

THE INTRODUCTION OF THE FINANCIAL OMBUDSMAN SCHEME AS AN ALTERNATIVE TO DISPUTE RESOLUTION IN THE ISLAMIC FINANCIAL SERVICES INDUSTRY IN MALAYSIA

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Abstract

With the enactment of the Islamic Financial Services Act 2013 (IFSA 2013) in Malaysia, the dispute resolution landscape has been transformed to reflect more on effective dispute settlement that would ensure consumer protection without prejudicing the interests of the financial service providers. The Central Bank of Malaysia, as the main regulatory body for the Islamic financial services industry in Malaysia, indicates that the Financial Mediation Bureau (FMB) is in the process of implementing the Financial Ombudsman Scheme (FOS). In analysing this statutory by-product of IFSA 2013, this paper examines the transformation of FMB as a structured statutory body in resolving Islamic finance disputes. In addition, the dispute resolution structure of FMB under the FOS is evaluated and appreciated. A comparative legal analysis is provided in a separate section by examining the structures of other financial ombudsmen as available in other jurisdictions. The examples are taken from other financial ombudsmen practices as applied in selected Commonwealth countries, i.e., Ireland, United Kingdom, and Pakistan.

Keywords: Islamic financial services, Dispute resolution, Financial Ombudsman Scheme, Ombudsman for Financial Services, IFSA 2013.

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I. INTRODUCTION

As one of the leading pioneer countries for Islamic financial service industry, Malaysia has a unique dual system that appreciates both the conventional and Islamic nature of banking and finance. After three decades from the establishment of the first Islamic bank in Malaysia, this country continues to contribute an outstanding example to the world for development of facilitative legal framework for the Islamic financial service industry. With conventional and Islamic financial services serving the public in a parallel manner, Malaysia has managed to present a strong proposition that the existence of the dual banking and finance systems are possible and hugely beneficial for the gaining of trusts of local and international players. The robust legal framework has also been able to attract confidence of the customers and other stakeholders to this country.

From the economic perspective, with a stable economic growth of 6.0% in 2014 and 5.0% for 2015, and an expected 4.1% and 4.4% for 2016 and 2017 respectively.² Malaysia qualifies as a haven for businesses, trades and investments. In addition, the introduction of Financial Services Act 2013 (FSA 2013) and Islamic Financial Services Act 2013 (IFSA 2013) reflects another wise move from the Malaysian legislators in attracting more confidence and trusts from the market participants, both locally and internationally. The promulgation of FSA 2013 and IFSA 2013 reaffirms the duality of the financial service systems as offered in Malaysia. FSA 2013 stands as the main legal reference for the conventional financial service industry in Malaysia, while the IFSA 2013 regulates the Islamic financial service industry.

IFSA 2013 is a phenomenal piece of regulation for Islamic financial service in Malaysia. IFSA 2013 is not merely repeating the old provisions of laws concerning Islamic banking and finance, but rather, it is a modern presentation of statutory provisions that give due appreciation to the *shari'ah* elements in Islamic-based transactions. IFSA 2013 can be considered an innovative and a revolutionary legal masterpiece which seamlessly embeds the legal

² "Malaysian Economic Outlook." accessed October 26, 2016, from *Focus Economic*, <http://www.focus-economics.com/countries/malaysia>.

framework for Islamic financial services with the underlying *shari'ah* principles through the amalgamation of several Acts.³ IFSA 2013 is evidence for the legal and regulatory effort of Malaysia in regulating its Islamic financial services to ensure financial stability and *shari'ah* compliance.

One of the key provisions of IFSA 2013 is regarding dispute management between Islamic financial service providers and their customers. Such dispute management can also be extended to any other innocent third party that might be affected directly or indirectly from the concluded Islamic financial service transactions. The unique formula of dispute resolution for Islamic financial services in Malaysia comes in the form of a scheme known as Financial Ombudsman Scheme (FOS).⁴

The main focus of this paper concerns this special scheme and the discussion is divided into seven separate sections: (i) Introduction; (ii) The Nature of Dispute Resolution in Islamic Financial Services in Malaysia; (iii) FOS and Financial Mediation Bureau (FMB); (iv) Ombudsman for Financial Services (OFS); (v) Financial Ombudsmen in other Commonwealth Countries and Their Comparison with the Malaysian FOS; (vi) Standards and Guidelines for FOS Implementation in Malaysian Islamic Financial Services Industry; and lastly, (vii) Conclusion.

