technicalities which should be for simplicity be clarified in the statute.

3. 7 The failure to provide for a single agency to enforce consumer credit has meant inconsistent application of the laws.

- 3. 8 The failure to adequately protect the interest of third parties.
- 3. 9 The failure to provide for equitable treatment of guarantors.
- 3.10 The various pieces of legislation contain inconsistent provisions, inter alia, in relation to:
 - 3.10. 1 Licensing.
 - 3.10. 2 Control of advertising.
 - 3.10. 3 Provision of information to consumers, in particular, information pertaining to interest and other charges, and, other terms of the contract.
 - 3.10. 4 Regulation of exorbitant interest and other charges.
 - 3.10. 5 Re-opening of contracts considered unfair.
 - 3.10. 6 Warning about legal action and the steps to be taken prior to, at the time of, and subsequent to, the issue of warnings.
 - 3.10. 7 Use of the credit-leverage for tied in sales such as insurances.

4. The Cost of Credit

4. 1 Consumer complaints as regards the cost of credit focus on three areas:

4. 1. 1 It is expensive, certainly more expensive by comparison to the rates paid by larger borrowers.

4. 1. 2 That the manner in which credit rates are presently calculated involves misrepresentation.

4. 1. 3 The creditor fails to provide the debtor with appropriate rebates when he makes early settlement of his debts.

4. 2 High Cost of Credit

4. 2. 1 What constitutes an equitable cost of credit is dependant on a host of factors, significant amongst which are whether there is security which will secure payment of the debt, the length of the repayment period, and, the legal form of the transaction. What is clear, however, is that the purchaser of goods pays a substantially larger cost for his credit than most other borrowers.

4. 2. 2 Whether the state should intervene and stipulate the maximum rates of interest charged is not one in which there is unanimity of opinion. Repetition, Malaysian legislation

of opinion. Regardless, Malaysian legislation already governs the interest rates in many areas. The Pawnbrokers Act 1972 and the Hire Purchase Act 1967 both serve to control the cost of credit. The former stipulates a maximum of 2% per month and the latter 10% per year. The business community has also been most strident in calling on Government to reduce the interest rates charged by banks and other financial institutions.

4. 2. 3 In the United Kingdom, the Consumer Credit Act of 1974 provides for the courts to assess, on an application by a debtor, whether the cost of credit in any transaction is excessive and to adjust the rates accordingly. It will be useful to emulate this in Malaysia.

4. 3 Misrepresenting the True Cost of Credit

4. 3. 1 The essence of most forms of purchase-money credit transactions is that the purchaser, in return for his not having to pay immediately, eventually pays more in total than the cash price of his purchase. The seller inevitably argues that the difference between the total sum the purchaser pays and the cash price is

not all interest, at least in the narrow sense; some of it may be needed to cover the seller's costs in connection with the credit transaction (like legal charges, required insurance costs etc). From the purchasers point of view, however, such a distinction between interest and costs is wholly irrelevant - the excess over the cash price that he pays represents the price he has to pay for credit. Hence, an equitable representation of the interest paid should:

- (i) include the whole of the difference between the cash price and the total amount paid; and
- (ii) be calculated from the price he would have paid if it had been a cash transaction and not the invariably higher "list price". The discount lost by buying on credit truly forms part of the charge for credit.

4. 3. 2 The true rate of interest paid by a purchaser is often masked by the manner in which the cost is represented.

4. 3. 3 A rate of interest may be defined as the amount of interest to be paid at the end of one unit interval of time for each unit of capital borrowed. For example if \$50 is borrowed and repayment is by a single payment of \$51 (\$50 capital and \$1 interest) one month later, the rate of interest is .20 (or 2%) per month. In applying this definition, any interest unpaid is deemed to be added to the capital borrowed and any repayment in excess of the interest due at any time is deemed to be deducted from the capital. Thus, if \$10,000 is borrowed at a rate of interest of 4% per half-year, but no payment of interest or capital is made until the end of a year, the total interest then payable will be \$816, consisting of \$400 for the first half-year and \$416, the interest on \$10,400, for the second half-year. It will be seen that the rate of interest in this example could be described either as 4% per half-year or 8.16% per year.

