# CUSTOMERS' PERCEPTIONS ON THE DISPUTE RESOLUTION CLAUSES IN ISLAMIC FINANCE CONTRACTS IN MALAYSIA

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## Abstract

*This empirical legal study examines the perceptions of retail customers on the dispute resolution clauses contained in the governing law and jurisdiction clauses in Islamic finance contracts in Malaysia. Since Islamic financial institutions and their customers are more likely to opt for litigation in the event of a dispute, this study explores ways of providing for unambiguous dispute resolution clauses that are well understood by the parties. Such clauses are expected to incorporate effective dispute resolution processes such as mediation and arbitration through a multi-tiered mechanism. Primary data collected through survey questionnaire administered on 160 Islamic bank customers is analysed using both factor analysis and structural equation modelling via the IBM SPSS version 20 software. The empirical legal study reveals that there is a statistically significant difference among two major groups of customers based on their legal understanding of the dispute resolution clauses in Islamic finance contracts. The group that sought further clarification has a statistically significant path from provision of legal clauses to legal understanding and indirectly to their choice of dispute resolution channels. It therefore follows that there is a need to provide for more effective clauses that allow for mediation and arbitration in the governing law and jurisdiction clauses of Islamic finance contracts in Malaysia. Such alternative dispute resolution processes can be structured in a multi-tiered manner that will only allow for litigation as a last resort. This will allow Islamic financial institutions and their customers to make informed decisions about the best option for effective dispute management.*

**Keywords:** alternative dispute resolution, Islamic finance contracts, Islamic finance, dispute resolution clauses

## INTRODUCTION

While recent estimates put the total value of global Islamic financial assets at over US$2 trillion, the total assets of Islamic financial services industry in Malaysia is estimated to be more than US$183 billion in August 2014 (Aziz, 2014). Considering the rapid growth of Islamic financial services and products and the potentials of Malaysia to be a global hub for Islamic finance, it is pertinent to probe into certain practices that can further strengthen the financial architecture of the industry. As part of the transformation programme of the Malaysian government to make the country a sustainable global Islamic finance hub, there have been several calls to put in place the necessary legal and regulatory framework to drive this ambition. While the regulatory authorities, such as Bank Negara Malaysia, have constantly introduced reforms that are worth emulating in other jurisdictions,[1] the challenge of adequate access to

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[1] For example, the Islamic Financial Services Act 2013 (Act 759) (IFSA 2013) was introduced on June 30, 2013. The IFSA 2013 is a comprehensive legislation which integrates a number of laws that previously regulate the Islamic financial services industry in Malaysia. The relevant laws repealed are: the Banking and Financial Institutions Act 1989 (BAFIA), the Islamic Banking Act

justice still lingers on despite the current diverse options available to the parties in Islamic banking issues (Oseni, 2012). This challnge goes to the very root of Islamic finance transactions: the contract agreement.

At present, apart from the widely known litigation process at the Muamalat Bench of the Commercial Division in the High Court of Malaya, currently, the Malaysian legal framework for dispute resolution in the Islamic financial services industry is enriched with other alternatives to litigation which are less formal in terms of procedural matters and legal technicalities. Such alternative mechanisms for dispute resolution include the recently established Kuala Lumpur Court Mediation Centre (KLCMC) annexed to the High Court, Islamic finance arbitration under the KLRCA i-Arbitration Rules 2012 of the Kuala Lumpur Regional Centre for Arbitration, and Financial Mediation Bureau (FMB) set up by Bank Negara Malaysia, and the recently established Securities Industry Dispute Resolution Centre (SIDREC) which is relevant for the resolution of disputes involving Sharī'ah-compliant securities. Consolidating these initiatives is expected to bring about sustainable practices in the industry through effective management of disputes emanating from Islamic finance contracts.

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

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

## LITERATURE REVIEW

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

1983 (IBA), Insurance Act 1996 (IA), Takaful Act 1984 (TA), Payment Systems Act 2003, and Exchange Control Act 1953. The long title of IFSA 2013 clearly states that the new law provides for the regulation and supervision of Islamic financial institutions, payment systems and other relevant entities and the oversight of the Islamic money market and Islamic foreign exchange market to promote financial stability and compliance with Sharī'ah and for related, consequential or incidental matters.

Islamic finance contracts. Therefore, this study primarily relates to three major blocs of literatures on dispute resolution in Islamic finance. These include literature on mechanisms of dispute resolution in Malaysia, the use of dispute resolution clauses in Islamic finance contracts, and the attitude of consumers to dispute resolution clauses in Islamic financial transactions.

**The Legal and Institutional framework for Dispute Resolution in Islamic Finance**

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

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

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

**The Nature of Dispute Resolution Clauses in Islamic Finance Contracts**

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

dispute settlement due to the perceived uncertainty surrounding the nature of Islamic law and codified laws in Muslim countries operating Islamic finance. Rather than applying English pirnciples of law to Islamic finance contracts, as evidenced in some cases before the English Court in the U.K. and even in Malaysia, one cannot agree more with Colón (2011) who argues that parties who prefer English law and forum will find friendlier mechanisms of commercial arbitration specializing in Islamic finance.

In fact, the release of KLRCA i-Arbitration Rules on 20 September 2012 by the Kuala Lumpur Regional Centre for Arbitration, which is specifically designed for disputes arising from contracts that contain Sharī'ah issues, is a major leap towards enhancing the dispute resolution framework of the Malaysian Islamic finance industry and beyond. This is expected to enhance the use of amicable dispute resolution clauses in Islamic finance contracts. But it thus appears most Islamic financial institutions still prefer to litigate commercial disputes, as they believe litigation protects them against legal risks in business. These concerns were well articulated by Zawawi Salleh, J. (as he then was) where he emphasized in *Malaysia Debt Ventures Bhd v MK Construction & Communication Sdn Bhd & Ors* [2012] MLJU 308, that the purpose of summary judgment is "to prevent a plaintiff being frustrated by a defendant who has bogus defence and who has entered appearance solely for the purpose of delay. The aim of the procedure is to save the parties and the Court the time and expense associated with unmeritorious claims and defence." But one may argue that compromise can be reached by the parties through binding mediation while expenses are reduced to the minimum.

In addition, Tun Abdul Hamid identified four major reasons why the Islamic banks would ordinarily prefer litigation over arbitration. First, most litigated cases involve payment defaults of which time is of essence. Most Islamic banks will not want to explore arbitration before litigation since the former has not proved to be cheaper than the latter in the real sense of it. Second, most Islamic financing products involve a charged asset. An order for the sale of a charged asset in the event of a default can only be made by the High Court. Third, parties in arbitration are under the assumption that the arbitrators are learned in Sharī'ah, law and finance, so they might not want to pay the arbitrator to refer a Sharī'ah issue to the Sharī'ah advisory Council (SAC). And fourth, it is generally claimed civil court judges are not learned in Sharī'ah and Islamic finance issues, but it is also difficult to find arbitrators that are learned in Islamic finance and Sharī'ah and have practical experience in legal practice. At the moment, most of the registered Islamic finance arbitrators at KLRCA are either lawyers or former judges of the civil court who do not necessarily have a sound background in Islamic finance and Sharī'ah generally. So, the Islamic financial institutions still face these legal risks in dispute resolution.

According to Bälz (2010), in order to minimize the legal risks associated with Islamic finance litigation, Islamic banks have adopted the practice of including in contractual agreements a "waiver of Sharī'ah defence" clause. This allows the bank to enforce the commercial agreement accordingly without giving the customer or borrower any opportunity to raise a defence based on Sharī'ah. In spite of the benevolent intentions of the Islamic banks in ensuring coherence and consistency in the governing law of a contract, there is an implicit objective in this disposition. It is believed some Islamic banks deliberately insert such clauses in commercial contracts to ensure their views prevail and their position affirmed by the court in the event of any dispute arising from such contracts. Once the borrowers default in the payment of a loan contract, the banks sue immediately in order to avoid the consequential credit risk.

