

## ISLAMIC BANKING DISPUTE RESOLUTION: THE EXPERIENCE OF MALAYSIA AND INDONESIA

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### ABSTRACT

The dispute resolution mechanism in a country involving Islamic banking depends on its applicable law. A workable mechanism guarantees a harmonious settlement and ensures justice is upheld in conjunction with the spirit of Islamic law. This study aims to analyse various mechanisms to resolve Islamic banking disputes in Malaysia and Indonesia by referring to the latest legal and judicial developments in both jurisdictions. It adopts doctrinal and comparative legal research methodology whereby the relevant primary and secondary sources of law were meticulously appraised. Findings of this study reveal that both countries have their own unique way of dealing with Islamic banking and finance cases. In Malaysia, the jurisdiction is vested in civil courts with mandatory reference to the SAC in deciding Shari'ah issues. Regarding Indonesia, Article 55 (1) of Law No. 21 (2008) provides that a Religious Court shall have jurisdiction to hear matters involving Islamic banking disputes, unless there is an agreement stating that the dispute resolution should be done in another manner, provided the chosen manner does not contradict with Shari'ah principles. There is also an option to refer to the Dewan Shari'ah Nasional Majelis Ulama Indonesia for expert opinions. Both jurisdictions also acknowledge alternative dispute resolution as a mechanism for dispute settlement. This study emphasises the need to enhance the knowledge and in-depth understanding of judges in the relevant field of law; Shari'ah law for civil court judges and civil law for religious court judges, to facilitate the dispute resolution process.

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**Keywords:** Islamic Banking and Finance, Alternative Dispute Resolution, Conflict of Jurisdiction, Civil Court, Shari'ah Court.

## **PENYELESAIAN PERTIKAIAN PERBANKAN ISLAM: PENGALAMAN MALAYSIA DAN INDONESIA**

### **ABSTRAK**

Mekanisme penyelesaian pertikaian yang melibatkan perbankan Islam di sesebuah negara bergantung kepada pelaksanaan undang-undang yang berkaitan. Mekanisme yang boleh dilaksanakan boleh menjamin penyelesaian yang harmoni dan memastikan keadilan ditegakkan selari dengan semangat undang-undang Islam. Kajian ini bertujuan untuk menganalisis pelbagai mekanisme untuk menyelesaikan pertikaian perbankan Islam di Malaysia dan Indonesia dengan merujuk kepada perkembangan undang-undang dan kehakiman terkini dalam kedua-dua bidang kuasa. Ia menggunakan metodologi penyelidikan undang-undang doktrin dan perbandingan di mana sumber undang-undang utama dan sekunder yang berkaitan dinilai dengan teliti. Hasil kajian ini mendedahkan bahawa kedua-dua negara mempunyai cara unik mereka untuk menangani kes perbankan dan kewangan Islam. Di Malaysia, bidang kuasa terletak pada mahkamah sivil dengan rujukan mandatori kepada Majlis Penasihat Syariah dalam memutuskan isu-isu Syariah. Mengenai Indonesia, Perkara 55 (1) Undang-undang No. 21 (2008) memperuntukkan bahawa mahkamah agama hendaklah mempunyai bidang kuasa untuk mendengar perkara yang melibatkan pertikaian perbankan Islam melainkan terdapat perjanjian yang menyatakan bahawa penyelesaian pertikaian hendaklah dilakukan dengan cara lain dengan syarat cara yang dipilih tidak boleh bercanggah dengan prinsip Syariah. Terdapat juga pilihan untuk merujuk kepada Dewan Syariah Nasional MUI untuk pendapat pakar. Kedua-dua bidang kuasa juga mengakui penyelesaian pertikaian alternatif sebagai mekanisme penyelesaian pertikaian. Kajian ini menekankan keperluan untuk meningkatkan pengetahuan dan pemahaman mendalam tentang hakim dalam bidang undang-undang yang berkaitan; Undang-undang Syariah untuk hakim mahkamah sivil dan undang-undang sivil untuk hakim mahkamah agama, untuk memudahkan proses penyelesaian pertikaian.

**Kata Kunci:** Perbankan dan Kewangan Islam, Penyelesaian Pertikaian Alternatif, Konflik Bidang Kuasa, Mahkamah Sivil, Mahkamah Syariah.

## INTRODUCTION

Spanning over seventy-five countries and charting an estimated average annual growth of 15 to 20 percent, Islamic finance has emerged as an internationally acknowledged and accepted form of financing. The positive development of Islamic banking globally indicates the viability of this system which is well-received by a large number of populations comprising individuals and businesses alike.<sup>1</sup> Malaysia and Indonesia are two emerging Islamic financial hubs which are outpacing many business segments in the global banking system. In Malaysia, the Islamic sector saw an 8.5% annual growth in 2020 in financing as compared to 0.5% for the conventional industry; a 7.7% yearly growth in deposits as compared to 2.4%; a notable 13.2% growth in assets compared with 7.3%.<sup>2</sup> Translated into actual figures, total Islamic assets at the end of 2020 reached RM1.09 trillion (US\$264.5 billion) – upon the RM1.02 trillion at the end of 2019. Total Islamic financing reached RM817.4 billion, an increase from RM753.61 billion, and total deposits and investment accounts reached RM889.95 billion, up from RM826.2 billion. In Indonesia, Islamic banking has been rising precipitously since the first establishment of Islamic banks in 1992. As of December 2021, Islamic Banks' assets in

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<sup>1</sup> Karyn Wang, "Islamic Banking and Finance in South-East Asia: Its Development and Future," *ASEAN Economic Bulletin* 24, no. 3 (2007): 372.

<sup>2</sup> "Malaysia's 34.2% Islamic Banking Market Share Edges Towards 50% Parity with Conventional Sector by 2030 as Sector Reinforces Its Resilience and Relevance during COVID-19 Pandemic," *DDCAP Group*, December 16, 2021, <https://www.ddcap.com/malaysias-34-2-islamic-banking-market-share-edges-towards-50-parity-with-conventional-sector-by-2030-as-sector-reinforces-its-resilience-and-relevance-during-covid-19-pandemic/>.

Indonesia stood at Rp 676.735 trillion, an increase of RP 82.787 trillion from December 2020. In terms of structure, Shari'ah Commercial Banks still dominate in the share of assets with 65.28%, followed by Shari'ah Business Units with 34.7%.<sup>3</sup>

Corresponding with this development, the regulators and stakeholders increasingly face challenges and opportunities in integrating the system of Islamic financing into mainstream financing systems. One of the critical aspects is settling the disputes arising out of the allegation of Shari'ah non-compliance is ironically raised by customers when they encounter a default event. Despite being subjected to Shari'ah principles, the operation of Islamic banking must likewise comply with the relevant civil laws. While the familiarity of the legal and judicial practitioners with the laws and practices of the conventional financial system is indisputable, it is incumbent on the legal practitioners and judges to be conversant with Shari'ah principles employed in product and operational structure as well as legal documentation. This need is attributed to the explicit distinction between these two different systems. The foundation of Islamic banking and finance is the opposite of the conventional financial system. The former prohibits *riba* (usury), which is the cornerstone of the latter. Islamic banking also condemns *maysir* (gambling), *gharar* (uncertainty), and funding activities treated as sinful in Islam, such as the casino or alcohol production industry. In contrast, such elements

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<sup>3</sup> "Islamic Banking Statistics," *Otoritas Jasa Keuangan*, 2021, accessed March 5, 2022, [https://www.ojk.go.id/en/kanal/perbankan/data-dan-statistik/statistik-perbankan-syariah/Documents/Pages/Sharia-Banking-Statistic---December-2021/SHARIA\\_BANKING\\_STATISTIC\\_DECEMBER\\_2021.pdf](https://www.ojk.go.id/en/kanal/perbankan/data-dan-statistik/statistik-perbankan-syariah/Documents/Pages/Sharia-Banking-Statistic---December-2021/SHARIA_BANKING_STATISTIC_DECEMBER_2021.pdf).

are tolerable in the conventional banking domain. Also, financing, investment, and deposit products are not based on an interest loan but on various modernised Islamic contracts.

