

A Comparative Assessment of Alternative Dispute Resolution for Financial Consumer Protection in Malaysia and Indonesia

Ibtisam @ Ilyana Ilias^{1*}, Muhamad Ikhwan Mohd Zain², Nur Ezan Rahmat¹, Dinda Keumala³

*Corresponding Author

¹ Faculty of Law, UiTM Shah Alam, Selangor, Malaysia

² Department of Law, UiTM Perak Branch, Tapah Campus, Malaysia

³ Faculty of Law, Universitas Trisakti, Jakarta, Indonesia

ilyanailias@uitm.edu.my, mikhwanzain@uitm.edu.my, nurezan@uitm.edu.my, dinda.k@trisakti.ac.id
Tel: 012-3357781

Abstract

The Ombudsman for Financial Services (OFS) handles financial services complaints in Malaysia. Meanwhile, the Alternative Institution for Dispute Resolution in the Financial Services Sector (LAPS SJK) handles financial disputes and safeguards customers from financial fraud in Indonesia. This study aims to analyse and compare the legal framework in both institutions for protecting financial consumers, considering their similarities and differences in regulatory approaches, consumer rights, and enforcement mechanisms. The findings of this study can provide insights for policymakers and regulators in both countries to enhance their efforts to safeguard the interests of financial consumers.

Keywords: Financial Dispute; Legal Framework; Alternative Dispute Resolution; Comparative Analysis

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1.0 Introduction

Establishing financial dispute resolution institutions is vital to strengthening financial consumer protection in many countries, including Malaysia and Indonesia. Malami and Yusoff (2017) postulate that responding to consumer complaints is one of the essential parts of the consumer protection agenda. It can be materialised through financial dispute resolution institutions that uphold transparency, accountability, and consumer trust, which fix their problems, protect them, encourage fair competition, and improve the market. In parallel, the Ombudsman for Financial Services (OFS) in Malaysia was established to handle financial disputes (Mohd Zain et al., 2022), and the Alternative Institution for Dispute Resolution in the Financial Services Sector (LAPS SJK) in Indonesia was established to deal with financial disputes and safeguard their customers (Nurhayati et al., 2022). Both play a crucial role in implementing their respective countries' financial services regulations and rules, ensuring consumers have a reliable platform to voice their concerns and seek redress.

It is crucial to have a proper institution to efficiently manage and resolve these disputes to avoid financial losses and maintain healthy business relationships. Financial disputes, or financial conflicts, are unavoidable since transactions occur constantly and every second. These disputes can arise due to various reasons, such as miscommunication, errors, fraud, or differences of opinion. Besides having the court system as the traditional platform, Alternative Dispute Resolution (ADR) institutions can also provide a platform for consumers to seek redress for their grievances against financial service providers, thereby promoting transparency and accountability in the financial sector. Concerning the functioning of ADR systems, the financial ombudsman is recognised as the most common financial ADR in Western Europe to increase consumer confidence in the financial system (The World Bank Group, 2017). Figure 1 illustrates the prevailing method of resolving financial disputes, wherein the financial consumer engages in either court litigation or pursues an out-of-court settlement (Agus et al., 2022).

Thus, in operating a comprehensive ADR institution, this study aims to explore the strengths and weaknesses of existing institutions and makes recommendations for improvement, considering their regulatory approaches, consumer rights, and enforcement mechanisms. This study discusses various prevalent forms of research, namely observational studies, which include the observation

and analysis of pre-existing data without any intervention, and meta-analyses, which amalgamate findings from multiple studies to derive comprehensive conclusions. Various study types offer researchers diverse methodologies to explore research inquiries and contribute to the collective knowledge within the field of study. This study hopes to improve financial dispute resolution institutions in Malaysia and Indonesia.