In a Pew Report (2012) study, it was found that most banks in the United States limit consumer options for dispute resolution in banking contracts. It is in the light of this finding that this research attempts to conduct an empirical study on the preferred processes of dispute resolution among the 16 Islamic banks operating in Malaysia. This new dimension to the study is unprecedented, as it includes a content analysis of the governing law clauses of various Islamic finance contracts utilized by such banks.

**The Perceptions of Consumers on Islamic Finance Transactions**

Since the introduction of Islamic financial services and products in Malaysia, the perceptions of the Malaysian customers towards such services and products are frequently being analysed by researchers. Such studies cut across different fields such as economics, finance, and Sharī'ah. Different methods have

been adopted in such studies which help to bridge the gap between the theoretical foundations of Islamic finance and practical realities in the industry. For instance, Dusuki and Abdullah (2006) examined the underlying reasons why Malaysians patronise Islamic banks. Such a study relates to the perceptions of the customers on the products being offered by Islamic banks in the country. As argued by Amin, et al. (2011), the perception of the customers is influential in forming their attitude and intention in choosing the Islamic finance products.

The consumers' perception on dispute resolution clauses in Islamic finance contracts has not attracted the attention of a wide body of researchers. Several empirical studies have been conducted on the perceptions of customers on specific Islamic finance contracts such as Islamic hire purchase, *Bai Bithaman Ajil* (BBA) and diminishing partnership for home financing (Abdul Razak & Md Taib, 2011), attitude and perceptions of Muslims and non-muslims toward Islamic banking products (Loo, 2010), perceptions of key Islamic financ eprofessionals on the practice of Islamic banking (Hanif & Iqbal, 2012), and attitudes of business firms and consumers towards Islamic method of finance. As far as our research reveals, no study has specifically focused on the attitude of consumers to dispute resolution clauses in Islamic finance contracts they enter into. This often-neglected aspect of the literature requires an empirical study, which is one of the main objectives of this present research. Even though the scholarship on dispute resolution in Islamic finance has mushroomed in the past decade, there has been little or no study on the consumers' perceptions of the dispute resolution clause in Islamic finance contracts.

## METHODOLOGY

### Data Collection

The target respondents in this study are the customers of Islamic banks in Malaysia. It is envisaged that relevant data related to the pertinent issues addressed in this study can be elicited from this group of respondents. Given that no sampling frame is used, 160 respondents are selected using a convenience sampling method by targeting them at various branches of various banks and other events like related seminars and workshops where target respondents can be reached.

A questionnaire survey that was developed by the authors based on the literature review and modification of some existing related survey questionnaire is used as the primary data collection instrument. The focus of the instrument is to elicit bank customers' perception about their awareness and understanding of the dispute resolution clauses contained in their financial contracts with the banks, and their choice of dispute resolution mechanism. Based on a 5-point Likert attitudinal scale, respondents are requested to indicate their level of agreement with a statement or indicate the frequency of carrying out some specific dispute resolution activities. For coding purposes '1' indicate 'Strongly Disagree' or 'Never, while 'Strongly Agree' or 'Always' is coded as '5'.

### Demographic Profile of Respondents

The demographic profiles of the respondents as shown in Table 1 indicated that as a reflection of the Malaysian population, most of the respondents are females and are mostly under 40 years old. The respondents are also highly literate as almost half have at least a bachelor degree. This is further strengthened by the fact that most of the respondents; more than a third are gainfully employed and have remarkable years of work experience. The income distribution indicates that most of the respondents are in the up to RM3,000 bracket, while at least more than a quarter of the respondents earn more than RM3,000. It is envisaged that the distribution of the respondents along these demographic divides should have positive implication for the quality of data obtained and the inferences drawn therefrom.

The data obtained indicates that most respondents, almost half indicated that they do not bother to read the documents while a quarter indicated that they are not sure which may be suggestive of casual or very minimal attempt at reading the contractual terms. Even more revealing is the fact that about 65

percent of the respondents indicate that they do not bother to further request their lawyers for further clarification relating to the clauses governing their contractual relations with the banks. This study also aims to test for invariance of the structural model along the divide of whether or not the banks further provides clarification to customers beyond the lengthy documents often handed over to them as clauses governing the latter's financial transaction with the former. The respondents are however, equally divided at 39 percent apiece as it relates to whether from their experience, bank officials attempt to explain further at their request on the clauses contained in their contractual documentations especially on the various dispute resolution channels.

TABLE 1
Demographic Profile of Respondents

| Demographic Variables | Frequency (%) |
|---|---|
| Gender | |
| Male | 38 |
| Female | 62 |
| Age | |
| 20-30 years | 59 |
| 31-40 years | 33 |
| 41-50 years | 7 |
| Above 50 years | 1 |
| Education Level | |
| Secondary school and below | 23 |
| Diploma | 10 |
| Bachelors | 41 |
| Postgraduate | 26 |
| Employment Status | |
| Employed | 87 |
| Unemployed | 13 |
| Working Experience | |
| Up to 5 years | 59 |
| 6-10 years | 10 |
| More than 10 years | 31 |
| Monthly Income | |
| None | 12 |
| Up to RM3,000 | 64 |
| RM3,001-RM5,000 | 18 |
| RM5,001-RM10,000 | 6 |
| Do you read clauses contained in Islamic finance contracts? | |
| Yes | 33 |
| No | 46 |
| Not sure | 21 |
| Does your bank provide clarification on the clauses contained in your Islamic Finance contracts? | |
| Yes | 39 |
| No | 39 |
| Not sure | 22 |
| Do you request further explanation from a legal practitioner on the clauses contained in your Islamic Finance contracts? | |
| Yes | 23 |
| No | 64 |
| Not sure | 13 |

Source: Authors' computation

## DATA ANALYSES

## Exploratory and Confirmatory Factor Analysis

The data obtained is subjected to data cleaning to check for missing data and normal distribution. Given that there is no missing data and the sample size is greater than 50, the data is subjected to the Kolmogorov-Smirnov test of normal distribution. The results indicate that the variables, are slightly non-normally distributed given that the p-value of the Kolmogorov-Smirnov test is less than 0.05. This is quite common with social science data (Smith and Langfield, 2004). Subsequent transformation of the data improved the result but data is still non-normally distributed. The other diagnostics including linearity and homoscedasticity indicate that the data is usable for a covariance-based multivariate data analysis.

The fact that the questionnaire used is developed newly, the uni-dimensionality of the variables of interest is conducted based on exploratory factor analysis. A principal axis factoring based on promax rotation with Kaiser Normalization and an Eigen value of '1' is conducted. The results obtained after deleting likely problematic questionnaire items revealed a pattern matrix with four variables viz. legal awareness, legal understanding, dispute resolution clause provision, and choice of dispute resolution. The KMO score of 0.862 indicate the adequacy of the sample and the Bartlett's test of sphericity is statistically significant at 0.05 indicating that the matrix generated is not an identity matrix. The four variables extracted also satisfy the Kaiser criterion by explaining a total variance of 61 percent. The pattern matrix exploratory factor analysis output is shown in Table 2 below:

TABLE 2
Pattern Matrix

| Components | 1 | 2 | 3 | 4 |
|---|---|---|---|---|
| LU25 | 0.915 | | | |
| LU24 | 0.862 | | | |
| LU29 | 0.739 | | | |
| LU27 | 0.677 | | | |
| LU23 | 0.636 | | | |
| LU26 | 0.613 | | | |
| DR20 | | 0.931 | | |
| DR22 | | 0.772 | | |
| Dr18 | | 0.760 | | |
| CC2 | | | 0.893 | |
| CC1 | | | 0.890 | |
| CC3 | | | 0.522 | |
| LA33 | | | | 0.808 |
| LA35 | | | | 0.671 |
| LA36 | | | | 0.609 |
| LA30 | | | | 0.598 |

Source: Authors' computation

Following the exploratory factor analysis, a confirmatory factor analysis of the variables obtained is tested in a measurement model as a prelude to conducting a full-fledged structural equation modelling as suggested by Mueller and Hanckocks (2008). The importance is to test for the construct reliability, as well as both the divergent and convergent validity of the variables extracted in the exploratory stage. Moreover, since an invariance analysis is conducted in this study, the need to do so can only be established if the configural and metric invariance analyses are satisfied in the measurement model stage (Gaskin, 2012). The goodness of fit of the measurement model is tested based on the maximum likelihood estimate given that it is fairly consistent by showing tolerance for mild non-normality of data and in reproducing observed data by picking the best estimates in the process (Adewale, 2014).