4. 3. 4 To specify a rate of interest, both the rate per unit and the period to which it relates must be given. To enable comparisons to be made, however, rates of interest are commonly

expressed as rates per year and confusion is caused by the fact that rates for a period other than a year are converted to annual rates by two different methods. The United States Truth in Lending Act relies on "nominal rates" and the United Kingdom Consumer Credit Act utilises the "effective annual rates". Nominal rates of interest, unlike effective annual rates, are only comparable one with another if they are convertible with the same frequency. For example, from the borrowers point of view 1% per month is a less favourable rate than 6% per half year, though both are equivalent to nominal rates of 12% a year. The effective annual rates of these being 12.68% and 12.36% respectively. Accordingly, if one wishes to compare the rate of interest paid by the borrower on two different credit transactions, the better course is to calculate the effective annual rate in each case, rather than the nominal rate.

4. 3. 5 The complexity that interest rate calculations pose is further compounded by what is a practice common in most purchase money credit transactions.

In such transactions the borrower undertakes to make a definite series of payments to discharge his debt, such as 12 or 24 monthly payments. To take an example, if a loan of \$200 were repaid by payments of \$10 a month for 2 years the total amount that would have been paid is \$240. The seller frequently represents this as being an interest charge of 10% per annum derived as follows: -

Total Credit \$200

Total Repaid \$240

Cost of Credit \$40 (20% of \$200)

Period of Credit 2 years

Interest Rate $20\% \div 2 = 10\%$ per annum.

The error in such a calculation of course is that it assumes that \$200 was borrowed for a year at the end of which a one lump sum payment of \$220 was made; and further, that another loan of \$200 was subsequently taken and repaid as another lump sum of \$220 at the end of the second year.

4. 3. 6 In the past, a great many ingenious approximate formulae for obtaining the rate of interest involved in a given transaction have been constructed. There is, however, no one reasonably

simple formula which gives good results for a wide range of terms and interest rates. Schedule 1 of the United Kingdom Advertisements (Hire-Purchase) Act, 1967 provides a useful formula:

$$\frac{200 \text{ md}}{p(n+1) + \frac{d}{3} (n-1)}$$

In this formula

m is the number of instalments per annum;

n is the total number of instalments;

p is the amount borrowed;

d is the total amount repaid as capital and interest less the amount borrowed.

4. 3. 7 Using our earlier example of a loan of \$200 repaid by payments of \$10 a month for 2 years, $m = 12$, $n = 24$, $p = 200$ and $d = 40$ (i.e. $24 \times 10 - 200$). The rate of interest given by the formula would be 18.09 per cent a year. This is the nominal annual rate of interest. The effective annual rate of interest can be calculated by modifying the formula thus

$$\frac{200 \text{ md}}{p(n+1) + \frac{d}{3} (n-3m+2)}$$

4. 3. 8 All this appears daunting and is clearly outside the competence of an average consumer. But there is really no cause for despair. If the use of a formula is prescribed by law as it clearly should be there is little doubt that tables would be produced which give the results of application of the formula for all values of m , n , and d/p likely to be met with in practice, the seller can then rapidly look up the rate of interest for any transaction in the appropriate table.

4. 4 Rebates for Early Settlement

4. 4. 1 Frequently, the borrower under an instalment credit agreement will wish to pay off the loan or complete the purchase at an earlier date than was originally envisaged. It is unfair to the borrower if he were compelled to pay the sum of the remaining payments due from him under the original agreement in order to terminate the contract. It is only fair that the amount of interest paid should be less since the loan has been outstanding for a shorter period.

4. 4. 2 Again several formulae have been computed and are in use in various countries. A formula adopted by the U.K. Consumer Credit Act, 1974 and the Hire

in other Purchase Acts of Malaysia and Singapore is
Kingdom, as follows:

$$\frac{t (t+1)}{n (n+1)} \times \text{total interest charge}$$

In the formula

n is the original number of instalments

t is the number of intervals before the

date of the final instalment the borrower

wishes to pay the remaining instalments.

For example, if a loan of \$100 was being repaid
by 12 quarterly instalments of \$10 and the borrower
wishes to repay at the end of 8 months, n would be
12 and t would be 8, so that the rebate would be:

$$\frac{8 (8+1)}{12 (12+1)} \times 20$$

4. 4. 3 It is only equitable that provision for rebates
for early settlement be made a requirement for all
forms of credit transactions.