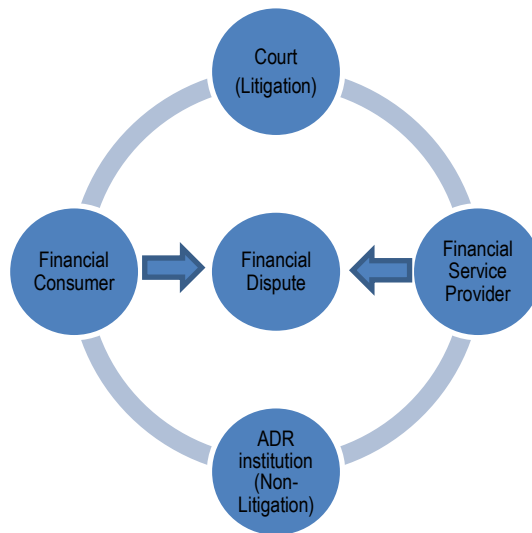


Figure 1: Available platforms for financial consumers
(Sources: Agus et al., 2022)

1.1 Problem Statement

The study concentrates on implementing the institutions in Malaysia, specifically the OFS, and Indonesia, specifically the LAPS SJK, and compares the efficacy of these two institutions in promoting financial stability and inclusion in their respective countries. However, several loopholes have been identified that may hamper its effectiveness and accessibility to a broader range of financial consumers. There is a need for improvements in both institutions to align with international ADR principles. It suggests that policymakers should prioritise making OFS more accessible, efficient, and transparent to ensure fair and effective dispute resolution.

Firstly, in Malaysia, the monetary jurisdiction is relatively limited, which may not align with the current market value. According to the Third Schedule in Regulation 18 of the FOS Regulations 2015, OFS only takes cases involving financial disputes that are not more than RM250,000 (Financial Services (Financial Ombudsman Scheme) Regulations 2015, 2015). Despite subsection 4 of Regulation 18 allowing the claim to exceed the monetary limit if there is agreement from the OFS, the eligible complainant, and the member involved, it is still restricted to the consent of all parties, including the OFS. Those limitations could lead to many unresolved disputes faced by consumers. Meanwhile, the jurisdiction in Indonesia has a challenge in handling the dualism between LAPS SJK and the other institutions known as the consumer dispute resolution body (BPSK), as it creates legal uncertainty among financial consumers. This fragmented system can make it complex and confusing for consumers to seek redress for financial issues.

Furthermore, the institution's location also contributes to the lack of accessibility for the financial consumer. According to Regulation 5(2)(b), OFS should provide accessible and affordable access to its services. However, since the introduction of the OFS in 2016, there has been only one office in the city centre of Kuala Lumpur. It poses difficulty for people outside Kuala Lumpur to access the ombudsman's services. Similarly, in Indonesia, LAPS SJK is only headquartered in Jakarta, limiting the number of walk-in consumers using its services (Agus et al., 2022; Nurhayati et al., 2022).

Concerning efficiency, limited human resources are needed to operate the OFS, which currently consists of only two ombudsman officers, fifteen case managers, and seven support staff to deal with thousands of cases. Additionally, there is no standard of certification or qualification in the 2015 FOS Regulations to determine the fit and proper criteria for appointing an ombudsman officer. The lack of standardisation may lead to inconsistencies in the quality of services provided by different officers. In comparison, while Indonesia has many officers in the institution, there must be a proportionate ratio to deal with the thousands of reported disputes.

Lastly, the OFS does not provide fully accessible decisions on successfully resolved cases. Regulation 5(2)(d) only allowed for the decision to be informed in writing, unlike the court, which provides open access to the entire case through the Current Law Journal (CLJ) website. This lack of transparency in the OFS decision-making process can lead to questions about accountability and fairness. It also limits the ability of interested parties to learn from previous cases and understand how decisions are made. In Indonesia, more transparency and accountability in decision-making are also required to protect consumers' rights. The government should strengthen regulations and enforcement mechanisms to address these issues.

In brief, both countries have similar principles that must be observed to enhance financial consumer protection. This issue raises concerns about transparency and accountability in the institution's decision-making process, which may undermine the trust of financial consumers in the alternative dispute resolution system.

1.2 Research Questions

- a) What are the current alternative dispute resolution system's drawbacks for resolving financial disputes in Malaysia and Indonesia?
- b) How to propose solutions to overcome the shortcomings of the current financial alternative dispute resolution institution?
- c) What are the preferred approaches to enhancing the effectiveness of the financial ombudsman in resolving consumer disputes?

