

The Development of Islamic Finance Alternative Dispute Resolution Framework in Malaysia

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Abstract: The sustainable growth and rapid evolution of Islamic finance industry depends on the comprehensive legal framework. The growth of Islamic finance industry has resulted in the increased levels of disputes and thus need for an authoritative and specialist body that can adjudicate and provide reliable decision. The objective of this study is to examine the development of Islamic finance dispute resolutions framework in Malaysia. It is argued that court is the proper forum of settlement. Nevertheless, the court faced many challenges in exercising its duty as to the nature of the transaction which combine both Islamic and conventional contract. The methodology adopted is qualitative in nature and institution analysis. The study analysed the institutional framework of ADR in Islamic finance industry, such as Kuala Lumpur Regional Centre for Arbitration (KLRCA), Financial Mediation Bureau, Shariah Advisory Council and Malaysia Mediation Centre. In conclusion, the study found that ADR supplements the current litigation process of Islamic finance cases.

Key words: Alternative disputes resolution, Islamic finance, litigation, arbitration, mediation

INTRODUCTION

The robust evolution of Islamic finance conforms to the innovative financial instruments in the market. Sound policy and comprehensive regulatory framework contribute vastly to the successful of the Islamic financial system. The developments have resulted in the increase of disputes, claims and complaints in financial transaction. Instead of settling the disputes in the civil court, the parties resort to Alternative Dispute Resolution (ADR) mechanism for settlement. The principles of sulh (reconciliation), tahkim (arbitration) and hybrid of some of the processes recognized in Islamic law also was applied in resolving financial disputes. These mechanisms promote the good values between the disputants by ensuring impartial decisions which amount to win-win settlement.

ENFORCEMENT OF ISLAMIC FINANCIAL LAWS IN MALAYSIA

In Malaysia, Islamic finance dispute fall under the civil courts jurisdiction (Markom *et al.*, 2013). Islamic financial matters referred to the item finance provided under the Federal List, 9th schedule of the Federal Constitution. Item 7, First schedule mentioned that

Federal List governs finance including banking, bills of exchange, promissory notes, other negotiable instruments and foreign exchange. Effective from 6th February, 2003, all Islamic banking cases were given special code to be filed in the respective courts and heard in Muamalah Bench in High Court of Kuala Lumpur. Nevertheless, for courts outside Kuala Lumpur, Islamic banking cases will be conducted by the same judge or magistrate who is dealing with conventional banking and commercial cases using the similar special codes.

CURRENT TRENDS IN ADJUDICATING ISLAMIC FINANCIAL DISPUTES

Litigation is the popular mode of adjudicating not because it is better than mediation and arbitration. It is the preferred choice for the ease of reference to precedents and familiarity of parties in conducting litigation process. Parties do not consciously choose litigation as their first choice rather it is more of customary practise. Islamic financial laws are unique in nature to the fact that it combines both Islamic transactions and the common law of contract. Thus, the situation posed constraints to the Islamic Financial Institutions with regards to dispute resolution. In the case of Islamic Investment Company of the Gulf (Bahamas) Ltd., v. Symphony Gems NV & Ors in

2002, WL 346969 (QB Comm. Ct 13 February, 2002) a case of murabahah (cost plus contract), the parties have agreed on the choice of law and jurisdiction as being the English law. The court after analysing the elements and conditions of the contract and opinions of the experts decided that English law of contract must apply to the purported murabahah contract despite the fact that the expert opinion revealed that the contract did not fulfil the requirement of a murabahah contract. Other than that clause 25 of the agreement provides that this agreement and each PURCHASE AGREEMENT shall be governed by and shall be construed in accordance with English law. Thus, with this clause the parties have agreed that the transaction, as well as any purchase agreement pursuant there to shall be governed and construed in accordance with the English law. In addition, clause 26 of the underlying agreement provides for an irrevocable submission to the jurisdiction of the English court (Balz, 2004). This case illustrates the challenges faced by the court in deciding the governing law of the Islamic financial transaction.

EMERGING TREND IN ALTERNATIVE DISPUTE RESOLUTION

The trend of Alternative Dispute Resolution (ADR) is a manifestation of global dissatisfaction with the litigation process fraught with delays, costliness and hostility (Rashid, 2004). As an option in settling the dispute, ADR refers to other methods which parties to a dispute may adopt in order to reach an amicable settlement of their differences. In other words, ADR refers to dispute settlement by other than a court system or litigation. The commonly kinds of ADR used are negotiation, conciliation, mediation and arbitration.

