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LEGAL FRAMEWORKON THE DISPUTE RESOLUTION MECHANISM IN ISLAMIC BANKING AND FINANCE IN INDONESIA AND MALAYSIA

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Introduction

Re-emergence of Islamic Banking and finance in the modern world with so many innovative financial products has resulted to the increasing amount of an Islamic financial institution. However, it satisfied the demand of Muslim community in fulfilling their economic needs without violating the rules of Islamic Law. Actually, it signs that an Islamic banking and finance institution deemed as among the most important instrument in practicing banking business and financial activities despite the existence of conventional banking institution on the other hand. Furthermore, the development of certain institution normally has to be balanced together with the establishment of a comprehensive legal framework in order to avoid any legal uncertainty regarding such matter. Doubtless, this is the main purpose of law to be enforced. However, all aspects of human life naturally shall be regulated.

Respectively, Islamic banking and finance is the most fundamental tool of economic development despite of conventional banking. The main difference between conventional and Islamic financial systems is that the latter is based on keeping in view certain social objectives intended for the benefit of society. This is because Islam is the universal ethical system which guides man in all his activities including commerce and trade as defined in the verse of Holy Quran as *rahmatan lil'alamin.*[1] Malaysia is the first South-east Asian country to develop an Islamic banking sector with the introduction of an Islamic Banking Act 1983 (IBA) and the simultaneous establishment of the Bank Islam Malaysia Berhad in 1983. Malaysian government over Islamic finance aimed to putting Malaysia as a regional hub for Islamic finance in South-east Asia. The legal infrastructure of Malaysian Islamic banking and Finance seemed to be simple but it is far from being without obstacles. There are some prominent issues which further would be discussed in this paper.

On the other hand, Islamic banking in Indonesia is not nearly as well as developed as it is in Malaysia. However, as mentioned, Indonesia is the world's most populous Muslim nation and in this respect the country represents a potentially huge market with enormous scope for growth and expansion. Development of Islamic institution in Indonesia has been started since the establishment of Bank Muamalat Indonesia (BMI) as the first Islamic bank in 1992 supported by the Law of 1992 on Banking. The progress of Islamic banking in Indonesia has been impeded by the lack of comprehensive of comprehensive and appropriate framework and instruments for regulation and supervision. Nonetheless, the dispute resolution is the most important issue to be concerned. It is because Islamic banking and finance activity was undoubtedly coming with inevitable dispute which resulted from its practice. This paper highlighting the issue of legal framework of Dispute resolution

1. Overview Dispute Resolution in Islam

Naturally, human needs an interaction to each other in their daily life. Certainly, it must be agreed that their life always comes with inevitable disputes among themselves. Accordingly, Islamic Law recognized the mechanism of amicable dispute resolution. There are several principal of Islamic law at this regard such as the principle of *sulh, tahkim, and muhtasib* and a hybrid of some of the processes recognized in Islamic Law. This mechanism advocated by the verse of Quran *"If two parties among the believers fall into a quarrel, make ye peace between them: but if one of them transgresses beyond bounds against the other, then fight ye (all) against the one that transgresses until it complies with the command of Allah; but if it complies, then make peace between them with justice, and be fair; for Allah loves those who are fair."*[2]At this regard, another verse of Quran further confirms "*And when you judge between man and man, that you judge with justice*"[3]

However, the dispute resolution as imposed by Shariah is set up to achieve an amicable dispute settlement by way of justice (*'adl*) and in line with Islamic Law. From the viewpoint of Islamic Law, the following represent the recognized process of dispute resolution:[4]

i. Sulh (good faith negotiation, mediation/conciliation, compromise of action);
ii. Tahkim (arbitration);
iii. Med-Arb (A combination of Sulh and Tahkim)

[1] Holy Quran: Al-anbiya': 21
[2] Holy Quran: Al-hujurat : 9
[3] Holy Quran, An-Nisa 4: 58
[4] For detail, see: Umar A. Oseni. *Dispute resolution in Islamic Banking and finance: Current trends and future perspectives*. Accessed on 5th of May 2013 http://www.badilag.net/data/e-dokumen/englishdoc/epublication/Dispute-resolution-in-islamic-banking.pdf

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iv. Muhtasib (Ombudsman);
v. Wali al-Madzalim (Informal Justice or Chancellor)
vi. Fatawa of Muftis (expert determinationor non-binding evaluate assessment)

2. Overview of Islamic Banking and Finance in Indonesia and Malaysia

Indonesia and Malaysia have been moving forward competitively on the development of Islamic banking and finance sector. It is because the Islamic Banking and Finance is the most prominent instrument of economic stability which must be carefully maintained by each country. There are some differences between both jurisdiction in the context of Islamic Banking advance and development.

