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Demystifying the Contractual Duty of Care of Islamic Banks in Malaysia

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Abstract: The general relationship between a bank and customer is contractual in nature. For conventional banks, the banker-customer relationship is based on the debtor-creditor relationship with the bank earning a profit from a spread made between interest charged on the borrower of funds and interest paid to the depositors. In Islamic banking, due to the different contractual transactions of Islamic banking operation, it is based on a multi-contractual relationships. However, bank consumers perceive that banks enhance their profits by treating consumers unfairly and failing to take responsibility when things go wrong. This study examines the duty of care of conventional and Islamic banks towards bank consumers. It also focuses on the Islamic banks' duty of care from the perspective of *maqāṣid al-Sharī'ah*, to those who use their services. Adopting the doctrinal analysis method, this study analyses and compares the duty of care of both conventional and Islamic banks. Findings of this study include that misconduct by banking industries remains rife and that unfair treatment of customers are frequent. As for Islamic banks, the *maqāṣid al-Sharī'ah* based duty of care is found missing in their Islamic banking operation. This study suggests that the duty of care for both banks should be reformed to improve bank consumers' experience. For Islamic banks, an improved standard is useful in performing their duties based on Islamic values.

KEYWORDS: Banker-customer Relationship, Duty of Care, Islamic banks, *Maqāṣid al-Sharī'ah, Malaysia.*

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Abstrak: Hubungan bank dengan pelanggan adalah berasaskan kepada kontrak. Bagi perbankan konvensional, hubungan bank-pelanggan ini berteraskan pemberi pinjaman dan peminjam yang mana perbezaan kadar faedah atau 'interest' di antara pembiayaan hutang dan produk deposit adalah keuntungan kepada bank. Hubungan kontraktual di perbankan Islam pula adalah berteraskan kepada pelbagai kontrak patuh Sharīʿah. Namun, pelanggan menganggap bahawa bank-bank tidak mengutamakan keadilan dalam hubungan bank-pelanggan dan penyelesaian kepada masalah-masalah perbankan. Justeru, objektif utama kajian ini ialah untuk mengenal pasti kewajipan penjagaan oleh perbankan konvensional dan Islam terhadap pelanggan. Fokus kajian ini juga termasuk kewajipan penjagaan berpandukan maqāṣid al-Sharīʿah terhadap pelanggan yang menggunakan perkhidmatan perbankan Islam. Berteraskan penyelidikan doktrin, kajian ini menganalisa perbandingan kewajipan penjagaan oleh perbankan konvensional dan Islam. Kajian menunjukkan tindakkan tidak adil oleh bank terhadap pelanggan masih berleluasa. Dapatan kajian juga membuktikan bahawa perbankan Islam tidak mempraktikkan kewajipan penjagaan berteraskan maqāṣid al-Sharīʿah. Maka, kajian ini mencadangkan bahawa kewajipan penjagaan pelanggan perlu di utamakan untuk kelangsungan hubungan baik dengan pelanggan. Penambahbaikan ini amat penting bagi perbankan Islam untuk kelangsungan perkhidmatan cemerlang berteraskan nilai-nilai Islam yang murni.

Introduction

The wave of banking scandals in recent years, from London Interbank Offered Rate (LIBOR) fixing in 2008 to the global financial crisis in 2007-2009 have led to an increasing number of banking customers and third parties filing claims against banks for instances like mis-selling of financial products, poor financial advice, insufficient disclosure of and warning about financial risks. In reality, many actions by the banking sector have been proved damaging which led to negative revenue for pension funds, malapportionment of resources, as well as financial crime. At the same time, bankers are excessively rewarded with large bonuses in good and bad times to the extent of being rewarded even during a credit crunch. For example, Wells Fargo, the third largest bank in the United States where a series of giant scams were reported in 2016 that Wells Fargo was opening around two million fake bank accounts without the consent of customers so as to get sales bonuses. As a result of the rapidly increasing number and different types of financial frauds, one may say that banks, be it conventional or Islamic are responsible

or legally obliged to avoid any acts or omission (which are reasonably foreseeable) that are likely to cause harm to bank customers. In other words, banks owe a duty of care that required them to act with caution, watchfulness and prudence that a professional banker in such circumstances would do so when dealing with their customers. Full weight must be emphasised to the exact reasonable duty of care in protecting bank customers and innocent third parties, otherwise the acts of banks are considered negligent such that bank customers can claim any resulting damages in a lawsuit.

It is beyond question that the banker-customer relationship is contractual in nature which specifies the obligations imposed on the bank and customer. Therefore, banks are initially guided by the principles of contract law. In a contractual relationship, both parties have fiduciary duty to act bona fide or in good faith towards each other. Such duty is owed not only to banking customers especially but also extended to third parties. Banks need to inform their customers regarding the risks associated with their loans. As for the third parties such as guarantors, banks should inform in circumstances when the said customers do not comply with their obligations to pay the debt. Furthermore, banks most certainly have a contractual duty to its customer to exercise reasonable care and skill in doing their banking business. Both banker and customer have certain duties to each other. Some of the many duties owed by the bank to the customer include duty to carry out customer's mandate, duty to alert customer when such instruction is incorrect or inappropriate, duty to obtain proper instructions from customer, duty to maintain secrecy of customers and duty to advice on investments. The customer also owes certain duties to the bank such as duty to notify the bank of any unauthorized operations on the account, duty to keep the securities features of payment instrument safe and duty not to misled bank when drawing cheques or other payment order.