It has been proved that Amicable Settlement of Dispute (ADR) is the foundation step towards dispute resolution in preference to litigation. For instance, in Surah Al-Hujurat (49): 9-10, translated as:

And if 2 parties (or groups) among the believers fall to fighting, then make peace between them both. But if one of them outrages against the other, then fight you (all) against the one which outrages till it complies with the command of Allah. Then if it complies, then make reconciliation between them justly and be equitable. Verily, Allah loves those who are equitable. The believers are nothing else than brothers (in Islamic religion). So make reconciliation between your brothers and fear Allah that you may receive mercy.

ISLAMIC FINANCE ALTERNATIVE DISPUTE RESOLUTION IN MALAYSIA

The need for ADR in Islamic finance industries owes to the following reasons. Firstly, the complicated nature of the Islamic financial instruments which need attention from the Shariah experts in dealing with the disputes. Then, the inadequacy of the present contract laws to deal with Islamic transactions matters. Among the types of ADR practised are as follows:

Arbitration: Arbitration connotes amicable dispute settlement of 2 parties. The parties submitted their claims to the third party in order to reach fair determination. There are 3 elements of arbitration which are the existence of dispute between the parties, an agreement between them to refer it to arbitration and both parties agreeing to be bound by the decision of arbitration (Yaacob, 2012). The disputes under arbitration will be resolved by an award made by an independent tribunal (third party or arbitrator). The Arbitration Act 2005 (Act 646) is the governing law of arbitration in Malaysia.

In addition, arbitration has adopted two essential method of dispute resolution. Firstly, the United Nations Commission on International Trade Law (UNCITRAL) model law. This model is made to help the member countries in improving and updating their laws on arbitral procedure in fulfilling the international commercial arbitration. It consists of arbitral process from the arbitration agreement, the composition and jurisdiction of the arbitral tribunal, the extent of court intervention, through to the recognition and enforcement of the arbitral award. The process reveals the nation compromise on important features of international arbitration practice consented by states in all regions of the world.

Next is the New York Convention Model, the 1958 New York Convention on the 'Recognition and Enforcement of Foreign Arbitral Awards' provides common legislative standards for the recognition of arbitration agreements, court recognition and enforcement of foreign arbitral awards. The aim of the convention is to require courts to give full effect to arbitration agreements by requiring courts to deny the parties access to court in contravention of an arbitration agreement. It ensures the recognition and enforcement capability of the parties in their jurisdiction similar to the domestic awards. By this way, it limits the non recognition of a foreign award, such as awards that are contrary to public policy, incapacity and improper notice of the appointment of the arbitrator or of the arbitration proceedings (UN, 1958).

Among the benefits of arbitration is the parties shall choose their own arbitrator. The parties have the right to choose their own arbitrator based on the expertise. Moreover, arbitration process is time consuming than the ordinary litigation. Then, the requirement of private meeting in which the consultation are confidential without the presence of the media and members of the public. In addition, the end results are not published and confidential. The process is more convenience as the hearings are arranged at times and places to suit the parties, arbitrators and witnesses. The element of finality for example no right of appeal in arbitration is upheld. Finally in the event of cross border cases, enforcement of arbitration award in other nation is generally easier than a court's judgement due to the provisions of the New York Convention 1958 (Lawrence *et al.*, 2012).

With regards to Malaysia, section 56 of the Central Bank of Malaysia 2009, recognised the importance of arbitration in Islamic finance where it provides that in any proceedings relating to Islamic finance, the court or arbitrator and if any case arise concerning shariah the court may refer to Shariah Advisory Council (SAC). The ruling that made by SAC is binding on the Islamic financial institutions and thus arbitration is encouraged to avoid legal risk.

Mediation: Mediation is another important method of alternative dispute resolution. It is a flexible process conducted confidentially in which a neutral person (the mediator) actively assists parties in working towards a negotiated agreement of a dispute or difference. There are several principles of mediation. First, a mediator conducts the mediation process. A mediator is a neutral person, assists the parties to reach settlement and no right to stop or proceed the mediation except with the consent of the parties. Mediation is a voluntary and confidential process. It will not be binding on any party unless and until agreement is reached. Mediation is conducted without prejudice to any legal rights which the parties may have. If mediation is unsuccessful other means of dispute resolution may be used or continued. The common advantages of mediation are the parties can reach the settlement by the assistance of mediator and settlement can be reached much more quickly than litigation (Rural Assistance Authority, n.a). Recently, Malaysia also started court-annexed mediation in encouraging the mediation as dispute resolution mechanism.