1.1. Islamic Banking in Indonesia

Islamic banking is a fast growing industry in Indonesia. The industry has a humble beginning with a single Islamic bank in 1992[5]. The bank named by Bank Muamalat Indonesia (BMI) which has been strengthened over the establishment of Law No 7 of 1992 on banking. However, the law No 7 of 1992 deemed as a founder to the establishment of a legitimate Islamic bank since the law allows the practice of interest-free banking. Despite the trivial industry, the Islamic banking has given an immense impact for the country in maintaining its economic stability. Currently, Indonesian Islamic banking is always developing to the step of better Islamic and financial institution.[6]

1.1.1. Legal framework of Islamic Banking & Finance

The precious notion to establish the pure Islamic banking in Indonesia was further supported by the enactment of Law No. 7 of 1992 on banking which provides opportunity for the development of interest-free banking[7]. The ambits of this law, however, become a foundation to the legitimation of interest-free banking before the law. Consequently, a query arises from this law when sections of which stated the interest-free banking without clear limitation. What is the definition of interest-free banking, which interest-free banking does it means, the law was silent of this issue. In addition, this issue resulting the ambiguous implementation of interest-free banking at that moment whether in the form of Islamic banking or conventional one.[8]In order to provide a stronger legal foundation for Islamic banking operations and to realize the wish of Muslims in Indonesia to have legitimate Islamic banking, the law No. 7 of 1992 was further amended in 1998 by law No. 10 of 1998. It means that the position of Islamic banking was gradually evolved as well as increasing demand of people for the service of Islamic Banking. Furthermore, the amendment of Law No. 7 of 1992 has given some prominent effects in strengthening the position of Islamic principle within banking and finance activity. It is actually by clearly recognizing the principle element of Islamic banking as "a bank based on Syariah principles"[9] and the Syariah Principle as "a rule of agreement based on Islamic Law"[10]. Furthermore, the amended law highlighting an important change by which the conventional bank granted concession to open Islamic banking units. However, it regarded as a process of incorporating Islamic principle within the banking business activity.

Afterwards, the Islamic banking welcomes its glorious period by a new sparkling law which enacted and passed by the Indonesian Parliament. This statute is the Law No. 21 of 2008 on Islamic Banking[11]. Notwithstanding, the enactment of the new law makes the Islamic Banking become independent and exclusive since previously it fell under the shade of conventional banking regulation as law No. 10 of 1998 on Banking. The Law of Islamic Banking could be considered as the successor of its predecessor law to assimilate Islam within the Indonesian economic system. By looking at the law, it fortunately covered all matters regarding Islamic banking, and then Islamic banking matters were not regulated under conventional statute anymore. Moreover, another important feature of amended law is the provision with regard to settlement of dispute. By looking at the section 55[12], it can be seen that the law concerns the inevitable disputes arising from Islamic banking relationship. The section actually regulates that settlement of Islamic Banking disputes is conducted in the religious court. Fortunately, by the virtue of this law, the religious court vested an absolute

[5] Rahmatina A. Krisnasari, *The Determinants of Islamic Banking Growth in Indonesia*. Accessed on 30th of April 2013. http://ibtra.com/pdf/journal/v6_n2_article3.pdf

[6] Currently, the number of banks conducting business activities based on Shariah principles are represented by 11 Islamic commercial banks, 24 Islamic business units and 159 Islamic rural banks and the total number of offices was 1.812 spreading over thirty-three provinces. It can be accessed on www.bi.go.id.

[7] The Pre-amendment of Law No 7 of 1992 in its Section 6 and 13 allows a bank to carry out banking business on the principle of Profit sharing.

[8] Cik Basir, *Penyelesaian Sengketa Perbankan Syariah di Pengadilan Agama dan Mahkamah Syar'iyah*. Kencana

[9] Section 6 m Law No. 10 of 2008: the operations of a Commercial bank shall encompass: (inter alia) providing financing and/or conducting other activities based on Shariah principles, in accordance with the regulations stipulated by Bank Indonesia.

[10] General provision Section 1 (13) of law no 10 of 2008 stated: Syariah principles are rules of agreement based on Islamic Law between bank and other party for depositing fund and/or financing business activities, or other activities which is stated as in accordance to Syariah principles, i.e. financing based on profit sharing principle (*mudharabah*), financing based on equity participation (*musharakah*), sales of goods with profit principle (*murabahah*), or financing of capital goods based on pure lease without option (*ijarah*) or with an option of ownership transfer of goods leased from bank to other party (*ijarah wa iqtina'*)

[11] The statute enacted and started to enforce on 16th of july 2008.