1.3 Research Objectives

- a) To identify the current alternative dispute resolution system's drawbacks for resolving financial disputes in Malaysia and Indonesia.
- b) To determine the solutions to overcome the shortcomings of the current financial alternative dispute resolution systems.
- c) To establish the preferred approaches to enhance the effectiveness of the financial ombudsman in resolving consumer disputes.

2.0 Literature Review

2.1 Definition of Financial Consumers and Financial Disputes

In recent times, there has been a growing emphasis on financial consumer protection among legislators (Gaganis et al., 2020). The change in emphasis can be attributed to the growing intricacy of financial products and services, along with the escalation of customer grievances and occurrences of wrongdoing within the sector. Consequently, authorities have acknowledged the necessity of implementing stringent laws and measures to protect the interests and rights of financial consumers. In understanding the term financial consumers, it has been laid down under section 121 of the Financial Service Act 2013 as anyone who uses, has used, or intends to use a financial service or product for personal, domestic, or household purposes in connection with a small business (Financial Services Act 2013, 2013). Based on the findings of the OECD (2021), individuals, households, and small enterprises, collectively referred to as consumers, are more inclined to cultivate resilience in environments characterised by their trust in the financial services sector, the provision of unambiguous information regarding their financial products and associated matters, their perception of fair and transparent treatment, and the availability of financial services that align with their physical and financial requirements. Financial consumers have rights and protections under this classification, including access to complaint mechanisms and compensation for financial service or product harm. The studies of financial consumers can also be analysed through the lens of the digital era, as explored by Dinh et al. (2023), which is shaped by the swift advancements in technology. In this context, individuals must ensure a secure transaction procedure when utilising online platforms for financial services. This holds significant importance, considering the rising incidence of cyber threats and instances of identity theft. Hence, financial customers must possess the necessary knowledge and resources to safeguard their personal and financial data during online transactions.

Incorporating the ombudsman into the system has shown to be highly beneficial in settling financial disputes (Mohd Zain et al., 2022). Their objectivity and competence have earned the trust of customers and financial institutions alike, assuring fair and just outcomes for all parties concerned. This is why the OECD (2021) report emphasised the importance of financial regulators and authorities throughout Asia in protecting and educating consumers. The financial consumer frequently lacks knowledge and awareness of the financial transaction, leading to many disputes with the financial service providers (FSP). A financial dispute commonly involves fraud cases on credit cards, online banking, automated teller machines, investment advice, and illegal fundraising, all of which occur regularly and cause financial consumers to incur losses and damages (Shen et al., 2016). Nurhayati et al. (2022) posit that financial disputes commonly encompass instances wherein individuals encounter conflicts on monetary obligations, contractual violations, or divergent interpretations of financial information. The resolution of financial conflicts frequently necessitates meticulous analysis and negotiation to identify a mutually agreeable solution that effectively addresses the underlying concerns of all involved parties.

In addition, disputes might emerge in certain instances because of divergent interpretations of insurance terms and conditions and arguments on the scope of coverage offered. Moreover, prolonging the process to collect essential documentation or conduct investigations might intensify the tensions among the parties concerned (Bowley, 2022). Regardless of the nature of the arguments, it is essential to acknowledge that such conflicts can substantially influence the financial well-being of consumers, leading to heightened levels of stress and financial adversity. Hence, pursuing a settlement via legal channels or alternative dispute resolution mechanisms can effectively reinstate customer trust and foster an equitable and open economic milieu.

2.2 Overview of the Legal Framework in Malaysia and Indonesia

Malaysia and Indonesia have different legal frameworks and regulatory bodies. Both countries have a constitution that serves as the supreme law of the land and a judiciary system that is independent of the executive and legislative branches.