Negotiation: Negotiation is an agreement between two or more parties to reach compromise. Traditionally, negotiation does not involve third party because negotiation directly between the parties and their counsel.

However, if there is a failure in negotiation, a third party may be introduced and it is known as facilitated negotiation. During the negotiation, the third party act as facilitator and communicate with the parties. The facilitator will assist the parties to reach a settlement without influence them (Berman, 1995).

INSTITUTIONAL FRAMEWORK FOR DISPUTE RESOLUTION IN ISLAMIC FINANCE IN MALAYSIA

There are several institution in Malaysia that obliged to undertake the services of resolving Islamic finance dispute. The dispute will be settled through mediation, arbitration or through any other process. The institutional framework for 'Alternative Dispute Resolution' for Islamic finance includes the following bodies:

- Kuala Lumpur Regional Centre for arbitration
- Financial Mediation Bureau
- Shariah Advisory Council of the Central Bank of Malaysia
- Malaysian Mediation Centre

Kuala Lumpur Regional Centre for arbitration: The Kuala Lumpur Regional Centre for Arbitration (KLRCA) is a dispute resolution body established under the Asian African Legal Consultative Organisation (AALCO) in 1978 in order to provide aggrieved parties an alternative to settling their dispute other than using court system (William, 2009). It is governed by Rules for arbitration of Kuala Lumpur Regional Centre for arbitration (Islamic banking and financial services) in 2007 to encourage the use of arbitration for disputes emanating from Islamic financial services. Based on rule 1, para 3, these rules shall be applicable for the purposes of arbitrating any commercial contract, business arrangement or transaction which is based on Shariah principles. The rules of the centre gives flexibility in the conduct of proceedings of the arbitration and give open discretion to the parties in choosing their arbitrators, conciliator and panellist. The parties also have a chance to choose the place of dispute resolution and the applicability of the procedural rules. In fact, foreign lawyers are allowed to appear in dispute resolution proceedings held at the centre. Finally, the Malaysian Arbitration Act 1952 was amended in 1980 and a new section 34 expressly excludes the centre from the supervision and intervention of courts. This section covers both domestic and international arbitration. However, there was criticism on the rules as its being a complete replica of the UNCITRAL Arbitration Rules of 1976 with some modifications in order to suit the specific needs of parties in Islamic financial transactions (Oseni, 2009).

Financial Mediation Bureau: The Financial Mediation Bureau (FMB) is an independent body and aims to provide dispute resolution services to customers and their financial services provider. As an alternative to the court system, FMB provides free, fast and efficient to customers and their financial services providers who are members. This body is under the supervision of the Central Bank of Malaysia. A number of financial institutions and about 16 Islamic banks in Malaysia are members of FMB. The FMB is very active in its service delivery in the Islamic finance industry because it is cost-effective and fast. Most of the cases involving disputes between banker-customer relationship, such as loss of deposits over the counter and unauthorized ATM withdrawal. This is due to the limited jurisdiction of the FMB (Oseni and Ahmad, 2011). The FMB will hear all complaints, disputes and claim on the matters, such as banking, personal loans and financing, housing loans, cash deposits machine, hire purchase, savings accounts, current accounts, fixed deposit, remittances, electronic banking, internet banking and insurance or takaful. The FMB can only handle disputes, claims or complaints involving financial loss of which the amount claimed does not exceed RM 100,000 for banking and financial related matters. The exceptions to this are fraud cases involving payment instruments, credit cards, charge cards, ATM cards and cheques whose maximum limit is set at RM 25,000. On the other hand, the maximum claim in disputes, claims or complaints involving insurance or takaful must not exceed RM 200,000 in motor and fire insurance/takaful and RM 100,000 for others. In addition, award and the decisions of the FMB is binding on the institution but not on the complainant. Thus, if the parties did not satisfied with the decision, the party may take legal actions against the institution concerned. However, if the parties have accepted the settlement by FMB, then the complainant will lose their right to take legal action.