The conundrum of the proper forum to resolve Islamic banking disputes is not a domestic issue but occurs in other jurisdictions. Litigation is the typical way resorted to in resolving disputes. Additionally, alternative dispute resolution (ADR) such as tribunal, arbitration,<sup>4</sup> negotiations, mediation, and the ombudsman are common ADRs currently being applied. These methods of ADRs are likewise recognised in Islam.<sup>5</sup>

Numerous studies have been conducted on dispute resolution in Islamic finance in Malaysia. The strand of literature is beneficial in enlightening the legal and judicial stance concerning Islamic finance disputes in Malaysia, albeit some updated legal and judicial developments are not incorporated therein. Ab Jabar, Said, and Ab Halim<sup>6</sup> outlined essential litigation, arbitration, mediation and ombudsman features. The discussion also extended to the application of these mechanisms from Islamic perspectives and the practices in the Malaysian financial industry. While the studies offer valuable insight

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<sup>4</sup> Mohammad Naqib Ishan Jan, "The Role of Arbitration in the Resolution of International Commercial Dispute," *IIUM Law Journal* 22, no. 2 (2014):265-294.

<sup>5</sup> Syed Khalid Rashid, "Alternative Dispute Resolution in the Context of Islamic Law," *The Vindobona Journal of International Commercial Law and Arbitration* 8, no. 1 (2004): 95–118.

<sup>6</sup> Siti Faridah Abdul Jabbar, Suzana Muhamad Said, and Asma Hakimah Ab Halim, "Prevailing Dispute Resolution Mechanisms in Islamic Finance," in *Dispute Resolution in Islamic Finance Alternatives to Litigation*, ed. Adnan Trakic, John Benson, and Pervaiz K Ahmed, 1st ed. (London, 2019), 30–53.

on the options available for Islamic finance dispute resolution, particularly the issues surrounding resolving Islamic banking disputes in Malaysia, no comparative analysis has been made with the position in Indonesia. Additionally, no reference has been made to i-Arbitration Rules 2021. Furthermore, Puneri<sup>7</sup> provides an extensive discussion on the legal framework governing Islamic banking disputes in Indonesia and the way forward. However, a comparative study on the position in Malaysia is absent.

Thus, this study attempts to close the gap by investigating the latest legal and judicial positions in Malaysia and Indonesia. One of the positive outcomes of this research is to propose the most viable approach to be adopted by these two jurisdictions to minimise the conflict of jurisdiction hence offering more extensive alternatives to the disputing parties in settling their disputes. This will finally ensure that justice is preserved.

## **EVOLUTION OF ISLAMIC BANKING IN MALAYSIA AND INDONESIA**

In Malaysia, the Islamic financial system landscape emerged with the establishment of the first Islamic savings institution, the pilgrimage fund (Tabung Haji), in 1963. The establishment of the first full-fledged Islamic bank, Bank Islam Malaysia Bhd, in 1983, governed by the Islamic Banking Act 1983, was another impactful milestone. In 1993, the developments continued with the introduction of Islamic windows

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<sup>7</sup> Atharyanshah Puneri, "Dispute Resolutions Mechanisms for Islamic Banks in Indonesia," *International Journal of Islamic Economics and Finance* 4(Special Issue), (2021): 153–180.

by conventional financial institutions, allowing conventional banking institutions to offer Islamic products and services. Following that, to internationalise the Islamic banking industry and transform Malaysia into an Islamic financial hub, the Malaysian market has been opened to international players, granting international banks that offer Islamic products the opportunity to operate branches in Malaysia. Currently, conventional banks interested in running full-fledged Islamic banks can establish their own Islamic subsidiaries. To date, the number of industry players has expanded to 17 institutions. Islamic banks are regulated by the Bank Negara Malaysia (Central Bank) and subjected to compliance with the critical governing law, the Islamic Financial Services Act 2013.<sup>8</sup>

The first Islamic bank in Indonesia is Bank Muamalat Indonesia, which was established on 1st May 1992 pursuant to the amendment of Indonesian Banking Act No. 7 of 1992. Further stimulus and support for Islamic banks were evidenced via the Amendments of Banking Act No. 10 of 1998. The word Shari'ah bank is expressly used in the said law, stipulating that commercial and rural banks can operate based on Shari'ah principles. The law provides a more detailed legal basis and types of businesses that Islamic banks can implement. Finally, in 2008, the Indonesian Government established a dedicated law for Islamic banking, the Islamic Banking Act No. 21 of 2008. Article 4 Paragraph 1 of the Act declares that Indonesia has a dual banking system. Hence, like Malaysia, the Islamic banking system runs parallel with its conventional counterpart under the supervision of the Financial

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<sup>8</sup> The law repeals the Islamic Banking Act 1983, the first legislation regulating Islamic banking in Malaysia.

Services Authority (OJK). As of October 2020, there are 12 Shari'ah commercial banks, 21 Shari'ah business units, and 164 Shari'ah rural banks established based on data from OJK.

## **ISLAMIC BANKING DISPUTES RESOLUTION IN MALAYSIA**

Islamic banking has been in existence in Malaysia for almost 39 years, manoeuvring throughout the financial system alongside conventional banking. One of the common hurdles facing the institutions offering Shari'ah-compliant financing is how to take legal action against the customers who defaulted on payments and argued that the products offered did not conform with Shari'ah principles. Past literature highlights numerous arguments regarding the proper body to adjudicate Islamic banking disputes, whether the civil court, Shari'ah court or ADR bodies. As far as Malaysia is concerned, the existing avenues are comprised of adjudication by a court or other ADR mechanisms. The next part scrutinises these two mechanisms.

### **Conventional Litigation Through Court Systems**

The role of a civil court in adjudicating disputes is unquestionable, including Islamic banking-related disputes. The first case that reached the civil court against Islamic banks three years after the establishment of the first Islamic bank in Malaysia was *Tinta Press Sdn Bhd v Bank Islam Malaysia Berhad*.<sup>9</sup> After that, civil courts continued to exercise their judicial authority to deal with a long list of cases against Islamic

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<sup>9</sup> [1987] 2 MLJ 192.



banks on diverse grounds. The subsequent parts analyse the relevant discussion on the adjudication of Islamic banking disputes via court litigation.

### ***Jurisdiction According to the Federal Constitution***

The civil and Shari'ah courts in Malaysia coexist in a dual court structure. The civil courts were established as federal courts to deal with federal matters. In contrast, the Shari'ah courts are provided for in the Federal Constitution as state courts that can be set to deal with issues of Islamic law.<sup>10</sup> Article 74 of the Federal Constitution provides the subject matter of the federal and state laws. This is further elaborated by the Ninth Schedule, which enumerates the matters falling under Federal List (List I) and State List (List II).

In this regard, Islamic banking falls within the ambit of Items 7 and 8 of the Federal List, namely finance and trade, commerce, and industry, respectively. The general jurisdiction of the Shari'ah Court is expressly provided for in the Federal Constitution under Article 74(2) and Para 1 List II, Ninth Schedule. Shari'ah courts have jurisdiction over 'Islamic law and personal and family law of persons professing the religion of Islam', which includes, inter alia, matters such as betrothal, marriage, divorce, legitimacy, dowry, maintenance,

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<sup>10</sup> The understanding of the Shari'ah courts as being subordinate to the civil courts has arguably been altered following the introduction of an amendment to article 121(1A) of the Constitution following the Constitutional Amendment Act 1988. Article 121(1A) now provides that the civil courts 'shall have no jurisdiction in respect of any matter within the jurisdiction of the Syariah Courts.' See Yvonne Tew, "The Malaysian Legal System: A Tale of Two Courts," *Commonwealth Judicial Journal* 19, (2011): 3–7.

adoption, succession, and religious endowments. This is consistent with the idea that the Shari'ah courts are meant to be state courts established to deal with Islamic law 'only over persons professing the religion of Islam'. State legislatures are then entrusted to specify the jurisdiction of the Shari'ah courts of their particular states within the general jurisdiction laid down by the Federal Constitution. Consequently, proper scrutiny of the Federal Constitution unambiguously confers the right to adjudicate Islamic banking matters to civil court irrespective of its Islamic law elements.

### ***Arguments of Court Jurisdictions in Decided Cases***

Several past cases have raised arguments on the disentitlement of civil courts to resolve Islamic banking disputes. The judges, however, maintained that the tasks are rightfully assigned to civil courts and not Shari'ah courts based on various justifications that sometimes overlapped with each other.

