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# DISPUTE RESOLUTION OVER UNFAIR TERMS IN ISLAMIC BANKING CONSUMER CONTRACTS: A STUDY OF THE *SHARI'AH* COMPLIANT LAW OF MALAYSIA AND THE UNITED KINGDOM LAW

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*The terms and conditions in Islamic banking consumer contract define the rights and duties of Islamic banks and banking consumers, who are bound by them. These standard terms used by Islamic banks have to be fair. Fairness occurs when there is a balance of rights and obligations between contracting parties, and that contract terms are drafted in plain and understandable language. In contrast, unfair contract terms occur when there is significant imbalance in the rights and obligations of the banking consumers on one hand and Islamic banks on the other hand and that contract terms are drafted in ambiguous language that hinders understanding on its legal impacts or consequences. The objective of this paper is to examine banking consumer empowerment/ protection, focusing on the FOS as an avenue for help and redress in resolving unfair contract term conflicts through an equitable process. Using a combination of comparative and content analysis methodology, this study examines the alternative dispute resolution as provided by the two most significant legislations that protects banking consumers from unfair contract terms, the Islamic Financial Services Act 2013 (IFSA) of Malaysia and Consumer Rights Act 2015 (CRA) of the United Kingdom. The findings reveal that a good dispute management framework is important in improving market discipline of the Islamic banks and enhancing banking consumer protection framework from unfair contract terms. This study recommends that Malaysia should replicate the Ombudsman service in the UK for its success in effectively handling disputes on unfair contract terms between consumers and banks. This paper would contribute to government policy in providing solutions for banking consumer's protection from unfair contract terms towards greater banking industry efficiency.*

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## Introduction

Malaysia's public policy on Islamic banking is the most conducive and proactive in the world. This is driven by a number of strategies and initiatives by the Malaysian government to develop the Islamic banking industry (NM. Yasin, 2007). To date, the robustness of the Islamic banking institutions is evidenced by the continued increase in overall assets from with RM742 billions in 2016, compared to RM685 billion in 2015 which is in line with the Central Bank of Malaysia's Financial Sector Blueprint 2011-2020[1]. In line with the consistent considerable growth, the banking consumers have increased tremendously from Muslims and non-Muslims alike, such that disputes and misunderstandings with the Islamic banks were certain to happen. Even though the number of disputes remains small in number related to the overall size of the Islamic banking sector and the number of interactions banking consumers have with the Islamic banks, the impact of financial disputes on the lives of banking consumers and their families can be detrimental. The increased interaction between banking consumers and the Islamic banks inevitably increase demand for dispute resolution.

The banking consumers call for free, convenient, speedy and effective methods of resolving unfair contract terms dispute highlights the importance of this matter for many Malaysians. The international framework such as 'Principle 9 of the G20 High Level Principles on Financial Consumer Protection' states that 'jurisdictions should ensure that consumers have access to adequate complaints handling and redress mechanisms that are accessible, affordable, independent, fair, accountable, timely and efficient'. Similarly, 'World Bank Good Practices on Financial Consumer Protection' recommend that 'every financial institution has a designated contact point with clear procedures for handling customer complaints, including complaints submitted verbally'. Within the context of Islamic banking sector, an appropriate alternative dispute resolution (ADR) is necessary due to the complexity of Islamic banking contracts, which require

simultaneous compliance with *Shari'ah* and national law requirements (A. Othman, 2014). ADR aims to create a win-win situation and resolve the dispute without any real losses (Y. Rahouti). It is more efficient, enjoys economic advantages over formal court proceedings, more expeditious as well as less costly than court proceedings[2]. The ADR processes can be divided into four: adjudication-based (arbitration, adjudication, expert determination), recommendation-based (conciliation, early neutral evaluation), facilitation-based (mediation, stakeholder dialogue), and hybrid processes (dispute resolution boards, ombudsman process, mediation-arbitration/ adjudication)[3].

Guidance as to the meaning of ADR can be found in dictionaries as: "the use of any means/ methods such as mediation or arbitration to resolve disputes outside the courtroom"[4]; "a forum or means for resolving disputes (as arbitration or private judging) that exists outside the state or federal justice system"[5] and "a procedure for settling dispute by means other than litigation, such as arbitration or mediation"[6]. The modern development of ADR in Islamic banking sector could revitalize a number of essential principles that underlie Muslim teachings and jurisprudence, delivering formal remedies as well as perceived justice, including to non-Muslims (M. Keshavjee, 2013).

The objective of this study is to examine banking consumer empowerment/ protection, focusing on the ADR as an avenue for help and redress in resolving unfair contract term conflicts through an equitable process. It is against this backdrop that this study seeks to analyze the ADR in two jurisdictions, namely Malaysia and the United Kingdom, within the context of unfair contract terms disputes from the legal perspectives. Discussion on ADR is centered on the two most important legislations that protects banking consumers from unfair contract terms and made available the use of ADR in consumer disputes, the Islamic Financial Services Act 2013 (IFSA) of Malaysia and Consumer Rights Act 2015 (CRA) of the United Kingdom. This paper is organized into six main sections. While the first section outlines the introduction, the second provides for the nature of unfair contract terms in consumer contracts. Third and

fourth sections describe the background and constitutional frameworks for dispute resolutions in Malaysia and UK respectively. The fifth section examines the similarities and differences of ADR in the two countries. This study concludes by describing the salient points of ADR in both countries and suggesting new directions towards better protection for banking consumers from unfair contract terms.

