

THE EFFECTIVENESS OF AN OMBUDSMAN FOR FINANCIAL SERVICES SCHEME: THE ALTERNATIVE AVENUE FOR FINANCIAL DISPUTE RESOLUTION

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Abstract

Ombudsman was set up as an alternative complaint or dispute resolution body to assist financial consumers to resolve their complaints or dispute. It is part of the access to justice system apart of traditional litigation scheme. It came into effect on 1st October 2016. The Ombudsman for Financial Services is approved by the Bank under the Financial Services Act 2013 and Islamic Financial Services Act 2013 to provide a fair and efficient avenue for financial consumers to resolve disputes against financial service providers. The Ombudsman for Financial Services serves as an independent redress mechanism with minimum formality for financial consumers to resolve disputes with financial service providers. This research aimed to discuss on the effectiveness of the Ombudsman itself in handling financial dispute. Being a library based-research, reference will be made to relevant authoritative texts; case studies, and applies the method of literature review through content analysis of documents. Generally, this research finds that its services are an alternative to, and not a replacement for legal actions taken in a court of law. The services of the Ombudsman for Financial Services are offered free of charge to financial consumers. The Ombudsman for Financial Services will operate in accordance with the principles of independence, fairness and impartiality, accessibility, accountability, transparent and effectiveness. Overall, the study highlighted that despite the introduction of the new financial ombudsman scheme strengthens the financial consumer protection framework in an environment of increasing diversity with competitive offerings of financial products and services, it also enhances governance and operational arrangements which is in line with international best practices to promote fair, effective and independent dispute resolution. Hence it is seen that the Ombudsman scheme continues to be the subject linked when talking about and referring to the financial consumers' rights in the access to justice system.

Key Words: *Ombudsman, Financial Services Scheme, ADR*

1.0 Introduction

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

The promulgation of FSA 2013 and IFSA 2013 reaffirms the duality of the financial service systems as offered in Malaysia. FSA 2013 stands as the main legal reference for the conventional financial service industry in Malaysia, while the IFSA 2013 regulates the Islamic financial service industry. IFSA 2013 is a phenomenal piece of regulation for Islamic financial service in Malaysia. IFSA 2013 is not merely repeating the old provisions of laws concerning Islamic banking and finance, but rather, it is a modern presentation of statutory provisions that give due appreciation to the *shari'ah* elements in Islamic-based transactions. IFSA 2013 can be considered an innovative and a revolutionary legal masterpiece which seamlessly embeds the legal framework for Islamic financial services with the underlying *shari'ah* principles through the amalgamation of several Acts. IFSA 2013 is evidence for the legal and regulatory effort of Malaysia in regulating its Islamic financial services to ensure financial stability and *shari'ah* compliance.

One of the key provisions of IFSA 2013 is regarding dispute management between Islamic financial service providers and their customers. Such dispute management can also be extended to any other innocent third party that might be affected directly or indirectly from the concluded Islamic financial service transactions. The unique formula of dispute resolution for Islamic financial services in Malaysia comes in the form of a scheme known as Financial Ombudsman Scheme (FOS) (Nor Razinah, Engku Rabiah Adawiah, 2014).

The Swedish term "Ombudsman" means "representative" or "proxy." The term is gender-neutral in origin. Variations of the term exist (i.e. Ombuds, Ombudsperson) and are common among those practicing in the Ombudsman field. At the most fundamental level, an Ombudsman assists individuals and groups in the resolution of conflicts or concerns (Marie Bombin, 2014). Ombuds face many challenges in our work that draw on our courage. Fear includes possible damage to our own or our office's credibility and reputation, or, in a worst case scenario, loss of our job. Personal fear includes fear of embarrassment, fear of pain, and fear of isolation and loneliness. Most people want to be liked by others, and taking courageous action can risk our relationships with others (Cynthia, 2014)

The main focus of this paper is to concern on how far the effectiveness of the Ombudsman itself in handling financial dispute. Being a library based-research, reference will be made to relevant authoritative texts; case studies, and applies the method of literature review through content analysis of documents.

2.0 The Nature of Dispute Resolution in Islamic Financial Services in Malaysia

In UK, ombudsmen have been described as having developed into five broad phases. Ombudsman schemes were first established in the public sector in the 1960s and 1970s. The next phase occurred during the 1980s and early 1990s, with the emergence of private sector ombudsman schemes in the financial services sector. Phase 3, this phase began in the early 1990s and continued into the 21st century, with the expansion of the ombudsman concept to areas of the private sector outside of financial services and the subsequent consolidation and formalisation of some ombudsmen schemes. The next phase, this phase began in the mid-1990s and 2000s and is characterised by the development of ombudsman schemes to cover private organisations that are delivering hybrid public/private service. The final phase, this phase began in the early 21st century with the devolution process in the United Kingdom. The major development during this phase was the creation of the 'one-stop-shop' model, which provided a single ombudsman covering all devolved public services (Morris, 2008).