SHARIAH ADVISORY COUNCIL OF THE CENTRAL BANK OF MALAYSIA

The Shariah Advisory Council of Bank Negara Malaysia (SAC) was established in May, 1997 as the highest Shariah authority in Islamic finance in Malaysia. The SAC has been given the authority to ascertain the Islamic law on any financial matter and issue a ruling upon reference made to it in accordance with this part to advise the bank on any Shariah issue relating to Islamic financial business, the activities or transactions of the bank to provide advice to any Islamic financial institution or any other person as may be provided under any written law and such other functions as may be determined by the

bank. This function closely related to the purpose in ADR which are dispute resolution and dispute avoidance. In this situation, when there is a reference of Shariah issue by the arbitral tribunal, the SAC will ascertain on such matter and issue a ruling. The ruling which provides by the SAC can facilitates for a quick settlement of the disputes. In addition, section 56 (1) of the Central Bank Act provides the circumstances where the published rulings of SAC may serve as dispute avoidance mechanism. This study clarifies that arbitral tribunal or court must take into consideration on the ruling relating to Islamic financial business where any question arises concerning a Shariah matter that publish by SAC.

Malaysian mediation centre: On 5 November, 1999, the Malaysian Bar Council set up the Malaysian Mediation Centre (MMC). The MMC deals with all types of commercial and matrimonial disputes in the country and is accessible to all parties (Yong, 2002). With regards to jurisdiction, there is no monetary limit on the claims. The MMC has 135 registered mediators and a total of 131 cases have been referred to mediation. The services which provides by MMC include mediation services, assistance and advice on how to persuade the other side to agree to mediation if one party has shown interest and provision of mediation training for those interested in becoming mediators. Other than that there has been an effort in encouraging the parties to settle a dispute through ADR process. Due to this reason, there was the issuance of the practice direction. Practice direction expressly provides for the use of MMC Code of Conduct and Mediation Rules. All court referrals are made to a mediator appointed from the list of neutrals furnished by the MMC, except otherwise provided by the parties. In addition, the Muamalat Bench of the Commercial Division of the High Court of Malaya will also have course to refer Islamic finance disputes to qualified mediators. In determining the issue, such mediators should come from expertise in the practice of Islamic finance with many years of experience.

Court annexed mediation: The court annexed mediation is a free mediation programme using judges as mediators to help the disputing parties in litigation find a solution. This service was provides by the judiciary as an alternative to a trial which was a win-lose proposition (Bernama, 2011a). The court annexed mediation programme has been introduced in order to ensure that mediation is available to all litigants and it might also as part of process which does not involve cost to the parties and nothing is lost by attempting to mediate a solution. For this purpose, the centre is set up in the court building. Thus, the mediation

process will no longer be conducted in the judge's chambers but only at the centre. Other than that, there will be a panel of appointed mediators who are comes from the judges (from the High Court and Sessions and Magistrate's courts). Among the advantages of the court annexed mediation is commitment of the counsels to the mediation process. A court-ordered mediation required the parties and their counsels to commit to the mediation process. The parties would have no option but to make good use of the time allocated and try to communicate and settle the dispute between them as it is done under the court authority. Then, the process assists the parties to evaluate their thinking towards the case. Finally, the discussion in the mediation proceedings are wider and not only limited to legal issue. The successful of mediation process could help the parties to avoid stress and keep commercial relationship and save cost and time. Other than that mediation process is more flexible and the settlement that reached by the parties shall be recorded as a judgment of the court and it's binding upon the parties (Bernama, 2011b).

CONCLUSION

Alternative Dispute Resolution (ADR) provides an avenue for win-win situations. It improves the application to out-of-court settlement over conventional judicial proceeding which is adversarial in nature. It is less expensive, less litigious and non-adversarial methods of dispute resolution. The said alternative dispute resolution mechanisms promote speedier way of settling disputes, freedom of choice over laws, procedures and language of the proceedings to the parties. The dispute resolution through mediation and arbitration has been acknowledged as an appropriate mechanism for resolution of disputes especially for commercial transaction or Islamic finance transaction. In addition, the parties involved may appoint a person who has special expertise in the case of dispute as the mediator or arbitrator. The contention is approved by Tan Sri Dr. Zeti Akhtar Aziz, the governor of the Central Bank of Malaysia in Star Biz dated 26th August, 2004 as follows:

To complement the court system, disputes may also be referred to the arbitration centre for resolution. In this regard, the Kuala Lumpur Regional Centre for Arbitration will be enhanced to serve as a platform to deal with cases involving Islamic banking and finance and to extend these services beyond the borders.

The earlier quotation indicates that ADR supplement the existing court system in providing better access to justice for the nation. As far as Islamic finance is concerned, the most significant characteristic of ADR is reference to the Shariah Advisory Council of the Central Bank of Malaysia. The law requires the arbitrator who is presiding over any dispute arising from Islamic financial business to refer to the published rulings of the Shariah Advisory Council or to request for advice from the council to determine any issue concerning a Shariah matter before them.

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