## Dispute Resolution Framework in Malaysian Islamic Banking Industry

The banking system in Malaysia plays a pivotal role in raising the living standards of all Malaysians by meeting their financial needs, which in turn facilitates sustainable economic transformation and growth of the Malaysian economy (Bank Negara Malaysia, 2016). The general legal relationship between Islamic banks and their customers is a contractual relationship, which is based on rights and duties in any commercial interactions. The banking contracts are normally in writing and consist of terms and conditions (T&Cs). These often set out in standard format that applies to all banking customers who use the same financial product or service. The basic legal rule that contracts must be honored presumes that banking consumers are bound by the T&Cs that relate to the financial product or service they have acquired, despite the fact that they opt not to read them beforehand. However, the legal position is often ambiguous and there are well-established exceptions to the rule that all terms of a contract must be adhered to. One such exception is when customers would be otherwise unfairly bound by the contract terms. Moreover, the T&Cs are drafted by the Islamic banks, presented in whole or in part in small print, and banking customers have effectively to "take it or leave it" as they do not have the power to make any changes. These unfair contract terms may cause disputes between Islamic banks and banking consumers.

The banking consumers can challenge the disputed terms over unfair contract terms that such terms should not be enforceable on them. Figure 1 below describe the current dispute resolution framework in Malaysia which consists of:

- Malaysian government;
- Bank Negara Malaysia (BNM) and Securities Commission Malaysia (SCM);
- Internal dispute resolution (IDR): Complaints Unit of the Islamic Banking Institutions (IBIs);
- External or ADR: financial ombudsman scheme (FOS), Kuala Lumpur Regional Centre for Arbitration (KLRCA-i), BNMLINK/ BNMTELELINK and Securities Industry Dispute Resolution Centre (SIDREC), Shariah Advisory Council (SAC) of BNM, and
- The court system

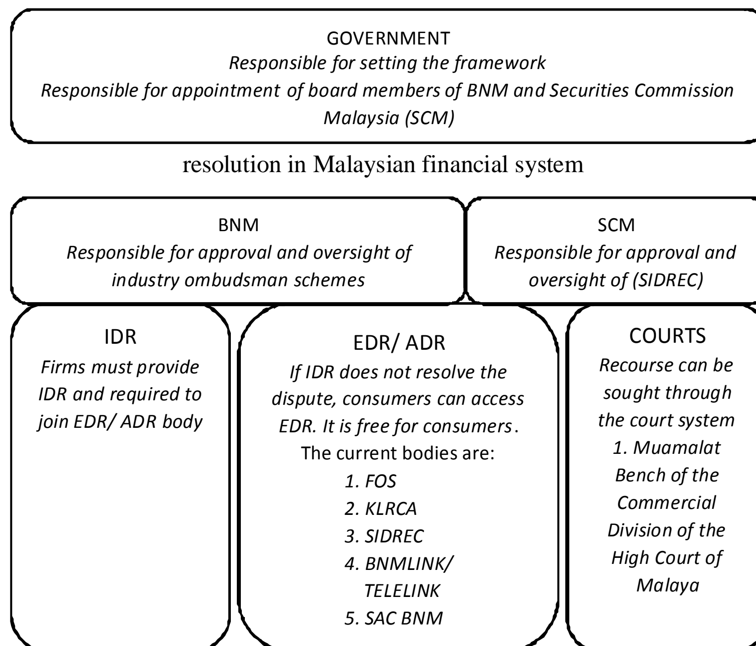



Figure 1: Dispute resolution in Malaysian financial system

The Central Bank of Malaysia Act 2009 (CBMA) accords BNM a regulatory role in the Malaysian financial services industry. As the financial regulator, BNM's oversight role includes to counter future

risks to financial stability in the financial sector, increase consumer protection, promotes competition in the broader financial services sector and to follow global trends in financial regulations. The Islamic Financial Services Act 2013 (IFSA) also grants BNM regulatory and supervisory authority to ensure that financial service providers (FSPs) are fair, responsible and employ professional conduct when dealing with financial consumers. BNM discharges its mandate by specifying business conduct standards and requirements on FSPs in areas that include:-

- Disclosure and transparency requirements
- Fairness of contract terms for financial services/ products
- Financial promotion of services/ products
- Provision of advice/ recommendation
- Complaints handling and dispute resolution mechanism

IFSA also enhanced avenues for financial consumer redress whereby BNM has power to approve FOS with the objectives of ensuring effective and fair handling of complaints and dispute resolution. BNM prescribes the function, duties and scope of such scheme. Apart from FOS and dedicated internal complaints units (IDR) within the IBIs, BNMLINK and BNMTELELINK also provide another alternative avenue for financial consumers to seek redress or resolve their disputes with FSPs. In 2015, after over the 10 years of operation, BNMLINK and BNMTELELINK have handled 480,000 of queries and complaints. However, fewer complaints were received against FSPs, which comprised mainly on more proactive complaint management by the FSPs, and focus on fair treatment to financial consumers and responsible business conduct among the FSPs. In addition, the SAC of BNM functions as the principal advisory body pertaining to Islamic finance industry as well as occupying the key role in dispute resolution and dispute avoidance. Section 16B of the CBMA provides for the establishment, appointment and regulation of SAC that advices on matters related to Islamic financial industry. Section 57 provides that any published deliberation of SAC pursuant to reference by the court, shall be taken into consideration by the court and for reference made by arbitral

tribunal, shall be binding on the arbitrator. This actually helps in resolving disputes between financial consumers and FSPs effectively and promptly. Both CBMA and IFSA provide greater clarity on BNM's financial stability mandates and vests BNM with the necessary supervisory powers and enforcement actions to achieve such mandates.

