

## Corporate Governance and Effective Dispute Management in Islamic Financial Institutions

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**Abstract:** The increasing growth of the Islamic finance industry and the proliferation of Islamic financial products in the global economy necessitate a framework for managing corporate disputes arising from internal differences and contractual relationships with third parties, particularly in banker-customer relationships. Quality management in Islamic financial institutions can be sustained through appropriate measures in managing such disputes effectively through some Shari'ah-based mechanisms. This study examines corporate governance and dispute effective dispute management within the framework of Islamic financial institutions and the need to revive the administrative dispute resolution office of *muhtasib* (ombudsman). The study presents a model for fusing such an independent office into the corporate structure of the financial institutions in order to promote effective governance. It is argued that instead of litigating petty claims against the financial institutions, the internal mechanism of *muhtasib* should be able to resolve such claims amicably without unnecessary escalation into full-blown disputes. The paper concludes that such an office, which serves the purpose of corporate self-regulation integrated into the corporate structure of the financial institution, will promote sustainable excellence.

**Key words:** corporate justice, dispute management, *muhtasib*, ombudsman, Islamic financial institutions.

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### INTRODUCTION

In order to scale up the functions of Islamic financial institutions (IFIs), there is a need for an internally driven dispute management mechanism to ensure corporate justice. In managing corporate governance, there must be concerted efforts to effectively manage internally originated disputes either among employees or between a client and the IFI. This study examines the concept of dispute management as a means of promoting corporate justice with special reference to the dispute resolution mechanisms in Islamic law. The focus of this theoretical framework is the IFIs. It is trite that the crystallisation of Islamic finance products has rekindled the need for an effective governance structure to manage the increasing number of disputes, claims and complaints faced by IFIs across the world. Meanwhile, the existence of a standard framework for corporate dispute management in IFIs is a matter of dire necessity, which the stakeholders must consider. The ripple effects of the woes recently experienced by the conventional financial sector coupled with series of investment claims, which have culminated into protracted lawsuits call for a Shari'ah-based framework to regulate the Islamic finance industry.

Against the above backdrop, the study is basically divided into six major parts. After the introduction, this study presents a brief research methodology in the second part. Subsequently, the third part examines the relevant literature on the major themes of the study. This is the kernel of the study. It comprises major themes like the concepts of corporate justice and corporate governance, Shari'ah standards on corporate governance, and the *muhtasib* (ombudsman) framework in Islamic law. The fourth part dilates on corporate justice in IFIs. Following suit is the fifth part, which gives the findings of the study. Finally, the sixth part of the study gives the conclusion, which comprises the research limitations, implications for future research, originality and the contribution of the study to existing knowledge.

#### **Research Methodology:**

The methodology adopted in this research consists of a critical review of a wide range of theoretical literature ranging from the primary literature on Islamic jurisprudence, relevant Islamic law literature to recent literature on corporate governance and effective dispute management. The relevant standards of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) on corporate governance and arbitration

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are carefully examined to propose a multiple-layer framework for the effective management of disputes through in-house mechanisms in IFIs. Besides, the *Guiding Principles on Corporate Governance* of the Islamic Financial Services Board (IFSB) is also examined with a view to determining whether there are elements of dispute avoidance and dispute resolution in the laid down guidelines. In addition, the *Shari'ah Governance Framework for Islamic Financial Institutions* of the Central Bank of Malaysia is also examined to ascertain whether there are relevant provisions on dispute management in corporate matters. These available literatures are examined through critical assessment and evaluation of the major themes and trends.