Like other Commonwealth countries in the world, the Malaysian legal system inherits the common law based legal system left by the imperial era, which is subsequently developed to suit the custom and needs of the locals. The common law tradition naturally transfixes it-

self with litigation as the main channel in resolving disputes. The courts handle the disputes that are brought before the judges and resolve them through the litigation process, which is complex and subject to procedural requirements and proceedings that are time-consuming and costly. With the passage of time and prolonged practices, litigation is viewed and accepted as a prime dispute resolution process for disputing parties to refer to. It is considered necessary for the sake of obtaining settlements in such instances.

However, litigation is not the only mechanism that can be used in reaching settlement for financial disputes. There are other dispute resolution mechanisms that can be invoked. Such other dispute resolution mechanisms can be more suitable to meet the needs of the parties. The bulk of other dispute resolution mechanisms, beside the litigation process, are collectively known nowadays as the Alternative Dispute Resolution or ADR. Phillips (2008) stated, ADR known as a flexible process conducted confidentially in which a neutral person assists the parties in working towards a negotiated agreement of a dispute or difference, with the parties in ultimate control of the decision to settle and the terms of resolution.

The term “alternative dispute resolution” or “ADR” is often used to describe a wide variety of dispute resolution mechanisms that are short of, or alternative to, full-scale court processes. The term can refer to everything from facilitated settlement negotiations in which disputants are encouraged to negotiate directly with each other prior to some other legal process, to arbitration systems or minitrials that look and feel very much like a courtroom process. Processes designed to manage community tension or facilitate community development issues can also be included within the rubric of ADR. ADR systems may be generally categorized as negotiation, conciliation/mediation, or arbitration systems. (Scott Brown, Christine Cervenak and David Fairman, 1993) ADR in general and mediation in particular, where it is the appropriate ADR mechanism, must become an integral part of our litigation culture. It must become such a well-established part of it that when considering the proper management of litigation it forms as intrinsic and as instinctive (Anthony, 2008)

Negotiation systems create a structure to encourage and facilitate direct negotiation between parties to a dispute, without the intervention of a third party. Mediation and conciliation systems are very similar in that they interject a third party between the disputants, either to mediate a specific dispute or to reconcile their relationship. Mediators and conciliators may simply facilitate communication, or may help direct and structure a settlement, but they do not have the authority to decide or rule on a settlement. Arbitration systems authorize a third party to decide how a dispute should be resolved.

3.0 Operationalisation of Financial Ombudsman Scheme

Bank Negara Malaysia is empowered (BNM) under the Financial Services Act 2013 (FSA) and the Islamic Financial Services Act 2013 (IFSA), which came into force in June 2013. The Ombudsman for Financial Services is approved by the Bank in order to provide a fair and efficient avenue for financial consumers to resolve disputes against financial service providers. The FOS will be a scheme that provides financial consumers with an inexpensive and effective independent redress mechanism with minimum formality to resolve their disputes with FSPs quickly. The service offered will be an alternative to, and not a replacement for, the courts. Through the scheme, there is significant agreement amongst observers that this development has been a broad success, improving access to justice and providing redress for consumers that would not otherwise have been available (Buck *et al*, 2011).

In Malaysia, the Financial Mediation Bureau (FMB), which commenced operations in 2005, currently provides consumers with an avenue for the objective and timely resolution of disputes, claims and complaints arising from services or products provided by FSPs that are supervised by the Bank. This is why in an effort to offer great consumer protection and pro-

vide rightful emphasis on handling consumer complaints; Bank Negara Malaysia took steps to establish an alternative dispute resolution channel with the introduction of the Insurance Mediation Bureau (IMB) in 1992 and the Banking Mediation Bureau (BMB) in 1997. In late 2004, the IMB and BMB were then merged into the Financial Mediation Bureau (FMB) so that Malaysians could enjoy the convenience of a one-stop alternative dispute resolution channel.

This scheme, which has been operating under a voluntary arrangement by FSPs as its members, is funded entirely by such FSPs via an annual levy, and the service is free to complainants. The existing arrangements and operations of the FMB are being reviewed with a view to transform the FMB into an FOS approved under the FSA and IFSA. This transformation of the FMB into the approved FOS aims to enhance access for complainants to an independent arrangement for resolving their disputes and complaints involving member FSPs.