The Securities Commission Malaysia (SCM) was established on 1 March 1993 under the Securities Commission Act 1993. It is a self-funding statutory body and the regulator for capital market with investigative and enforcement powers. It reports to the Minister of Finance and its accounts are tabled in Parliament annually. For investors who have monetary disputes on capital market investment with a SIDREC member[7] and unable to resolve such disputes, may access the SIDREC for an independent, fair and expert help. SIDREC was established by SCM in 2011 as an independent, impartial and affordable dispute resolution avenue with capital market expertise. Its services are free to complainants and provide mediation for claims up to RM250,000 or exceeding such amount provided that both parties are consensual to it.

Another important point to note is that arbitration in Islamic banking industry is emerging as many cases in Malaysia have been settled by arbitration. The establishment of Kuala Lumpur Regional CENTRE for Arbitration (KLRCA) in 2005 in Malaysia, whereby the KLRCA i-Arbitration Rules (Islamic arbitration) paves the way for Malaysia to become a choice jurisdiction for cross-border Islamic finance disputes. Awards issued under the KLRCA cannot be impugned on grounds that they are not *Shari'ah* compliant (Hamid Sultan, 2016). The AAOFI, IFSB and OIC all have a critical role in harmonizing, standardizing *Shari'ah* practices globally and developing a globally accepted standard through *ijtihad* (reasoning).

The Muamalat Bench was a special high court set up in 2003 by BNM[8] in cooperation of judicial body, placed at the High Court Kuala Lumpur Commercial Division 4 and presided by the High Court Judge to hear Islamic banking cases (Zulkifli, 2012). All cases involving Islamic banking and finance matters are registered and adjudicated at the Muamalat Bench[9]. The Court consists of one High

Court judge, one deputy registrar and one senior assistant registrar (Hakimah, 2011). It may refer to SAC for advice and ruling involving Islamic financial disputes. In 2016, there are 26 cases registered at the Muamalat Court, 285 cases brought forward from 2016, 12 cases had been disposed of and leaving 17 pending cases (Malaysian Judiciary, 2016). Litigation within the existing judicial framework is still the popular mode of dispute resolution in Malaysia despite some flaws under the present civil court structure that might affect effective adjudication of Islamic finance cases (Hizri, 2016).

## Islamic Financial Services Act 2013: Malaysia

This section will first address the history of ADR in Malaysia pre IFSA 2013 as well as analyzing statistical data on cases handled by the Financial Mediation Bureau (FMB) since its inception. It will examine the period of FMB's tenure from 2005 to 2015. It is needless to say that the FMB has lived up to be recognized as an independent and impartial ADR channel for Malaysian financial service industry. Then, discussion on the situation of ADR post IFSA 2013 and beyond will be examined.

### *Dispute resolution Pre IFSA 2013: FMB*

To offer better financial consumer protection framework and strengthen redress mechanisms, BNM get things rolling by establishing an ADR. It is an alternative channel for resolving disputes between Financial Service Providers (FSPs) and financial consumers. Before the formation of FMB, two separate bureaus handled disputes concerning insurance and banking. In 1992, the Insurance Mediation Bureau (IMB) was introduced and subsequently the Banking Mediation Bureau (BMB) in 1997. Both IMB and BMB were modeled based on the UK's ombudsman scheme. Despite the fact that both bureaus were funded by the respective financial services, the Mediator's decisions remained independent and impartial. Such is the public's perception of both Bureaus, which was the cornerstone to their long success.

Towards the end of 2004, the IMB and BMB were then amalgamated into Financial Mediation Bureau (FMB) to enable

Malaysians to enjoy the convenience of a one-stop alternative dispute resolution channel (Segara, 2009). This has been part of BNM's efforts to strengthen complaints redress mechanism as part of the 'Financial Consumer Protection Framework' as stated in the Financial Sector Master Plan 2001-2010. The FMB is an integrated dispute resolution center for financial services supervised by BNM. Its service is free of charge and having the objectives of being convenient, timely resolution dispute, efficient and independent. The creation of FMB is also in line with international trends on resolution centers with the framework and model benchmarked against best practices worldwide such as the United Kingdom, Canada and Australia. The coverage of FMB has been expanded and the jurisdiction increased from RM25,000 to RM100,000 for banking disputes and from RM100,000 to RM200,000 for motor and life insurance disputes of former Mediation Bureaus[10]. The creation of FMB represents an important milestone in enhancing financial consumer protection infrastructure. Since its inception in 2005, the FMB has successfully resolved over 22,000 cases on both insurance/*takaful* and conventional/ Islamic banking claims. Table 1 below shows a summary of complaints registered in FMB in the last 10 years (2005-2015).

Table 1
Summary of Complaint Registered in FMB (2005-2015)

| *Year* | *2005* | *2006* | *2007* | *2008* | *2009* | *2010* | *2011* | *2012* | *2013* | *2014* | *2015* |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Brought forward | 348 | 575 | 865 | 1,166 | 1,917 | 2,743 | 3,150 | 2,540 | 1,741 | 1,030 | 615 |
| New cases | 1,934 | 2,107 | 2,287 | 2,337 | 2,624 | 2,150 | 2,224 | 1,919 | 1,881 | 1,691 | 1,707 |
| Disposed | 1,707 | 1,817 | 1,986 | 1,586 | 1,798 | 1,743 | 2,834 | 2,718 | 2,592 | 2,106 | 1,876 |
| Pending cases | 575 | 865 | 1,166 | 1,917 | 2,743 | 3,150 | 2,540 | 1,741 | 1,030 | 615 | 446 |

*Source:* Financial Mediation Bureau, 2015 (pg.13)

The reduction of number of pending cases from 2011 to 2015 clearly shows the result of concerted efforts taken by Financial Service Providers (FSPs) and FMB in resolving disputes efficiently in a timely manner. The lower number of new cases handled by FMB as at 2011 until 2015 also reflects the positive outcome of awareness programs

of organized by FMB over its jurisdiction and terms of reference. To expedite the handling of enquiries and complaints from financial consumers against FSPs, in 2012, the Complaints Management Unit (CMU) was set up as a 'front-line'. CMU is responsible to conduct preliminary investigation to assess disputes, claims and complaints to ensure they are within the jurisdiction of FMB and that all relevant documents are compiled before being accepted for mediation. In circumstances where complaints fall out of FMB's jurisdiction, such cases will then be referred to other appropriate agencies such as BNM.