For example, N.H. Chan J, in the case of *Bank Islam Malaysia Bhd v. Adnan Bin Omar*, emphasised that the civil court has jurisdiction to hear all cases falling under the federal list.<sup>11</sup> Thus, banking and its related matters fall within the ambit of the Federal list. i.e., civil courts have the authority to decide on the issue. In this case, the defendant raised a preliminary objection that as the plaintiff was an Islamic bank, the court, therefore, had no jurisdiction to hear the case following the inclusion of Clause (1A) of Article 121 of the Federal Constitution. In dismissing the objection, the court, among others, ruled that since Bank

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<sup>11</sup> *Bank Islam Malaysia Berhad v Adnan Omar*, [1994] 3 CLJ 735.

Islam is a body corporate, it does not have a religion and, as such, will not be subject to the jurisdiction of the Shari'ah Court. Abdul Hamid JCA also argued that disputes over Islamic banking transactions involve not only Islamic law but also the applications of other statutes under the civil law, namely the National Land Code, the Contracts Act 1950 and more. Hence, not only do the Shari'ah Courts have no jurisdiction, their judges are also not trained in and not familiar with those statutory provisions. Secondly is the power of enforcement and remedies, which are unavailable or even very limited in the Shari'ah Court. Furthermore, facts have shown that Islamic banking customers are not only confined to Muslims but also include non-Muslims. Therefore, because Shari'ah Court does not have jurisdiction over non-Muslims and non-Muslim lawyers may not appear in the Shari'ah Court either, the Shari'ah Court should not be seen as an excellent forum to decide Islamic banking cases.

The lack of Shari'ah Court's jurisdiction to deal with financial disputes was also discussed in the case of *Mohd Alias Ibrahim v. RHB & Anor*.<sup>12</sup> It was held that the Shari'ah Courts have authority over Islamic law in Malaysia and are empowered by a state statute established according to Article 74(2) of the Federal Constitution, which follows para. 1, List II, Ninth Schedule to the Federal Constitution. However, civil courts will have jurisdiction to consider these issues in cases involving Islamic financial transactions. This is because the Federal List, Ninth Schedule of the Federal Constitution, covers the law governing finance, trade, commerce, and industry.

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<sup>12</sup> *Mohd Alias Ibrahim v. RHB Bank Bhd & Anor*, [2011] 4 CLJ 654.

### *The Competency of Civil Court Judges*

The primary issue leading to the debate questioning the jurisdiction of a civil court to adjudicate Islamic banking cases is the competency of the judges and the legal counsels representing the parties. The major challenge faced by the judge is applying relevant laws to Islamic finance transactions, which are structured based on sale and purchase transactions differently from a conventional loan.<sup>13</sup>

Although competency is relatively subjective, to achieve a certain level of expertise, they are expected to have some background knowledge of *fiqh muamalat* (Islamic commercial transaction law). Unfortunately, this is not the case since most of them are civil law-trained judges and lawyers who are well versed in civil laws as opposed to Shari'ah. Moreover, these professions are not only confined to Muslims but non-Muslims alike. This fact is acknowledged by Suriyadi Halim Omar J (as he then was) in the case of *Arab Malaysian Merchant Bank Bhd v. Silver Concept Sdn Bhd*<sup>14</sup>, who reiterated that:

“...in the event any litigation is commenced, it must be appreciated that not every presiding judge is a Muslim, and even if so, may not be sufficiently equipped to deal with the matters, which *ulama* take years to comprehend.”<sup>15</sup>

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<sup>13</sup> Arifin Zakaria, “A Judicial Perspective on Islamic Finance Litigation in Malaysia,” *IIUM Law Journal* 21, no. 2 (2014):143-182.; Muhammad Abdurrahman Sadique, “Applications of Decreasing Partnership (*Al-Mushārah Al-Mutanāqishah*) in Islamic Banking: Some Relevant Shari'ah Aspects,” *IIUM Law Journal* 20, no.1 (2012):1-27.

<sup>14</sup> [2005] 5 MLJ 201.

<sup>15</sup> [2005] 5 MLJ 215.

A couple of decided cases can illustrate this statement. In *Dato' Hj Nik Mahmud bin Daud v. Bank Islam Malaysia Bhd*,<sup>16</sup> the plaintiff sought declaratory reliefs to declare the charge, the Property Sale Agreement, and Property Purchase Agreement null and void. Instead of ascertaining the validity of the *Bay' Bithaman Ajil* (BBA) contract, the learned judge treated the execution of the Property Purchase Agreement and the Property Sale Agreement as a mere formality and procedural requirement under Islamic banking, which has no legal significance. In *Malayan Banking Bhd v Marilyn Ho Siok Lin*,<sup>17</sup> David Wong J, a non-Muslim judge, while delivering a judgement, made an unsettling remark that a court is entitled to ignore and rewrite the term of the BBA contract if it seems unjust. This conclusion was drawn based on his interpretation of section 148(2)(c) [*Sarawak Land Code* 1958 (Sarawak), Ch 81].

### ***Measures to Provide Solutions***

One of the earliest attempts to resolve the issue was by introducing the *Muamalat* Court; a dedicated division administratively set up for filing cases related to Islamic banking and finance cases in Kuala Lumpur High Court under the Commercial Division. This special division has demonstrated significant progress over the years. Most of the cases handled by this division are BBA-based facilities on the issue of the quantum of a claim brought by the customers.<sup>18</sup> However, the lack of

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<sup>16</sup> [1983] 3 CLJ 605; *Datuk Haji Nik Mahmud bin Daud v. Bank Islam Malaysia Bhd* [1998] 3 MLJ 393.

<sup>17</sup> *Malayan Banking Bhd v. Marilyn Ho Siok Lin*. (David Wong J), [2006] 7 MLJ 249.

<sup>18</sup> Hakimah Yaacob, "Analysis of Legal Disputes in Islamic Finance and the

workforce to hold an escalating number of cases requires the involvement of other judges in the commercial division who were familiar with conventional banking cases but not conversant in Islamic finance to preside over the hearing.<sup>19</sup> Thus, civil laws have greatly influenced the way judgements are arrived at, resulting in some wrong decisions that have enticed critiques from Islamic finance practitioners.

Another approach employed to tackle this problem is through the amendment of the law imposing reference to SAC. It can be divided into two stages, namely non-mandatory reference and mandatory reference. In 2003, the Central Bank of Malaysia Act (CBMA) 1958 was amended by the CBM (Amendment) Act 2003.<sup>20</sup> According to this amendment, a new section 16B is added to CBMA 1958 whereby the position of the SAC is elevated to “be the authority for the ascertainment of Islamic law for Islamic banking business, takaful business, Islamic financial business, Islamic development financial business, or any other business which is based on Shari’ah principles and is supervised and regulated by the Bank”. At this stage, reference to SAC by the court of the arbitrator for the ascertainment of the Shari’ah issue is not mandatory for judges. Even if the reference is made, the ruling given by the SAC under such reference is not binding

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Way Forward: With Special Reference to a Study Conducted at Muamalat Court, Kuala Lumpur, Malaysia,” *ISRA*, (2011).

<sup>19</sup> Umar A. Oseni, and Abu Umar Faruq Ahmad, “Dispute Resolution in Islamic Finance: A Case Analysis of Malaysia,” *Ethics, Governance and Regulation in Islamic Finance*, 2015, [https://ireview.com/wp-content/uploads/2019/07/Islamic-Finance-Book\\_Volume\\_4.pdf#page=140](https://ireview.com/wp-content/uploads/2019/07/Islamic-Finance-Book_Volume_4.pdf#page=140).

<sup>20</sup> The amendment came into force on 1 January 2004.

on the court. However, if the arbitrator opts to refer the issue to the SAC, the ruling of the SAC is binding on the arbitrator.<sup>21</sup>

This non-mandatory obligation received mixed responses from the judges in deciding Shari'ah issues. For instance, in *Arab-Malaysian Merchant Bank Bhd v Silver Concept Sdn Bhd*,<sup>22</sup> the issues were first whether a BBA transaction was prohibited by the Shari'ah and secondly the issue of deprivation of the defendant's right to a rebate (*ibra'*). The judge thought it was unnecessary to refer the matters to the SAC. Instead, the learned judge initiated to expound on the Shari'ah principles involved. In the case of *Affin Bank Bhd v Zulkifli bin Abdullah*,<sup>23</sup> the issue before the court was the calculation of the actual amount payable to the bank under a BBA facility in the event of a default. The learned judge refused to refer to the SAC on the ground that the issue concerned a question of "interpretation and application of the terms of the contractual documents between the parties" rather than a Shari'ah issue.<sup>24</sup> Instead of referring the matter to SAC, the judge in *Arab-Malaysian Finance Bhd v Taman Ihsan Jaya Sdn Bhd*.<sup>25</sup>

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<sup>21</sup> Central Bank of Malaysia Act 1958 (Act 509) (Malaysia), s 16B (7)-(9).