[12] Section 55: (1) settlement of disputes of Sharia (Islamic) Banking is conducted by a court in the religious court; (2) in the case that the parties have already agreed the settlement of disputes besides as considered as in paragraph (1), the dispute settlement shall be according to the akad content; (3) settlement of disputes as considered in paragraph (2) may not be contrary to the Sharia Principle.

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jurisdiction to settle the dispute of Islamic banking. In short, it fulfilled the expectation of Shariah since the religious court is a competent institution to settle the dispute of such matter.

1.1.2. Islamic banking dispute resolution

In addition, the existing dispute resolution mechanism in Islamic banking can be either by litigation process at the court or non-litigation process which well known as Alternative dispute resolution (ADR). The litigation process of Islamic banking shall be made under licensed court which has jurisdiction to tackle such dispute. At this regard, the Religious Court is an authorized jurisdiction to resolve the matters regarding Islamic banking and finance despite another type of courts[13]. Moreover, the Religious Court Jurisdiction over Islamic Banking and finance disputes has been regulated by law No. 50 of 2009[14] as the second amendment of Law No. 7 of 1989 on Religious Court specifically in Section 49 (i).[15] The appearance of Law No 21 of 2008 on Islamic Banking is not merely as a statutory regulation to ascertain the conformity of Islamic banking and finance activity with the Shariah rulings, but however, it also re-emphasized explicitly the court under which jurisdiction the settlement of inevitable dispute arisen from Islamic Banking activity shall be heard. The Section 55 of Islamic Banking Law appointed the religious courts to have a judicial power to tackle any disputes arisen from Islamic Banking and Finance activity. It is by mentioning in the Section 55:

(1) Settlement of disputes of sharia (Islamic) Banking is conducted by a court in the Religious Court,
(2) in the case that the parties have already agreed the settlement of disputes as considered as paragraph (1), the settlement shall be according to *akad* content,
(3) Settlement of disputes as considered in paragraph (2) may not be contrary to the sharia principle.

It can be understood that a religious court has a competence to settle the dispute of Islamic banking. Moreover, religious court is one among other type of court jurisdiction of which decides the matters relating to Islamic Matters as regulated by the Indonesian Constitution.[16] However, the regulations unfortunately said to be complicated as leads to discrepancy over the jurisdiction of religious court to settle Islamic Banking dispute. This is because the subsection 2 of Section 55 of Islamic Banking Law allows the contracting parties to appoint any mechanism of dispute settlement at the clause of their contract (*akad*) particularly provides "*the settlement shall be according to akad content*". This is actually the main issue of Islamic banking dispute mechanism in Indonesia which is still unresolved. Subsequently, the jurisdiction of Shariah court over Islamic banking dispute seemed to be reduced by such prescription, the parties could appoint another jurisdiction in their clause of contract for instance civil court. Thus, the regulation does not work as the purpose of its establishment.

Alternative Dispute Resolution

Despite litigation, an alternative dispute resolution also available for the Islamic Banking and finance dispute. Basically, this is a strongly recommended mechanism for settlement such dispute by which the disputing parties could resolve their dispute without court trial which brings bad publicy, acrimony, high cost, and high technicality.[17]The regulation of Arbitration regulated under the law no 30 of 1999 concerning arbitration and Alternative Dispute resolution.[18] In relation, an appropriate ADR of Islamic banking dispute in Indonesia is settlement over BASYARNAS[19] (*Badan Arbitrase Shariah Nasional* – National Shariah Arbitration Body) which is the only Islamic arbitration body in Indonesia. It was established on October 21, 1993 with the initiative of MUI (Majelis Ulama Indonesia – Indonesian Ulama Council). The BASYARNAS is considered appropriate forum for the resolution of Islamic banking and finance disputes because its main objective is to provide a quick and fair resolution, based on Shari'ah principles, in matters of *Mu'amalat* disputes arising in the field of trade, commerce, financial industry, service,

[13] As regulated under law no 48 of 2009 on judicial court Section 25 there are 4 type of court namely. General Court, Religious Court, Military Court and State Administrative Court. These are supervised by the Supreme Court which is as the highest judicial institution. The religious court is the only court which vested an absolute power by the law to resolve Islamic economic dispute including Islamic banking. On the other hand Malaysian law at different sense in which the Islamic banking disputes shall be decided at the civil court with the guidelines of Shariah Advisory Council Rulings.

[14] By The Law No. 7 of 1989, the Shariah Court previously did not have jurisdiction to settle Islamic banking dispute. then By the virtue of its amendment, the Shariah Court vested a power to settle Islamic economics dispute.