In 2015, the main types of inquiries and complaints received from the banking sector, which includes Islamic banking sector are: amount of loan outstanding, credit card payments, delay of loan disbursements or housing related loans, maintenance fees imposed by FSPs, among others. The new cases registered with FMB are 652 in 2013 as compared to 601 in 2012. This represents an increase of 8.5% on the total number of complaints from banking consumers against the banking sector, which includes Islamic banks. There was an increase of 8.8% in the overall number of complaints against the banking sector from 554 cases in 2014 to 603 in 2015. Table 2 below shows the relevant statistics on banking cases received by FMB from 2012 to 2015. However, the total number of cases registered with FMB is comparatively lower by 15% from 652 in 2013 to 554 in 2014.

The majority of complaints received from 2012 to 2015 were related to credit/ debit cards, Internet banking and non/ short dispensations of ATM. There are also complaints with regards to alleged mis-selling or misleading advice, which resulted in banking consumers to purchase insurance related products (bank assurance). In 2015, 35 cases on disputes received from contractual issues are lower than 39 cases in 2014 which generally include penalty charges, excessive fees, and exit penalty to name a few.

Nevertheless, FMB has successfully mediated quite a considerable number of complaints from 2012 to 2015. For example, cases resolved in 2015 were considerably higher than 2012, 675 as compared to 652. The 230 outstanding cases brought forward from 2014 were resolved in 2015 and that 73.8% of new cases in the same year were

Table 2
Comparison of Banking (including Islamic Banking)
Cases received from 2012 to 2015

| *Cases handled Categories Resolved* | *2012** | | *2013** | | *2014** | | *2015** | |
|---|---|---|---|---|---|---|---|---|
| | *Received* | *Resolved* | *Received* | *Resolved* | *Received* | *Resolved* | *Received* | |
| Credit/Charge and Debit Cards | 272 | 284 | 318 | 286 | 270 | 347 | 268 | 303 |
| Internet Banking | 89 | 350 | 79 | 90 | 72 | 105 | 113 | 137 |
| Operational Issues | 49 | 64 | 57 | 94 | 43 | 51 | 45 | 44 |
| Contractual Issues | 47 | 80 | 61 | 89 | 39 | 47 | 35 | 35 |
| ATM Non/ Short Dispensations | 75 | 197 | 67 | 90 | 76 | 90 | 83 | 93 |
| ATM Unauthorized Withdrawals | 51 | 132 | 52 | 52 | 34 | 90 | 32 | 30 |
| Cash Deposit Machine (CDM) | 18 | 54 | 18 | 39 | 20 | 14 | 27 | 33 |
| Total | 601 | 1,161 | 652 | 740 | 554 | 744 | 603 | 675 |

*in 2012, there 1,068 cases brought forward from 2011; 2013, cases brought forward are 508 and 420 cases pending; 2014, 420 cases are brought forward; 2015, 230 cases are brought forward and 158 cases pending
*Source:* Financial Mediation Bureau 2013 & 2015

resolved in the span of one year (FMB, 2015). The lower of number of outstanding cases at the end of 2015 was contributed to the timely manner by the Mediation team to resolve dispute. Over the years, the timely resolution of cases by the FMB resulted in them gaining trust and respect from BNM, FSPs and banking consumers in discharging its role as an independent and impartial ADR body for the financial sector in Malaysia. Starting from a humble beginning, the FMB has grown to be a reputable ADR body, which has contributed immensely in enhancing complaints handling process to the Malaysian financial industry.

### *Dispute Resolution Post IFSA 2013 and Beyond: Financial Ombudsman Scheme (FOS)*

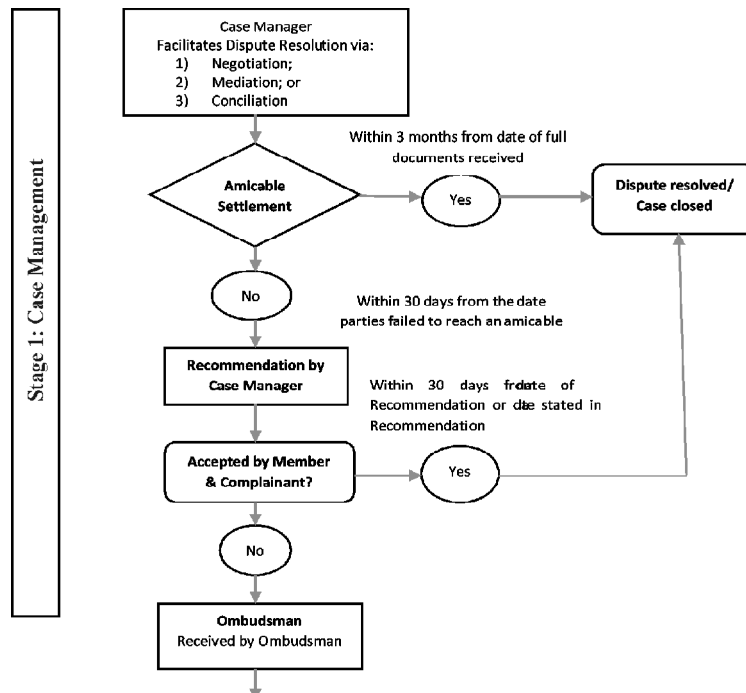
The Financial Sector Blueprint 2011-2020 calls for the establishment of a FOS to promote effective and fair handling of dispute resolution arrangement in Malaysia. To give effect to this recommendation,