The scope of banks' duty of care to its customers is broad which includes protecting a customer from fraud by a person in chief such as directors or partners making payment orders on behalf of customer, ensuring that financial advice given to customer is sound and reliable such as explaining the meaning and risks of security documents. As conventional and Islamic banks assume the advisory roles as investment and financial advisors, the banker-customer relationship continues to evolve such that their fiduciary duty to customers becomes obvious.

However, this list is not exhaustive and whether a bank owes a duty of care to bank customer depends on the facts of each case. Then the test applied is whether such injury suffered by the customer is due to action or inaction of the bank in question that banks have reasonably foreseen such action or inaction would likely to injure the customer.

The objective of this study is to discuss the duty of care of Islamic banks towards bank consumers as compared to their conventional counterparts, and examine the similarities and convergences prevalent between both financial institutions. Most importantly, this study looks into the duty of care of Islamic banks as a key part of the higher objectives of *Sharīʿah* (*maqāṣid al-Sharīʿah*), with bank customers who use their services. Introducing an expanded scope of a duty of care would create a level playing field between institutions and banking customers, and would rebalance the information and bargaining position asymmetries between banks and banking consumers to the extent of preventing poor conduct.

The remaining parts of the article are divided into the following sections. Section two highlights the methodology of this study, while section three highlights the review of literature on the importance of banker-customer relationship and the laws applicable in conventional and Islamic banks respectively. As identifying the duty of care in conventional banking is only one part of the study, the *maqāṣid al-Sharīʿah* based duty of care for Islamic banks is also the focus of section three. In section four, special focus is given to identify similarities and differences in duty of care of conventional and Islamic banks as well as the importance of having an improved standards across the banking sector necessary for developing a more consumer-centric banking system. Additionally, some propositions are made towards demystifying the duty of care of Islamic banks in enhancing the Islamic banking model. The last section offers a conclusion to the study.

Methodology

This study is a qualitative research which emphasises on discussion and arguments based on case laws, legislations, documentary references on the duty of care of conventional and Islamic banks towards their customers. The study uses secondary data derived from various sources such as websites, bulletins and other published materials. To improve the duty of care of Islamic banks, a comparative study is carried out

with the conventional banks as well. It is hoped that this research would be helpful to government policy in changing the financial culture of Islamic banks in creating a positive banking culture that will help steer Islamic banking industries to greater height of achievement.

Bank-Customers Relations

It may be said that for a person to become a bank customer a business relationship needs to be established first (*Woods v Martins Bank Ltd*,1959). Based on this, two important conditions are important to become a bank customer: first, there exists some dealing habit between customer and banker irrespective of whether an account is opened; and second, the transactions made are in the nature of regular banking business. The history of conventional banking shows that the banker-customer relationships have arisen on a basis of interest. In this regard, conventional banks earn their money by charging bank customers interests and fees for services. However, Islam prohibits interest as the Quran explicitly mentions (*Al Baqarah 2:275*) that trading is permitted while *riba* (usury/ interest) is forbidden. Therefore, the elimination of interest in Islamic banking transactions and the introduction of banking based on *Sharī'ah* jurisprudence resulting in the banker-customer relationships in Islamic banking take a new dimension. Islamic banks earn their money by trading, leasing, charging fees for services rendered, profit and loss sharing, as well as using other *Sharī'ah* prescribed ways.

The legal principles that govern the banking business and the relationship between a banker and its customers are drawn from a variety of sources such as the terms of the contract between the contracting parties, statute, the common law, equity, as well as code of banking practices (Islam, 2016). The colonization of British in Malaya has brought together the English Law which later on became one of Malaysia's sources of law. The British government officially stepped in Malaya via the Anglo-Dutch treaty and acquired Singapore, Penang and Malacca through a contract known as the Straits Settlement. The British then gradually took control of the peninsular states. In 1956, a year before independence of Malaya in 1957, the British enacted the Civil Law Act which enabled the use of common law of England and rules of equity when there is lacuna in the provision of any written law. The English case law, also known as the common law originated in England is based on the system of precedent derived from judgements of the

judges. It is a type of an unwritten law which consists of decisions of the superior courts that binds the lower courts. The rules of equity is not a complete body of rules which merely fill the gaps in the common law and softened the strict rules of common law. In the event of a conflict between common laws and equity, the equity should always prevail. Section 3 of the Civil Law Act 1956 allows Malaysian judges to make reference to court cases and make use of common law only in the absence of any written law as administered and enforced in England on 7 April 1956 for Peninsular Malaysia, on 1 December 1951 for Sabah and 12 December 1949 for Sarawak as stipulated thereunder.

In Malaysia, although there are Financial Services Act 2013 and Islamic Financial Services Act 2013, these Acts are not exhaustive. Since the Malaysian legal system is based upon the English common law, any ambiguities, clarifications and interpretation are referred to the civil courts. The common law principles are applied in all legal matters of the civil courts. As such, the focus here is to examine the common law duty of care that a conventional and Islamic bank owe to their customers when using banking services.