5. A New Order for Consumer Credit Transactions

5. 1 The previous sessions of this seminar and paras 3.1 to
3.8 have served to highlight the shortcomings of the current
legislation pertaining to consumer credit. There clearly
exists an urgent need for a review of our current legislation
with a view to providing for appropriate changes. Reviews

in other countries including the U.S., the United Kingdom, Australia, New Zealand and much of Europe have resulted in a whole new order in consumer credit legislation.

5. 2 In the United Kingdom a committee on Consumer Credit chaired by Lord Crowther undertook a detailed study of the law applicable to consumer credit. Faced with the alternative of recommending minor changes in credit law or a sweeping review, the Committee came down firmly in favour of the latter. The proposed new legal framework rested on two fundamental points:

5. 2. 1 Recognition that the extension of credit in a sale or hire-purchase transaction is in reality a loan, and the reservation of little under a hire-purchase or conditional sale agreement or finance lease is in reality a chattel mortgage securing a loan.

5. 2. 2 Replacement of what was distinct sets of rules for different security devices by a legal structure applicable uniformly to all forms of security interest.

5. 3 The Crowther Committee did not propose that there should be standard forms of instrument and it was recommended that parties be free to choose the form of agreement they propose.

However, all forms of agreement serving a similar purpose; it was recommended be regulated alike.

5. 4 As a result of the Crowther Committee's recommendations the Consumer Credit Act 1974 was enacted. This Act is the subject of the session immediately following on this. Briefly, the Act:

5. 4. 1 Established a comprehensive code of regulation for the supply to individuals (including sole traders and partnerships) of credit not exceeding £5,000 throughout the United Kingdom.

5. 4. 2 Provided for the licensing of those who carry on business of granting consumer credit and of ancillary credit businesses.

5. 4. 3 Repealed numerous existing statutes that regulated the supply of Credit including the Pawnbrokers Acts, the Moneylenders Acts and the Hire-Purchase Act.

5. 4. 4 Extended to cover transactions previously unregulated by any enactment and thus affected banks, finance houses, building societies, local authorities, life insurance offices, moneylenders, pawnbrokers, cheque and voucher traders, the issuers of credit cards, mail order companies, retailers,

service industries, mortgage companies and other businesses providing financial accomodation.

5. 4. 5 Regulated consumer hire agreements where the hirer is an individual (including sole trader or partnership). It thus affected not only those who let goods on hire for domestic purposes, eg. television sets, but also those who lease or let out on hire commercial and industrial equipment, including vehicles, for business purposes.

5. 4. 6 Required a licence for consumer hire businesses.

5. 5 In the Australian state of Victoria (as in New South Wales and Western Australia) the Credit Act 1984 regulates all providers of credit for the following transactions:

5. 5. 1 Credit Sale Contracts - This is a credit for the sale of goods or services, where credit is provided to the consumer by the trader to allow the consumer to pay for the goods or services.

5. 5. 2 Loan Contracts - This is a contract where a person in business agrees to provide credit to another person by paying money to that person. It is still a loan if the person who borrows the money instructs the credit provider

to pay it to someone else.

5. 5. 3 Continuing Credit Contracts - This is a contract where a person in business agrees to provide credit to a consumer so that the consumer can pay for goods or services from time to time. The goods or services for cash may be supplied by the credit provider or by a third person (eg. Bankcard, Retail Store Credit Cards etc.)

5. 6 The Victorian Credit Act 1984 made sweeping changes:

5. 6. 1 Established a Credit Division of the Small Claims Tribunal to settle disputes between consumers, credit providers and/or traders. The Tribunal is an inexpensive and informal forum.
5. 6. 2 Provided for a licensing system of credit providers with powers for the licensing authority to suspend, cancel or modify the terms of the licences.
5. 6. 3 Required the provision^{of specified information}/about the credit contract before and after signing.
5. 6. 4 Consumers unable to meet their obligations under the credit contract due to illness, unemployment or any other reasonable cause can apply to their credit provider for relief. If refused, ^{they}he can turn to the Small Claims Tribunal.