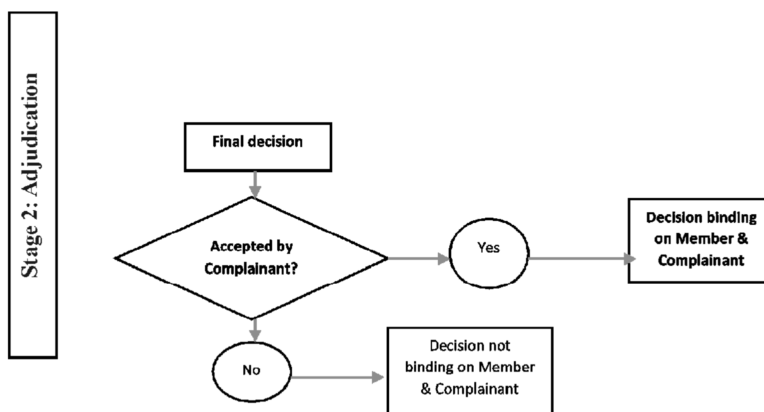
BNM in August 2014 publish a concept paper, which sets out proposals to transform the then existing FMB into a formalized FOS with extended powers legislated under the IFSA. The IFSA 2013 empowered BNM to enhance the structural framework for consumer redress in ensuring effective and fair handling of dispute arising from financial services and products. It also provide for the approval of FOS in promoting effective and fair handling of complaints and redress mechanism to financial consumers. On 14 September 2015, the Islamic Financial Services (Financial Ombudsman Scheme) Regulations 2015 came into force, which paved the way for the establishment of FOS in Malaysia.

Technically, FMB was changed to Ombudsman of Financial Services (OFS) in June 2016 to enable the OFS to carry out its expanded mandate and reflect its new role as operator of the FOS. The introduction of FOS intends to further strengthen the protection framework for financial consumers in Malaysia in an environment of increasing diversity with competitive offerings of financial products and services. However, BNM has made several improvements to the previous FMB which included: providing periodic review of monetary award limit, imposing duty on the FOS directors to act in the best interest of FOS, coming up with a two-stage dispute resolution process comprising of mediation and adjudication in providing greater chance for disputing parties to reach amicable solution, and adopting a fee structure that encourage FSPs to improve their handling of complaints. BNM appointed OFS as the operator of the FOS pursuant to Section 138(2) of IFSA 2013 to provide a fair and efficient channel for financial consumers to resolve disputes against FSPs.

The FOS serves as an independent redress mechanism with minimum formality for financial consumers to resolve disputes with FSPs and it is free of charge. Its services are an alternative to, and not a replacement for legal actions taken in a court of law. It is governed by a board of directors and headed by a Chairman. In operating the FOS, the OFS incorporates enhanced governance and operational arrangements with the principles of 'independence, fairness and impartiality, accessibility, accountability, transparency and

effectiveness', which is in line with the international best practices to promote fair, effective and independent dispute resolution. Financial consumers can file disputes with the OFS but it must not exceed RM250, 000[11]. Under FOS, the dispute resolution is further enhanced with a two-tier approach as illustrated in Figure 2 below which provides an overview of FOS' dispute resolution process[12]. The Case Manager manages dispute at the first stage of the resolution process by encouraging and facilitating dialogue, providing guidance, and assisting disputing parties to clarify their interests in working towards a mutually acceptable settlement. Otherwise, the Case Manager will make recommendations as to the best possible manner but which is not binding on the complainant. The complainant may choose to proceed to the second stage of dispute resolution by referring the Ombudsman for adjudication or proceeding a legal redress. The enhancement of dispute resolution process would definitely bring positive changes to the Malaysian dispute resolution landscape.






*Source:* FOS 2016

Figure 2: FOS's dispute resolution process

Table 3 below shows a summary of cases handled by FOS after its implementation in 2016.

Table 3
Summary of Cases Handled in 2016 (FOS)

| *Categories* | *Received* | *Resolved* | *Outstanding* |
|---|---|---|---|
| Credit/ Debit Card | 104 | 16 | 88 |
| Internet Banking | 11 | 0 | 11 |
| Operational Issues | 13 | 2 | 11 |
| Contractual Issues | 12 | 0 | 12 |
| ATM Non/ Short Dispensations | 17 | 0 | 17 |
| ATM Unauthorized Withdrawal | 5 | 1 | 4 |
| Cash Deposit Machine (CDM) | 3 | 0 | 3 |
| Total | 165 | 19 | 146 |

*Source:* Operator Financial Scheme, 2016 (pg.46)

Since the implementation of FOS on 1st October, 2016 a total of 165 cases were received between October and December 2016 (OFS, 2016). It is clearly shown that the majority of cases received are regarding to debit or credit cards whereby from the total of 165 cases received, 19 were resolved at the tier one of Case Management stage and 146 cases pending as at 31 December 2016. As commented by Jeremy Lee, Chief Executive Officer of the OFS that:

"The introduction of the new FOS is timely which further strengthens the financial consumer protection framework in an environment of increasing diversity with competitive offerings of financial products and services. In operating the scheme, the OFS incorporates enhanced governance and operational arrangements which is in line with international best practices to promote fair, effective and independent dispute resolution."