[15] It saw an expansion to cover the matters not only confined to the areas of marriage, inheritance, test ament, grant, wakaf and sadaqah (alms), but also to resolve disputes regarding Islamic economics.

[16] Fourth amendment of Indonesian Constitution 1945 Article 24.

[17] Syed Khalid Rasyid. Alternative Dispute Resolution In Malaysia. 2000. Kuala Lumpur: Kulliyyah of Laws, IIUM. P. 11

[18] Section 3 and 11 of the law regulates that the court do not entitled to settle any dispute which has been stipulated in the agreement to be settled over Alternative Dispute Resolution.

[19] BASYARNAS previously was known as BAMUI (*Badan Arbitrase Mu'amalat Indonesia/* Indonesia Muamalat Arbitration Body) which established on 1992 with the initiative of Majlis Ulama Indonesia (Indonesian Ulama Council). For detail, see http://www.mui.or.id/index.php?option=com_content&view=article&id=57&Itemid=83

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etc.[20] According to the opinion of Prof. Mariam Darus Badruzzaman,, he said the BASYARNAS was appropriately established as through which the parties could resolve many Islamic business disputes by employing Islamic law.

The jurisdiction of BASYARNAS mentioned in section 1 of its procedural rules which clearly says:

a. Resolving in fairly and quickly a *Mu'amalat* / civil dispute arising in trade, finance, industry, services and others in which pursuant to law and regulation are fully controlled by the disputing parties, and the parties agree in writing to submit a resolution to BASYARNAS in accordance with the Procedural Rules of BASYARNAS.
b. Giving a binding opinion at the request of the parties without any dispute about an issue in an agreement.

In short, BASYARNAS shows very important role in supporting Islamic banking and finance activities to maintain its Islamic purity upon the dispute settlement mechanism. By this, the Islamic Banking could achieve the purpose for which it set up. The parties also could appoint BASYARNAS as their dispute resolution by conducting agreement in writing indicating that they agree to do so and also follow its Procedural Rules.

Cases related to the practice of dispute settlement

There are several decided cases to the practice of Islamic banking dispute resolution at the religious court. In addition, since the enactment of Law No. 3 of 2006 concerning religious court in 2006 and up to now, only nine cases of Islamic banking disputes have reached the Religious Court, and out of these, two cases are brought to the Supreme Court for cassation and case review.[21]The leading case reached the Supreme Court namely case of H. EFFENDI bin RAJAB v Dra. Psi. FITRI EFFENDI binti MUNIR and PT. BANK SYARIAH MANDIRI. This is the earliest case pertaining to Islamic banking received by the Religious Court since the enactment of Law No. 3 of 2006 concerning the Religious Court in 2006 is the case No: 284/Pdt.G/2006/PA.Bkt. This case previously was decided by the Religious Court of Bukittinggi in respect of ' Akad Murabahah' carried out by H. Effendi bin Rajab & Drs. Fitri Effendi binti Munir v Bank Bukopin Syariah & Ors, both as the plaintiffs and defendant respectively.

Prior to this case decided in 2004 by the Religious Court, a defendant (at that time, as a plaintiff) filed a lawsuit against the plaintiffs (at that time as defendants) at a District Court (*Pengadilan Negeri*) in Bukittinggi. The plaintiffs defaulted to pay an installment as agreed in the *murabahah* contract. The District Court of Bukittingi accepted a lawsuit and issued an order to execute auction towards the plaintiffs' collateral.The plaintiffs just realized that a murabahah contract which they carried out with the defendant (Bank Bukopin Shari'ah) was invalid and contrary to shari'ah principles.After carefully examining the practice of such murabahah contracts, the plaintiffs realized that it was absolutely invalid and contrary to Shariah principles because no real goods were bought or sold by the defendant to the plaintiffs Furthermore, the plaintiff also argued that at the previous decision in 2004, the District Court of Bukittingi did not have the authority to settle Islamic banking dispute since the time of the enactment of Law No. 3 of 2006, when the jurisdiction to settle Islamic banking disputes had been handed over to the Religious Court. As a result, the execution of the auction as mentioned above was also unacceptable.However, the defendant refuted the plaintiffs' arguments mainly on the ground that the Religious Court did not have jurisdiction to adjudicate the case because it had been decided by the District Court of Bukittinggi and had permanent legal force with case No: 08/PDT.BTH/2004/PN.BT.

The judges further found that the two murabahah contracts carried out by the plaintiffs and defendant were invalid because of the absence of goods. The existence of goods is compulsory in a murabahah contract; it is in line with the fatwa of NSC-MUI No. 04/DSN-MUI/IV/2000 concerning Murabahah.