#### **Literature Review:**

##### **3.1. The Theory of Corporate Justice and Corporate Governance:**

Corporate justice is concerned with the promotion of corporate accountability through Corporate Social Responsibility (CSR) and other sustainable means to ensure the protection of the rights of all stakeholders in the corporate business. The twin concepts of corporate accountability and CSR form the foundation for corporate justice. While discussing the theory of "Corporate Justice", one may begin to think of how to fight back in the courtroom and protect one's company in a corporate dispute with a third party, but there is more to the concept (Willis, 2006). Corporate justice extends to labour disputes within the company, customer-banker relationship disputes, and disputes with some other companies with whom one has transacted any business. However, due to the projected "big pay" which a company intends to realize from litigating a case in the court, most Chief Executives Officers (CEOs) are more often than not blindfolded and thus head to the court. In the long run, it will be discovered that to fund lawsuits and pay damages will definitely be counter-productive and may singlehandedly result into the winding-up of the company (Poon, 2010; Oseni, 2009). The proliferation of bogus claims and grossly inflated damages with interest in many corporate disputes justifies the need for an alternative forum for effective dispute management (Willis, 2006). As for the IFIs, what is being avoided, based on the underlying philosophy of the industry, will then be the consequence of unguided steps. Litigating Islamic finance disputes and claims, especially in the modern civil courts, is a navigation through uncharted waters, which is fraught with excessive risks and uncertainties. These business risks occasioned by lack of sufficient legal and regulatory framework in the IFIs justify the need for effective corporate governance through dispute management. "This approach reconfirms that the quality of bank management, and especially the risk management process, are the key concerns in ensuring the safety and stability of both individual banks and the banking system as a whole" (Greuning & Bratanovic, 2003: 5). What is observed nowadays in many conventional companies is the establishment of the office of ombudsman within the management cadre to reduce the risk associated with litigation (Rowe, 1987; Kolb, 1987).

The method or process through which a company is effectively directed, administered and controlled is known as corporate governance. As evident in the relevant literature, there is no generally acceptable definition of corporate governance but some experts have attempted to define the concept. Parkinson (1993: 159) defines good governance as "the process of supervision and control ... intended to ensure that the company's management acts in accordance with the interests of shareholders". A definition which emphasizes due process and effective management of challenges including disputes within a corporate setting suggests that "corporate governance is the system of checks and balances, both internal and external to companies, which ensures that companies discharge their accountability to all their stakeholders and act in a socially responsible way in all areas of their business activity" (Solomon, 2010: 3).

Within the context of modern IFIs, there is some sort of dividing line between corporate governance and Shari'ah governance. This distinction between the two related concepts may be justified to some extent. But considering the IFIs in a holistic manner, it is pertinent to merge the two concepts. Since the foundation of IFIs is the Shari'ah, it is more appropriate to begin to think of a hybrid form of corporate governance through the incorporation of the Shari'ah prescriptions into the governance of companies transacting Shari'ah compliant businesses (Ibrahim, 2006). Nevertheless, though the concept of Shari'ah governance or 'Islamic corporate governance' has emerged in the past two decades, the concept of corporate governance has been a western concept used extensively as a western concept in the conventional financial institutions (Yunis, 2007). In fact, the existing models, which some experts in Islamic finance have proposed to "Islamize", include the Anglo-American model and the Franco-German model. Undoubtedly, a close study of these models reveals some modicum of Islamic theory of justice, transparency and ethics in business dealings. To begin with, these principles of law and commerce in the primary sources of Shari'ah are essentially general outlines of the law (Kamali, 2002). The details of the applicable rules are required to be expounded by qualified jurists based on recognized rules and methodologies in Islamic jurisprudence to meet the demands of particular periods of human history (Hassan, 1993; Nyazee, 2006; Kamali, 2009).

