

## COMPARISON OF MALAYSIA-DUBAI APPROACH FOR THE ISLAMIC DISPUTE RESOLUTION SYSTEM IN ISLAMIC FINANCE

(Perbandingan Pendekatan Malaysia-Dubai dalam Sistem Penyelesaian  
Semula Pertikaian bagi Kewangan Islam)

Ai KAWAMURA\*

Graduate School of Asian and African Area Studies, Kyoto University,  
606-8304, Japan

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### ABSTRACT

This paper aims to discuss the development of the dispute resolution system for Islamic finance by a cross-national perspective in the Islamic world. The mainstays of the Islamic financial market, nowadays, are the Gulf countries and Southeast Asia. In particular, the United Arab Emirates (UAE) and Malaysia are countries that have developed the industry since its inception. Therefore, this paper will focus on these two countries as case studies. As the market grew, disputes in the Islamic finance industry also increased and raised the question of how the jurisdiction for this new industry could be separated from that of conventional finance. There are discussions on how Islamic finance dispute cases should be dealt with. Malaysia has been working on these issues by focusing on Alternative Dispute Resolution (ADR) as the potential solution. On the other hand the UAE has established an epoch-making system, the 'Dubai Approach'. This system has been used to settle not only disputes that were related to the financial crisis that occurred in Dubai in 2009, but also those related to Islamic finance transactions. Although the dispute resolution system for Islamic finance is in the developing stage, these two countries' systems have unique features. Therefore, this paper will indicate the developing process for the dispute resolution system for Islamic finance.

**Keywords:** Dispute resolution system; Dubai; Malaysia; Islamic finance; Alternative Dispute Resolution (ADR)

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\*Corresponding author: Ai KAWAMURA, Graduate School of Asian and African Area Studies, Kyoto University, 606-8304, Japan, e-mail: bdzuki4@gmail.com  
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## **ABSTRAK**

*Artikel ini membincangkan pembangunan sistem penyelesaian semula pertikaian untuk kewangan Islam merentas negara. Negara teluk dan Asia Tenggara merupakan tulang belakang kepada pasaran kewangan Islam hari ini. Khususnya, United Arab Emirates (UAE) dan Malaysia adalah dua negara yang telah membangunkan industri kewangan Islam. Maka artikel ini akan memfokuskan kedua-dua negara ini sebagai subjek kajian. Apabila pasaran kewangan Islam berkembang, pertikaian dalam industri turut meningkat dan persoalan bidang kuasa bagi industri ini perlu diasingkan dari sistem kewangan konvensional. Perbincangan bagaimana menangani kes-kes pertikaian dalam kewangan Islam telah wujud. Di Malaysia, alternatif penyelesaian semula pertikaian (APP) adalah kaedah yang digunakan bagi menangani kes pertikaian. Sebaliknya UAE menggunakan (sistem mengikut zaman) yang dinamakan 'Pendekatan Dubai'. Sistem ini digunakan bukan hanya untuk menyelesaikan pertikaian yang berlaku semasa krisis kewangan 2009, tetapi ia juga melibatkan transaksi dalam kewangan Islam. Walaupun sistem penyelesaian semula pertikaian masih dalam peringkat pembangunan, sistem yang digunakan oleh kedua-dua negara mempunyai ciri yang unik. Maka, artikel akan menjelaskan bagaimana proses membangunkan sistem penyelesaian semula pertikaian bagi kewangan Islam.*

**Kata kunci:** *Sistem penyelesaian semula pertikaian; Dubai; Malaysia; kewangan Islam; alternatif penyelesaian semula pertikaian*

## **INTRODUCTION**

The UAE and Malaysia have been using Islamic finance since the 1980s, which indicates that these countries had Islamic finance from the earliest stage of this industry. The UAE had the world's first commercial Islamic financial institution, the Dubai Islamic Bank, which was established in 1975. Dubai Islamic Bank is still one of the leading banks for Islamic banking and finance. Malaysia established the Islamic Banking Act 1983 to introduce special laws for Islamic finance, and has been updating these laws until recently.

These two nations are geographically far from each other, but they have both been developing their legal systems for Islamic finance independently from conventional finance legislation. In addition, these countries have mixed legal systems. The UAE has a mixture of French law, Common law and Islamic law. Each of these legal systems is applied in certain fields. Family law, the law of succession and a part of the criminal law are under Islamic jurisdiction. However, the other legal systems are

mostly under a jurisdiction that is rooted in French and UK law. Similarly, Malaysia also has mixed legal system of Common law, Islamic law and *adat*, the customary law. The jurisdiction of each legal system depends on the particular province of Malaysia, but for the most part Islamic law is applied to family law and other fields as in the UAE.