To assess the measurement model fit, Hair et al (2010) and Mueller and Hancocks (2008) suggested that some fit indices criteria should be satisfied. As stated in Adewale et al (2013), these indices include the normed chi-square (minimum value of the discrepancy between the observed data and the

hypothesized model divided by the degree of freedom (CMN/df), as well as the p-value as an indicator of whether the null model should be rejected or not. There are other measures of fit suggested by Mueller and Hancocks (2008) vis. the Comparative Fit Index (CFI), and the Root Mean Square Error of Approximation (RMSEA). Table 3 below shows some of the output obtained from the measurement model analysis. The hypothesised measurement model is shown in figure 1 below while the results based on recommended threshold in most SEM extant literature is shown in table 3. In addition, the results of the construct reliability, convergent validity and divergent validity are shown in Table 4 below.

TABLE 3 Results of Measurement Model Analysis

| Model | $\chi^2$/DF | CFI | RMSEA |
|---|---|---|---|
| Cut-off point | <5 | > 0.90 | < 0.10 |
| CFA (Measurement model) | 2.225 | 0.925 | 0.088 |

Source: Authors' computation

Figure 1 Measurement Model

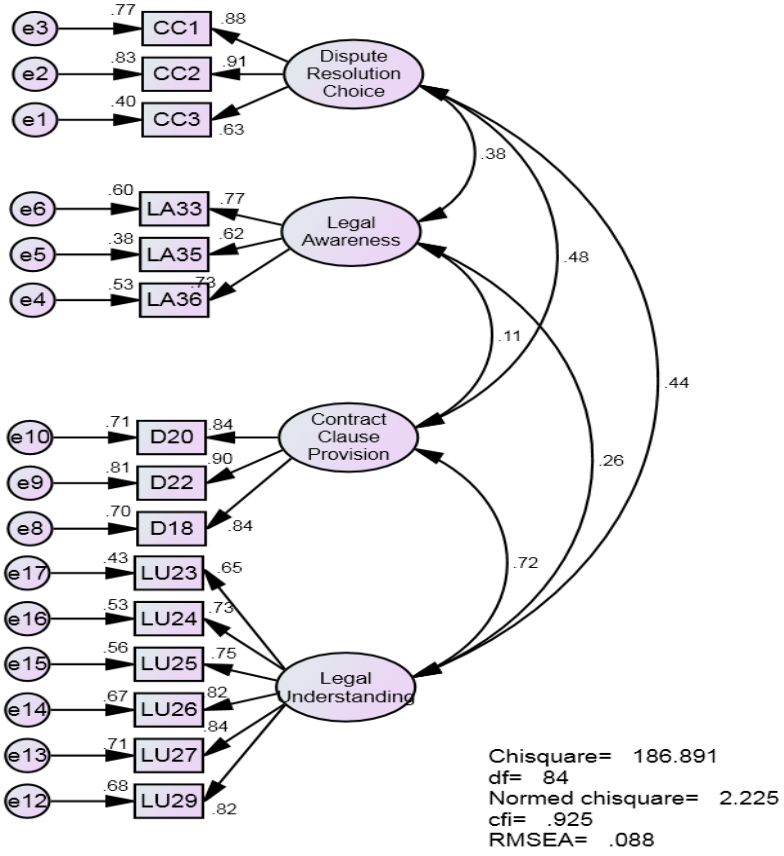



TABLE 4 Convergent and Divergent Validity

| Variables | CR | AVE | MSV | ASV |
|---|---|---|---|---|
| Cut-off point | > 0.7 | CR >AVE > 0.5 | AVE > MSV | AVE > ASV |
| Contract Clause Provision | 0.895 | 0.739 | 0.520 | 0.255 |
| Dispute Resolution Choice | 0.854 | 0.666 | 0.232 | 0.191 |
| Legal Awareness | 0.751 | 0.503 | 0.143 | 0.074 |
| Legal Understanding | 0.898 | 0.596 | 0.520 | 0.261 |

Source: Authors' computation

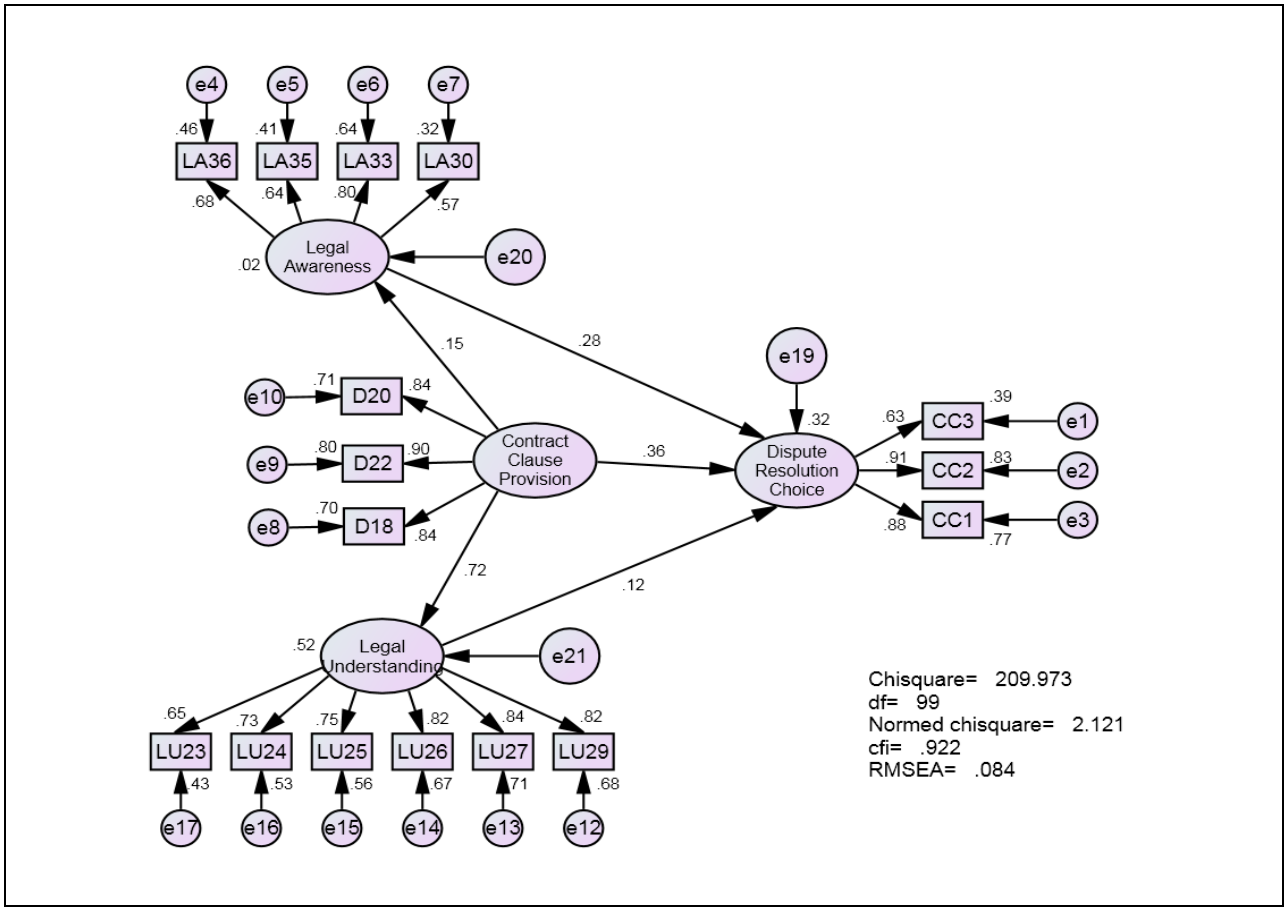
CR = Construct Reliability, AVE = Average Variance Explained MSV = Maximum Shared Variance, ASV= Average Shared Variance

The results in table 3 and table 4 indicate that the various fit indices criteria for the measurment model is satsified. The only exception is the p-value which is less than 0.05 thus indicating that the null model should be rejected. The susceptibility of chi-square as the test statistics to large sample size is noted in the extant SEM literature. According to Adewale et al (2012) a normed chi-square should be used instead. According to Hair et al. (2006:748), generally, $\chi^2$:*df* ratios on the order of 3:1 or less are associated with better fitting models except when sample size is greater than 750. The criteria for construct reliability, as well as both the convergent and divergent validity are also satisfied. A subsequent test for configural and metric invariance as suggested by Gaskin (2012) is carried out. The results indicate that at the 0.05 significance level, the model is invariant across the three divides of respondents that indicated that they sought and got further explanation from their bankers and those that indicated otherwise.