Therefore, since the whole concept of Islamic finance is relatively new, there has been no need to develop this aspect of corporate governance in Islamic jurisprudence. This explains the level of flexibility in Islamic law, since jurists often come out with specific rules based on the general rules in the primary sources of Shari'ah, particularly in commercial transactions, to cater for novel issues (Archer & Karim, 1997). Sequel to

this inherent mechanism in Islamic jurisprudence, many finance products were developed in the twilight of the 20<sup>th</sup> century through the beginning of the 21<sup>st</sup> century, which have been approved as Shari'ah-compliant products (Muda & Jalil, 2007). The same process is now being adopted to develop a framework for corporate governance from the Islamic perspective. It is therefore argued that it will be more appropriate to have a general framework for Islamic corporate governance for all Shari'ah-based companies, including the IFIs. Comprehensive guidelines on this are necessary to avoid a bifurcation of the twin concepts –corporate governance and Shari'ah governance. A hybrid of the twin concepts based on the general prescriptions of the Shari'ah will go a long way to usher in a new regime for quality management. This will definitely place the IFIs at the leading edge of quality management and corporate excellence.

### **3.2 *Dispute Management and Notable Shari'ah Standards on Corporate Governance:***

Over the years, the key standard setting bodies in the Islamic finance industry have continuously strive to ensure sound corporate governance policies in IFIs that would ensure cutting-edge management practices. Accordingly, three notable Shari'ah standards on corporate governance for IFIs are briefly examined in this subsection. They are: *AAOIFI Standards on Corporate Governance*, *IFSB Guiding Principles on Corporate Governance*, and the *Guidelines on Shariah Governance Framework for Islamic Financial Institutions* of Bank Negara Malaysia.

#### **3.2.1. *AAOIFI Standards on Corporate Governance:***

One of the key issues discussed and deliberated upon during the Annual Conference on Islamic Banking and Finance organized by AAOIFI in Bahrain held in 2010 was corporate governance requirements for Shari'ah Supervisory Boards. In its Accounting, Auditing & Governance Standards (for Islamic Financial Institutions) issued in 2010, AAOIFI has 7 Governance Standards and 2 codes of ethics. The main headings of the 7 Governance Standards are:

1. Shari'ah Supervisory Board: Appointment, Composition and Report.
2. Shari'ah Review.
3. Internal Shari'ah Review.
4. Audit and Governance Committee for IFIs.
5. Independence of Shari'ah Supervisory Board.
6. Statement on Governance Principles for IFIs.
7. Corporate Social Responsibility (AAOIFI, 2010).

The above governance standards are part of the concerted efforts towards improving corporate governance in IFIs in order to ensure excellent performance. However, a major aspect left out here is the dispute management standard, which should be regarded as part of corporate governance practices. The 7 Governance Standards listed above are geared towards dispute avoidance because when there is corporate failure and the company faces liquidation, a plethora of disputes emerges. However, AAOIFI provides for a mechanism for dispute resolution in the Shari'ah Standard on Arbitration (*tahkim*). This standard is No. 32 of the AAOIFI Shari'ah Standards released in 2010. The importance of this particular standard cannot be overemphasized owing to its relevance to dispute resolution between IFIs and their counterparties (AAOIFI, 2010). Considering the importance of dispute management in corporate governance, there is a need to complement the provisions in the AAOIFI Shari'ah Standard on Arbitration by taking a step further to introduce the *muhtasib* model within the IFIs for early evaluation of disputes and dispute avoidance. Such should be the preliminary step before embarking on arbitration. It is therefore proposed (as shown in Figure 1 below) that the dispute resolution clause in contractual agreements involving the IFIs and their clients should expressly provide for a three-tiered dispute resolution mechanism comprising: *muhtasib*, as an internal mechanism; an *independent financial mediation/arbitration tribunal*; and, finally, *litigation*.

#### **3.2.2. *IFSB Guiding Principles on Corporate Governance:***

In December 2009, the Islamic Financial Services Board (IFSB), a leading international standard-setting organization, issued the *Guiding Principles on Shari'ah Governance Systems for Institutions Offering Islamic Financial Services* ("IFSB Guiding Principles"). The set of guiding principles are expected among others to "facilitate better understanding of *Shari'ah* governance issues and how stakeholders should satisfy themselves that an appropriate and effective *Shari'ah* governance system is in place" (IFSB, 2009). The following illustration is given in the IFSB Guiding Principles, which shows how the Shari'ah governance systems complement the existing structure in the conventional financial institutions.