## Consumer Rights Act 2015: United Kingdom

This section will deal with the situation of ADR pre and post CRA 2015. It is important to note here that the advent of CRA 2015 has boosted the statutory rights of consumers in the UK, such that the new provisions on ADR allows consumers to complain on unfair terms to the FOS and seek to resolve such dispute without going to court (FCA, 2013). On 1 October 2015, the main provisions of CRA 2015 came into force which further clarifies and consolidates the existing consumer rights law into a single piece of legislation[13]. Provision concerning unfair contract terms are found in Part 2 CRA. More importantly, CRA makes ADR available to all businesses to assist in a dispute with consumers that failed to settle directly. Before the CRA became law, such service was only available to certain sectors. CRA also brings new ADR requirements for businesses that they will now need to make the consumer aware of a relevant certified ADR provider and their intention whether or not to use such resolution to help settle dispute. However, for financial services in the UK, the Financial Services and Market Act 2000 makes it mandatory for businesses to use the ADR in help settle disputes between consumers and UK based businesses that provide financial services which include: banks, investment companies, insurance companies, building societies, financial advisers and finance companies[14].

### *Dispute resolution Pre CRA 2015: Ombudsmen*

Previously, legislation governing unfair contract terms in consumer contracts in the UK were found in two separate legislations: the Unfair Contract Terms Act 1977 (UCTA) and the Unfair Terms in Consumer Contract Regulations 1999 (UTCCR). UCTA only

applies to business contracts, such as between contracts of two businesses or business and consumers with regards to individually negotiated and non-negotiated terms. It imposes statutory limits on the avoidance of civil liability through clauses in business contracts which exclude or limit liability such as negligence which led to death or personal injury, negligence causing other loss, and breach of contract[15]. Exclusion that meet the 'reasonableness requirement' will be exempted. However, UCTA only concerned with exclusion clauses, and does not examine whether a contract is unfair generally[16]. The UTCCR applies only to non-negotiated (standard form) contract between business and a consumer. They provide that contract terms must be "fair" and written in "plain, intelligible language". The definition of fairness differs from the reasonableness test in the UCTA.

Under the CRA 2015 and with regards to unfair terms in consumer contracts, the 'fairness test' remains the same as the one provided by the Unfair Contract Terms Act 1977 (UCTA). In addition, now it also includes a 'prominence' requirement, whereby terms that specify 'main subject matter' of the contract or 'set the price' will be fair provided they are: firstly, transparent (legible, in simple and easy to understand language), and secondly, prominent such that they must be brought to the attention of consumers such that an average consumer would be aware of their existence. Another important change brought about by CRA 2016 is the addition of three new list of terms that will automatically be regarded as 'unfair' which include:

- Where the trader can decide the characteristics of the subject matter after the consumer has agreed to the contract
- Where the trader can make disproportionate charges or require the consumer to pay for services which have not been supplied when the consumer ends the contract, or
- Where the trader is allowed discretion over the price after the consumer has entered into the contract.

With reference to notices by traders, any notices that try to restrict the trader's liability, including oral or written announcements and communications, must also now comply with the fairness test.

The Financial Ombudsman Scheme (FOS) was a public body set up in 2000 by Parliament. It is an ombudsman and the UK's

official expert in resolving individual disputes between consumers and financial companies 'fairly, reasonably, quickly and informally' (FOS, 2016). They are the statutory dispute-resolution scheme set up under Part XVI and Schedule 17 of the Financial Services and Markets Act 2000 (as amended) and given statutory powers to help put matters right. If they decide, after considering both sides of story and weighing all relevant facts, that financial companies have treated consumers fairly, they will explain why to consumer. In circumstances that financial companies are found to act wrongly, they will order them to put things right. Consumers have a choice whether to accept or not the decision made by the ombudsman, and if they accept such decision, then it is binding on both parties. Their service is free to consumers. The ombudsman scheme is administered by the scheme operator, which is called the Financial Ombudsman Service Limited. It has a board consisting of six directors including the chairman. All are appointed by the Financial Conduct Authority (FCA) under the Financial Services and Markets Act 2000. The Chairman of the board is also appointed by the FCA with approval of the HM Treasury. The directors are not involved in considering individual complaints but to ensure that the ombudsman service is resourced properly to enable them to work effectively and efficiently. They also appoint the panel of ombudsmen and publish a report annually.

In the event that financial consumers have disputes on unfair contract terms with a financial company, there are normally three steps on how to complain:

- Firstly; talk to the financial company and for them to sort things out at an early stage themselves. They have around eight weeks to give an answer and resolve such complaints.
- Secondly, if the financial company refuses to sort out the problem, consumers need to ask for a 'letter of deadlock' to prove that they have done whatever necessary to put things right. If the financial company failed to respond the final letter within a reasonable period, consumers can refer the complaint to an independent complaints service, usually the Financial Ombudsman Service (FOS) within six months of receiving this letter.

- Thirdly, get in touch with the FOS via phone, walk-in to their office or go to their website and fill in a complaint form. Wait for FOS's decision. The FOS will consider evidence provided by both parties and will write details of what financial companies must do to put things right.
- Fourthly, instead of pursuing a claim in court, banking consumers can report the trader to the Competition and Markets Authority (CMA) or Financial Conduct Authority (FCA). Both CMA and FCA will enforce consumer protection legislation such as CRA 2015.

When dealing with banking disputes involving unfair contract terms, the FOS would take into consideration the banks' duties under the Banking Codes. At the same time, FOS considers relevant statutes such as the UCTA 1977 and UTCCRs 1999. They also consider the Financial Services Authority's Statement of Practice "Fairness of Terms in Consumer Contracts"[17]. This gives an indication of how financial firms can avoid using terms that could be potentially unfair.