II. THE NATURE OF DISPUTE RESOLUTION IN ISLAMIC FINANCIAL SERVICES IN MALAYSIA

Like other Commonwealth countries in the world, the Malaysian legal system inherits the common law based legal system left by the imperial era, which is subsequently developed to suit the custom and needs of the locals. The common law tradition naturally transfixes itself with litigation as the main channel in resolving disputes. The courts handle the disputes that are brought before the judges and resolve them through the litigation process, which is complex and subject to procedural requirements and proceedings that are

³ “Financial Services Act 243 and Islamic Financial Services Act 2013 Come into Force.” accessed August 12, 2014, from The Central Bank of Malaysia, Press Release, http://www.bnm.gov.my/index.php?ch=en_press_all&ac=2837.

⁴ Islamic Financial Services Act 2013.

time-consuming and costly. With the passage of time and prolonged practices, litigation is viewed and accepted as a prime dispute resolution process for disputing parties to refer to. It is considered necessary for the sake of obtaining settlements in such instances. However, litigation is not the only mechanism that can be used in reaching settlement for financial disputes. There are other dispute resolution mechanisms that can be invoked. Such other dispute resolution mechanisms can be more suitable to meet the needs of the parties. The bulk of other dispute resolution mechanisms, beside the litigation process, are collectively known nowadays as the Alternative Dispute Resolution or ADR.

The FOS as introduced by IFSA 2013 can be considered as a groundbreaking formula for Malaysia in handling disputes between the Islamic financial service providers and their customers. The FOS brings a new dimension for settlement of disputes, where the parties who dispute (which emerged from Islamic financial service transactions) can go for ADR mechanisms, instead of litigation, in reaching a resolution. This, however, does not deny the important role of sanction and absolute enforceability of court orders that can only be obtained through litigation.

Unfortunately, litigation is less favorable within the realm of the business world and Islamic financial service industry. Instead of winning over the other party before the court, priority is given in maintaining a good relationship between the parties to avail better chances of commercial benefits in potential dealings between them in the future. By using ADR as an option for litigation, importance is given to a win-win settlement, which is able to provide an equal platform in fulfilling the needs and demands of both disputing parties. At the same time, such a process is able to generate better and more cordial understandings between the parties.

Focusing on the Islamic financial service industry, the use of ADR as mechanisms for settlement of disputes, instead of litigation, is undeniably favorable. This is essential especially for achieving a sustainable framework for dispute resolution. Such sustainable framework of dispute resolution is important for an Islamic financial service industry to flourish further, while providing protection for existing and potential customers. At the same time, the confidence

and trust of the customers can be secured for the Islamic financial service providers, with additional advantages of good reputation, and time and cost savings. Therefore, the introduction of FOS is essential and current with the fast growing Islamic financial service business.

The customers of Islamic financial service industry can be divided into two main groups, which are: (a) individual customers and (b) corporate customers. The individual customers are usually involved in retail transactions with the Islamic banks by having saving accounts, home financing or other financing facilities to meet their day-to-day needs. The corporate customers are usually legal persons who possess legal identity where their rights exist as the creation of statutes. For example, a corporate customer can be a limited company which is incorporated under the Companies Act 1965 and fulfills the definition of limited company as provided under Section 2 of the said Act.

Although dispute is undeniably unwanted, it is sometimes difficult to avoid. In facing impacts from disputes which arise from Islamic financial service transactions, customers usually have to sacrifice a great deal. This happens regardless of whether they are individual customers or corporate customers. From the loss of profit, unstable business flow and loss of proper money-making businesses, the corporate customers have to face a lot in addition to the loss of reputation and good name before the financial service providers. However, more severe impacts can be faced by individual customers.

Based on observations made in the legal practice, usually less-customer friendly options are left for individual customers in disputes with the financial service providers. They usually are put at the mercy of the financial service providers for settlement of the disputes. Without any financial or legal support, the individual customers are left without much choice except to submit themselves to the demands of their financial service providers who are in denials of the customers' claims.

Unfortunately, despite the existence of FMB as a center of choice in making claims or demands against the financial service providers, many members of the public do not have knowledge about its existence and procedures. Thus, they opt to defend themselves or