An organ within the management of the IFIs in the Table 1 is the Internal Shari'ah Compliance Unit/Department (ISCU). The ISCU is not saddled with the responsibility of dispute management but is merely a compliance unit. The shaded part of the above table, which is not part of the original, has been added in this paper to reflect the imperativeness of proper management of disputes arising out of the normal banker-customer

relationship in a corporate setting. The next subsection of this paper discusses the differences between ISCU and the office of the *muhtasib*.

**Table 1:** Guiding Principles on Sharī'ah Governance Systems for Institutions Offering Islamic Financial Services.

FUNCTIONS	TYPICAL FINANCIAL INSTITUTION	ADDITIONS IN IFIs
Governance	▪ Board of directors	▪ Sharī'ah Board
Control	▪ Internal auditor ▪ External auditor	▪ ISRU ▪ External Sharī'ah Review
Compliance	▪ Regulatory and financial compliance officers, unit or department	▪ ISCU
Dispute Management	▪ Ombudsman	▪ <i>Muhtasib</i>

Source: IFSB (2009)

Even though the IFSB Guiding Principles vests the powers of carrying out and implementing the Sharī'ah governance system on the Sharī'ah Board of IFIs, the office of the *muhtasib* will serve as a complementing organ to the Board that investigates the level of implementation of the Sharī'ah governance system and resolves disputes relating to some breaches of laid down procedures. In addition, when disputes arise in the process of implementing the Sharī'ah governance system, the office of the *muhtasib* may effectively manage such disputes through mediation and sometimes conciliation whose decision will be considered binding on the IFIs.

**3.2.3. Differences between *muhtasib* and the Internal Sharī'ah Compliance Unit/Department:**

Though there are some elements of the office of the *muhtasib* in the ISCU, there are some remarkable differences in the two organs in the management of IFIs. On the basis of the modern role of *muhtasib* and its proactive functions as suggested by modern scholars, the following are some of the notable differences between the institution and the ISCU:

1. The ISCU reports to the Sharī'ah Board while the *muhtasib* reports directly to the Board of Directors since the latter's terms of reference covers all the transactions and activities of the IFI, which includes the Sharī'ah Board;
2. The Sharī'ah Board cannot delegate its functions to the *muhtasib*, but can issue official directives to the office of the *muhtasib* to commence an investigation or a fact-finding process on the level of compliance of certain departments of the IFI with the laid down rules, regulations or standards. However, the Sharī'ah Board can delegate its functions directly to the ISCU.
3. The office of the *muhtasib*, though to be appointed by the Board of Directors, is an independent organ of the IFI. On the other hand, the ISCU is attached to the Sharī'ah Board and in most cases, it is considered as the secretariat for the Sharī'ah Board.
4. In most cases, the ISCU handles the processing and secretariat matters to be considered by the Sharī'ah Board, while the office of *muhtasib* does not get involved in such secretariat matters and is not attached to the apron string of the Sharī'ah Board.
5. The *muhtasib* office is an additive to other organs of the IFI such as the Legal, Audit or ISCU but it is practically independent from them.
6. Rather counter-intuitively, the *muhtasib* as an informal corporate justice channel is an employee of the IFI appointed by the Board of Directors, but it is not part of the IFI in the true sense due to its high level of independence.

Be that as it may, there are some areas of convergence between the functions of the officers of the ISCU and the office of *muhtasib*. The two organs disseminate information on new standards, pronouncements, resolutions to the operative personnel in the relevant departments of the IFIs. They both monitor the day-to-day compliance of the operative personnel with the Sharī'ah standards in all the transactions carried out by the IFIs (IFSB, 2009).