Conventional Bankers' Contractual Duty of Care to Customers

The relationship between a banker and a customer is a contractual one which comes about as soon as a customer opens a deposit or current account with a banker. The application to open an account by the customer is treated as a letter of agreement towards establishing the banker-customer relationship. Simply put, although there are various dimensions of the general banker-customer relationship the primary banker-customer relationship in conventional banking is the debtor-creditor relationship where bank earns money from interest received on loans and other assets, and it pays out money to customers who deposit money into interest-bearing account. In the course of his day to day business, a banker also enters into different kinds of relationships with its customers whereby such relationship between a bank and its customers can be broadly categorized into general relationship of debtor-creditor or creditor-debtor as the case may be and that of special relationship such as bank as a trustee, bailee-bailor, lessor-lessee, agent-principle as well as bank acting as a guarantor (Poh, 2016).

Firstly, the primarily debtor and creditor relationship which was based on the principles decided in the landmark case of *Foley v Hill*

[1848] 2 H.L.Cas.28, 9 ER 1002 *and others (Joachimson v Swiss Bank Corporation [1921] 3 KB 110)* with the bank being the debtor of the customer when the customer deposits money in a bank account. This characterization was important for the functioning of banking business since a bank can use the money deposited by account holders as it sees fit since the money becomes the property of the bank and, the bank needs not inform the customer how the funds are utilised. In *R. v. Davenport* [1954] 1 W.L.R. 569, Lord Goddard C.J. decided that a customer whose money was fraudulently withdrawn by means of larceny by another person, was not entitled to recover the money because the money belonged to the bank and not the customer. The bank's undertakings include to repay the money deposited when demanded by the customer. In *Kian Lup Construction v. Hongkong Bank Malaysia Bhd* [2007] 7 C.L.J. 32, Ramly Ali J. (now JCA) decided that the relationship of debtor-creditor arises when the bank provides a loan or financial facility to the customer and not fiduciary in nature. In other words, the bank is only liable to pay the equivalent amount demanded by the customer addressed to the branch of the bank where the account is kept but not the full amount of his balance (see *Joachimson v Swiss Bank Corporation*). Otherwise, when the bank lends money to a customer, it becomes the creditor of such customer with the customer as a debtor of the bank. The fundamental characteristics of the banker and customer relationship was first enunciated by the House of Lords in *Foley v Hill* (1848) whereby Lord Cottenham L.C. noted the following.

> Money, when paid into a bank, ceases altogether to be the money of the principal; it is then the money of the banker, who is bound to return an equivalent by paying a similar sum to that deposited with him when he is asked for it. The money paid into the banker's is money known by the principal to be placed there for the purpose of being under the control of the banker; it is then the banker's money; he is known to deal with it as his own; he makes what profit he can, which profit he retains to himself, paying back only the principal, according to the custom of bankers in some places, or the principal and a small rate of interest, according to the custom of bankers in other places. The money placed in the custody of a banker is, to all intents and purposes, the money of the banker, to do with it as he pleases; he is guilty of no breach of trust in employing it; he is not answerable to the principal if he puts it into jeopardy, if he engages in a hazardous

> speculation; he is not bound to keep it, or deal with it, as the property of his principal, but he is of course answerable for the amount, because he was contracted, having received that money, to repay to the principal, when demanded, sum equivalent to that into his hands.

Besides that of the ordinary relationship of banker and customer with nothing fiduciary between them, and with the banking services becoming more extensive and expanding, other relationships also arise depending on the types of services rendered by the bank. For example, the relationship of principal-agent exists when the customer give instruction to his bank to buy or sell for him, and the relationship at times can be that of bailor-bailee when goods are kept in safe-custody. When the banks are entrusted as executor to administer their deceased customers' estate the relationship present is that of trustee and beneficiary. Duties similar to trusteeship might also exist when a bank has possession of funds or property belonging to a third party and after selling such property in mortgage, the surplus is handed to the subsequent mortgagee. The relationship in such situation here with the customer being that of the mortgagor and mortgagee. In all these special relationships between the bank and the customer, the bank is fiduciary in these relationships and are obliged to the principles of good faith and fair dealing. To discharge this fiduciary duty, the bank relies predominantly on the banking practice because in the commercial world such relationship between the bank and its customers relies on the general banking practices.

However, the contractual banker-customer relationship imposes a duty on the banker to exercise reasonable care and skill when operating the customer's account, a duty which extends to the entire range of banking business with the customer or to some circumstances even to a third party. In accordance to the contractual duty of care, the common law has established the 'neighbour principle' duty of care arising from the land mark case of *Donoghue v Stevenson* (1932) All ER 1, that one has a duty not to injure their neighbour. Breach of a duty of care by the banker may give rise to liability in tort or contract, depending facts or circumstances of each case in question. While this principle enunciates that a person owed a duty of care to anybody whom could be reasonably harmed by his action or inaction as the case may be, there is no liability attached provided the harm suffered was foreseeable in nature. The point here is that a banker is bound to honour payment instructions to

himself or third party provided there is sufficient fund to satisfy the amount payable. Indeed, failure or neglect to do so as per customer's instruction without justification constitutes a breach of duty for which the banker would be liable for damages in contract, or negligence or even for libel since wrongful dishonor of a cheques may impair the drawer's credit or defame him.