## Structural Model

Given that the measurement model fits the observed data, the structural model indicated in figure 2 is also tested to assess hypothesised relationships indicated in the diagram.

Figure 2
**Structural Model**




Source: Authors' Computation
An oval represent represents a latent variable, while a rectangle represents an observed variable or indicators. A small eclipse is used to represent the residual error term for both the latent and observed variables. For further explanation see Byrne (2010).

## RESULTS

### Analysis of the Structural Model

The hypothesized model in Figure 2 above is evaluated using IBM SPSS version 20 via AMoS add-on option and based on the indices suggested by Mueller and Hancocks (2008). These indices include the chi-square test, the comparative fit index (CFI), and the root mean square error of approximation (RMSEA). Furthermore, the explained paths coefficients in the model indicated by the single-head arrows are investigated for statistical significance at $p < .05$. Table 5 below shows the results obtained.

Table 5. Tabular Presentation of Fit Indices Criteria Compared to Baseline Model Output

| Fit Indices | Recommended Threshold | Model Output |
|---|---|---|
| CMINDF | $2 \geq$ CMINDF $\leq 5$ | 2.121 |
| P | $P \geq 0.05$ | 0.000 |
| CFI | CFI $\geq 0.90$ | 0.922 |
| RMSEA | RMSEA $\leq 0.10$ | 0.084 |

Source: Authors' Computations

As shown in Table 5 above, the chi-square test is statistically significant, $\chi^2$ (99, N=160) = 209.973, *p* =0.000, which suggests that the model should be rejected. However, given that the model yielded satisfactory fit in other indices, the model is still acceptable for further interpretation. The acceptance of the model is hinged on a normed chi-square (CMINDF) value of 2.121 which is falls within the acceptance range of 1-3 as suggested by Hair et al (2006). The CFI value of 0.922 also falls within acceptable range of 0.90 and 1.00, while the RMSEA value of 0.084 is below the 0.10 threshold indicated in Gaskin (2012). Based on these indices, the structural model is acceptable as such the path coefficients can be assessed for both practical and statistical significance. The results are shown in Table 6 below.

TABLE 6
Regression Weights: (Structural model)

| | | | Estimate | S.E | C.R | P | Significance |
|---|---|---|---|---|---|---|---|
| Legal Awareness | ← | Contract Clause Provision | 0.057 | 0.036 | 1.569 | 0.117 | Not Sig. |
| Legal Understanding | ← | Contract Clause Provision | 0.756 | 0.089 | 8.540 | 0.000 | Sig. |
| Dispute Resolution Choice | ← | Contract Clause Provision | 0.163 | 0.058 | 2.815 | 0.005 | Sig. |
| Dispute Resolution Choice | ← | Legal Understanding | 0.050 | 0.052 | 0.968 | 0.333 | Sig. |
| Dispute Resolution Choice | ← | Legal Awareness | 0.334 | 0.107 | 3.123 | 0.002 | Sig. |

Source: Authors' computation

## Structural Relationships among Variables

The exogenous variable in the model is the contractual clause provision in Islamic finance transactions. It is conceptualized that the type of legal channel pursued for dispute resolution purposes may largely be confined to the provisions made in the contractual agreements. As noted in the literature, the prevailing practice whereby Islamic banks prefer litigation given its inherent benefits to the banks limits the option of the customers to have an amicable dispute resolution in the event of a dispute. While relative importance of litigation may not be discountable, it apparently skews the benefits arising therefrom to the banks. The thesis sponsored is that a multi-tiered approach holds mutual benefits to both the banks and the customers in which case alternative channels like arbitration and mediation can be explored before the more expensive and time-consuming alternative of litigation is explored.

The direct path from contractual clause provision to dispute resolution choice is both statistically and practically significant. This is supported with a regression weight or standardized β of 0.36, which is also statistically significant given that the critical ratio score of 2.815 is greater than the 1.96 threshold at an alpha level of 0.05. Furthermore, the results as indicated in the figure 2 also show that the provision of the dispute resolution clauses enhances the legal awareness and legal understanding of clients about dispute resolution.

Furthermore, it is likely, that even where it is not explicitly included in the contractual clause the lack of legal awareness may impede the customers' likelihood of using alternative dispute resolution channels like arbitration. The direct path from contract clause provision to legal awareness indicates its practical significance given that its standardized β score of 0.15 is greater than 0.10 as mentioned in Gaskin (2012). However, the path is not statistically significant given that its critical ratio score of 1.569 is less than the 1.96 threshold at an alpha level of 0.05. Such insignificant path is an indication of lack of mediating effect of legal awareness on the direct path between contract clause provision and dispute resolution channel. In other words, provisions of the contractual clauses do not significantly enhance the customers' legal awareness. This is also attested to by the fact that the squared multiple correlation score of 0.02 is far less than the 0.10 threshold mentioned in Gaskin (2012) as the minimum coefficient of determination score for any meaningful inferences to be drawn. Consequently, an indirect effect is tested by multiplying the paths from contract clause provision to legal awareness, and to dispute resolution channel. The indirect relationship is also not statistically significant given that the score of 0.04 obtained is less than the 0.08 threshold often stated in SEM literature.

In a similar vein, it is likely that legal understanding may also have a mediating effect on the relationship between contractual clause provision and dispute resolution channels. The path from dispute resolution clause and legal understanding is both practically and statistically significant. With a standardized β of 0.72 and a critical ratio of 8.540 which is greater than the 1.96 threshold, contractual clause provision seems to greatly enhance legal understanding of the consumers. This is further strengthened by the coefficient of determination score of 0.52 which is quite strong. However, the path from legal understanding to dispute resolution channel is not statistically significant given that its critical ratio score of 0.968 is less than the 1.96 threshold at an alpha level of 0.05. Such insignificant path is an indication of lack of mediating effect of legal awareness on the direct path between contract clause provision and dispute resolution channel. Nonetheless, legal understanding seems to have practical significance since the multiplication of the path from contractual clause provision to legal understanding and also to dispute resolution channel is statistically significant. This is so given that the score of 0.082 obtained is greater than the 0.08 threshold often stated in SEM literature.

As indicated in the baseline model in Figure 2, the $R^2$ for the endogenous variable – dispute resolution channel is 0.19. Even though it is not too strong, it is nonetheless an admissible proportion of the total variance explained. Moreover, the indicators of the endogenous variable indicate that while they are all statistically significant, litigation has the highest factor loading of 0.91. This is followed by mediation and arbitration with factor loadings of 0.88 and 0.63 in that order.

## Structural Invariance Analysis

To test invariance of the structural model across the divides of those customers that sought clarification from their bankers and those that did otherwise, the data was split into three groups. Afterwards, a simultaneous analysis based on the groupings is carried out based on both a constrained and unconstrained model. As such, the path coefficients: Contract clause provision → legal awareness, Contract clause provision → legal understanding, Contract clause provision → dispute resolution channels, Legal awareness→ dispute resolution channels , and legal understanding →dispute resolution channels are constrained to be equal to each other across the groups that sought clarification and those that did otherwise. The chi-square test for group differences indicates that the baseline structural model is not invariant across the groups. This result is shown in Table 7 below:

TABLE 7
Results of Multiple Group Modelling (Seeking Clarification)

| Model | $\chi^2$ | Df | Critical-Value | $\Delta\chi^2$ | Sig. |
|---|---|---|---|---|---|
| Unconstrained | 501.228 | 297 | | | |
| Constrained | 514.416 | 307 | 11.345 | 13.188 | Sig. |

*P*< 0.01

Although the results from the invariance analysis suggest that the model is invariant across the divides of whether or not clarification is sought about by the customers from their bankers about the clauses contained in their contracts, the models nonetheless still fit the data. As such, it a further test based on the group difference across path divides as suggested by Gaskin (2012) is carried out. The results reveal that there is a statistically significant differences among the groups based on their legal understanding. Expectedly, the group that sough further clarification has a statistically significant path from provision of legal clauses to legal understanding and indirectly to their choice of dispute resolution channels. Other paths retained their invariance status as obtained in the baseline structural model.