<sup>22</sup> *Arab Malaysian Merchant Bank Berhad v. Silver Concept Sdn. Bhd.*, [2005] 5 MLJ 210.

<sup>23</sup> *Affin Bank Bhd v. Zulkifli bin Abdullah*, [2006] 3 MLJ 67.

<sup>24</sup> *Ibid.*, 75.

<sup>25</sup> *Arab-Malaysian Finance Bhd v Taman Ihsan Jaya dn Bhd* [2009] 1 CLJ 424. This contention was reversed by the Court of Appeal which ruled that the learned judge had misinterpreted the meaning of "do not involve any element which is not approved by the Religion of Islam." First, under section 2 of the Islamic Banking Act 1983, "Islamic Banking Business" does not mean a banking business whose aims and operations are approved by all four schools of thought. Secondly, the religion of Islam is not confined to the four schools of thought alone, as the sources of Islamic law are not limited to the opinions of the four Imams. Islamic law is derived from the primary sources, i.e., Al-Quran and Hadith and

made his own Shari'ah rulings to the effect that the BBA contract was only acceptable to one *mazhab* (school of thought); and that was not sufficient to say that it was approved by the religion of Islam, which was the requirement of the Islamic Banking Act 1983.

The learned judge in *Tan Sri Abdul Khalid bin Ibrahim v Bank Islam Malaysia Berhad* also decided not to refer the issue of the validity of the BBA contract to the SAC having accepted and agreed with the ruling made by the SAC that BBA is a recognised form of transaction and is within Shari'ah.<sup>26</sup> Likewise in the case of *Bank Islam Malaysia Berhad v Lim Kok Hoe*,<sup>27</sup> although no reference was made to the SAC in determining whether the BBA was valid or not, the Court of Appeal sharply accentuated that it is not for the civil court judges to decide whether a matter is Shari'ah-compliant or not and in deciding so, the judge must take cognisance to the resolutions of the Shari'ah Advisory Council of the Central Bank Malaysia and the Shari'ah Advisory body of BIMB.<sup>28</sup>

After that, reference to the SAC is made compulsory under the CBMA 2009. Two significant provisions have been incorporated concerning reference to SAC when the judges or arbitrators are confronted with Shari'ah issues. Section 56 of the CBMA 2009 makes it mandatory for a civil court judge or arbitrator to either refer the issue to the published resolutions of the SAC on the matter (if any), or to

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secondary sources. There are other secondary sources of Islamic law in addition to the jurisprudence of the four schools of thought. Judges in civil courts should not take it upon themselves to declare whether a matter was in accordance with the religion of Islam or otherwise.

<sup>26</sup> *Bank Islam Malaysia Bhd & Another Case*, [2010] 4 CLJ 388, 401.

<sup>27</sup> *Lim Kok Hoe & Anor and Other Appeals*, [2009] 6 CLJ 22.

<sup>28</sup> *Ibid.*, 38-39.



refer the issue to the SAC for its ascertainment. The ruling made by the SAC upon such reference is binding on the court or arbitrator by virtue of section 57. There were positive developments after these provisions came into force, whereby judges began to refer to SAC to ascertain Shari'ah issues. Among others, Mohd Zawawi J (as he then was) has posed several questions, such as whether the rate of *ta'wid* (compensation) could be fixed or agreed upon (predetermined) by contracting parties in an agreement without any proof of the loss suffered by the bank and also the question on the subject of *al-rahn* (pledge).<sup>29</sup>

Although the constitutionality of these provisions has been contested by the plaintiff in the case of *Mohd Alias Ibrahim v RHB Bank Bhd*,<sup>30</sup> the learned Mohd Zawawi J (as he then was) forwarded a formidable argument to the contrary. After referring to the Federal Court judgment in *PP v Kok Wah Kuan*,<sup>31</sup> he concluded that "judicial power" is vested in the two High Courts (that is, the High Court in Malaya, and the High Court in Sabah and Sarawak), but the extent to which it is vested in them will depend on what federal law provides.<sup>32</sup>

To facilitate the reference process of Shari'ah issues only, the SAC has issued *Manual Rujukan Mahkamah dan Penimbang Tara Kepada Majlis Penasihat Shari'ah Bank Negara Malaysia*

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<sup>29</sup> Tun Abdul Hamid Mohamad, and Adnan Trakic, "The Adjudication of Shari'ah Issues in Islamic Finance Contracts: Guidance from Malaysia." *Journal of Banking and Finance-Law and Practice* 26, no. 1 (2015): 39-59.

<sup>30</sup> *Mohd Alias Ibrahim v. RHB Bank Bhd & Anor*, [2011] 4 CLJ 654.

<sup>31</sup> *Pp v. Kok Wah Kuan*, [2007] 6 CLJ 341.

<sup>32</sup> See also *Mohd Alias Ibrahim v RHB Bank Bhd* [2011] 4 CLJ 654 at 657-658.

(the Manual).<sup>33</sup> The Manual defines a question concerning a Shari'ah matter as follows:

“Concerning Islamic finance, a Shari'ah question involves a matter(s) that have yet to be determined by the SAC. Such questions include, but are not limited to, such aspects of the Islamic finance business as the structure, the products or services, the operation, the terms and conditions of or the documentation used in the business.”<sup>34</sup>

To counter the sceptical allegation that SAC usurps the court's function, the Manual explains that it is not a judicial body and that it is empowered only to rule on the Shari'ah compliance of the issues referred to it. The jurisdiction to make a finding of fact or to apply a particular ruling to the facts of a case and to decide thereon is vested wholly and solely in the court and the arbitrator.<sup>35</sup>

The constitutionality of section 56 and section 57 of the CBMA 2009 have been contested again in two cases in 2012 and 2019, respectively. The Court of Appeal in *Tan Sri Abdul Khalid Ibrahim v Bank Islam Malaysia Berhad* arrived at a conclusion that these two sections do not take away the court's judicial function but rather stated that the role of the SAC is equivalent to that of a “statutory expert”.<sup>36</sup> This stance is regarded as problematic since it departs from the basic common law norm that expert evidence should not be binding on the

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<sup>33</sup> “Manual Rujukan Mahkamah dan Penimbang Tara kepada Majlis Penasihat Syariah Bank Negara Malaysia di bawah Seksyen 51 dan Seksyen 56 Akta Bank Negara Malaysia 2009,” Bank Negara Malaysia, (2014), <https://www.bnm.gov.my/documents/20124/38335/Manual+Rujukan+Mahkamah+dan+Penimbang+Tara.pdf>

<sup>34</sup> *Ibid.*, 6.

<sup>35</sup> *Ibid.*, 7.

<sup>36</sup> *Tan Sri Abdul Khalid Ibrahim v. Bank Islam Malaysia Bhd*, [2013]1 CLJ 436, 446.

court. The court is also not bound to accept the opinions if the court doubts their credibility.<sup>37</sup> Subsequently, the Federal Court in *JRI Resources Sdn Bhd v Kuwait Finance House (M) Bhd (President of Association of Islamic Banking Institutions Malaysia & Anor, interveners)* held on 15th April 15, 2019, in the first-ever sitting of a full nine-member bench in Malaysia, that Islamic finance rulings by the SAC under sections 56 and 57 of the CBA are constitutional and binding on civil courts as they do not amount to judicial decisions.<sup>38</sup>

Most judges concluded that the SAC does not trespass on judicial power because the trial judge is still responsible for resolving the case based on the facts and applying the SAC's ruling.<sup>39</sup> The minority judges, on the other hand, believed that the SAC exercises judicial power in the sense that the trial judge is compelled to adopt the SAC's decision about Islamic law presented to it.<sup>40</sup>

## ADR For Islamic Banking Dispute Settlement in Malaysia

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<sup>37</sup> Adnan Trakic, "Settlement of Islamic Finance Disputes in Malaysia," *Dispute Resolution in Islamic Finance Alternatives to Litigation*, ed. Adnan Trakic, John Benson, and Pervaiz K Ahmed, 1st edition (London: Routledge, 2019): 103.