By virtue of the above considerations, the panel judges decided inter alia :

1. Accepted the suit of the plaintiff.
2. Declared that the murabahah contract conducted by the plaintiffs and defendant was null and void before the law.
3. Declared that the relationship between the plaintiffs and the defendant was a money borrowing relationship according to al -qard contract in Islam.

Despite the decisions of the panel judges above, both the plaintiffs and defendant were not satisfied. They therefore appealed to the Religious High Court in 2007. The panel of judge in the Religious High Court referred their consideration to the agreement of both party and found in Section 17 of the two murabahah contract the clause to refer any legal consequences to the Indonesia Muamalat Body (BAMUI). Therefore, in accordance with such contract, BAMUI is entitled to settle such dispute. The Supreme Court also accepted such decision in the case review filed by the defendant.The above case clarified the competency of Religious Court in the settlement of Islamic Banking disputes. As mentioned in the case, the High Religious Court of Padang overruled decision of the Religious Court Bukittinggi since it was clearly mentioned in the clause of agreement to appoint BAMUI as a medium for dispute settlement. In addition, however, the verification of the case document must be important in order to avoid any conflict of law.

1.2. Islamic Banking in Malaysia

[20] A. Rahmat Rosyadi. *Arbitrase dalam perspektif Islam dan hukum positif.* (Bandung: PT. Citra Aditya Bakti) P. 55-56

[21] Abdul Rasyid, Sonny Zulhuda. *Legal Reform in Islamic Banking and Finance In Indonesia: Issues and challenges*. Retrieved on 25th of June 2013 in http://conference.qfis.edu.qa/app/media/295

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Malaysian Islamic Banking is a fast growing since its establishment in 1983 together with the enactment of Islamic Banking Act 1983 (IBA). Yet the establishment of first Islamic banking namely Bank Islam Malaysia Berhad (BIMB) then supported by the respective law. However, in compare with Indonesia, the legal framework of Malaysian Islamic banking is older about nine years rather than Indonesia which formally enforced in 1992.

Nonetheless, the most important issue must be noted that the legal framework of Malaysian Islamic Banking is almost consistent to further development although some obstacles and challenges of Islamic banking and finance industry was inevitable.

1.2.1. Legal Framework of Islamic Banking & Finance

The position of Islamic Banking and Finance services in Malaysia regulated by two main Acts Namely Islamic Banking Act 1983 (IBA)[22] and Banking and Financial Institutions Act 1989 (BAFIA) since the Malaysian dual system that allows both Islamic banks and conventional banks to offer Islamic banking and finance services.[23]Islamic Banking Act (IBA) which regulated on 1983 is the most prominent law for the existence of real Universal Islamic banking and finance. In short, the ambit of IBA is basically to regulate the licensing and regulation of all full pledged Islamic banks in Malaysia. The term of "Islamic Bank" and "Islamic banking business" has been defined in Section 2 of IBA which provides:

"*Islamic Banking means any company that carries on Islamic Banking business and holds a valid licence; and all the offices and branches in Malaysia of such a bank shall be deemed to be one bank*"

Another subsection defined:

"*Islamic Banking Business" means "banking business whose aims and operations do not involve any element which is not approved by religion of Islam*" at this regard, the definition of Islamic Banking business as defined in IBA leads to ambiguity due to the expression of "*any element which is not approved by the religion of Islam*" is not clearly defined. This is because Islam comprising four School (madzhab) namely shafi'ie, Maliki, Hanbali, and Hanafi. A query then arisen, it is difficult to interpret weather the opinion of one madzhab which was rejected by another madzhab deemed as approved by the religion Islam. This is due to the different opinion among them concerning *mu'amalat* and other matters. For instance, the practice of *bay' al inah* is validated by the Shafi'is school but it is not by Hanbali and nor Hanafi.[24]

On the other hand, the legal framework does not merely covered a full pledged Islamic bank, but at the wider scope it also prescribed a conventional bank and financial institutions on carrying Islamic banking business. Therefore, BAFIA Act also estimated as important law to assimilate Islamic Principle within conventional Banks. This is because BAFIA provides for the licensing and regulations for conventional banks and financial Institutions to participate in Islamic banking. Section 124 caters an important chance by allowing the conventional banking to operate or Islamic banking or Islamic financial business. It is by provides in Section 124 (1):

"*Except provided in Secction 33, nothing in this Act or the Islamic Banking Act 1983[Act 276] shall prohibit or restrict any licensed institution from carrying on Islamic banking business or Islamic financial Business, in addition to its existing licensed business, provided that licensed institution shall consult the Bank before it carries on Islamic banking business or any Islamic financial business."*

A conventional bank which allowed to the operation of Islamic banking business as prescribed under BAFIA also known as the "Islamic window operation". However, despite Section 124(1) BAFIA allows a conventional bank operates Islamic banking but unfortunately the law does not recognize it as an Islamic bank. This is clearly stated in Section 124 (5) of BAFIA:

"*Any licensed institution carrying on Islamic banking business or Islamic financial business shall be deemed to be not an Islamic bank*."