## PRACTICAL IMPLICATIONS AND RECOMMENDATIONS

With the new legal regime in the Islamic finance industry in Malaysia and specifically, the quest for innovative ideas to operationalise the Financial Ombudsman Scheme provided for in section 138 of the Islamic Financial Services Act 2013, the groundwork for reforms in the dispute resolution sector of the industry has been put in place. What is needed, which is the principal objective of this empirical legal study, is to address the cause rather than the symptoms. The root cause of disputes goes back to the way the Islamic finance contract is drafted; hence, as a way forward to the discourse on the customers' perceptions on dispute resolution clauses in Islamic finance contracts, this study proposes a multi-tiered dispute resolution framework to be incorporated into the Islamic finance contract. To achieve this, the institutional framework for dispute resolution in Malaysia must be strengthened, and to a large extent, integrated to establish a link that would ensure effective dispute settlement in the Islamic finance industry. A proposal for a multi-tiered dispute resolution clause will depend on the nature of transaction whether it's a stand-alone agreement or a bundled contract. Each of these variants might require different forms of multi-tiered and optional dispute resolution clauses.

### Integrating the Existing Mechanisms for Dispute Resolution in Malaysia

The recent legal controversy relates to the constitutionality of the powers and functions of SAC in relation to the court's duty to determine all issues coming before it. In *Tan Sri Khalid bin Ibrahim v Bank Islam Malaysia Bhd*,[2] the constitutionality of the power of SAC is being challenged. It goes without saying that SAC has helped to stabilize the Islamic finance industry in Malaysia but when Sharī'ah comes into direct contact with a civil court system which is based on the English common law, there are bound to be some elements of incompatibility of rules and procedures. While the matter is currently before the Federal Court, one may suggest that the way out of this legal quandary is to integrate litigation with other specialized forms of dispute resolution where the former is utilized as a last resort in the continuum of processes of dispute resolution. There has been a continuous call for the establishment of special arbitration tribunal for Islamic finance disputes due to the *sui generis* nature of Islamic finance disputes and the complex Sharī'ah issues involved (Tun Arifin Bin Zakaria, 2014). This might probably be the right time to actualize such a proposal. Such tribunal might be a multi-door dispute resolution institution which will ultimately be linked with the Muamalat Bench of the High Court. The Chief Justice of Malaysia, Tun Arifin Bin Zakaria explains the need for such a tribunal in the light of current legal controversy on the powers of SAC:

> Since the existence of the SAC may cause conflict and in view of the inadequacy of the civil court on Shariah matters we should give serious consideration to the establishment of specialist tribunal to handle Islamic Finance matters. Such a tribunal will be better equipped to deal with Shariah matters and indirectly, the conflict on constitutional issues within section 56 and section 57 of CBMA can be avoided. The order issued by the tribunal shall be made enforceable by the court, as in the case of arbitration award (Tun Arifin Bin Zakaria, 2014: 39).

The need to integrate the tribunal into the court system is also emphasized below:

> …where Shariah issues are raised it may be advisable to have a separate regime independent of the courts' jurisdiction by providing alternative dispute resolutions such as tribunal or arbitration and the order or awards to be made enforceable as Court orders (Tun Arifin Bin Zakaria, 2014: 43).

The proposed integration of the processes goes to the very foundation of the Sharī'ah-compliant transactions which is the contract. Once the Islamic finance contracts are properly drafted in a way and

[2] [2012]7 MLJ 597.

manner that will enhance better understanding of the most important clauses that ensure consumer protection, then the Malaysia's Islamic financial services industry would have been placed on a strong footing worth emulating by other jurisdictions (Oseni, 2014).

## Proposing a Dispute Resolution Clause for Islamic Finance Contracts in Malaysia

In most common law jurisdiction, the prevailing practice is to provide for a general clause that provides that the rights and obligations of the parties to the contract are to be governed and construed according to the laws of the country. Besides, when one carefully examines the clauses in a typical Islamic finance contract, it will be revealed that the whole transaction is skewed to reflect the prevailing concepts and ideals of the legal system. In the case of Malaysia, the whole legal system is still generally based on the English common law model. In fact, most of the clauses contained in Islamic finance contracts reviewed in this research are modified versions of conventional financing contracts.

There is a paradigm shift in financial dispute resolution in advanced jurisdictions such as the United States and United Kingdom. Even though the litigation culture emerged from such jurisdictions, there is a general move towards giving pre-eminence to less formal processes such as arbitration and mediation. In fact, some of the leading banks in the U.S. such as Bank of America (BoFA) introduced mandatory arbitration clauses as part of their contracts with customers (See Appendix 2 for the dispute resolution clause that was used in Bank of America's Loan Agreement). For BoFA, arbitration is cost-effective and time-efficient when compared to litigation; so, it is considered as part of consumer protection to implement such a policy. However, this practice of including mandatory arbitration clauses in contracts was dropped in August 2009 giving customers the option to explore other dispute resolution processes, including court proceedings. Nevertheless, BoFA still requires mandatory arbitration for matters relating to "its securities businesses and wealthiest clients" (Sidel, 2009). The use of mandatory pre-dispute arbitration clause by the largest banks in the U.S. has been one of the most controversial issues in the banking industry (Consumer Financial Protection Bureau, 2013). In a 2011 Pew Report, "68 percent of respondents believed that they should be able to choose whether to go to court or participate in arbitration after a dispute arises". It thus appears the U.S. is now giving priority to the choice of the parties. The good and best practices in dispute resolution in consumer banking in the U.S. are presented in Appendix 3.

We adopt the Pew definition of be practices which include "Offering consumers a meaningful choice to resolve a problem with their bank rather than including mandatory binding arbitration clauses in checking account agreements" (The Pew Charitable Trusts, 2013). This is the philosophy of dispute resolution in Islamic law. Even though amicable settlement of commercial disputes is highly encouraged, parties to a financial agreement cannot, and should not, be forced to utilise just one process while contractually excluding others. Party autonomy is important in Sharī'ah-related transactions but such must fulfil the general principles of Sharī'ah. Therefore, a pre-dispute arbitration clause in an Islamic finance contract should not be exclusive to make it mandatory. This is where a multi-tiered clause approach will work better.

## Understanding the Legal Implications of the Governing Law and Jurisdiction Clause

While it is believed by practitioners that the "Governing Law and Jurisdiction" clause, with special reference to the practice in Malaysia, should be crafted in a general manner to reflect the jurisdiction and Sharī'ah compliance of the contract, it might be difficult for the customers to have a firm understanding of the available avenues for redress. For instance, in a Tawarruq Master Facility Agreement – Property Financing-i (Tawarruq) of a leading Islamic bank in Malaysia (*name anonymised*), the "Governing Law and Jurisdiction" clause provides:

> This Agreement shall be governed by and construed, interpreted and applied in accordance with the laws of Malaysia provided always that in the event there is a conflict between the civil laws and the Sharī'ah on any matter whatsoever, the Sharī'ah shall prevail.

Therefore, while the above "Governing Law and Jurisdiction" clauses may be retained, there should be a "Dispute Resolution Clause" in every contract that will clearly state the available options based on the proposed multi-tiered process. This clause will provide the customers meaningful choice for dispute resolution.