### *Dispute resolution Post CRA 2015: Ombudsmen*

The changes on dispute resolution in CRA 2015 were brought about by the European Directive on alternative dispute resolution (ADR Directive) and the European Regulation on online dispute resolution for commercial disputes (ODR Regulation). Both ADR Directive and ODR Regulation affects all businesses selling goods and services or digital contents to consumers in the UK, except for health professionals. With the coming of CRA 2015, ADR are made accessible to consumers and they now have a statutory right to enter into ADR proceedings such as referral to the Consumer Ombudsman, which is cheaper and affords them a greater chance to settle dispute out of court. Also, certified ADR providers were made readily available to all businesses that sell goods and services to consumers. Although it is not mandatory for businesses to participate in ADR, but they are required provide consumers with relevant information on ADR and direct consumers to certified ADR providers in the event that disputes cannot be resolved internally. They must also decide whether or not the intention to engage ADR in resolving any

future disputes with consumers. As for online traders, they must provide such information on their website.

In 2015-2016, FOS received 34,095 disputes and closed 32,871 disputes (FOS, 2016). These figures reflect a 7% increase on the number of disputes received during 2014-2015 compared to 5% decrease on the number of disputes closed in 2014-2015. Also, based on the annual report 2015/2016, a survey carried out by the FOS found that 75% of adults across the UK said they trust the ombudsman service, compared with 71% last year. It is not surprising that majority of consumers whose complaints were upheld, said that they were happy with the Ombudsman service. Nine in ten people whose complaints were upheld indicates their willingness to recommend Ombudsman service to their family and friends. As for consumers who had not got the outcome they had hoped for, 57% are satisfied nevertheless, and still gave positive feedback which indicates a rise of 16% from last year. Four of ten complainants will recommend Ombudsman to their friends and families. The following Table 4 illustrates how the outcome of a complaint pursued people to the Ombudsman affected their views about the Ombudsman's service.

Table 4
How Ombudsman were rated by people who used their service

| *2015/2016* | *% who agree* | *% who expressed no comment* | *% who disagrees* |
|---|---|---|---|
| You gave me clear answer and honest answer and let me know where I stood | 70 | 12 | 18 |
| You got to grip with things and used common sense | 62 | 13 | 25 |
| You listened to me and cared about what I had to say | 68 | 10 | 22 |

*Source:* Financial Ombudsman Service 2016

The figure above shows that more consumers are satisfied with the service of the Ombudsman as compared to those who do not. This encouraging result was due to an improved communication such as more personal touch and humanly approach, between the Ombudsmen and people that complaint, is well received by the

customers regardless of the outcome of the cases. According to the Chairman of the FOS, Sir Nicholas Montagu:

> *"Among consumers whose complaints we have not upheld, a significant majority are satisfied nevertheless, feeling that they have been listened to and that they have received a clear explanation as to how things stand. So often, this satisfaction is a question of our being able to step in as early as possible and the main thing is that we are more flexible, gearing our approach to the fairest and quickest result for the consumers."*

## Overview of IFSA 2013 and CRA 2015

This section discusses the key similarities and differences between both existing FOS of the UK and Malaysia. Table 5 below summarises and compare key features of FOS in both countries.

Table 5
Key features of FOS in Malaysia and UK

| | *FOS Malaysia* | *FOS UK* |
|---|---|---|
| *Type of scheme* | *Single scheme* | *Single scheme* |
| No of disputes (2015-2016) | 8,386 complaints received, but only 1,588 falls within the OFS's jurisdiction. | 340,889 complaints/ enquiries. |
| Who lodged disputes (2015-2016) | Individuals & SMEs | Individuals, Claims Management Companies, Consumer Advice Agencies, SMEs |
| Cost to banking consumers | Free for complainants | Free for complainants |
| Legislative base | Statutory authority established under the IFSA 2013 | Statutory authority established under FSMA 2000. |
| Binding determinations | Complainants are not bound by determinations | Complainants are not bound by determinations |
| Frequency of independent reviews | Board has committed to annual review | Board has committed to annual review |
| Jurisdiction | Monetary limit: the value of the claim under dispute must not exceed RM250,000 | Monetary limit: maximum limit is £150,000 |

*contd. table 5*

| *Type of scheme* | *FOS Malaysia*<br>*Single scheme* | *FOS UK*<br>*Single scheme* |
|---|---|---|
| Governance | Governed by board of directors and led by the Chairman of the OFS. | Governed by board of directors and led by the Chairman of FOS. |
| Funding arrangements | Funded by FOS members[18] | Funded by FOS members |
| Models of dispute resolution | Two-tier approach: mediation & adjudication. | Multi-tiered procedure: (1) internal complaint procedures, (2) frontline call office, (3) adjudicator conciliation, (4) ombudsman review. |
| Dispute resolution criteria | Guided by principles of 'independence, fairness and impartiality, accessibility, accountability, transparency and effectiveness'. | Guided by 'fair and reasonable standard' to provide speedy, fair outcome for complainants, accessible, informal and innovative processes. |
| Accountability | BNM oversees FOS, which must comply with Schedule 7 IFSA prohibits FSPs from engaging in unfair business conduct. | FOS is an independent body but FOS and FCA coordinate one another and sharing of information and resources. |
| Rights of appeal | Complainant are not bound by FOS decision, can still go to court/ mediation. FOS' decision is binding on the FSPs and obliged to comply with the awards granted by FOS. | Complainant are not bound by FOS decision, can institute legal proceedings/ mediation. Financial firms are bound by FOS decision, can appeal in limited circumstances. |
| Final resort compensation scheme | Yes | Yes |
| Relationship to IDR | Consumer must have attempted IDR before accessing FOS. | Consumer must have attempted IDR before accessing FOS. |