5. 6. 5 Allows for the re-opening of unjust contracts by applying to the Small Claims Tribunal.
5. 6. 6 Consumers threatened with legal action may negotiate with their credit provider for postponement of the action.
5. 6. 7 Consumers get more warning about any legal action a months notice in writing explaining why the action is being taken and what can be done to stop it is now required.
5. 6. 8 Consumers cannot be forced to take out certain types of insurance as a condition of receiving credit.
5. 6. 9 Guarantors get the same information and protection as debtors.
5. 6.10 The same method of calculating interest (known as 'simple' or 'acturial') must be used in all contracts so as to facilitate comparison.
5. 6.11 Provides stringent rules against false, misleading or deceptive advertising and credit hawking.
5. 6.12 In some instances, imposes joint liability between a credit provider and a trader who have a 'linked credit' agreement.

5. 7 The U.K. and Australian legislation provide models of consumer credit legislation that can usefully be emulated in Malaysia. Their adoption however must be done after a comprehensive review of the current law and practice.
5. 8 The Ministry of Trade and Industry has for the past few years intermittently reviewed the Hire Purchase Act 1967 but no changes to the law have yet been effected. This is a gross failing on the part of the Ministry and raises a fundamental issue - is a Ministry of Trade and Industry committed to the expansion of trade and industry and having the form of contacts with business interests necessary for such a task, the most appropriate authority for undertaking consumer protection. The Ministry's record hitherto would suggest otherwise. In the U.K. the Office of Fair Trading was established under the Fair Trading Act to regulate fair trading and has been entrusted to also implement the Consumer Credit Act. It will be useful to consider a similar arrangement for Malaysia.
5. 9 The adequate regulation of consumer credit, especially the protection of poorer consumers, awaits decisive action by Government.

6. Summary and Conclusion

6. 1 Credit is an integral feature of our economic system and its provision stimulates the economy and by and large benefits the consumer. Nonetheless, unregulated credit provision can and does make credit unjustly expensive, discriminatory in its provision and draws consumers into unmanageable debt. The legitimate interests of consumers are thus sacrificed.
6. 2 The current law pertaining to credit is piecemeal. Regulation is at present achieved partly by statutory provisions controlling the conduct of business generally, and partly by the statutory stipulation of rights and duties in relation to individual transactions. The law fails to distinguish consumer from commercial transactions, and consequently, fails to provide the form of protection that consumers need.
6. 3 In other jurisdictions, notably in the United States, United Kingdom and much of Europe, Australia and New Zealand significant steps have been made towards rationalising the credit laws so as to provide for consumer protection.
6. 4 In the United Kingdom following an extensive report of the Crowther Committee on Consumer Credit, the Consumer Credit Act 1974 was adopted. This comprehensive piece of legislation repealed the whole or part of 60 pieces of legislation

including those pertaining to moneylending, pawnbroking, and hire-purchase. The Consumer Credit Act provides for the licensing of all credit and hire businesses, controls their advertising and canvassing, stipulates the form of the contracts entered into and the regulation governing any security provided, regulates default and termination proceedings and augments the role of the courts in relation to the supervision of consumer credit transactions.

6. 5 In Australia for instance, The Credit Act and the Credit (Administration) Act of 1984 represent major consumer law reforms. The Credit Act is uniform in Victoria, New South Wales and Western Australia though the administration aspects dealt with in the Credit (Administration) Act are different for each of the states. The Credit Act applies to finance companies, retail stores which provide credit, small companies which may lend money as part of their business, companies which issue credit cards, banks and building societies. The Act refers to all these as credit providers and, inter alia, provides for their licensing, governs the information they may and must provide, protects their consumers who are unable to meet credit obligations because of illness, unemployment or any other reasonable cause. The Act also provides for the manner in which and credit charges are to be stipulated, controls advertising and credit hawking.

6. 6 These pieces of legislation are forerunners in comprehensive consumer credit legislation and are worthy of emulation. This the Ministry of Trade and Industry, as the government appointed consumer watch-dog has to do. Though, it is hoped that this will be achieved shortly, it is seriously doubted that the Ministry of Trade and Industry has the will and capacity to undertake this task. Adequate and comprehensive consumer credit regulation, as indeed any consumer protection legislation, may only be achieved if an agency independent of the Ministry of Trade and Industry is entrusted with the task of consumer protection.