Most financing facilities used in conventional banks in Malaysia provide a clause on "Independent Legal Advice", which provides for some form of warranty to the effect that the borrower has obtained and relied upon its own independent legal advice in executing the facilities agreement. The borrower is also expected to confirm by such clause that the bank only entered into the agreement in full reliance upon the warranty given by him or her.[3] A quick perusal of a number of Sharī'ah-compliant Master Facility Agreements popularly used by Islamic banks in Malaysia reveals that there is no such provision in most of the contract templates analysed. The implication of this discrepancy between the agreements used by the conventional banks and those of Islamic banks within the same jurisdiction is far reaching. It appears most Islamic bank customers, even though they are aware of the existence of a number of avenues for seeking redress, might not really understand the implication of such contractual provisions. While some customers seek clarifications about the terms of the contract, others do not really care since they generally believe everything is in order, being largely influenced by the faith premium.

Since one of the major findings of this study is that those customers who seek further clarifications from their bank or lawyers understand the legal implications of their rights and obligations under the contract, it is expected that their choice of dispute resolution will be based on informed decision. On the other hand, those who do not really care to clarify the terms of the contract, including the avenues available for seeking redress, might be aware that there are other avenues for dispute settlement apart from litigation generally, but will believe the court is the only avenue for financial dispute settlement. The preference for amicable dispute settlement in Islamic law in family disputes or when there is marital discord is well ingrained in the psyches of Malaysian Muslims and the institutional framework for such family dispute resolution is established by the relevant laws (Abdul Hak & and Oseni, 2011). This might create a wrong perception about the applicability of such marital dispute settlement principles in Islamic finance matters.

The way forward is therefore the need to provide clear, relationship building, and binding processes of dispute resolution in the Islamic finance contracts. At the time of concluding the contract, parties should not only be required to legally warrant that they have sought independent legal advice before executing the contract, but the bank must ensure the customer relationship officer explains the key details of the contract to the customer and identify avenues for seeking redress in the event of a dispute, claim or complaints. This is part of the requirements of a valid contract in Islamic commercial law; and incidentally, it has been one of the major factors that lead to dispute in most modern Islamic finance contracts. So, apart from the general awareness, which may be a result of an element of subconsciousness, Islamic finance customers should also understand their specific rights and obligations under the Sharī'ah-compliant agreement.

## CONCLUSION

This study has proposed the integration of the existing dispute resolution mechanisms in the Islamic financial services industry in Malaysia through the interlinking of the initiatives in a way that would

[3] An Independent Legal Advice clause in the Housing Loan Facility Agreement of a Conventional Bank in Malaysia (*name anonymised*) provides: "The Borrower represents and warrants to the Bank that the Borrower has obtained and relied upon its own independent legal advice in executing this Agreement and acknowledges that the Bank has accepted and entered into this Agreement in full reliance upon his warranty. The Borrower confirms having read and understood this Agreement." In most cases, borrowers and customers do not read the terms of the contract, and do not even bother to seek independent legal advice.

allow for the adoption of multi-tiered clauses of dispute resolution in Islamic finance contracts. While relying on empirical evidence on the perceptions of customers on the dispute resolution clauses in Islamic finance contracts used in Malaysia and the experiences of the leading financial institutions in the U.S., this study concludes that a distinct Dispute Resolution clause will enhance better legal understanding among the bank customer of available options for effective dispute resolution in the event of any dispute.

Financial transactions are better resolved through amicable dispute settlement processes. But with the legal transplant of the English-styled common law to Malaysia as part of the colonial heritage, Islamic finance disputes fall under the civil courts. As demonstrated in this study and other relevant literature, Islamic finance litigation does not fit the very nature of Islamic financial services industry. Such choice of dispute resolution process is made at the contract stage. The prevailing practice in Malaysia's Islamic financial services industry is the general use of certain templates that are products of the conventional finance industry. Since Malaysia aspires to be recognised as the global hub for Islamic finance, and chosen as the preferred jurisdiction as well as Malaysian law as choice of law, it must put in place a friendly framework for Islamic finance contract. A robust dispute resolution framework in Malaysia will encourage foreign investors, particularly from the Gulf Cooperation Council (GCC) countries, to invest in the country. A viable and favourable legal framework encourages investments. Besides, parties engaging in cross-border Islamic finance transactions will easily choose Malaysia as the forum for dispute resolution; hence, Malaysia will become a favourable forum for settling Islamic finance-related disputes while utilizing the available options. This can only be achieved if matters relating to choice of law and dispute resolution are well addressed in a way that will promote consumer protection through proper understanding of rights and obligations under an Islamic finance contract.

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## APPENDIX 1
## Dispute Resolution Clauses of Selected Islamic Finance Contracts used in Malaysia

| | Mode of Financing | Type of Contract | Channel for Redress | Governing Law and Jurisdiction Clause |
|---|---|---|---|---|
| 1. | Tawarruq | Tawarruq Master Facility Agreement | Court | This Agreement shall be governed by and construed, interpreted and applied in accordance with the laws of Malaysia provided always that in the event there is a conflict between the civil laws and the Sharī'ah on any matter whatsoever, the Sharī'ah shall prevail. |
| 2. | Wakalah | Tawarruq Agency Agreement | Court | This Agreement is governed by, and shall be construed in accordance with the laws of Malaysia. |
| 3. | Bai Bitham Ajil (BBA) | Deed of Assignment (Property) | Court | This Assignment shall be governed by and construed in all respects in accordance with the laws of Malaysia but in enforcing this Assignment, the Bank shall be at liberty to initiate and take actions or proceedings or otherwise against the Assignor(s) in Malaysia and/or elsewhere as the Bank may deem fit and the parties hereto hereby agree that where any actions or proceedings are initiated and taken in Malaysia they shall submit to the non-exclusive jurisdiction of the Courts of the States of Malaysia in all matters connected with the obligations and liabilities of the parties hereto under or arising out of this Assignment. |
| 4. | Musharakah Mutanaqisah | Diminishing Musharakah Co-Ownership Agreement (Property Completed) | Court | The Transaction Documents and the rights and duties of the parties hereunder shall be governed by, and construed and interpreted in accordance with, the laws of Malaysia and Sharī'ah Principles and in relation to any legal action or proceedings arising out of or in connection with the Transaction Documents ("Proceedings"), the Customer irrevocably submits to the jurisdiction of the courts of Malaysia, and waives any objections to Proceedings in any court on the grounds that the Proceedings have been brought in an inconvenient forum and the parties herein further agree to make an application for the courts to refer any question involving a Sharī'ah matter to the Syariah Advisory Council of Bank Negara Malaysia pursuant to Section 56 of the Central Bank of Malaysia Act 2009 for a ruling. |
| 5. | Murabahah | Corporate Murabahah Master Agreement | Court | This Agreement shall be governed by and construed in accordance with the laws of Malaysia and each of the Parties hereto irrevocably agrees that the Courts of Malaysia shall have exclusive jurisdiction for the purpose of any proceedings arising out of or in connection with this Agreement, and, for such purposes, irrevocably submits to the jurisdiction of such courts. |
| 6. | Murabahah | Interbank Murabahah Master Agreement | Court | This Agreement shall be governed by and construed in accordance with the laws of Malaysia in so far as it complies with the Sharī'ah Principles and each of the Parties hereto irrevocably agrees that the Courts of Malaysia shall have exclusive jurisdiction for the purpose of any proceedings arising out of or in connection with this Agreement in so far as it complies with the Sharī'ah principles, and, for such purposes, irrevocably submits to the jurisdiction of such courts. |
| 7. | Wakalah | Corporate Wakalah Placement Agreement | Court | The Parties irrevocably agree that the courts of Malaysia are to have jurisdiction to settle any disputes which may arise out of or in connection with this Agreement and each Transaction. The Parties hereby irrevocably submit to the jurisdiction of th e Malaysian courts and waive any objection on the ground of venue or on the ground that the proceedings have been brought in an inconvenient forum provided that this Clause shall be without prejudice to the right to bring proceedings in any other jurisdict ion for the purpose of enforcement or execution of any judgement or other settlement in any other courts |
| 8. | Takaful | Private Car Driver & Passenger Takaful | 1. Arbitration<br>2. Mediation (FMB)<br>3. Court (as last resort) | If any difference arises as to the amount of the Takaful Operator 's liability under this Certificate, such difference shall independently of all other questions be referred to the decision of an arbitrator to be appointed in writing by both parties or if they cannot agree upon a single arbitrator, to the decision of two arbitrators of whom one shall be appointed in writing by each of the parties within (3) three calendar months after having required to do so in writing by the other party and in case of disagreement between the arbitrators, the difference shall be referred to the decision of an umpire who shall have been appointed in writing by the arbitrators before entering on the reference, and an award by arbitration shall be a condition precedent to any right of action against the Takaful Operator as regards any dispute regarding the amount of the Takaful Operator 's liability under this Certificate. In no case whatever shall the Takaful Operator be liable for any claim after the expiration of twelve (12) months from the happening of the Event unless the claim is the subject of pending court action or arbitration. |

Source: Oseni (2014)

## APPENDIX 2

### Dispute Resolution Clause for Loan Agreements of Bank of America – Binding Arbitration

11. THIS PARAGRAPH, INCLUDING THE SUBPARAGRAPHS BELOW, IS REFERRED TO AS THE "DISPUTE RESOLUTION PROVISION." THIS DISPUTE RESOLUTION PROVISION IS A MATERIAL INDUCEMENT FOR THE PARTIES ENTERING INTO THIS AGREEMENT.