At the same time, these two countries are notable for having established a separated jurisdiction for Islamic and conventional finance. Rather than blending in with conventional finance, Islamic finance has been developed separately by having a different jurisdiction. Moreover, Rather than making use of the conventional legal system, a new legislation for Islamic finance has been established in these two countries instead of using the conventional legal system.

In the first section of this paper, I'll describe the development of the legal system for Islamic finance in both countries was illustrated as case study. This section will investigate the general legal history for Islamic finance and show how its legal system is separated from conventional finance. The second section will compare how these two nations are dealing with Islamic finance dispute cases.

### **Legal History of Islamic Finance**

Islamic finance has now entered its second stage which can be described as determining how to maintain market stability. In order to stabilize the market, there is an interesting discussion done by Yaacob, which mentions the needs for a common standard in the global market of Islamic finance. In this perspective, it is pointed out that the lack of global standardization for Islamic finance will be a factor for creating an unstable market (Yaacob & Abdullah 2012). Yaacob mentions that the key element to avoiding a desperate battle for the Islamic financial industries is to adhere to its Islamic principles, and that it is necessary to standardize the legislation of Islamic finance (Yaacob et al. 2011; Yaacob & Abdullah 2012).

He also mentions that the members of the Organization of Islamic Countries (OIC), should make a *lex mercatoria* in order to form an international convention or 'Model Law of Arbitration' and that this will smooth the misunderstandings occurring in the Islamic financial industry (Yaacob et al. 2011).

### **LEGAL HISTORY AND DEVELOPMENT OF ISLAMIC FINANCE LEGAL SYSTEM IN THE UAE**

Islamic finance and conventional finance were separated when Federal Law No. 6 of 1985 Regarding Islamic Banks, Financial Institutions and Investment Companies

*(Qanūn Ittihādī Raqm 6 li-Sana 1985 bi-Shu'ūn al-Makārif wa al-Muassasāt al-Mālīya wa al-Istithmārīya al-Islāmīya)* was issued.

The legal system for the Islamic institutions in the UAE has not changed much, but the market has been increasing rapidly. Nevertheless, interest is legal for commercial transactions in the UAE (Hasan 2010). This is in contradiction to the Islamic principle of prohibiting *ribā*. As Islamic finance needs to be compliant with Islamic principles, its jurisdiction should preferably be under Islamic law.

Al-Tamimi mentioned that although the UAE civil law has adopted French law and Common law as a model, the actual source of law for the UAE civil law and the UAE commercial law is the Islamic law (al-Tamimi 2003). Similarly, Coulson pointed out that in the UAE court, the Islamic law concept of syariah and the common law concept of loan were put together as legal requisites (Coulson 1964).

However, when it comes to the court cases after the legal changes during the 1980s, it could be said that the UAE legal system has some portions that are not syariah compliant. A conspicuous example is related to *ribā*, the issues of interest. According to Article 714 of Union law No. 5 of 1985, interest was prohibited. This Union law No. 5 of 1985 is known as the Civil Transaction Law. Thus, the Union law No. 1 of 1987 stated that the prohibition of interest would be limited. Any issues related to civil and commercial would be dealt with under the Union law No. 5 of 1985 until the commercial law could be established (Ghanem 1991; Hosni 1992). Union law No. 1 of 1987 was established in order to broaden the legal jurisdiction of the Union law No. 5 of 1985 and Union law No. 8 of 1984 which is the company law. It was intended to legalize various companies which were not able to be categorized as a company under the previous legislation. By Union law No. 3 and No. 4 of 1987, commercial transactions which dealt with interest were excluded from the previous law and interest which did not exceed 9% was permissible (al-Suwaidi 1993).