The establishment of the FOS will further strengthen consumer confidence and market discipline in the financial sector. It will provide consumers with a user-friendly and efficient redress mechanism to resolve disputes. This mechanism will continue to benefit both consumers and FSP. Over the past 12 years, the FOS has helped to resolve close to 25,000 financial disputes. It saved significant costs and time for both consumers and FSPs. Assuming a cost of about RM15,000 to resolve a case through a court proceeding, it will translate to a cost savings of RM375million (Muhd bin Ibrahim, 2016). The need to establish this independent and impartial body is clear, as in 2015 alone, FMB has received a whopping 10,323 of enquiries and complaints in 2015, out of which only fell under the jurisdiction of FMB.

However, not all the cases can be settled through FOS. The FOS has its own jurisdiction. The FOS only has the jurisdiction to hear or handle the disputes involving banks, insurance companies, *takaful* operators, development financial institutions, insurance and *takaful* brokers to the FOS. Disputes filed with FOS must not exceed RM250,000. Lower limits apply for disputes on motor third party property damage insurance claims and unauthorized transactions involving payment instruments and payment channels. As part of the transformation, the current governance and operational arrangements of the FMB will be enhanced in line with international best practices, to promote a fair, effective and independent dispute resolution process.

4.0 The Effectiveness of an Ombudsman for Financial Services Scheme

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

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

The operationalisation of FOS was enhanced by providing for the periodic review of monetary limit applied to eligible disputes to ensure that it is reflective of changes in the value of financial services of products. Besides, it imposed a clear duty on directors of the FOS to act at all times in the best interest of the FOS and independently of any particular group or body which individual directors might belong to.

Focusing on the Islamic financial service industry, the use of ADR as mechanisms for settlement of disputes, instead of litigation, is undeniably favorable. This is essential especially for achieving a sustainable framework for dispute resolution. Such sustainable framework of dispute resolution is important for an Islamic financial service industry to flourish further, while providing protection for existing and potential customers. At the same time, the confidence and trust of the customers can be secured for the Islamic financial service providers, with additional advantages of good reputation, and time and cost savings (Nor Razinah & Engku Rabiah, 2014).

FOS also affirming a two-stage dispute resolution process comprising mediation and adjudication which provides ample opportunity for disputing parties to review the relevant facts, issues and disagreements in an attempt to reach an amicable agreement. Where an agreement cannot be reached, a decision by the FOS must be supported by his reasoning for the decision and is binding on the FSP if accepted by the complainant. The board of the FOS is required to put in place procedures to accept referrals from FSPs for the sole purpose of its internal review to continuously improve the effectiveness of the FOS. Such information will also be available for the bank's and independent party reviews of the FOS's operations. However, it will not affect the finality of decisions made by FOS which is critical to ensure the effectiveness of the FOS as an alternative dispute resolution mechanism.

Other than that, FOS is there to be of assistance to financial consumers, who would otherwise find it difficult to advocate their cause; or consumers who are unable or unwilling to engage in slow, costly litigation. In other words, the implementation of FOS, undeniably favorable because FOS services will be provided to consumers at no cost. In a sense, the function of the FOS is to defend the rights of the consumer of financial services. But FOS should also stress that consumers have responsibilities. It is the consumer's responsibility, for example, to provide complete and accurate information on his financial status: to read and to try to understand the agreements he signs and to take responsibility for his financial decisions. Against this background, FOS should be prepared to be honest and forthright with any consumer whose complaint is deemed to have no merit (Ewart S Williams, 2012). Therefore, the introduction of FOS is essential and current with the fast growing Islamic financial service business.

5.0 Conclusion

As a conclusion, it is undeniable that litigation through court process is still the popular mode to settle the disputes. However, this research finds that instead of litigation, focusing on the Islamic financial service industry, the use of ADR as mechanisms for settlement of disputes is undeniably favorable. This is essential especially for achieving the six principles that has been highlighted to achieve as an effective mechanism to settle disputes. The adoption of six fundamental principles for the FOS in line with international best practices, namely independence, fairness and impartiality, accessibility, accountability, transparency and effectiveness.

Considering that the establishment of FOS is still new and not all people or consumers aware about this mechanism, this research proposes that the awareness on FOS should be exposed to consumers and the body has to take an initiative to give an exposure towards public on their rights as a consumer. Indirectly, this had substantially helped in reducing the

backlog of cases in the courts. At the same time, the confidence and trust of the customers can be secured for the Islamic financial service providers, with additional advantages of good reputation, and time and cost savings.

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