The law in *Donoghue v Stevenson* also lays down the general rules of the standard of care to be attained and it is a question of fact in determining whether one has failed or otherwise in attaining the standard of care required in any particular case in question. The standard of care required is based on a person of ordinary prudence whom is using ordinary care and skill, and for professionals, the standard of care required is that of any ordinary professional. This means that a person cannot merely state a defense that he has acted to the best of his own judgement, should his best judgement fell short of the ordinary reasonable man or professional man standard. The House of Lords summed up the neighbour principle as follows:

> The rule that you are to love your neighbour becomes the law. You must not injure your neighbour. You must take reasonable care to avoid acts or omissions which you can reasonably foresee would likely to injure your neighbour. Your neighbour are the persons who are so closely and directly affected by your act that you ought to reasonably to have them in contemplation as being affected when you are directing your mind to the acts or omissions which are called in questions.

Based on the neighbour principle, it can be stated that the standard of care that a bank owes to its customers or third party is that of a reasonable banker such that he can reasonably foresee as likely to suffer injury by his action or inaction. Since the banker-customer relationship is contractual in nature which specifies the obligations imposed on the bank and the customer, it can be considered that a bank has a contractual duty to its customer to exercise reasonable care and skill in doing the banking business. The nature and extent of the contractual duty of care owed by a paying bank to its customer was considered in *Selangor United Rubber Estates Ltd. v. Cradock* (No. 3) [1968] 1 W.L.R. 1555, where the court decided that a wider duty of care is owed by the paying banker to its customer such that:

> ...a bank has a duty under its contract with its customer to exercise 'reasonable care and skill' in carrying out its part with regard to operations within its contract with its customer. The standard of that reasonable care and skill is an objective standard applicable to bankers. Whether or not it has been attained in any particular case has to be decided in the light of all the relevant facts, which can vary almost infinitely. The relevant considerations include the prima facie assumption that men are honest, the practice of bankers, very limited time in which banks have to decide what course to take with regard to a cheques presented for payment without risking liability for delay, and to the extent to which an operation is unusual or out of the ordinary course of business. An operation which is reasonably consonant with the normal conduct of business of necessity does not suggest that it is out of the ordinary of course of business.

The reasonable banker contractual duty of care is an objective test to be decided based on the facts of the case. For instance, a banker may make inquiries that are appropriate and practical in any given circumstances with a view to keep the customer's money in safe custody and payable when demanded, including to ensure that the customer's money in the banker's custody and under his control is not being subject to being tampered illegally or unnecessarily by fraudsters. There is no doubt that a banker's duty to exercise reasonable care and skill on the operation of customer's account, which extends to the whole range of banking business within the contract with customer. Such standard was mentioned by Ungoed-Thomas J. in *Karak Brothers Company Ltd v Burden* (1972) All ER 1210 as follows:

> The normal contractual relationship of banker and customer include the normal obligation of using reasonable skill and care, and that duty, on part of the bank, of using reasonable skill and care, is a duty owed to the other party to the contract, the customer. So the duty of skill and care applies to interpreting, ascertaining, and acting in accordance with the instructions of a customer. Of course a bank should normally act in accordance with the mandate/ instructions of a customer – but not if reasonable skill and care indicate a different course.

In the case law and legislation, the scope of bank's duty of care owed by banks to customers when selling financial products seem to

expand. The following discussion would entail three types of duty owed by banks to customers which are expressly recognised by case law. First, the duty not to misled or misstate information or commonly known as the *Hedley Byrne* principles *(Hedley Byrne & Co v Heller & Partners Ltd* [1964] AC 465*)*. The duty of care is of a lower standard when a banker provides information to customers on a product to take reasonable steps not to misstate or misled. This case regards that a banker's duty of care to its customers arise in tort, that the idea of "assumption of responsibility" was introduced which recognised the liability of bankers for pure economic loss not arising from a contractual relationship. It may be concluded that where a bank gives information it assumed responsibility for such information then there is a duty not to mislead or misstate when giving information.

Secondly, the advisory duty which banks provide to customers. The banks must ensure that the advice given is full and accurate. In *Banker's Trust International v PT Dharmala Sakti Sejahtera* [1996] CLC 518, the court states that the duty of banker when providing an explanation or tenders advice, must give advice in full, accurate and proper, and even in some cases to comply with the relevant regulatory regime. Full advice here means advice which covers all available options including the pros and cons of recommended product for customer to make informed decision. To determine whether advice or information was provided by the banker, the court in *Rubenstein v HSBC* [2011] EWHC 2304 QB held that it would look whether such information was provided either with a recommendation on the relevance of such information to customer's investment decision or the process of product selection involves value judgement that such information influence the customer's decision. In a situation when the advisory relationship is absent, it was held in *Green & Rowley* [2013] EWCA Civ 1197 and *Thornbridge v Barclay* [2015] EWHC 3430 that the banker's duty of care is that of *Hedley Byrne* duty since an intermediate duty could exist outside the advisory relationship. The circumstances for bank's duty of care to exist and the extent of such duty depend on facts of the case and a matter of policy appropriate to impose such duty. In circumstances where a bank is subjected to regulatory regime (in this case the Financial Services Markets Act 2000 UK) the advisory duty may extend further which requires compliance with such legislation.

