



Contents lists available at ScienceDirect

## Review of Financial Economics

journal homepage: [www.elsevier.com/locate/rfe](http://www.elsevier.com/locate/rfe)

## Customers' perceptions on the dispute resolution clauses in Islamic finance contracts in Malaysia

Umar A. Oseni <sup>a,\*</sup>, Abideen Adewale <sup>a</sup>, Nor Razinah Binti Mohd Zain <sup>b</sup>

<sup>a</sup> IUM Institute of Islamic Banking and Finance, International Islamic University Malaysia, P.O. Box 10, 50728, Kuala Lumpur, Malaysia

<sup>b</sup> Ahmad Ibrahim Kulliyah (Faculty) of Laws, International Islamic University Malaysia, Kuala Lumpur, Malaysia

### ARTICLE INFO

#### Article history:

Received 4 May 2015

Received in revised form 30 March 2016

Accepted 12 May 2016

Available online xxxx

#### Keywords:

Alternative dispute resolution

Islamic finance contracts

Islamic finance

Dispute resolution clauses

### ABSTRACT

This empirical legal study examines the perceptions of retail customers on the dispute resolution clauses contained in the governing law and jurisdiction clauses in Islamic finance contracts in Malaysia. Since Islamic financial institutions and their customers are more likely to opt for litigation in the event of a dispute, this study explores ways of providing for unambiguous dispute resolution clauses that are well understood by the parties. Such clauses are expected to incorporate effective dispute resolution processes such as mediation and arbitration through a multi-tiered mechanism. Primary data collected through survey questionnaire administered on 160 Islamic bank customers is analysed using both factor analysis and structural equation modelling. The empirical legal study reveals that there is a statistically significant direct effect of dispute resolution clauses in Islamic finance contracts on the legal awareness and understanding of the customers and indirect effect on the customers' dispute resolution channels. It therefore follows that there is a need to provide for more effective clauses that allow for mediation and arbitration in the governing law and jurisdiction clauses of Islamic finance contracts in Malaysia. Such alternative dispute resolution processes can be structured in a multi-tiered manner that will only allow for litigation as a last resort. This will allow Islamic financial institutions and their customers to make informed decisions about the best option for effective dispute management.

© 2016 Elsevier Inc. All rights reserved.

### 1. Introduction

While recent estimates put the total value of global Islamic financial assets at over US\$2 trillion, the total assets of Islamic financial services industry in Malaysia is estimated to be more than US\$183 billion in August 2014 (Aziz, 2014). Considering the rapid growth of Islamic financial services and products and the potentials of Malaysia to be a global hub for Islamic finance, it is pertinent to probe into certain practises that can further strengthen the financial architecture of the industry. As part of the transformation programme of the Malaysian government to make the country a sustainable global Islamic finance hub, there have been several calls to put in place the necessary legal and regulatory framework to drive this ambition. While the regulatory authorities, such as Bank Negara

Malaysia, have constantly introduced reforms that are worth emulating in other jurisdictions,<sup>1</sup> the challenge of adequate access to justice still lingers on despite the current diverse options available to the parties in Islamic banking issues (Oseni, 2012). This challenge goes to the very root of Islamic finance transactions: the contract agreement.

At present, apart from the widely known litigation process at the Muamalat Bench of the Commercial Division in the High Court of Malaya, currently, the Malaysian legal framework for dispute resolution in the Islamic financial services industry is enriched with other

<sup>1</sup> For example, the Islamic Financial Services Act 2013 (Act 759) (IFSA 2013) was introduced on June 30, 2013. The IFSA 2013 is a comprehensive legislation which integrates a number of laws that previously regulate the Islamic financial services industry in Malaysia. The relevant laws repealed are: the Banking and Financial Institutions Act 1989 (BAFIA), the Islamic Banking Act 1983 (IBA), Insurance Act 1996 (IA), Takaful Act 1984 (TA), Payment Systems Act 2003, and Exchange Control Act 1953. The long title of IFSA 2013 clearly states that the new law provides for the regulation and supervision of Islamic financial institutions, payment systems and other relevant entities and the oversight of the Islamic money market and Islamic foreign exchange market to promote financial stability and compliance with Shari'ah and for related, consequential or incidental matters.

\* Corresponding author.

E-mail addresses: [umaroseni@ium.edu.my](mailto:umaroseni@ium.edu.my) (U.A. Oseni), [abidewale@ium.edu.my](mailto:abidewale@ium.edu.my) (A. Adewale), [mumtaz\\_razi@hotmail.com](mailto:mumtaz_razi@hotmail.com) (N.R.B. Mohd Zain).

alternatives to litigation which are less formal in terms of procedural matters and legal technicalities. Such alternative mechanisms for dispute resolution include the Kuala Lumpur Court Mediation Centre (KLCMC) annexed to the High Court, Islamic finance arbitration under the KLRCA i-Arbitration Rules 2013 of the Kuala Lumpur Regional Centre for Arbitration, and Financial Mediation Bureau (FMB) set up by Bank Negara Malaysia, and the Securities Industry Dispute Resolution Centre (SIDREC) which is relevant for the resolution of disputes involving Shari'ah-compliant securities. Consolidating these initiatives is expected to bring about sustainable practises in the industry through effective management of disputes emanating from Islamic finance contracts.

Though the legal framework for Islamic finance in Malaysia has undergone series of reforms, the continued preference for litigation in Islamic finance contracts is not sustainable in the long run. In most cases, bank customers do not have a choice than to accept a pre-prepared commercial agreement which becomes binding on them upon signing the contract. Hence, the need to come up with a sustainable mechanism of dispute resolution in the Islamic finance industry in Malaysia that would integrate the existing processes into a comprehensive multi-tiered framework. Therefore, this study is based on the premise that since most Islamic financial services providers and their customers in Malaysia are more likely to use litigation for breach of contract; such attitude has relegated other sustainable processes of dispute resolution to the background and thus reducing their relevance in the Islamic financial services industry.