**3.2.4. Bank Negara Malaysia Guidelines on Corporate Governance:**

Bank Negara Malaysia issued the “*Guidelines on Corporate Governance for Licensed Islamic Bank*” (the BNM Guidelines) with the primary objective of promoting “the adoption of effective and high standards of corporate governance practices by Islamic bank and Islamic bank holding companies” (Islamic Banking & Takaful Department, 2007). The minimum standards required of Islamic banks and Islamic bank holding companies are clearly set out in the BNM Guidelines to ensure sound and robust corporate governance practices. With 14 principles of corporate governance dealing with Board matters, management oversight, accountability and audit, and transparency, the Guidelines is to be read together with enabling legislations such as the Islamic Banking Act 1983, the Companies Act 1965, and other relevant guidelines, regulations and circulars relating to corporate governance including the IFSB Guiding Principles. A careful study of the BNM Guidelines reveals the absence of a dedicated organ like ISCU saddled with the responsibility of ensuring compliance with laid down standards and resolutions. The reason for such omission is not far-fetched, as the Board of Directors is

saddled with the responsibility of ensuring proper management of the financial institution. However, such duties which are part of the functions of the office of *muhtasib* are subsumed under the major responsibilities of the Board of Directors of IFIs. In a similar vein, when petty disputes escalate, the courts are seized with the jurisdiction of hearing and determining such disputes. The Board of Directors may not be on ground to monitor such compliance, since it only acts based on reports brought before it and makes policy decisions. To this end, the Board of Directors should delegate this power to an independent organ to handle and effectively resolve such issues.

### **3.3. The Muhtasib Framework in Islamic Law:**

By and large, Islamic historians believe the institution of *hisbah* greatly influenced the modern ombudsman. Apart from the fact that the idea originated from the prime sources of the Shari'ah and further developed during the golden era of the four rightly guided Caliphs as an administrative and grievance-remedial scheme for business and religious-related issues, it is believed that it had its first contact with Europe after the conquest of Spain in 711 C.E. Subsequently, *hisbah* was recognized as an institution for compliant-handling and conflict management in Spain. Even though there may not be specific reference to the institution of *hisbah* in some historical references on Islam in Spain, it formed part of the administrative-cum-regulatory organ of the Muslim community (Khan, 1982). At the time of the conquest of Spain, the Umayyad Caliphate was at its zenith and this was the period where such Islamic institutions were consolidated (Watt & Cachia, 2007).

According to Rashid (2008), it is well-known that the institution of *hisbah* was in practice in Spain for over 700 years; so probably, Ombudsman was borrowed from the Islamic law, and the concept was refined to fit into the institutional framework of administrative dispute resolution in the West. However, in the western world, the history of ombudsman whose functions are not different from those of the classical *muhtasib* dates back to 1809 when it emerged in Sweden (Seneviratne, 1994; Seneviratne, 2002). This brief historical account is necessary to accentuate the importance and significance of this age-long but derelict institution in the lives of Muslims particularly in business transactions. A modern practice of *hisbah* can be seen in the *Wafaqi Mohtasib* (Ombudsman) system of Pakistan where there is a standard Order (No. 1 of 1983) by the Government of Pakistan on administrative dispute resolution (Malik, 2007). It is important to also observe that the banking industry in Pakistan has a statutory body for dispute management in the industry known as Banking Mohtasib.

According to Hamdani (2008), the institution of *hisbah* has been an important Islamic institution during the medieval period and its functions have crystallized after some time (Zaidan, 2006). The underlying philosophy of the office of *muhtasib* is enjoining people to do good and forbidding them from wrongdoing (Ibn al-Ukhuwah, 1976). The *muhtasib* had the powers to make binding decisions in some cases and this is the reason why Al-Mawardi rightly pointed out that *hisbah* is the intermediate point between the powers of a court and the special tribunals of wrongs (*mazālim*) (Al-Mawardi, 1983; Al-Mawardi, 1996). According to Kamali (1998), *muhtasib* "lies at the root of many Islamic laws and institutions". The tripartite role of a *muhtasib* comprises dispute avoidance, dispute resolution and enforcement of due process within the Islamic financial institution. However, the functions of the classical *muhtasib* have been specifically identified by Al-Mawardi (1983):