Thirdly, the intermediary or mezzanine duty. This duty is more extensive and higher than the duty in *Hedley Byrne*, but lower than the advisory duty which was first mentioned in *Crestsign Ltd v National Westminster Bank* [2014] EWHC 3034 (Ch). On the facts, this was a negligence claim due to mis-selling of bank's derivate product by hedging on interest rate which resulted in economic loss allegedly suffered by Crestsign from the advice or statement made by the banker, NatWest Bank. In sum, the relationship was non-advisory since no advice was given which excluded the bank from any duty and responsibility for the negligent advice on the suitability of the swap product due to a disclaimer in the bank's terms and conditions. However, the bank owed a duty not to mislead Crestsign and "to give explanation or tender such advice fully, accurately and properly" (as per Mance J).

The case of *Philip Thomas & anr v Triodos Bank NV* [2017] EWHC 314 (QB) provides a useful illustration that a bank owed a "mezzanine duty" to its customer in the form identified in *Crestsign* case. In this case the bank or financial institution was held to a higher duty of care to be liable for mis-selling an interest rate derivative to its customer, even though the relationship is non-advisory. The court ruled that Triodos Bank, as the defendant has breached the duty of care to clearly explain to the claimant (customer) the features and financial risks of a derivative including to give a balanced view of product in plain English, particularly in a situation where the bank has signed up to a voluntary code of practice which requires fairness commitments. The bank has advertised that it subscribed to the business banking code (BBC), which is now superseded by the Standards of Lending Practice with effect of 1 July 2017. In circumstances where the bank has signed up to a voluntary code of practice, they should consider fairness commitment relevant to customers including how the code relates to specific product terms and conditions like exclusions or exemption clauses. In this case, there were no disclaimers or exclusion clauses in the terms and conditions applied between both parties to conclude that the bank was not willing to assume responsibility to honour such promise.

To conclude, it has long been accepted that there is a clear distinction between the duties a bank owes when (1) giving advice to customer in purchasing a financial product, and (2) when bank provides information only about a product to a customer. The decision in *Thomas v Triodos* to some extent has blurred such distinction by introducing a new

"intermediate or mezzanine duty" to explain a product to a customer, which falls between full advisory and the standard duty not to mislead or misstate when providing financial product information to a customer. No doubt the standard of ordinary prudent banker depends on the particular facts of each case.

Contractual Duty of Care of Islamic Banks to Customers

In Malaysia, the legislative framework consists of mixed legal system such as the common law and ShariÑah law (Bari, 2005). With the Federal Constitution placing Islamic banking matters as a commercial matter, any disputes are tried in civil courts and not the Shari'ah court. In the case of *Bank Islam Malaysia Bhd v. Adnan bin Omar [1994] 3 CLJ*, the High Court held that Islamic banking matters were under the jurisdiction of the civil court. This indicates that not only do Islamic banks have to adhere to *Sharī'ah* framework they also are bound by other *Sharī'ah* compliant laws of Malaysia which is based on common laws.

For Islamic banks the governing law here is the Malaysian contract law, Islamic banking law including the Islamic Financial Services Act (IFSA) 2013 to the extent that these laws do not conflict with the provisions of *Sharī'ah* and *maqāṣid al-Sharī'ah*. Further, since Islamic banking is a commercial matter, any disputes are tried in civil courts and not the Shariah court. Eventually with judges in the civil courts facing difficulties to comprehend some concepts and terms to Islamic banking, the Central Bank of Malaysia (also known as Bank Negara Malaysia (BNM)) in cooperation of the judicial body, has set up a special High Court in the Commercial Division known as the Muamalah Bench, which deals specifically on Islamic banking cases. In this regard, referencing to English cases is essential since Malaysia operates within both *Sharī'ah* and common law traditions in facilitating Islamic banking transactions. This means that the existing laws in Malaysia and common law principles which are in line with *Sharī'ah* principles are implemented to further strengthen the legal infrastructure of Islamic banking.

Since Islamic banks operate in parallel with conventional banks, many procedural laws and substantive legislation which are based on common law principles also become relevant to Islamic banking. For example, the standard of care which the Islamic bank is required to

exercise is similar to that of the conventional bank, namely the normal care standard which is the established duty of care of a reasonable competent banker specialising in specific nature of banking transactions. A useful examination by the High Court on a tortious duty of care owed by an arranging bank of a sukuk (Islamic structured transaction) to investors/ Sukuk certificate holders was provided in a recent Commercial Court decisions in the United Kingdom. In *Golden Belt 1 Sukuk Company BSC (c) v BNP Paribas; FCOF II UB Securities LLC and others v BNP Paribas [2017] EWIIC 3182 (Comm),* Males J held that BNP Paribas was in breach of the established duty of care to the Funds (i.e. the certificate holders) to *"live up to the standard of the ordinary skilled banker engaged in a transaction of this nature"* and take reasonable care and skill in ensuring that the Promissory Note in question was properly executed. The standard of care which BNP Paribas was required to exercise was that of a usual negligence standard of a reasonably competent banker specialising in capital market transactions. In establishing a tortious duty of care in investment cases, Males J considered the three following tests: (1) assumption of responsibility i.e. the investors' dependence on the bank; (2) the three-stage test of foreseeability, proximity as well as whether it would be just, fair and reasonable to impose such duty; and (3) the incremental test of whether the law should develop novel categories of negligence incrementally and by analogy with established categories. Based on all the three tests, the court therefore found BNP Paribas had failed to meet this standard of care which made it negligent by failing to ensure that a wet ink signature was secured since a duly executed promissory is enforceable under the law of Saudi Arabia in protecting Sukuk certificate holders. However, the court held that the Bank did not owe a duty of care to Golden Belt as the issuer.