(a) THIS DISPUTE RESOLUTION PROVISION CONCERNS THE RESOLUTION OF ANY CONTROVERSIES OR CLAIMS BETWEEN THE PARTIES, WHETHER ARISING IN CONTRACT, TORT OR BY STATUTE, INCLUDING BUT NOT LIMITED TO CONTROVERSIES OR CLAIMS THAT ARISE OUT OF OR RELATE TO: (I) THIS AGREEMENT (INCLUDING ANY RENEWALS, EXTENSIONS OR MODIFICATIONS); OR (II) ANY DOCUMENT RELATED TO THIS AGREEMENT (COLLECTIVELY A "CLAIM"). FOR THE PURPOSES OF THIS DISPUTE RESOLUTION PROVISION ONLY, THE TERM "PARTIES" SHALL INCLUDE ANY PARENT CORPORATION, SUBSIDIARY OR AFFILIATE OF THE LENDER INVOLVED IN THE SERVICING, MANAGEMENT OR ADMINISTRATION OF ANY OBLIGATION DESCRIBED OR EVIDENCED BY THIS AGREEMENT.

(b) AT THE REQUEST OF ANY PARTY TO THIS AGREEMENT, ANY CLAIM SHALL BE RESOLVED BY BINDING ARBITRATION IN ACCORDANCE WITH THE FEDERAL ARBITRATION ACT (TITLE 9, U.S. CODE) (THE "ACT"). THE ACT WILL APPLY EVEN THOUGH THIS AGREEMENT PROVIDES THAT IT IS GOVERNED BY THE LAW OF A SPECIFIED STATE.

(c) ARBITRATION PROCEEDINGS WILL BE DETERMINED IN ACCORDANCE WITH THE ACT, THE THEN-CURRENT RULES AND PROCEDURES FOR THE ARBITRATION OF FINANCIAL SERVICES DISPUTES OF THE AMERICAN ARBITRATION ASSOCIATION OR ANY SUCCESSOR THEREOF ("AAA"), AND THE TERMS OF THIS DISPUTE RESOLUTION PROVISION. IN THE EVENT OF ANY INCONSISTENCY, THE TERMS OF THIS DISPUTE RESOLUTION PROVISION SHALL CONTROL. IF AAA IS UNWILLING OR UNABLE TO (I) SERVE AS THE PROVIDER OF ARBITRATION OR (II) ENFORCE ANY PROVISION OF THIS ARBITRATION CLAUSE, THE LENDER MAY DESIGNATE ANOTHER ARBITRATION ORGANIZATION WITH SIMILAR PROCEDURES TO SERVE AS THE PROVIDER OF ARBITRATION.

(d) THE ARBITRATION SHALL BE ADMINISTERED BY AAA AND CONDUCTED, UNLESS OTHERWISE REQUIRED BY LAW, IN ANY U.S. STATE WHERE REAL OR TANGIBLE PERSONAL PROPERTY COLLATERAL FOR THIS CREDIT IS LOCATED OR IF THERE IS NO SUCH COLLATERAL, IN THE STATE SPECIFIED IN THE GOVERNING LAW SECTION OF THIS AGREEMENT. ALL CLAIMS SHALL BE DETERMINED BY ONE ARBITRATOR; HOWEVER, IF CLAIMS EXCEED FIVE MILLION DOLLARS ($5,000,000), UPON THE REQUEST OF ANY PARTY, THE CLAIMS SHALL BE DECIDED BY THREE ARBITRATORS. ALL ARBITRATION HEARINGS SHALL COMMENCE WITHIN NINETY (90) DAYS OF THE DEMAND FOR ARBITRATION AND CLOSE WITHIN NINETY (90) DAYS OF COMMENCEMENT AND THE AWARD OF THE ARBITRATOR(S) SHALL BE ISSUED WITHIN THIRTY (30) DAYS OF THE CLOSE OF THE HEARING. HOWEVER, THE ARBITRATOR(S), UPON A SHOWING OF GOOD CAUSE, MAY EXTEND THE COMMENCEMENT OF THE HEARING FOR UP TO AN ADDITIONAL SIXTY (60) DAYS. THE ARBITRATOR(S) SHALL PROVIDE A CONCISE WRITTEN STATEMENT OF REASONS FOR THE AWARD. THE ARBITRATION AWARD MAY BE SUBMITTED TO ANY COURT HAVING JURISDICTION TO BE CONFIRMED AND HAVE JUDGMENT ENTERED AND ENFORCED.

(e) THE ARBITRATOR(S) WILL GIVE EFFECT TO STATUTES OF LIMITATION IN DETERMINING ANY CLAIM AND MAY DISMISS THE ARBITRATION ON THE BASIS THAT THE CLAIM IS BARRED. FOR PURPOSES OF THE APPLICATION OF ANY STATUTES OF LIMITATION, THE SERVICE ON AAA UNDER APPLICABLE AAA RULES OF A NOTICE OF CLAIM IS THE EQUIVALENT OF THE FILING OF A LAWSUIT. ANY DISPUTE CONCERNING THIS ARBITRATION PROVISION OR WHETHER A CLAIM IS ARBITRABLE SHALL BE DETERMINED BY THE ARBITRATOR(S), EXCEPT AS SET FORTH AT SUBPARAGRAPH (H) OF THIS DISPUTE RESOLUTION PROVISION. THE ARBITRATOR(S) SHALL HAVE THE POWER TO AWARD LEGAL FEES PURSUANT TO THE TERMS OF THIS AGREEMENT.

(f) THIS PARAGRAPH DOES NOT LIMIT THE RIGHT OF ANY PARTY TO: (I) EXERCISE SELF-HELP REMEDIES, SUCH AS BUT NOT LIMITED TO, SETOFF; (II) INITIATE JUDICIAL OR NON-JUDICIAL FORECLOSURE AGAINST ANY REAL OR PERSONAL PROPERTY COLLATERAL; (III) EXERCISE ANY JUDICIAL OR POWER OF SALE RIGHTS, OR (IV) ACT IN A COURT OF LAW TO OBTAIN AN INTERIM REMEDY, SUCH AS BUT NOT LIMITED TO, INJUNCTIVE RELIEF, WRIT OF POSSESSION OR APPOINTMENT OF A RECEIVER, OR ADDITIONAL OR SUPPLEMENTARY REMEDIES.

(g) THE FILING OF A COURT ACTION IS NOT INTENDED TO CONSTITUTE A WAIVER OF THE RIGHT OF ANY PARTY, INCLUDING THE SUING PARTY, THEREAFTER TO REQUIRE SUBMITTAL OF THE CLAIM TO ARBITRATION.