In short, the ambit of BAFIA is to regulate the Islamic banking business within the conventional banks since the conventional banks and financial institutions falls under the regulations of BAFIA.

Notwithstanding, it worth to be noted that that the establishment of Shariah Advisory Council (SAC) is deemed as important issue to ascertain the legality of incorporation Islamic principle within the legal framework of banking and financial institution. The existing law basically clearly regulates this matter. Firstly, Central Bank Malaysia Act 2009 regulates in its Section 55: "*The bank may establish a Shariah Advisory Council in Islamic Finance which shall be the authority for the ascertainment of Islamic Law for the purposes of Islamic Financial Business*".[25] Similarly, IBA confirms the position of SAC within Islamic banking business in the Section 13.A which provides: "*An Islamic Bank may seek the advice of Syariah Advisory Council on Syariah matters relating to its banking business and the Islamic bank shall comply with the advice of Syariah Advisory Council*." Moreover, BAFIA also supports the reference to SAC guidelines. BAFIA provides: "*Any licensed institution carrying Islamic banking business or Islamic financial business in addition to its existing licensed business may, from time to time seek the advice of Shariah Advisory council*

[22] IBA is a brief Act containing 60 sections divided into eight parts.

[23] Rusni Hassan. *Islamic Banking and Takaful 2nd edition*. Malaysia: Pearson. 2012. P. 152

[24] Norhashimah Mohd. Yasin: *Universal Banking: IBA 1983 vs BAFIA 1989*. Al-Nahdah Vol.18 No.3 (1999).

[25] Prior to amendment, the CBMA 1958 only provides for one provision under Section 16B with 12 subsections. After the amendment in 2009, CBMA provides Part VII concerning the establishment and functions Shariah Advisory Council.

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established under subsection (7), on the operations of its business in order to ensure that it does not involve any element which is not approved by the religion of Islam."

However, after looking at the above legal framework, it can be known that Malaysian Islamic banking and Finance centralized its Shariah rulings to the supervisions of Shariah Advisory Council. This is the most distinguishing feature of Malaysian Islamic banking and finance legal framework in compare with other country.[26] Furthermore, such ruling is deemed to be important to the Islamic banking generally and its dispute resolution particularly. This is because the law regulates that a judge shall refer their decision to the SAC guidelines. This topic will further discussed in subsection regarding Islamic banking dispute resolution.Generally, this is among the most relevant legal framework of Malaysian Islamic banking and finance despite another statutes as regulated in Development of Financial Institutions Act 2002 (DFIA), Takaful Act, Stamp Act 1989, Government funding Act 2005 (GFA).

Currently, Malaysian government is going to move forward by promoting a new comprehensive legal framework for the regulation of Islamic banking and finance which known as Islamic Financial Service Act 2013. IFSA 2013 expected to be a comprehensive and adequate legal framework of Islamic banking and finance activities since the law consolidates core Islamic finance regulations namely Islamic Banking Act 1983, Takaful Act 1984 Payments system Act 2003 and Exchange Control Act 1953. In short, among the key feature of IFSA is the incorporation of Islamic Principle within banking and financial Institution by providing Shariah compliant and Islamic Governance regulations.

1.2.2. Islamic banking Dispute resolution mechanism

Actually, the dispute resolution mechanism of Islamic Banking in Malaysia is quite different rather than Indonesia. Despite at the context of legal system[27], another clear cut differences is at the point of court jurisdiction under which the settlement of disputes regarding Islamic Banking and Finance shall be made. In short, the Malaysian regulatory framework provides two mechanisms for settlement of dispute in Islamic banking and finance. It can be either through the courts (litigation) or the arbitration process (non-litigation). Both mechanisms will be discussed further consecutively.