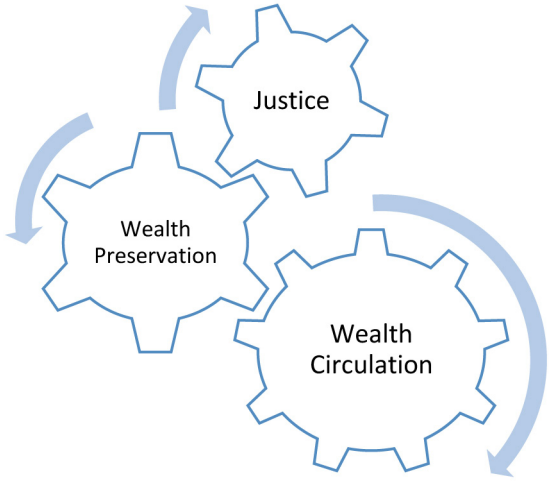
Essentially, to satisfy the standard of care, the court opined that BNP Paribas should have insisted on a physical signing meeting to be attended by its international or local counsel, or may be by using the technology of providing virtual attendance at signings. Even though for the purposes of enforceability in Saudi Arabia witnesses are not required to witness Mr Al-Sanea's (the Chairman of a limited partnership company) signature by either BNP Paribas' own representatives or their legal advisers, the court still found that BNP Paribas had failed to meet this standard of care. This case acts as a cautionary reminder for arranger banks that they may owe a duty of care albeit in some limited

circumstances to sukuk certificate holders. It also serves as an important reminder to arranging banks as well as participants in capital markets on the need to ensure that documents are properly executed in accordance with the local laws requirements.

However, an important point to note is that the duty of care in Islamic banks is a duty which is guided by faith. Islam propagates economic well-being of the ummah, universal brotherhood, justice and equitable income distribution. These values and ethical conduct are inherent in the objectives of *Sharī'ah* or *maqāṣid al-Sharī'ah* which focuses on the enhancement of people's well-being and saving them from harms through preservation of wealth, faith, lives, posterity and intellect (al-Ghazali (d.505AH/ 1111AC). Chapra (2008) expresses *maqāṣid al-Sharī'ah* from the perspective of human development and well-being through the strife for enriching five primary ingredients of human self *(nafs),* faith (din), intellect (Ñaql), posterity (nasl) and wealth (mal) to enable them to perform the duty as vicegerent of Allah.

The Maqasid al-Shariah which is the basis of Islamic banking is probably best theorized by 'Izz al-Din 'Abd al-Salam (d.660/1262), in his renowned work entitled *Qawa´id al-Ahkam* which characterised the various aspects of the *maqāṣid al-Sharī'ah* based on the relationship to Ñ*illah* (effective cause) and *maslahah* (public interest) in order to facilitate benefits (*mas*É*lih*) and the means that secure them or prevention of evil. Thus he concluded that the reason d'être of the *Sharī'ah* in financial transactions is its uncompromising emphasis on socio-economic justice, equitable circulation/ distribution of and preservation of income and wealth. In the context of Islamic banking business, preservation of wealth goes beyond its literal meaning which includes encouragement to generate and distribute the wealth in a just and fair manner, as well as prohibiting transgression of rights of others to name a few. Wealth circulation in this context indicates equitable distribution of wealth, prohibition of hoarding wealth, and channeling of wealth to productive sector. As for socio-economic justice, unjust elements such as uncertainty, unfair contract terms and exploitation should be minimised or avoided at all costs. Diagram 4.2 illustrates the intended outcomes of Shariah, specifically in banking transactions.

Diagram 4.2: Intended outcome of Shariah



Source: BNM Strategy Paper on Values-based banking (2017, p.14)

Based on the perspective of *maqāṣid al-Sharī'ah,* the banker-customer relationship goes beyond profit maximisation and shareholders' interest which highlights the call for justice, fairness, cooperation, avoiding extremism, promoting shared responsibility in business transactions and realisation of benefits to stakeholders of Islamic banks (Noor & Nor, 2018a). The Islamic Financial Services Board (IFSB, 2016) defines *maqāṣid al-Sharī'ah* as the fundamental objective of Sharī'ah, which promotes and protects the interests of all human beings as well as avert any harm that may affect their wellbeing. This indicates that the contractual standard of care imposed by the *Sharī'ah* on Islamic bankers in banking transaction is considerably higher in standard than the bankers in the conventional banks which is explained earlier. The *Sharī'ah* poses a much higher duty of care and skill for Islamic bankers to act diligently when performing their obligations which is based on ethical considerations and legal requirements (ethico-legal). The following ethical considerations as proposed by *maqāṣid al-Sharī'ah* highlight Islamic banks' standard of care:

a. Forbidding the use of banking instruments that are based on interest. Interest is considered unjust since remuneration for the use of money is agreed in advance. As a consequence, all the

risks lie with the borrower and not the lender. Injustice also perpetuates when the banker is being assured of a positive return without sharing the risk or doing any work, while the banking customer is not guaranteed a positive return despite having to work hard. These imbalances are in conflict with Islamic views on income and risk distribution as well as establishing justice between the borrower and the lender.