However, charging interest in commercial transactions was legitimated by the Federal law No. 11 of 1992. It is said that this revision of the law was justified by applying the ideology of necessity, which is mentioned as *Dharuriyat*; namely 'for the economic stability and the needs of the people' (Hasan 2010). This Federal law No. 11 of 1992 will not be retroactive with the former legislations, although generally interest was legitimated, and there was a judicial precedent made in 1997 that stated interest on a debt must be paid, and interest was legitimate (Price & al-Tamimi 1998). Tamimi mentioned two cases from the Federal Supreme Court of Abu Dhabi to describe the legitimacy of using interest as a necessity for banks transactions (Tamimi 2002). He mentioned one decision by the Federal Supreme Court of Abu Dhabi in 1981 as below (Tamimi 2002):

Necessity requires permitting the charging of simple interest in connection with banking operations taking into consideration that banks in their current status have become a necessity for the economic existence of the State of the United Arab Emirates (UAE) and the well-being and benefit of the people, the prohibition of which should not be considered until after the elimination of the necessity to apply the banking and financial system

Hence, from some aspects, it is difficult to say that the UAE law took Islamic law into proper consideration. In addition, most of the law firms were said to come from common law backgrounds, and this resulted in the fact that English law was frequently applied when forming contracts in the UAE (al-Tamimi 2003). Although the legal framework of Islamic finance is separated from the conventional framework, in terms of its establishment and operation, it is not separated when it comes to dispute cases in the UAE (Kawamura 2012).

## **LEGAL HISTORY AND DEVELOPMENT OF ISLAMIC FINANCE LEGAL SYSTEM IN MALAYSIA**

Malaysia started its adoption of Islamic finance from the social side. The Perbadanan Wang Simpanan Bakal-bakal Haji was established in 1962. This institution was combined with the Pilgrims Affairs Office and became Pilgrims and Fund Management Board, Tabung Haji in 1969. Although this was a form of social financing to manage Muslim savings without charging interest, it was the first step for Malaysia to get involved in the Islamic finance industry.

In the year 1983, the Islamic Banking Act 1983 (IBA 1983) was passed and Bank Islam Malaysia Berhad started business in the same year. Bank Islam Malaysia was under the jurisdiction of Bank Negara (Central Bank of Malaysia) according to the IBA 1983. The Banking and Financial Institution Act 1989 was established for conventional commercial banks, and merchant banks and other financial institutions were governed by this law, except for Islamic financial institutions. In 1993, conventional banks were allowed to open Islamic windows, which meant that conventional banks were able to deal with Islamic financial products or open an Islamic branch.

The Islamic financial legal system was developed further when the amendment on the Central Bank of Malaysia Act 2009 was enacted. Articles 55 to 58 stated that when disputes related to Islamic finance occurred, the Malaysian court would need to seek advice from the Syariah Advisory Council (SAC).

Recently in June 2013, Islamic Finance Services Act 2013 (IFSA) was established and tried to unite the legal system of Islamic finance and conventional finance. The

IFSA is said to clarify more details of the Islamic financial market to be compliant with Islamic principles and governance (Ref No: 07/13/01). When compared to the UAE, it could be said that the Malaysian government has taken more initiative in developing the country's Islamic financial market. One of the main reasons was to stimulate the Malay society to commit more to economic activities by promoting Islamic finance (Venardos 2006). It is often mentioned that Malaysian Islamic financial infrastructures were developed by applying a top down model.

Another feature of the Malaysian legal system is that, historically, it has a dual legal system. As Malaysia was colonized by Britain, most of the business law fields inherited the English legal system, the Common law. However, as Islamic finance emerged after the legal system had been established, the Islamic finance legal system was a latecomer compared with the legal system for conventional finance (Ibrahim & Joned 1987). There was also a strong demand from the local Malaysians to adapt Islamic finance, which also supported the separation of Islamic finance and conventional finance (Lock 1987). However, it was also pointed out that the differentiation between the Islamic financial legal system and the conventional legal system was not as clear as had been expected (Halim 2011).

### **MALAYSIA'S ADVANCES IN DISPUTE RESOLUTION FOR ISLAMIC FINANCE**

It is known that Islamic finance dispute cases are dealt with in the Malaysian court. Civil suits related to Islamic finance are dealt with in a court which does not apply Islamic law but follows legislation rooted in the Common law. Previous studies have analyzed how the Malaysian court has dealt with Islamic finance cases since the 1980s (Hasan & Asutay 2011). This research has focused on how the Malaysian court was proactive against judging *bay' bi-thaman ājil* (BBA) and *bay' īna* (Hasan & Asutay 2011). BBA is one of the main schemes that has been used for deferred payment for housing. And *bay' īna* is a new Islamic financial scheme for liquidating currency for consumer credit. On the other hand, there is some criticism regarding dealing with Islamic financial cases in the court system, as the court judges are lacking in knowledge of Islamic law and can't decide issues related to compliance with Islamic law (Ibrahim 2008).