Generally, cases involving Islamic Banking and Finance in Malaysia shall be heard at the civil court. A civil court practically has an absolute jurisdiction for the settlement of Islamic banking and finance dispute. It was statutorily stipulated in Federal Constitution of Malaysia List I of the 9th Schedule which asserts the powers of all courts other than Shariah Courts and native customary courts is very comprehensive and includes banking and constitutions. While, the virtue of List II provides for the constitution, organization and procedure of Shariah Court[28], which shall have the jurisdiction only over person professing the religion of Islam and in respect only of any of the matters, included which exclude Islamic Banking.[29] Thus, the civil court shall have jurisdiction, among other matters which come under the civil court's jurisdiction are contracts such as partnership, agency and banking facilities such as negotiable instrument, bill of exchange, cheques, promissory notes, foreign exchange and others. As a result, banking and financial laws will fall under the jurisdiction of civil law. However, the issue was raised over the jurisdiction of civil court to settle Islamic banking disputes. It said to be irrelevant since Shariah court obviously has no jurisdiction and sufficient power and legal provisions which would enable it to hear Islamic banking cases. Furthermore, the civil courts are not equipped to decide on Shariah issues arising from Islamic banking disputes due to the civil court judges are not trained in Islamic law and thus are not in the position to ascertain the law.

It was suggested that the civil court judge, in hearing Islamic banking disputes should be assisted by a Shariah Advisor who must be well versed in Islamic banking. The judge would pose the Shariah issues to the Shariah advisor for his ruling and the ruling would be binding on the judge. Accordingly, Central Bank of Malaysia Act 2009 (CBMA) regulated such issue in order to anticipate the weaknesses over the jurisdiction of civil court to settle Islamic banking dispute in Section 56 which provides:

(1) Where in any proceedings relating to Islamic financial business before any court or arbitrator any question arises concerning a Shariah matter, the court or the arbitrator, as the case may be, shall—

a) take into consideration any published rulings of the Shariah Advisory Council; or
b) refer such question to the Shariah Advisory Council for its ruling.

(2) Any request for advice or a ruling of the Shariah Advisory Council under this Act or any other law shall be submitted to the secretariat

In addition, this is the most prominent issue from which can be derived that Malaysian Islamic banking and finance legal framework has been centralized to the control and rulings of SAC as an authorized institution to supervise matters

[26] Rusni Hassan. *Islamic Banking and Takaful 2nd edition*. Malaysia: Pearson. 2012. P. 166

[27] The legal system of malaysia is English common law system while Indonesia legal system based on Civil Law system

[28] The Shariah court comprises the Shariah Subordinate Court, Shariah High Court and Shariah Court of Appeal. These courts deal principally with the personal and family laws of persons professing the religion of Islam, Islamic law of succession, betrothal, marriage, divorce, dower, maintenance, adoption, legitimacy, and criminal offences under Islamic law

[29] In view of the above, the most significant change to the jurisdiction fo the Shariah courts was affected by the amendment of article 121 of the Federal Constitution in 1988 that among others added a new clause (1A) which stipulates that the High Court in Malaya and the High Court in Borneo shall have no jurisdiction In respect to any matter within thejurosdiction of the Shariah Court.

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regarding Islamic Law. In the context of dispute resolution, the word "shall" in Section 56 means mandatory, consequently a court or arbitrator in their adjudication are bound to the Ruling of SAC.

Alternative Dispute Resolution

Islamic banking and finance disputes in Malaysia were subject to arbitration as alternative dispute resolution. The Arbitration of Islamic banking and finance regulated under Kuala Lumpur Regional Centre for Arbitration (KLRCA) (Islamic banking and financial services) 2010.[30] The model of arbitration which can be adopted by any party in their disputes provided by the rules for Arbitration (Islamic Banking and Financial Services):

> *"Any dispute, controversy or claim arising from Islamic banking business, takaful business, Islamic financial business, Islamic development financial business, Islamic capital market products or services or any other transaction business which is based on Shariah principles out of this agreement/contract shall be decided by arbitration in accordance with the Rules for Arbitration of Kuala Lumpur Regional Centre for Arbitration (Islamic Banking and Financial Services)"*[31]

Rule of 33 (Procedure and reference) of the Rules for Arbitration (Islamic Banking and Financial Services) 2007 states that:

1. Subject to paragraph 2, whenever the arbitrator has to:
   (i) form an opinion on a point related to Shariah principles; and
   (ii) decide on a dispute arising from the Shariah aspect of an Islamic banking business, takaful business, Islamic financial business, Islamic development financial business, Islamic capital market products or services or any other transaction business which is based on Shariah principles,

   the arbitrator shall refer the matter to the relevant Council for its decision, setting out the relevant information as the relevant Council may require to form its opinion including the question or issue so referred, the relevant facts, issues and the question to be answered by the relevant Council.
2. Whenever the arbitration relates to a dispute arising from the Shariah aspect of an Islamic banking business, takaful business, Islamic financial business, Islamic development financial business, Islamic capital market products or services or any other transaction business which is based on Shariah principles that is beyond the purview of the relevant Council and the arbitrator has to form an opinion on a point related to Shariah principles and decide on a dispute arising from the Shariah aspect, the arbitrator shall refer the matter to a Shariah expert or council to be agreed between the parties, setting out the relevant information as the Shariah expert may require to form its opinion including the question or issue so referred, the relevant facts, issues and the question to be answered by the Shariah expert for his/their opinion in accordance with Rule 32.