1. Investigation of manifest immoral actions in order to have them reprehended and to look for any good conduct that has been abandoned in order to re-establish same.
2. Hearing appeals about reprehensible conducts by listening to complainants or informants;
3. Questioning of individuals found in questionable or suspicious situations in the society;
4. Employ and use his deputies to help in the corrective and investigative measures to be more effective in discharging the responsibility with which he is saddled.
5. Empowered to penalize a minor violation which is evident but such must not reach the level of legal punishment.
6. Freedom to exercise his independent judgment in conventional matters which are customary to a particular profession.

In spite of these functions identified by the early jurists, it is obvious that the powers vested in the *muhtasib* are wider than those being enjoyed by the western Ombudsman since the powers of the former covers both mundane and spiritual matters (Rashid, 2004). This is a good meeting point between the relevance of the office of the *muhtasib* in both corporate governance and Shari'ah governance of the IFIs which makes the two concepts inextricable.

Realizing the significance of the institution of *hisbah*, this research seeks to propose a new model for dispute management as part of corporate governance in IFIs which is based on the institutionalization of the Islamic ombudsman. Even though the classical *muhtasib* was more of market supervision, the principle of *siyāsah al-shar'īyyah* allowed for gradual transformation of these classical functions (Al-Awa, 1975). Therefore, if rudimentary practices of profits and loss sharing through *mushārakah*, *mudārabah*, *ijārah* and other modes of financing that were in vogue during the time of the Prophet and the succeeding generations could be transformed to highly sophisticated Islamic financial products in the modern world, it is equally

possible to incorporate the institution of *muhtasib* into the corporate governance system to ensure corporate justice. As earlier emphasized, this will serve as an internal mechanism to promote due process, administrative efficiency, corporate excellence and effective dispute management through dispute avoidance and resolution (Garas & Pierce, 2010). Periodical fact-finding reports on the level of compliance of different departments in the IFI should be prepared and submitted to the Management Board or Board of Directors by the office of the *muhtasib* to ensure quality and organizational excellence. This will complement the functions of the Shari'ah Board in a great deal.

***Proposed Framework: Corporate Justice in Islamic Financial Institutions:***

Several scholars have repeatedly emphasized the tremendous growth experienced in the Islamic finance industry in the modern world and the exponential growth of Islamic financial products in the global economy (El Diwany, 2010). The products have continued to grow in size and significance in spite of some initial challenges it faced (Siddiqui, 2010). With up to \$750 billion Shari'ah-compliant assets and over 600 IFIs in over 75 countries across the world, corporate justice is an inevitable phenomenon which must be associated with sustainable growth (Khan & Shariff, 2009). One major thing every IFIs aims to achieve is certainty in its transactions, profits and dividends (Ayub, 2007; Hassan, 1999). Lawsuits in corporate claims bring nothing but risk to the business and no prospective investor will want his or her money to go down the drain through protracted legal battles with bogus claims against the company.

It is pertinent to note that the Qur'anic concept of corporate justice promotes the shareholder value-system, stakeholder value-system, and ultimately the underlying philosophy of corporate excellence which is in form of mutualistic symbiotic relationship which brings about benefits to all (Beekun, 1996).

It is the duty of a *muhtasib* to ensure prudent practices within the governance structure of an IFI, and he must ensure that due process and relevant standards of practice are followed to the letter. Hence, the office of *muhtasib* must ensure strict complaint with the rules, regulations, standards and the local laws in all financial transactions and policies of the company. There are instances where the *muhtasib* will have to resolve some disputes involving banker-customer relationship instantaneously especially when the customer comes forward with justifiable claims. Thus, the *muhtasib* can act as a mediator and sometimes conciliator. But whatever be the case, he must follow the laid down rules and regulations in accordance with the mandatory prescriptions of the Shari'ah: "Verily, Allah commands you to make over the trusts to those entitled to them; and that when you judge between them, you judge with justice" (Qur'an 4:58).