b. The prohibition of excessive incurrence of profits and taking undue advantage of buyers.
c. Transparent, accurate and full disclosure of all necessary information to contract so that no party has advantage over the other contracting party.
d. Contracts having high degree of uncertainty (*gharar*) would be rendered invalid. For example, uncertainty of one party's ability to honour its rights and obligations or contract terms that are hazardous, excessively risky due to uncertainty and speculative to either contracting party. This would negate the problem of information asymmetry between the banks and bank customers.
e. The avoidance of oppression (*zulm*) such as inequity, exploitation, injustice or extremism to the contracting parties like using unfair contract terms which are detrimental to banking consumers.
f. Ease of conduct which requires the banks to be reasonable and fair when setting the contractual terms of the contract including to maintain efficient service. And,
g. Developing innovative products of Islamic banks that comply with the *maqāṣid al-Sharī'ah.*

The points mentioned above illustrate that the banker-customer relationship of Islamic banks differs completely from conventional banks due to the fact that under the Islamic banking law, there exist multiple contractual relationship which not only confined to debtor-creditor relationship but very much are subjected to the different types of contracts employed by contracting parties (Norhashimah, 2012). Norhashimah (2012) also reinstated that the banker-customer relationship in Islamic bank is further strengthened by the Islamic law principles of equity and fairness (*'adl wal ihsan)*. Therefore, it is clear that *maqāṣid al-Sharī'ah* calls for justice, fairness, shared responsibility

and cooperation in banking transactions. Since Sharīʿah imposes a much higher duty of care, as elaborated above, it can be concluded that equity-based and debt-based financial products of Islamic banks should not only be Sharīʿah compliant but also Sharīʿah based.

Analysis

This part compares the fundamentals of conventional and Islamic banks as well as their duty of care.

Table 1: Comparison between Islamic and conventional banks

	Conventional Banking System	**Islamic Banking System**
Banking Principles	It is profit-oriented and its purpose is to make money through interest.	It aims at maximizing profit but subject to Shariah restrictions since interest in completely prohibited in Islamic banking. It only finances economic activities with positive environment, social and planetary impact.
Ethical banking	X	√
Has responsibility or the legal obligation to avoid acts or omissions (which can be reasonably foreseen) to be likely to cause harm to others.	√	√ The duty of care is very much a key part of the *maqāṣid al-Sharīʿah*.
Governing Law	To comply with civil and common law.	To comply with civil, common and Shariah law.
Business Design/ Model	Product Centric	Product Centric

Product Transparency & Disclosure	Lacking as bank show only exciting product highlights and obscure less exciting and onerous terms under "other terms and conditions apply" as footnotes or in small print.	Lacking as bank show only exciting product highlights and obscure less exciting and onerous terms under "other terms and conditions apply" as footnotes or in small print.
Bank owes a legal duty to exercise reasonable care in and about executing a customer's order	√	√
Banks are under a duty to prevent fraudulent transactions	√	√
Banks have a duty to exercise skill and care when giving investment advice	√	√
Collecting bank has a duty of care to the true owner of cheques not to act negligently when dealing with the cheques	√	√
Governing Act	Financial Services Act (FSA) 2013	Islamic Financial Services Act (IFSA) 2013
Remedies to customer under public law	√	√

The analysis of the data in Table 1 provides a number of insight. First, Islamic banking is differentiated from the conventional banking in that it explicitly complies with principles of the Sharīʿah (Islamic law). The activities of Islamic banks must comply with the principles of Sharīʿah and, thus, must be both lawful and ethical to please Allah (SWT). The business of Islamic banks is also practical from the perspective of

Islamic economics which encompasses God-related and human related objectives and contributes towards economic development. The Shariah prohibits the fixed or floating payment or acceptance of specific interest or fees (known as riba or usury) for loans of money. In addition to that, investing in businesses that provide goods or services contrary to Islamic principles such as trade of pork, idols, statutes or intoxicants is also *haram* (forbidden).

Second, the Sharīʿah generated or prescribed principles are universal, complete, all-inclusive and applicable at all times, unlike the common law that is still evolving. The common law principles are developed through written opinion of judges which are normally given when the trial or an appeal ends. Through the doctrine of judicial precedent, lower courts must follow decisions of higher court in future similar cases. The disadvantages of common law include the perpetuation of bad rulings and inherent difficulties in circumstances when no precedent for the case exist before the court. Once a higher court has made a bad decision, such decision will remain law until the same court, or a higher court, overrules the decision. Courts are found to be reluctant to overrule their own decisions unless it is absolutely necessary to do so which results in bad decisions remaining as laws for a long time. Another problem area is when the court has no precedent to apply to the case before it. In such cases where no previous law existed, a court will still make a ruling based on its discretion.

Third, it is evident that both Islamic and conventional banks must adhere to some specific rules of banking conduct, also known as the duty of care. Both conventional and Islamic banks must adhere to the typical banking duty of care which includes among others obliging banks to provide relevant banking product information such as risks, financial information leaflet, quotation, credit prospectus etc prior to the conclusion of an agreement to enable banking consumers to adequately assess the product in making a well-founded decision. The banking product that banks recommend should link up with bank customer profile. This is done by seeking relevant information from the customer on his financial standing, experience, and knowledge as well as risk profile. However, for Islamic banks the standard of care imposed by the Sharīʿah on both provider and seeker of credit is considerably higher than the standards prevailing in the conventional banks, which are based

on the principles of either *caveat venditor* (let the seller beware) or *caveat emptor* (let the buyer beware).