<sup>38</sup> *JRI Resources Sdn Bhd v. Kuwait Finance House (M) Bhd*, [2019] 3 MLJ 561.

<sup>39</sup> Oomen Koshy, and Muhammad Suhaib, "Bank Negara SAC's Findings Binding on Civil Courts," *Legal Insights A Skrine Newsletter*, 2019. [https://www.skrine.com/Skrine/media/Assets/Legal\\_Insights/2019/Legal-Insights-Issue-2-2019.pdf?ext=.pdf](https://www.skrine.com/Skrine/media/Assets/Legal_Insights/2019/Legal-Insights-Issue-2-2019.pdf?ext=.pdf).

<sup>40</sup> *Ibid.*

From the provision of section 56 of the CBMA 2009, it can be inferred that ADR, such as arbitration, has been statutorily recognised as an alternative mechanism that can be used to settle Islamic banking disputes. In tandem with the growing trends of ADR, several institutions in Malaysia provide alternatives to court litigation, such as the Asian International Arbitration Centre, Malaysian Mediation Centre, and Ombudsman for Financial Services.

### ***Mediation***

To encourage amicable resolution of Islamic finance disputes, Practice Direction on Mediation (No 4 of 2016) (Practice Direction) has been issued.<sup>41</sup> The overarching goal of this Practice Direction is to enable parties to reach a mutually beneficial agreement without undergoing the rigours of a trial or appeal. The advantage of a mediation settlement is that both parties approve it, it is swift, and it is final.<sup>42</sup>

According to this Practice Direction, all Judges of the High Court and its Deputy Registrars and all Judges of the Sessions Court and Magistrates and their Assistant Registrars may, at the pre-trial case management stage as stipulated under Order 34 Rule 2 of the Rules of Court 2012, give such directions that the parties facilitate the settlement of the matter before the court by way of mediation.<sup>43</sup> The suggestion may be made during the interlocutory application, at the pre-trial case

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<sup>41</sup> Practice Direction No 4 of 2016 took effect on 15 July 2016. It superseded Practice Direction on Mediation No 5 of 2010.

<sup>42</sup> Item 2.1 of Practice Direction.

<sup>43</sup> Item 1 of Practice Direction.

management, during the trial, after the trial, or even at the appeal stage.<sup>44</sup> Mediation may be pursued by one of the following options: -<sup>45</sup>

1) Judge-led mediation:

The parties are given the option to choose whether the mediating judge is the same as the judge hearing the case or not. However, the general rule is that the hearing judge should not mediate the case. In the event the mediation fails, the original judge will hear and decide the case. The procedures are also flexible depending on the manners acceptable to both parties. In normal circumstances where the parties are represented, the mediation will take place in the presence of the lawyers. If the mediation is successful, the judge mediating shall record a consent judgment on the terms agreeable by the parties.

2) Mediation by Kuala Lumpur Regional Centre for Arbitration (now known as the Asian International Arbitration Centre):

The parties may opt to use the mediation service provided by the AIAC, whereby the plaintiff's solicitor shall give a seven-calendar-day written notice to AIAC. The AIAC will then proceed with mediation in accordance with the Mediation Rules in force.

3) Mediation by other mediators agreeable by both parties:

Another feasible avenue for Islamic banking dispute resolution is via mediation offered by the Malaysian Mediation Centre (MMC), which is established by Bar Council in 1999. It shares similar objectives with other mediation institutions, namely promoting mediation as a means

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<sup>44</sup> Item 3 of Practice Direction.

<sup>45</sup> Item 5 of Practice Direction.

of ADR and providing a proper avenue for successful dispute resolutions. The parties can select from the list of certified mediators furnished by the MMC or any other mediator chosen by the parties. The mediator's role is to facilitate negotiation between the disputing parties and navigate the direction of the mediation session to find a mutually acceptable solution.

It is submitted that this initiative is laudable to achieve a common goal of resolving disputes amicably and expeditiously. In this regard, selecting an expert mediator is of prime importance to enable proper decisions in line with Shari'ah principles.

### ***Arbitration***

The primary institution offering arbitration services in Malaysia is AIAC. This body is formed pursuant to the host country agreement between Malaysia and the Asian-African Legal Consultative Organisation (AALCO). The AIAC is a not-for-profit, non-governmental international arbitral institution that has been accorded independence and certain privileges and immunities by the Government of Malaysia to execute its functions as an independent, global organisation. As an ADR provider, the AIAC offers an array of services, including services in arbitration, adjudication, mediation, and domain name dispute resolution.

To cater to Islamic banking and finance disputes locally and internationally, AIAC has introduced a series of i-Arbitration Rules to allow for the arbitration of disputes arising from any contract that contains Shari'ah. The latest version is the AIAC i-Arbitration Rules 2021 which took effect on 1st November 2021. Guided by Shari'ah

principles, the AIAC i-Arbitration Rules shall apply to all contracts that have contractually agreed to arbitrate under these rules or separate arbitration contracts that have referred to these rules. Upon the AIAC i-Arbitration Rules coming into effect, all previous editions of the AIAC i-Arbitration Rules shall no longer apply to arbitral proceedings commenced after this date unless otherwise agreed to by the Parties. Rule 29 of the AIAC i-Arbitration Rules highlights the provision of reference to Shari'ah Counsel.

### ***Mediation-Arbitration***

Additionally, Mediation-Arbitration (Med-Arb), a blend of mediation and arbitration, is also provided by the AIAC. Med-Arb enables the parties to initiate mediation before resorting to arbitration. If the parties cannot resolve their dispute through mediation, they may attempt to settle their dispute through arbitration. As one of the leading international mediation centres in Asia, the AIAC offers Med-Arb proceedings that leverage an experienced and impartial mediator panel conducted in accordance with international standards and best practice procedures for mediation. The AIAC Mediation Rules 2018 and Malaysian Mediation Act 2012 become the primary guidance for AIAC in terms of procedural rules of mediation.

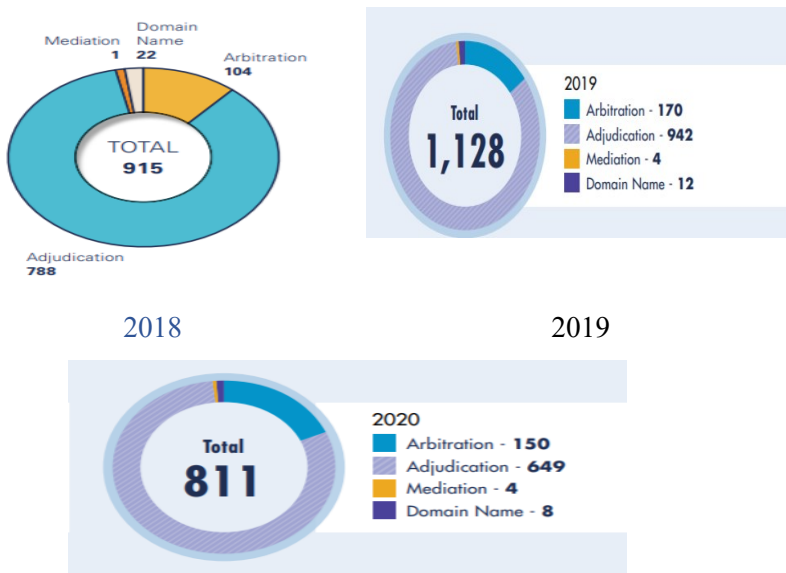
The total number of cases referred to AIAC from 2018 until 2020 is depicted in Figure 1. Based on the AIAC Annual Reports for 2018,<sup>46</sup>

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<sup>46</sup> AIAC Report 2018,  
<https://www.aiac.world/wp-content/uploads/2018/CIPAA%20Report%202018.pdf>;

2019, and 2020,<sup>47</sup> the i-Arbitration Rules were not applied during the arbitration held in those years, indicating the absence of Islamic banking disputes being arbitrated by AIAC in those years. Based on Annual Report 2019-2020, the number of cases referred to AIAC for mediation was four, respectively.