In relation, it can be understood that Arbitration is a strongly suggested medium for the settlement dispute regarding Islamic Banking and finance. However, the core feature of arbitration under the virtue of the Rules for Arbitration is the consistency to the Shariah principle. It is because the arbitrator bound to refer its decision either to the relevant council or to Shariah principles.

Cases related to the practice of Dispute settlement

The leading case for the practice of Islamic banking and finance dispute would be the case of *Bank Islam Malaysia Bhd (BIMB) v Adnan bin Omar*.[32] In contention of case, the defendant argued that because representation of BIMB is an Islamic bank, the civil court then has no jurisdiction to hear the case in view of Section 121 (1A) of the Federal Constitution. Such Section stipulates that the High court in Malaysia and The High Court in Borneo shall have no jurisdiction in respect of any matter within the jurisdiction of Shariah Court. Judge NH Chan J overruled that objection and held that the matter was rightly brought before the civil court as confirmed List 1 and List II of the 9th schedule of Federal Constitution.

The other case is case of *Dato' Haji Nik Mahmud bin Daud v Bank Islam Malaysia Berhad.*[33] In which Dato' Haji nik Mahmud as the plaintiff contended that the execution of all the agreement were against the provisions of the Kelantan Malay Reservations Enactment 1930 and the national Land Code 1965. This is by virtue of section 7 (i) of the enactment prohibiting any transfer or transmission or vesting of any right or interest of a malay reservation land to or in any person not being a Malay, and in which all dealings or disposal whatsoever and all attempts to deal in and dispose of reservation land contrary to the provisions of this enactment shall be null and void.[34] BIMB then argued that the plaintiff has entered into an Islamic banking transaction in which the execution of the two agreements (PPA & PSA) were vital in order to comply with Shariah principles. However, the court dismissing the appeal and it was held it was never the intention of the parties to involve any transfer of proprietorship. The judge actually in deciding the case only made a reference to the general law of sales of land and transfer of title under national land code 1965.

[30] The revision of Rules for Arbitration (Islamic Banking and Financial Services) 2007.
[31] Appendix C (Model Arbitration Clause) of the rules for arbitration (Islamic Banking And Financial Services) 2010.
[32] Bank Islam Malaysia Bhd (BIMB) v Adnan bin Omar [1994} 3 CLJ 735
[33] [1998] 3 CLJ 605
[34] Section 12 (i) of the Kelantan Malay Reservation Enactment.

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By looking at the above case, it can be seen that the judge did not use the Islamic principle in deciding the case which more concern on Islamic banking since the judge understanding of Islamic Financial transaction seemed to be very minimal. However, this fact was become the challenge that Malaysian Islamic banking would face.

3. Finding/ Conclusion

The foregoing analysis indicates the legal framework has an entire significant effect to the reform of Islamic banking and finance institutions either to its concept or to the practice. In relation, the dispute resolution also deemed as important aspect through which the Islamic banking stakeholders are possible to settle their Islamic banking and finance dispute.Moreover, the legal reform of Islamic banking in Indonesia resulting several complication and conflict of law in the mechanism of dispute resolution. This is because the legal framework of Islamic banking did not supported by an integrated regulation of judicial power. Although the Religious Court has a jurisdiction to settle Islamic banking disputes, but the jurisdiction still faced many challenges and issues. It must be noted by Religious Court's judges and disputing parties to refer to the documentation of filed case in order to avoid any conflict of law. On the other hand, the legal framework of Malaysian Islamic Banking which established earlier than Indonesia (1983) seemed very simple. As compared, the dispute resolution of Islamic banking and finance in Malaysia was practically unlike as exercised in Indonesia since it belong to the jurisdiction of civil court. Although the dispute mechanism seemed very conventional, but the law regulates that the civil court's judge shall refer their decision to the rulings of Shariah Advisory Council (SAC). However, it can be concluded that Malaysian Islamic banking and finance legal framework has been centralized to the role and presentation of SAC as the expert in Shariah matters. To sum up, the spirit of Islamization of Islamic banking's legal infrastructure should be continued consistently in order to achieve the main purpose of Islamic banking. Despite of that, the attention of '*Ulama* (scholars), Islamic Banking practitioners, and Muslim society toward whole aspects of Islamic banking system deemed important in order to maintain the existence of Islamic banking. However, although rapid development of Islamic banking system still going consistently, it doesn't mean that its operations are being without obstacles.

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