***4.1. Proposed functions of the Corporate Muhtasib of IFI:***

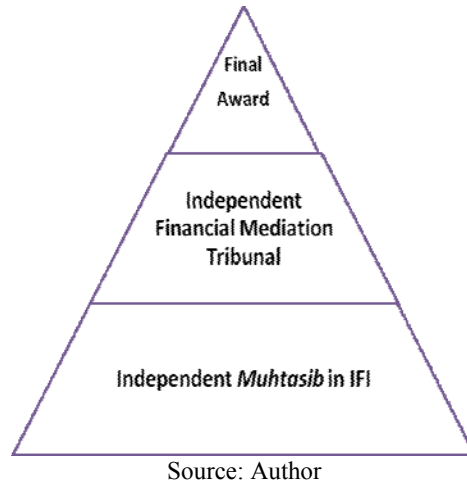
The need for reforms in the IFIs is steering at everybody's face in the ever-increasing phenomenal sophistication of modern businesses. In effect, the proposed framework for corporate justice through effective management of disputes and claims is based on the concept of *hisbah*. The independent organ established within the managerial cadre of the IFI should be saddled with the following responsibilities:

1. Investigation of compliance with laid down rules, regulations and industry standards;
2. Review of claims against the IFI by third parties, particularly customers and such mandatory preliminary practice should be incorporated into all contractual transactions of the IFI. No lawsuit should be filed by a customer over any claim without having the case reviewed by the corporate *muhtasib*.
3. Mediation of cases and claims against the company and rendering decisions. Any decision made by the *muhtasib* with regards to a claim or dispute against the IFI is binding on it but if such decision is against the customer, the decision is appealable to an Independent Financial Mediation Tribunal to be set up by a Memorandum of Understanding among IFIs in a country and duly coordinated by the Central Bank. There is a similar arrangement in Malaysia where Banks and Insurance companies, including Islamic banks and Takaful, came together under an arrangement and agreed to set up the Financial Mediation Bureau. This body provides free, efficient, fast, convenient and cost-effective services for parties having complaints, disputes or claims against their financial institutions (Segara, 2009).
4. Hearing and determination of any claim or complaints by shareholders against the management of the IFI or by the minority shareholders against the majority shareholders in the event of some undue preferences.
5. Drafting of code of conduct for all staff of the IFI subject to the ratification of the Board of Directors.

What the foregoing responsibilities entail in a corporate setting is nothing but corporate justice embellished with elements of dispute resolution, dispute avoidance and enforcement of due process within the IFIs.

***4.2. Stages of Corporate Justice Framework for Dispute Management:***

Figure 1 below shows the stages through which corporate claims, disputes and complaints should pass for effective dispute management to reduce the risk of litigation



**Fig. 1:** Stages of Corporate Justice Framework for Dispute Management.

It is now clear that the office of a *muhtasib* is critical to corporate governance, and specifically, corporate justice and risk mitigation in IFIs. The corporate governance framework for dispute management is *muhtasib* but specific guidelines must be formulated by experts to establish a competitive modern ombudsman mechanism for the effective management of corporate disputes. This will invariably promote CSR and investors will be ready, with assurance, to invest in such financial institution which manages its risks effectively through appropriate mechanisms of corporate justice built into the general system of corporate governance.