Figure 1: Number of Cases Referred to AIAC Based on Types of ADR from 2018-2020



Source: AIAC

<sup>47</sup> AIAC Report 2019 & 2010;  
[https://admin.aiac.world/uploads/ckupload/ckupload\\_20210727102858\\_34.pdf](https://admin.aiac.world/uploads/ckupload/ckupload_20210727102858_34.pdf)



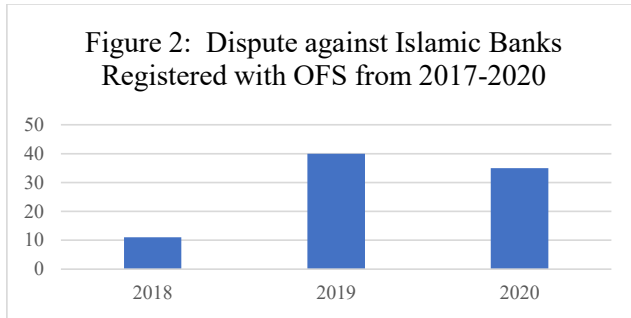
### ***Ombudsman***

Strengthening financial consumer protection is the fundamental reason which underscores the establishment of the Ombudsman for Financial Services (OFS), the first operator of a financial ombudsman scheme introduced in the Islamic Financial Services Act 2013. Eligible complainants are strictly confined to financial consumers of financial service providers who are members of the OFS, including Islamic banks. In general, members refer to financial institutions governed by BNM. Thus, this platform cannot be resorted to if Islamic banks wish to pursue legal action against the consumers. Based on the OFS Annual Report 2020, common types of disputes related to Islamic financing are unreasonable or wrong charges of the profit rate, incorrect calculation of instalments, and conflicts in the method of profit computation.<sup>48</sup> Other than that, disputes may arise due to card-based electronic payment systems, operational issues, electronic terminals, internet banking, and e-money.<sup>49</sup> Figure 2 illustrates the number of disputes registered with the OFS against Islamic banks from 2018 to 2020.

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<sup>48</sup> “Ombudsman for Financial Services Annual Report 2020,” Ombudsman for Financial Services, accessed March 10, 2022. [https://www.ofs.org.my/en/news/ofsa\\_annual\\_report\\_2019.html](https://www.ofs.org.my/en/news/ofsa_annual_report_2019.html)

<sup>49</sup> *Ibid.*



Source: OFS

The OFS is a new version of the Financial Mediation Bureau, which operates under the comprehensive guidance of the Islamic Financial Services (Financial Ombudsman Scheme) Regulation 2014 (IFSR) and its Terms of Reference (TOR) duly approved by BNM. The IFSR entails the OFS to abide by the core ombudsman principle, namely independence, fairness and impartiality, accessibility, accountability, transparency, and effectiveness, and this is precisely incorporated in its TOR. The service is free and simple since the OFS is not bound by strict court procedures. With strong legal and regulatory support guiding its operation, the OFS offers a better choice for consumers facing problems with financial service providers, including Islamic banks.

The Third Schedule of the IFSR specifies three different types of monetary thresholds. To begin, a monetary limit of RM250,000 applies to disputes involving financial services or products developed, offered, or marketed by a member, or by a member for or on behalf of another person. Second, the monetary limit for a dispute involving third-party property damage caused by a motor vehicle is RM10,000.

Finally, the limit for a dispute involving an unauthorised transaction via a designated payment instrument or a payment channel such as Internet banking, mobile banking, telephone banking, or an automated teller machine; or unauthorised use of a cheque as defined in section 73 of the Bills of Exchange Act 1949 is RM25,000.<sup>50</sup>

Disputes may be referred to the OFS after an attempt to resolve at the bank's level via its Complaint Unit fails. The complaint must be immediately made within six months from the date of the decision made by the respective bank. In the event the bank does not provide any response to the complaint made, the complaint to the OFS may be made within sixty calendar days from the date the complaint is referred to the bank. There are several options available on the method of the complaint, including by post, fax, walk-in or online. The electronic mode (email/online) remained the preferred mode for inquiries and lodging of complaints.

Negotiation, conciliation, mediation, or adjudication are among the techniques which may be utilised by the case manager or adjudicator during the entire resolution process. Being an ADR body, the methods are inquisitorial and not bound by conventional court procedures such as rules of evidence, prosecution, defence by a lawyer, sworn witnesses, cross-examinations, and formal legal procedures, while the investigation and examination of evidence will be carried out by case managers or adjudicators themselves. A meeting or an interview may be conducted with the parties either jointly or individually. The process is not a mandatory procedure and the OFS has the full

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<sup>50</sup> Schedule 2 of the IFSR.

discretion to decide on the most effective approach to resolving the dispute.

The decision made by the ombudsman is final and the end of the OFS's dispute resolution process. However, neither party can appeal against the ombudsman's decision. The eligible complainant can choose whether or not to accept the said decision. If he accepts the decision within 30 days from the date of the decision, the parties are bound by such a decision. The timeframe, however, may be extended subject to consideration by the ombudsman on the reason for any delay. The terms of settlement agreeable by the parties shall be recorded in writing, and a settlement agreement shall be executed accordingly. A member must comply with the award within 14 days from the date the eligible complainant informed the member of his acceptance of the award. Once the dispute is resolved by mutual agreement of the parties, the member shall not initiate any legal proceedings that are inconsistent with that agreement. Conversely, if the award is not acceptable to the eligible complainant, the disputing parties are free to pursue their rights through any other means, including a legal process or arbitration. The award may be in the form of a monetary award of such amount that the ombudsman considers fair compensation subject to the prescribed monetary limit.

## **ISLAMIC BANKING DISPUTES SETTLEMENT IN INDONESIA**

Similar to Malaysia, the proliferation of Islamic banks in Indonesia poses legal issues to the existing legal structure. This encompasses legislation governing Islamic banks as well as Islamic banks' dispute

resolution. After a series of legislative amendments, the current position is that Islamic banking disputes can be resolved either through court litigation whereby the mandate is given to a Religious Court or non-litigation by way of ADR. Subsequent sections analyse these two mechanisms.

### **Religious Court**

The Religious Court is one of the judicial bodies that exercise judicial power to examine, decide, and resolve certain matters among Muslims. Under the previous Law No. 7 of 1989, the jurisdiction of the Religious Court is confined to cases on marriage, inheritances, wills, *hibah* (gift), *waqf* (endowment), and *sadaqah* (donation). The introduction of Law No. 3 of 2006 amending Law No. 7 of 1989 concerning the Religious Court has provided a legal basis for the Religious Court to deal with Islamic banking disputes. Specifically, Article 49 of Law No. 3 of 2006 extends the jurisdiction of the Religious Court to cover three new areas, namely *zakat* (almsgiving), *infaq* (charitable spending), and Shari'ah economics. Shari'ah economics refers to an act or business activity carried out according to Shari'ah principles, including Islamic banking.

The enactment of Law No. 21 of 2008 further strengthens the mechanism of settling disputes between the Islamic bank and the customer. The method of Islamic banking dispute resolution has been regulated in Article 55 of Islamic Banking Act No. 21 of 2008. Based on Article 55, dispute resolution related to activities of Islamic banking is capable of being resolved in two ways, litigation and non-litigation. The first paragraph prescribes that the resolution of Islamic banking

disputes falls under the purview of the religious court.<sup>51</sup> The second paragraph clarifies that in the event the parties have agreed to the resolution of a dispute other than the one referred to in paragraph (1), dispute resolution is carried out in accordance with the contents of the contract.<sup>52</sup> It further stipulates that dispute resolution as intended in paragraph (2) shall not conflict with Shari'ah principles.<sup>53</sup> Explanation to Article 55 (2) elucidates the meaning of "dispute resolution done in accordance with the content of the contract" to refer to the following techniques, namely mutual understanding, banking mediation, arbitration by the National Sharia Arbitration Board (Basyarnas) or arbitration institutions other and/or through the commercial courts.

Although the hearing is made in a Religious Court, the procedural aspects are still subject to Indonesian Civil Procedural Law.<sup>54</sup> However, most of the procedures are aligned with Shari'ah principles, albeit certain issues such as the imposition of penalties, which is deemed as *riba*.<sup>55</sup> It is submitted that one of the challenging tasks of the Religious Court is to apply the proper law while deciding Islamic banking cases since judges are expected to have a comprehensive understanding of all civil and Islamic laws, including those that are

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<sup>51</sup> Article 55(1) of Islamic Banking Act No.21 of 2008.