In addition, there are more issues related to dealing with Islamic financial dispute cases in the court. There is a possibility that the court will not seek advice from the SAC, but the court judge will decide the Islamic financial case without the SAC's advice (Markom & Yaakub 2012). Although the Malaysian government is proactive in reforming its Islamic finance legal systems, the legislation and system for dealing Islamic finance dispute cases is still searching for a solution.

As an alternative to the court system, the Alternative Dispute Resolution (ADR) is seen as the solution. In order to avoid the issues that arise from dealing with Islamic financial cases in the conventional courts, there are some other options mentioned for Alternative Dispute Resolution (ADR); like arbitration, mediation and conciliation. Especially, arbitration is said to be the ideal solution for the issues that the court is facing when dealing with Islamic finance dispute cases (Yaacob 2009).

Kuala Lumpur Regional Centre for Arbitration (KLRCA) will solve Islamic financial dispute cases by applying 'i-Arbitration Rules' which are a legal framework for dealing such disputes. KLRCA i-Arbitration has gain a lot of attention from the world, as there are not many models for rules to deal with Islamic financial disputes in the ADR. However, generally ADR also has several issues. The first is that its decisions are not legally binding so it cannot force one or both or parties to follow its decisions against their will.

The second is that ADR has recently been recognized as a complaint process rather than a dispute resolution process. Also the procedures are becoming more complicated as there is a need for the conflict clause to be prescribed in the contracts. If no specific clauses are mentioned in the contract it would be difficult to bring the conflict to the ADR. In addition, when the conflict cannot be solved by mediation and conciliation, if there is a 'Multi-Tiered Dispute Resolution Clause', the parties could use arbitration as the next step (Chapman 2010; Kayali 2010). Thus, these processes are making the ADR less simple than it used to be. Therefore, if the conflict is not resolved after the ADR, theoretically, the case would be brought to court.

As ADR is a way to resolve dispute cases by providing a place to bring both parties together to negotiate their arguments, the third issue comes from the difficulty of getting both parties to attend the ADR session for a resolution. In most cases, either or both of the parties might have a deep emotional problem that would cause them to avoid any contact with the other party. These conditions are not common only to the Islamic financial sector but can also be seen in any legal disputes.

### **THE EMERGE OF 'DUBAI APPROACH'**

In the UAE, the court has dealt with some Islamic financial cases during the 2000s (Kawamura 2013a). It is also known that some Islamic law scholars are critical of the ordinary court dealing with Islamic finance cases (Kawamura 2013b). There are some ADR institutions, which deal with Islamic financial dispute cases in the UAE. The International Islamic Centre for Reconciliation and Arbitration (IICRA) is located in Dubai and it deals with mediation and arbitration for Islamic finance.

IICRA was established in 2005, and it does not only deal with Islamic finance but also with other cases related to Islamic principles.

The UAE was affected by the financial crisis of 2009. Islamic financial transactions were also deeply involved in this crisis. Although, there were no models or precedents for dealing with such a crisis where Islamic finance was involved, Dubai found a way to deal such a situation. This epoch-making system was named the 'Dubai Approach' as it had unique features that the court and other ADR systems had not yet been endowed with (Kawamura 2013b).

The main feature is that the 'Dubai Approach' indicates a breakthrough for the issues that are discussed among the court systems and the ADR. The 'Dubai Approach' deals with Islamic financial cases by appointing a Special Judicial Committee for a specific term, shorter than the court system, but its decisions are legal binding which is something that the ADR lacks.

As the regular courts lack knowledge of Islamic finance, this new system will improve the situation by adding an Islamic financial specialist in the Special Judicial Committee. Also, while the ADR's decision is not legally binding, the decision made by the Special Judicial Committee is.

## **CONCLUSION**

As the Islamic financial market is becoming global, future research will need to expand its perspective from the analysis of one nation to a cross-national analysis. Islamic financial research is becoming mature in that it is more concentrated on stabilizing the market, as it has already become an effective market for the national economy. As was pointed out in this discussion, both the court and the ADR have some demerits when dealing with Islamic finance dispute cases. Malaysia prefers to deal with Islamic finance cases in the ADR. Although, the UAE does not have as much legislation as Malaysia for Islamic finance and dispute resolution, it was able to establish the 'Dubai Approach'. The debate on effective dispute resolution for Islamic finance has begun, and analyzing these two leading countries in the field of Islamic finance could indicate the divergence of the Islamic finance industry, and how this affects the methods employed for solving dispute cases.



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