The bedrock of every financial transaction is the underlying contract. The governing law clause, otherwise called, jurisdiction clause, or as it used in some Islamic finance contracts in Malaysia, governing law and jurisdiction clause is a major determinant of the way and manner a dispute arising out of such a contract will be resolved (Oseni & Hassan, 2014). Whether the customers of Islamic financial institutions understand the terms of such a clause is an issue which requires an empirical probing to determine the choices available to them when a dispute arises. One might not be sure whether the dispute resolution clauses in Islamic finance contracts currently used by Islamic banks in Malaysia represent the interest of all the parties. In order to establish this fact, this study examines the perceptions of Islamic finance consumers about the dispute resolution clauses in their Islamic finance contracts. This is expected to allow such consumers make informed decision when faced with an Islamic finance contract-related dispute. Since more than 91% of Malaysians are multi-banked according to Ernst and Young (2013), bank customers will ultimately prefer financial institutions that are consumer friendly, particularly when it comes to handling complaints and dispute management.

## 2. Literature review

The past decade has seen a growing body of literature on the legal framework for dispute resolution in Islamic finance. There has also been keen interest in aspects relating to the nature of dispute resolution clauses in Islamic finance contracts, as well as the major institutions offering dispute resolution services to the Islamic financial services industry. With particular reference to the perceptions of Islamic finance consumers or customers regarding certain products and services offered by Islamic financial institutions, a survey of literature also reveals the growing interest among Islamic finance researchers on the issues. One aspect which has been inadvertently neglected or given less attention is the perceptions of customers of Islamic financial institutions on the dispute resolution or governing law and jurisdiction clauses in their Islamic finance contracts. Therefore, this study primarily relates to three major blocs of literatures on dispute resolution in Islamic finance. These include literature on mechanisms of dispute resolution in Malaysia, the use of dispute resolution clauses in Islamic finance contracts, and the attitude of consumers to dispute resolution clauses in Islamic financial transactions.

### 2.1. The legal and institutional framework for dispute resolution in Islamic finance

The literature on the mechanisms of dispute resolution in Malaysia, with particular reference to the Islamic finance industry, is gradually increasing considering the need to seek for sustainable means to resolve such commercial disputes. However, the different manifestations of the existing processes are mirrored in a number of studies conducted within the past decade. For instance, Nadar (2009) gives a general discussion on dispute resolution in Islamic finance with particular reference to commercial arbitration. She particularly identifies the unique challenges Islamic finance is facing in the English courts and the need to have an alternative avenue for resolving such cases through the commercial arbitration paradigm. While the suggestions she proffered sound interesting from the global perspective of Islamic finance and the English courts, the Malaysian experience seems to be different. This is reflected in Markom et al. (2013) where the dynamics and trends of adjudication of Islamic finance disputes in the civil courts of Malaysia are closely discussed. While utilizing the legal content analysis method of Islamic finance cases decided between 1986 and 2009, the study finds that the existing legal framework for dispute resolution in the Islamic finance industry in Malaysia is inadequate. Hasan and Asutay (2011) also expressed similar concern where they argue that disputes are inevitable in an industry that is experiencing tremendous growth; hence, the need for adequate institutional infrastructure and a sustainable legal framework to address the increasing number of Islamic finance cases in the courts as identified by Engku Ali (2008), Oseni (2009), Yaacob (2011), and Ali Tajuddin (2012).

Litigation of Islamic finance disputes, though not totally dispensable as it is needed to enforce arbitration awards and negotiated settlements, seems to be the most prevalent mechanism for dispute resolution in most Islamic finance jurisdictions including Malaysia. As Markom and Yaakub (2015) argue, litigation involving Islamic finance matters in civil law courts has its inherent problems as it has proven to be inadequate in the sustainability of the Islamic finance industry. Such legal constraints were earlier pointed out by Engku Ali (2008) but there have been significant developments since then in Malaysia. In spite of the developments that have taken place identified by Yaacob (2012), there is a need to step up the ladder to establish a sustainable framework for dispute resolution that would serve as a benchmark for other jurisdictions. This requires a comprehensive framework of dispute management which necessity is supported by relevant empirical evidence (Oseni & Hassan, 2011).

In the meantime, more innovative conceptual studies have emerged recently where the dispute resolution mechanisms in Islamic finance were evaluated. Through SWOT analysis, studies such as Engku Ali, Zubair, and Oseni (2014), and Zubair and Oseni (2014) examined the strength and weaknesses of the existing dispute resolution mechanisms available to the stakeholders in the Islamic finance industry in Malaysia. Nevertheless, there has not been an empirical study of the dynamics of Islamic finance disputes in relation to the legal awareness and understanding on the part of the customers of the terms of contract relating to dispute settlement.

### 2.2. The nature of dispute resolution clauses in Islamic finance contracts

In general, unlike the literature on the mechanisms of dispute resolution in Islamic finance, the use of amicable dispute resolution clauses in Islamic finance contracts has not captured the attention of many researchers so far despite the increasing number of disputes emanating from such contracts. It must be borne in mind that "Islamic finance contracts" here is broadly construed, as it includes the normal financial contracts used by Islamic financial institutions as well as investment certificates such as sukuk. While focusing on sukuk transactions, Oseni (2012) analyzes the governing law clauses of 10 sukuk prospectuses and finds that most of the draughtsmen prefer to choose English forum and English law for dispute settlement due to the perceived

Download English Version:

<https://daneshyari.com/en/article/5104391>

Download Persian Version:

<https://daneshyari.com/article/5104391>

[Daneshyari.com](https://daneshyari.com)