<sup>52</sup> Article 55(2) of Islamic Banking Act No.21 of 2008.

<sup>53</sup> Article 55(3) of Islamic Banking Act No.21 of 2008.

<sup>54</sup> Hasanuddin Muhammad, "Implementasi Penyelesaian Sengketa Perbankan Syariah Di Pengadilan Agama," PhD Dissertation, Universitas Islam Indonesia, (2015): 98.

<sup>55</sup> Atharyanshah Puneri, "Dispute Resolution for Islamic Banks in Indonesia," *International Journal of Islamic Economics and Finance (IJIEF)* 4 (Special Issue), (2022): 162.

substantive and procedural.<sup>56</sup> In this regard, for a better understanding of Islamic banking cases, judges are allowed to refer to Dewan Shari'ah Nasional Majelis Ulama Indonesia (DSNMUI), whereby any member of DSNMUI can be invited to come to the court as an expert witness. DSNMUI members are responsible for assisting judges by giving their expert opinion. This statutory duty is stated in Act No. Kep-754/MUI/II/1999.<sup>57</sup> DSNMUI has also actively trained judges based on a collaboration program between DSNMUI and the Ministry of Justice and Human Rights. Testimony from the expert witness undeniably enlightens the judges about the case, but it is not binding.<sup>58</sup> Hasan lists down several advantages of empowering the Religious Court in Indonesia to handle Islamic banks cases, among other things, strong support from the predominantly Muslim public, the Government as evidenced by the enactment of the Religious Court Act No. 3 of 2006, the central bank, and also from Islamic financial institutions in Indonesia.<sup>59</sup> The availability of branches all over Indonesia is also considered an advantage as it allows wider access. Nevertheless, some weaknesses may prevent this institution's efficacy in handling Islamic banking disputes, such as the absence of clear regulation or act that regulates Shari'ah economics in Indonesia. Supriyatni<sup>60</sup> stated that in

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<sup>56</sup> Abdul Manan, *Penerapan Hukum Acara Perdata Di Lingkungan Peradilan Agama*, (Cetakan Kencana, 2005).

<sup>57</sup> This legislation provides for the establishment of DSNMUI including its functions.

<sup>58</sup> Danggur Konradus, *Membedah Hukum Acara Perdata Indonesia*, (Bangka Adinatha Mulia, 2016).

<sup>59</sup> Hasbi Hasan, *Kompetensi Peradilan Agama Dalam Penyelesaian Sengketa Ekonomi Syariah*, (Gramata Publishing, 2010).

<sup>60</sup> Renny Supriyatni, "Penerapan Fiqih Muamalat Sebagai Dasar Kewenangan," *Syar'at Hukum* 12, no. 3 (2010): 189–206.

such absence, the Religious Court is dependent on books in *Fiqh Muamalat* in deciding cases. Judges in the Religious Court may have a good understanding of Shari'ah disputes, but they lack understanding and knowledge of banking and economics, especially about Islamic banking activities. Furthermore, Arto highlighted five juridical constraints, namely:<sup>61</sup>

- a) Lack of laws and regulations governing the competency of the Religious Court and the availability of procedural law.
- b) Conflicting laws and regulations.
- c) Incomplete laws and regulations that are difficult to implement.
- d) Gap between the competencies provided by the law to the Religious Courts and the competencies required by a developing society.
- e) Absence of legislation that governs specific issues being brought to the court.

There are a couple of decided cases to illustrate the issue of court jurisdiction in determining Islamic banking cases. In *PT. BPR Shari'ah Buana Mitra v. Herman Rasno Wibowo bin Sodirin and Harni binti H. Ahmad Sudarmo*, the plaintiff filed a complaint against the defendants in the Purbalingga Religious Court because the defendants had breached the *Musharakah* (partnership) agreement. According to *Musharakah* Financing Contract, the plaintiff promised to invest Rp30.000.000 in the defendant's brown sugar and groceries company. On the other hand, the defendants were dishonest, diverting the funds

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<https://www.neliti.com/publications/25258/penerapan-fiqih-muamalah-sebagai-dasar-kewenangan-pengadilan-agama-dalam-penyele>.

<sup>61</sup> Mukti Arto, *Pembaharuan Hukum Islam Melalui Putusan Hakim*, (Pustaka Pelajar, 2015).



to another venture without the plaintiff's authorisation. As a result, the plaintiff experienced a setback. The plaintiff requested that its money be withdrawn, but the defendants refused.

The plaintiff then filed a complaint in Purbalingga Religious Court, requesting that the court issue an order requiring the defendants to restore the funds. After a failure to comply, the court was petitioned to issue an order seizing the defendant's collateral and auctioning it off. The panel judges then decided, among other things, that the defendant had defaulted, and that the *Musharakah* Financing Contract had been cancelled.

Later on, through their proxy, the defendants filed a case review to the Supreme Court against the decision of the Purbalingga Religious Court. The defendants' major argument was that, under section 12 of the *Musharakah* Financing Contract, if there was a dispute between the plaintiff and defendants, the matter should be submitted to the Shari'ah Arbitration Body in Jakarta or the District Court of Purbalingga or/and Affairs Committee of State Receivable (*Panitia Urusan Piutang Negara*/PUPLN) / Office of Government Credit Service and Auction (*Kantor Pelayanan Piutang dan Lelang Negara - KP2LN*) in Semarang and not the Purbalingga Religious Court. The Supreme Court, on the other hand, held that the rationale given could not be justified because the Religious Court had jurisdiction over Islamic economic disputes, including Islamic banking disputes, based on section 49 of Law No. 3 of 2006. In the case of *Fatimah v. PT Bank Mega Syariah, Kementerian Republik Indonesia & H. Panataran Marpaung*,<sup>62</sup> it was

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<sup>62</sup> "Putusan PN KISARAN Nomor 60/Pdt.Bth/2017/PN Kis," Direktori Putusan Mahkamah Agung Republik Indonesia, accessed March 20,

held that since the first defendant is an Islamic bank, the Kisaran District Court has no jurisdiction to decide and hear this case.

### **Arbitration**

Arbitration can be conducted by BASYARNAS or other arbitration bodies. The arbitration process is regulated under the Arbitration Rules and Procedures issued by Badan Arbitrase Nasional Indonesia (BANI) or the Indonesian National Arbitration Center.

Similar to Religious Court judges, if the arbitrators do not have adequate knowledge regarding Shari'ah matters in Islamic banking cases, a reference may be made to DSNMUI. The members of DSNMUI may be called to become expert witnesses under Article 49 of the Arbitration Act No. 30 of 1999. The expert witness must ensure that the confidentiality of the dispute must be observed. Prakoso<sup>63</sup> reflected that one of the main problems of arbitration in Indonesia is the enforcement of arbitration awards. Any outcome of arbitration cannot be legally enforced unless registered first with the court. If the court disagrees with the award, it will become null and void. Nonetheless, the Religious Courts cannot arbitrarily cancel the decision made by way of arbitration. Widjaja and Yani<sup>64</sup> highlighted that the

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2022,  
<https://putusan3.mahkamahagung.go.id/direktori/putusan/561a0bc105aa4b309761878c0003f75b.html>

<sup>63</sup> Andria Luhur Prakoso, "Tinjauan Terhadap Arbitrase Syariah Sebagai Alternatif Penyelesaian Sengketa Di Bidang Perbankan Syariah," *Jurnal Jurisprudence* 7, no. 1 (2017): 65.

<sup>64</sup> Gunawan Widjaja, and Ahmad Yani "Hukum Arbitrase," *Raja Grafindo Persada*, 2003.

Religious Court could cancel the decision made in the arbitration if any of the following requirements are not fulfilled:

- a) The selection of arbitrators is agreed upon by all parties involved.
- b) The type of dispute which is settled by the arbitration is legally allowed to be examined and decided by way of arbitration.
- c) The outcome of the arbitration process is according to the law and is not against the public order.