An aggrieved party who has some complaints or claims against the IFI may go through the following stages to resolve the dispute amicably and responsibly:

- 1<sup>st</sup> Stage:** Once a dispute arises either between a customer and the financial institution or between shareholders and the management, the first step a complainant should take is to contact the *muhtasib* office of the IFI and lodge the complaint. The *muhtasib* will review the case and attempt to resolve the dispute amicably based on the laid down rules, regulations and industry standards. The decision of a *muhtasib* is enforceable against the IFI but not binding on the complainant. It is expected that most cases will not go beyond this stage if the internal dispute resolution process of the IFI is well managed.
- 2<sup>nd</sup> Stage:** If the complainant is not satisfied with the decision of the *muhtasib* attached to the IFI, he or she can file an appeal at a separate Independent Financial Mediation Tribunal where experts will hear and determine the case accordingly. The Independent Financial Mediation Tribunal will review the case and work with both the IFI and the complainant to resolve the dispute through *sulh* (mediation or conciliation).
- 3<sup>rd</sup> Stage:** In the event of a deadlock between the parties, the complainant and not the IFI, can proceed to a competent court to enforce his or her right. However, another adjudicatory option which is less formal is *tahkim* (arbitration) which the parties can explore for a binding decision. The AAOIFI Standard on Arbitration should be the guiding principles for the arbitration process. This may be a better option than proceeding to the court because, unlike what is obtainable in the courts, the arbitrators are required to be learned in the dynamics of Islamic banking and finance in the modern economic parlance.

#### **Findings and Conclusion:**

The paper finds a high degree of inadequacy of the in-house mechanism for dispute management in most IFIs. A framework based on the *muhtasib* model is required to rescue the industry from litigious marauders who sometimes apply principles of common law of contract in Islamic finance cases. In addition, in instances where the Shari'ah Board is being suspected of playing to the gallery in the ratification of new Islamic finance products, the *muhtasib* as a neutral, and independent organ, can commence a confidential investigation into such allegation and recommend appropriate steps to the Board of Directors or General Meeting of shareholders. To this end, there is a huge model from the classical practice of *muhtasib* to be maximally exploited to further streamline corporate governance through adequate dispute management in IFIs. This will definitely promote sustainable responsible business culture which is informed by some forms of corporate self-regulation integrated into the business of IFI. Beyond any iota of doubt, this will promote the CSR of the IFIs in the modern competitive business environment and will enhance sustainable excellence. Furthermore, the paper also finds

some degree of dispute avoidance procedures in the corporate governance standards of AAOIFI, IFSB and Bank Negara Malaysia Guidelines respectively.

From the foregoing conceptual analysis coupled with the proposed framework for dispute management which covers both dispute resolution and dispute avoidance, it is crystal-clear that the crystallization of the Islamic finance products at the end of the first decade of the 21<sup>st</sup> century calls for certain reforms in the industry as proposed in this paper.

This paper only establishes a theoretical framework for the effective management of disputes in the Islamic finance industry which, as proposed, should be part of good corporate governance. This justifies why an empirical method has not been used to analyze the kernel of the paper. However, with regard to implications for future research, an empirical research may be conducted to review how selected world-class IFIs manage their disputes. In addition, specific guidelines for the duties of an independent *muhtasib* in IFIs should be formulated and adopted at the level of AAOIFI and IFSB as internationally recognized standards. This can definitely form the crux of further research to propose a workable model for the standard-setting bodies.

Be that as it may, this paper extensively contributes to the literature gap about effective dispute management in the Islamic finance industry through in-house mechanisms. Such framework is important at the early stages of disputes to avoid its eventual escalation into full-blown disputes that may pass through stringent hurdles of court litigation. For effective and high standards of corporate governance in Islamic banks, there is a need to inculcate dispute management mechanism into the process. It is therefore concluded that “the level of good governance actually required by Shariah principles transcends the levels usually required under conventional financial systems. This is because Islamic financial principles categorize an IFI as a trustee of its investors. As such, the IFI must be transparent, act fairly and be held accountable to the investors” (Khan & Shariff, 2009). The issues discussed in this paper are by no means exhaustive but merely serves as a spring board for further research in this important aspect of management of IFIs.

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