Despite the similarities between Malaysian FOS and the UKs, perhaps the latter has been referred as a model for reform in many countries due to its success in 'achieving extraordinary rates of

voluntary settlements, covers a broad array of disputes, and enjoys remarkable support among the British consumers, consumer groups, industry, and academics' (Schwarcz, 2009). This is reflected in the volumes of calls that FOS's technical helpline received of more than 23,000 in 2015/2016 which gives good indication that people in the financial industry continue to look to the FOS for clarity and common sense (FOS, 2016). The UK's FOS comparative success is also attributable to the ways it blends and combines various ADR strategies such as internal complaint handling by firms, state-provided complaint conciliation, as well arbitration into one single coordinated scheme. This structure inadvertently resulted in fair, reasonable, quick, informal and cheaper ADR process. So, it was not surprising that FOS UK was awarded 'Public Service Organisation of the year 2016' by the National Centre for Diversity. The achievements of FOS are also attributable to the commitment and professionalism of their staffs whom has made substantial progress in settling disputes by focusing on the real underlying concerns and resolved them quickly and informally to the satisfaction of consumers and firms alike. Finally, the unique equitable principles of 'reasonable fairness standard' being applied by UK's FOS by 'being fair and feeling fair' promotes fairer and quicker outcomes for consumers.

## Conclusions

This study has found that the existing FOS in Malaysia is a cornerstone of the FOS in the UK and performs well against the core principles set by the IFSA 2013. However, there are several values of the UK FOS that are worth considering such that the scheme are flexible and innovative by employing a variety of dispute resolution procedures as well as developing new and flexible processes for dealing with specific issues like financial hardship. They focus on providing fair outcome complainants through substantive (taking into account case law, legislation and other factors) and procedural fairness and also by providing speedy dispute resolution approximately an average of 68 days to resolve.

FOS as an ADR remains an important means of ensuring access to redress in disputes on unfair contract terms and consumer notices.

It also provides a viable alternative to the court system with free, fast and flexible access to redress. Indeed, this external ADR has enormous potential that satisfies the Islamic ethics in Islamic banking industry and the law of Malaysia. This study also found that present system of FOS is working well by remaining free access to banking consumers and provide value for money for Islamic banks. It also plays a prominent role in improving industry behaviour by working with Islamic banks to identify an address systemic issues that will bolster the effectiveness of IDR. The scheme nonetheless has undertaken outreach programs to improve accessibility of vulnerable complainants. As the first financial ombudsman scheme in Malaysia, FOS without a doubt is a step in the right direction for BNM in enhancing financial dispute resolution framework for consumers, at the same time strengthens financial consumer protection in the financial industry.

However, there is scope to enhance the outcomes for banking consumers against dispute resolution on unfair terms and notices, especially by addressing problems caused by inadequacy of specific legal protection against unfair contract terms and consumer notices in Malaysia. This study suggests that Malaysia can overcome the problem of unfair contract terms disputes between banking consumers and Islamic banks by making some legal adjustments through enacting a Consumer Rights Act, similar to that of the UK. Besides, not all elements in CRA 2015 contradict the *Shari'ah* whereby to bridge such gap, some common legal elements can be explored, improved and implemented. Therefore, for better protection of banking consumers in Malaysia from unfair contract terms and consumer notices, an effective as well as independent redress mechanism is paramount. The banking industry should also be foreseen by a strong and effective regulatory framework tailored specific against unfair terms and notices.

## *Notes*

1. Islamic Financial Services Industry Stability Report 2016.
2. World Bank, 2011. Alternative Dispute Resolution Guidelines.
3. Ibid.

4. See the Oxford English Dictionary
5. See the Merriam-Webster Dictionary
6. See the Black's Law Dictionary pg. 91 (9th ed. 2009)
7. SIDREC has 191 members such as stockbrokers, derivatives brokers, fund managers, unit trust management companies, providers and distributors for private retirement.
8. BNM in its Malaysian Financial Masterplan 2001-2010 recommended the establishment of a dedicated Shariah Commercial Court to deal with Islamic finance disputes.
9. Practice Direction No.1/2003, paragraph 2, stated that all cases under the code 22A (now is 22M) filed in the High Court of Malaya will be registered and heard in the Muamalat Bench.
10. The scope of FMB covers also licensed banks and Islamic banks, licensed insurers and takaful operators, development financial institutions, selected payment system operators and non-bank issuers of credit and charge cards, and approved insurance and takaful brokers.
11. Lower limits apply to disputes on motor third party property damage insurance claims, and unauthorized transactions involving payment instruments/ channels.
12. FOS Annual Report 2016.
13. It applies to consumer contracts entered after October 2015. It replaces Sale of Goods Act, Unfair Terms in Consumer Contracts Regulations 1999 and the Supply of Goods and Services Act 1982.
14. Unlike financial services, businesses that do not have existing legislation that makes it mandatory to use ADR, do not have to resort to ADR for help.
15. The High Court in *Avrora Fine Arts Investment Limited v Christie, Manson & Woods Limited[2012] EWHC 2198 (Ch)*, applied UCTA to exclusion and disclaimer clauses.
16. UCTA does not define "exclusion clause" but Section 13 indicates that it includes such clauses that attempt to restrict or exclude liability; enforcement of liability through restrictive or onerous conditions; restrict the rights and remedies of an aggrieved party; or restrict evidence rules or procedure.
17. As published in May 2005

18. Members of FOS are FSPs such as insurance and *takaful* brokers, and financial advisers joining banks, insurers, *takaful* operators, development financial institutions and designated payment instrument issuers which are current members of FMB.

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