### **Mediation**

Generally, mediation is governed under the Supreme Court Regulation No. 1 of 2008 concerning mediation. The regulation specifies that mediation can be utilised either inside or outside court proceedings. It also requires every judge to order all parties to go through a mediation process before the commencement of court proceedings. However, there are exceptions to this general rule regarding disputes on inheritance, *hibah*, and the legal status of an individual.

Banking mediation is regulated under the Central Bank Circular Letter No. 10/1/PBI/2008 dated 30th January 2008. The Letter states that mediation for Islamic bank disputes can be carried out inside or outside the court. Usually, if the mediation is done inside the court, the mediator is usually the same judge. On the contrary, if the mediation is carried out outside the court, it indicates that the parties do not bring their case to the court and choose mediation to solve it. Nevertheless, monetary capping is prescribed, whereby mediation is permissible only if the dispute involves financial loss with the maximum value of Rp 500,000,000.

After the establishment of the OJK in January 2014, the Circular Letter No. 1/POJK.07/2014 on Alternative Dispute Resolution in Financial Sector was issued (Letter). This Letter does not revoke the previous Letter from the Central Bank (the Circular Letter No.10/1/PBI/2008 dated 30th January 2008). Hence, the rules about mediation from the Letter are still applicable. By virtue of this Letter, an institution called *Lembaga Alternative Penyelesaian Sengketa Perbankan Indonesia* (Institution of Alternative Dispute Resolution for Banking) was established. Any mediation for Islamic banks outside the court is conducted by this institution.

### **Commercial Court**

It is submitted that the option of using a commercial court to handle Islamic bank disputes is controversial.<sup>65</sup> This is in contrast to Article 55 paragraph (1), which placed dispute resolution for Islamic banks under the Religious Court's competence. Dadang Achmad (Director of CV. Benua Engineering Consultant) filed a case in the Indonesian Constitutional Court on 19th October 2012 to undertake a judicial review on this subject. The Constitutional Court ruled that commercial courts lack jurisdiction over Islamic bank issues (Constitutional Court Proceedings, case No.93/PUU-X/2012).

### **COMPARATIVE ANALYSIS**

The preceding discussion reveals similarities and differences in the approaches embraced by Malaysia and Indonesia in resolving Islamic

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<sup>65</sup> Atharyanshah Puneri, "Dispute Resolution for Islamic Banks in Indonesia." *International Journal of Islamic Economics and Finance (IJIEF)* 4 (Special Issue), (2021): 153-180.

banking disputes. In general, both have adopted the regular route of dispute settlement, namely through litigation and ADR. Nevertheless, there is one stark contrast in respect of the former approach. In Malaysia, the jurisdiction lies with the civil court and not the Shari'ah court. In contrast, in Indonesia, the Religious Court has been primarily entrusted to deal with legal actions between Islamic banks and the customers, in addition to other ADR mechanisms. Irrespective of the approach, the fundamental issue arising is analogous, namely the expertise of the judges with the applicable laws and principles governing Islamic banking products and documentation. Civil court judges lack comprehensive knowledge of Shari'ah law. At the same time, Religious Court judges also struggle to comprehend the civil law part of the products and documentation, which are not structured purely based on Shari'ah but a mixture of civil laws including contract, commercial, land, companies, evidence and so on. Both jurisdictions employ a similar approach to elevate the judges' confidence in deciding the case through reference to the experts in Islamic banking. In Malaysia, mandatory reference to the SAC has been imposed on civil court judges, either to the existing decisions made or personal reference. This approach intends to ensure uniformity and clarity in deciding Shari'ah issues. However, some legal experts have viewed this as appropriating the court's judicial power. Nevertheless, the favourable view is that such provisions do not amount to encroachment of the court's judicial power. In Indonesia, Religious Court judges are also allowed to call any member of DNSMUI as an expert witness if they need further clarification on specific issues while dealing with

Islamic banking disputes. However, judges are not bound by the opinion given by DSNMUI members.

Both jurisdictions also offer various ADR options if the parties opt not to elect conventional court litigation and the standard modes are in the form of mediation or arbitration. In Indonesia, mutual understanding is also regarded as one choice of ADR. Likewise, if the arbitrators in Malaysia encounter Shari'ah issues, they must refer to the SAC for deliberation, while in Indonesia, a reference may be made to the DSNMUI. In Malaysia, consumers who are aggrieved with the acts or decisions of Islamic banks can pursue a free course of action via OFS. The summary of the comparison is depicted in Table 1.

Table 1: Islamic Banking Dispute Resolution Mechanisms in Malaysia and Indonesia

MECHANISMS	MALAYSIA	INDONESIA
Litigation by the Civil Court	Civil Court has sole jurisdiction by virtue of List I 9 <sup>th</sup> Schedule of Federal Constitution	By virtue of Article 55 of Islamic Banking Act No. 21 of 2008, the civil court may hear the dispute if the disputing parties agree. However, the dispute resolution must not conflict with Shari'ah principles.  However, the Constitutional Court ruled that commercial courts lacked jurisdiction

		over Islamic bank issues in 2012.
Litigation by Shari'ah Court/Religious Court	Shari'ah Court has no jurisdiction by virtue of List II 9 <sup>th</sup> Schedule of the Federal Constitution	Under Article 55 of Islamic Banking Act No. 21 of 2008, dispute resolution is initially vested in the Religious Court.
Mediation	<ul style="list-style-type: none"> <li>● Judge-led mediation</li> <li>● Mediation by AIAC</li> <li>● Mediation by certified mediators, including by MMC</li> </ul>	<p>Under Article 55 of Islamic Banking Act No. 21 of 2008, banking mediation is allowed if agreed upon by the disputing parties, provided the dispute resolution must not conflict with Shari'ah principles.</p> <p>Provided by Institution of Alternative Dispute Resolution for Banking.</p>
Arbitration	Governed by i-Arbitration Rules 2021	Under Article 55 of Islamic Banking Act No. 21 (2008), arbitration by the National Shari'ah Arbitration Board or

	<p>Provided by AIAC</p> <p>other arbitration institutions is allowed if agreed upon by the disputing parties, provided the dispute resolution must not conflict with Shari'ah principles.</p> <p>Provided by BASYARNAS or other arbitration bodies.</p> <p>The process of arbitration is regulated under the Arbitration Rules and Procedures issued by BANI or the Indonesian National Arbitration Centre.</p>	
Med-Arb	<p>Provided by AIAC</p>	Not stated in the list in article 55(2)
Ombudsman	<p>Provided by OFS</p>	No ombudsman-based institution established to settle financial disputes

Source: Authors own

## CONCLUSION AND RECOMMENDATIONS

It is submitted that both jurisdictions have undertaken a continuous endeavour to create a viable dispute resolution platform concerning Islamic banking disputes with the ultimate objective of attaining justice. The preceding discussion reveals the pros and cons of both



approaches, which fundamentally stem from the fact that the judges are not well equipped with one of the two main disciplines required to enable them to resolve Islamic banking disputes that serve two primary requirements, namely to be in line with Shari'ah (thus demanding Shari'ah knowledge) and comply with civil law principles (thereby requiring knowledge of civil laws). Consequently, it is viewed that a continuous knowledge transfer programme is necessary to equip the existing judges with relevant knowledge and assist them in better understanding various Shari'ah principles. At the same time, the capacity-building programme is pertinent to developing a pool of competent professionals mastering civil and Shari'ah laws relating to Islamic banking to fill the current gap. This initiative has been explored by Indonesia whereby certification training in Islamic finance is offered for judges in collaboration with the central bank, Islamic banks, the Ministry of Finance, and the OJK as well as sending judges on short courses, particularly to the Middle East with a more developed Islamic financial industry. Moreover, formal and easy-to-refer materials should also be set up. In Malaysia, BNM has initiated a compilation of SAC decisions that are accessible online or by hardcopy. Likewise, for Indonesia, all *fatwa*, guidelines, and regulations from DSNMUI, the Central Bank, and OJK pertaining to Islamic Banking are correctly compiled. The Supreme Court also issues the "Kompilasi Hukum Ekonomi Shari'ah" to guide Religious Court judges in deciding Islamic bank disputes. In terms of practical guidance, the Supreme Court on 22nd December 2016 introduced the Supreme Court Regulation No. 14 encompassing the procedures for handling Islamic economic disputes. Additionally, the establishment of the OFS is also a remarkable effort

that is worth to be emulated by Indonesia in providing cheap and effective financial dispute resolution.