(h) ANY ARBITRATION OR TRIAL BY A JUDGE OF ANY CLAIM WILL TAKE PLACE ON AN INDIVIDUAL BASIS WITHOUT RESORT TO ANY FORM OF CLASS OR REPRESENTATIVE ACTION (THE "CLASS ACTION WAIVER"). REGARDLESS OF ANYTHING ELSE IN THIS DISPUTE RESOLUTION PROVISION, THE VALIDITY AND EFFECT OF THE CLASS ACTION WAIVER MAY BE DETERMINED ONLY BY A COURT AND NOT BY AN ARBITRATOR. THE PARTIES TO THIS AGREEMENT ACKNOWLEDGE THAT THE CLASS ACTION WAIVER IS MATERIAL AND ESSENTIAL TO THE ARBITRATION OF ANY DISPUTES BETWEEN THE PARTIES AND IS NONSEVERABLE FROM THE AGREEMENT TO ARBITRATE CLAIMS. IF THE CLASS ACTION WAIVER IS LIMITED, VOIDED OR FOUND UNENFORCEABLE, THEN THE PARTIES' AGREEMENT TO ARBITRATE SHALL BE NULL AND VOID WITH RESPECT TO SUCH PROCEEDING, SUBJECT TO THE RIGHT TO APPEAL THE LIMITATION OR INVALIDATION OF THE CLASS ACTION WAIVER. THE PARTIES ACKNOWLEDGE AND AGREE THAT UNDER NO CIRCUMSTANCES WILL A CLASS ACTION BE ARBITRATED.

(i) BY AGREEING TO BINDING ARBITRATION, THE PARTIES IRREVOCABLY AND VOLUNTARILY WAIVE ANY RIGHT THEY MAY HAVE TO A TRIAL BY JURY IN RESPECT OF ANY CLAIM. FURTHERMORE, WITHOUT INTENDING IN ANY WAY TO LIMIT THIS AGREEMENT TO ARBITRATE, TO THE EXTENT ANY CLAIM IS NOT ARBITRATED, THE PARTIES IRREVOCABLY AND VOLUNTARILY WAIVE ANY RIGHT THEY MAY HAVE TO A TRIAL BY JURY IN RESPECT OF SUCH CLAIM. THIS WAIVER OF JURY TRIAL SHALL REMAIN IN EFFECT EVEN IF THE CLASS ACTION WAIVER IS LIMITED, VOIDED OR FOUND UNENFORCEABLE. WHETHER THE CLAIM IS DECIDED BY ARBITRATION OR BY TRIAL BY A JUDGE, THE PARTIES AGREE AND UNDERSTAND THAT THE EFFECT OF THIS AGREEMENT IS THAT THEY ARE GIVING UP THE RIGHT TO TRIAL BY JURY TO THE EXTENT PERMITTED BY LAW.

Source: U.S. Securities and Exchange Commission
(http://www.sec.gov/Archives/edgar/data/1388319/000095014407007544/g05278a3exv10w15.htm)

# APPENDIX 3

## An Overview of Bank Dispute Resolution Best and Good Practices in the U.S.

Banks ordered by total number of best practices, total number of good practices, and, for the same rating, alphabetically

| Dispute resolution | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Bank name | Best practices | | | Good practices | | | Total best practices out of 3 | Total good practices out of 3 |
| | No mandatory binding arbitration | No class action bans | No "loss, costs, and expenses" clauses | Opt-out option | No jury trial waiver | Small-claims exemption | | |
| Ally Bank | ★ | ★ | ★ | ✓ | ✓ | ✓ | ★ = 3 | ✓ = 3 |
| Commerce Bank | ★ | ★ | ★ | ✓ | ✓ | ✓ | ★ = 3 | ✓ = 3 |
| RBS Citizens | ★ | ★ | ★ | ✓ | ✓ | ✓ | ★ = 3 | ✓ = 3 |
| Bank of America | ★ | ★ | ★ | ✓ | ✓ | ✓ | ★ = 3 | ✓ = 2 |
| Bank of Hawaii | ★ | ★ | ★ | ✓ | ✓ | ✓ | ★ = 3 | ✓ = 2 |
| Comerica Bank | ★ | ★ | ★ | ✓ | ✓ | ✓ | ★ = 3 | ✓ = 2 |
| Signature Bank | ★ | ★ | ★ | ✓ | ✓ | ✓ | ★ = 3 | ✓ = 2 |
| TD Bank | ★ | ★ | ★ | ✓ | ✓ | ✓ | ★ = 3 | ✓ = 2 |
| Bank of the West | ★ | ★ | ✶ | ✓ | ✓ | ✓ | ★ = 2 | ✓ = 3 |
| First Republic Bank | ★ | ★ | ✶ | ✓ | ✓ | ✓ | ★ = 2 | ✓ = 3 |
| PNC Bank | ★ | ★ | ✶ | ✓ | ✓ | ✓ | ★ = 2 | ✓ = 3 |
| Susquehanna Bank | ★ | ★ | ✶ | ✓ | ✓ | ✓ | ★ = 2 | ✓ = 3 |
| Capital One Bank | ★ | ★ | ✶ | ✓ | ✓ | ✓ | ★ = 2 | ✓ = 2 |
| Fifth Third Bank | ★ | ★ | ✶ | ✓ | ✓ | ✓ | ★ = 2 | ✓ = 2 |
| HSBC | ★ | ★ | ✶ | ✓ | ✓ | ✓ | ★ = 2 | ✓ = 2 |
| Associated Bank | ✶ | ★ | ★ | ✓ | ✓ | ✓ | ★ = 2 | ✓ = 0 |
| Charles Schwab Bank | ✶ | ★ | ★ | ✓ | ✓ | ✓ | ★ = 2 | ✓ = 0 |
| JPMorgan Chase Bank | ✶ | ✶ | ★ | ✓ | ✓ | ✓ | ★ = 1 | ✓ = 2 |
| Sovereign Bank | ✶ | ✶ | ★ | ✓ | ✓ | ✓ | ★ = 1 | ✓ = 2 |
| SunTrust Bank | ✶ | ✶ | ★ | ✓ | ✓ | ✓ | ★ = 1 | ✓ = 2 |
| TCF National Bank | ✶ | ✶ | ★ | ✓ | ✓ | ✓ | ★ = 1 | ✓ = 2 |
| BB&T | ✶ | ✶ | ★ | ✓ | ✓ | ✓ | ★ = 1 | ✓ = 1 |
| Citibank | ✶ | ✶ | ★ | ✓ | ✓ | ✓ | ★ = 1 | ✓ = 1 |
| City National Bank | ✶ | ✶ | ★ | ✓ | ✓ | ✓ | ★ = 1 | ✓ = 1 |
| Compass Bank | ✶ | ✶ | ★ | ✓ | ✓ | ✓ | ★ = 1 | ✓ = 1 |
| First Tennessee Bank | ✶ | ✶ | ★ | ✓ | ✓ | ✓ | ★ = 1 | ✓ = 1 |
| KeyBank | ✶ | ✶ | ★ | ✓ | ✓ | ✓ | ★ = 1 | ✓ = 1 |
| OneWest Bank | ✶ | ✶ | ★ | ✓ | ✓ | ✓ | ★ = 1 | ✓ = 1 |
| Union Bank | ✶ | ✶ | ★ | ✓ | ✓ | ✓ | ★ = 1 | ✓ = 1 |
| USAA Federal Savings Bank | ✶ | ✶ | ★ | ✓ | ✓ | ✓ | ★ = 1 | ✓ = 1 |
| Webster Bank | ✶ | ✶ | ★ | ✓ | ✓ | ✓ | ★ = 1 | ✓ = 1 |
| Wells Fargo Bank | ✶ | ✶ | ★ | ✓ | ✓ | ✓ | ★ = 1 | ✓ = 1 |
| Zions First National Bank | ✶ | ✶ | ★ | ✓ | ✓ | ✓ | ★ = 1 | ✓ = 0 |
| First Niagara Bank | ✶ | ✶ | ✶ | ✓ | ✓ | ✓ | ★ = 0 | ✓ = 2 |
| Frost Bank | ✶ | ✶ | ✶ | ✓ | ✓ | ✓ | ★ = 0 | ✓ = 1 |
| U.S. Bank | ✶ | ✶ | ✶ | ✓ | ✓ | ✓ | ★ = 0 | ✓ = 1 |

★ = Engages in this best practice ✓ = Engages in this good practice ✶ = Does not engage in this best practice ✓ = Does not engage in this good practice

Source: The Pew Charitable Trusts (2013: 34)