Fourth, Islamic bank is an ethical banking system whereas conventional banks are merely profit-making financial institutions. As an ethical Bank the former practices embrace environment, social and moral standards. The standard of care in the Sharīʿah is based on ethico-legal principles that link ethical considerations to legal requirements. Banks must seek to avoid excessive borrowing. Its operations should be aligned with *maqāṣid al-Sharīʿah* and a duty of care. Importance is also given to the public interest or *maslahah*. The ultimate aim of Islamic banks is to ensure growth with fairness, equality and morality (Kmeid, 2015). In other words, ethical banks seek to impact economic development and growth including to promote social inclusion, sustainable development and development of social entrepreneurship (Tariqullah & Amiirah, 2017). Accordingly, Islamic banks are responsible for advocating 'value-based self-governance and best conduct', which are intrinsically linked to *maqāṣid al-Sharīʿah* and the maxim of moderation, excellence and justice, so as to make an impactful and socially responsible banking environment (Noor & Nor, 2017). On the contrary, the conventional banks are based on man-made laws placing capital and profit-making as the primary objective.

Fifth, the business designs of both banks are product centric as opposed to consumer centric. While Sharīʿah compliance has been achieved in most areas, the spirit of Sharīʿah is sometimes compromised in practice by overlooking certain ethical dimensions that Islam proposes to achieve. For example, in Islamic banks the current offerings of Sharīʿah-compliant products is focused on *halāl* or legal aspect of transaction, without taking into considerations the ethical dimensions of proactive response to customer needs and fair treatment to customers that Islam proposes to achieve. Based on this, bank products must be Sharīʿah-based products that are designed based on changing needs and interests of bank consumer as well as legal requirements (Ahmed, 2011). In this regard, Islamic banks are under a duty of care to distribute banking products and services to the extent of mitigating misselling and reputational risks. In addition, Islamic banks must also educate the bank customers in advising them only be adopt debt as a last resort when there exist a genuine need (Rafe & Edib, 2010). Even if debt is halal, it must be done with due care and consideration, but not according

to customers' whims and fancies. This indicates that Islamic banks should only introduce products to the consumer at large after setting the appropriate systems, monitoring and controlling the support system that product are in place, as well as ensuring proper training to the marketing staff.

Sixth, on enforcement and remedies, this new duty of care should work in a preventative manner with consumers using the Financial Ombudsman Scheme (FOS) under FSA 2013 and IFSA 2013 to resolve complaints in a fair and efficient manner. According to Aziz & Hamid (2017) the new financial ombudsman scheme not only strengthens the financial consumer protection framework in competitive offerings of financial products and services towards better access to the justice system, but also enhances governance and operational arrangements in line with international best practices in promoting fair, effective and independent dispute resolution. Interestingly, the Malaysian financial regulator, the Central Bank of Malaysia (Bank Negara Malaysia) is vested with powers under the FSA 2013 and IFSA 2013 to force financial institutions to provide redress to customers having suffered harm due to financial misconduct. This is potentially a very powerful tool which provides damages via remedy, which could contribute to a much higher percentage of affected customers to receive redress. A good dispute management framework is important in improving market discipline of both banks and enhancing bank consumer protection framework (Noor & Nor, 2018b). Also, the BNM needs to impose *caveat venditor* and stop *caveat emptor* on both Islamic and conventional bankers as sellers of banking goods and services to ensure bankers fulfill their of duty of care (Rafe, 2016).

The similarities and differences that are established on both conventional and Islamic banks are prevalent in reviewing and restating the duty of care of both institutions in making them more effective. Such is the consideration that will help in reducing the burden of bank customers when faced with financial losses.

Conclusion

The recent increase in number of banking customers and third parties filing claims against banks indicates that the scope of bank's duty of care needs to be expanded. With the banking law being wide-ranging and constantly changing area of the law, banks not only have to protect

bank customers from unclear risks of complicated products but must also extend such protection to professional parties from obvious risks of straightforward banking products. For Islamic banks, this duty of care requires strategic actions of Islamic banks in putting people before profit, while focusing their resources to deliver sustainable social, economy and environmental impact. This duty of care of Islamic banks towards banking consumers is a key part of the *maqāṣid al-Sharīʿah*.

Understanding the ShariÑah values in implementing such duty of care for bankers and an attitude that supports will be vital to effect the change required as a fulfillment of *maqāṣid al-Sharīʿah*. This expanded duty of care is a challenging, interesting and important body of knowledge for bankers. For all that is worth, bankers in conventional and Islamic banks need to be aware of this new increased duties of care when dealing with bank customers. The analysis in this article indicates that the banker-customer relationship is important from the perspective of humanity which entails good manners, justice, ethics, benevolence, empathy and cooperation in helping the customer to use banking goods and services which undoubtedly would result in good impression to the organisational image of an Islamic bank in gaining competitive edge in the banking industry. Specific to Islamic banks, an improved standards across the banking sector would be useful in performing their duties with professional competence as ethical banks based on the true values of Islamic duty of care, at the same time contributing towards sustainable development of Islamic banking industries worldwide.

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Note from the Guest Editor

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