In Malaysia, the legal framework is based on common law and Islamic law. Common law is derived from the British legal system and is applied to civil and criminal cases. On the other hand, Islamic law is applied to matters related to family law and inheritance. Both laws will provide a legal framework for resolving disputes in Malaysian courts, the traditional medium for dealing with cases. The court system is the primary venue for any action the parties take. It ensures that decisions are made following the rule of law by providing a formal and structured process for resolving disputes. It is also possible to present and examine evidence in an open public forum during court proceedings. With the passing of the Arbitration Act in 2005, ADR in Malaysia has a solid legal basis (Abraham, 2000). Due to this law, arbitration has become increasingly popular in Malaysia to resolve legal disputes, especially in business and international law. Later, the government passed the Mediation Act of 2012 and the Construction Industry Payment and Adjudication Act of 2012, respectively, to govern mediation and adjudication. These acts were enacted to provide a more efficient and cost-effective method of

resolving disputes, and they have decreased the number of disputes that end up in court. Since then, the country has seen a significant increase in alternative dispute resolution methods, resulting in faster and more cost-effective dispute resolution.

In Indonesia, civil law predominates. Civil law is a formal or codified legal system based on written laws and codes instead of judicial decisions and precedents. Due to the corrupted and manipulated system by the ruler, the people did not believe in the rule of law despite the system's longstanding existence (Gillespie, 2007). According to Suran Ningsih (2019), the formal judicial system is not truly accepted by Indonesians. Due to lacking confidence in the formal judicial system, many Indonesians have turned to ADR methods such as mediation and arbitration. These methods are believed to be more efficient and effective at resolving disputes. Later, the Indonesian Arbitration and Alternative Dispute Resolution Act (Law No. 30 of 1999) formally identified arbitration as the country's groundbreaking ADR mechanism (Republic of Indonesia, 1999). The law provides a comprehensive legal framework for arbitration, making it a reliable and effective method for resolving disputes in Indonesia. Since then, the ADR mechanism has also been applied to many other kinds of disputes, including consumer disputes. The table below provides a summary of the legal systems of Malaysia and Indonesia.

Table 1: An overview of the legal framework in Malaysia and Indonesia

Element	Malaysia	Indonesia
Legal system	Common Law (British colonisation)	Civil Law (Dutch colonisation)
Highest court of law	Federal Court (1994)	Supreme Court (1945)
The highest law of the land	Federal Constitution	1945 Constitution
Implementation of the ADR mechanism	Since 2005	Since 1999

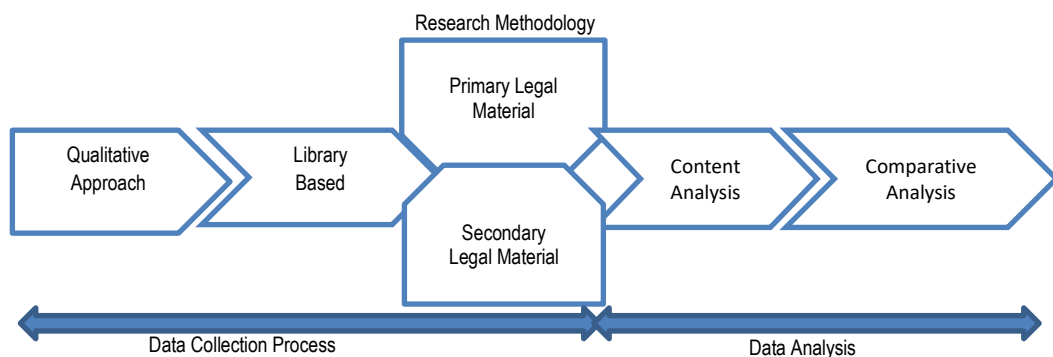
(Source: Abraham (2000), Gillespie (2007), Suran Ningsih (2019))

3.0 Research Methodology

This study employs a qualitative approach to gather data for a literature review on financial dispute resolution in Indonesia and Malaysia. Qualitative processes include a variety of methods, such as purposeful sampling, the collection of open-ended data, the analysis of written or visual materials, the presentation of information in figures and tables, and the subjective interpretation of the results (John W, 2009). These methodologies emphasise comprehending the contextual framework and semantic significance of the data rather than exclusively concentrating on quantitative measurements. Furthermore, qualitative methodologies frequently employ iterative data gathering and analysis procedures, facilitating the discovery of emergent themes and insights. The primary legal materials are reviewed, including all statutes and regulations relevant to the financial disputes in both countries. Secondary legal materials are also reviewed, including textbooks about the judicial system and the concept of alternative dispute resolution.

In data analysis, qualitative content analysis is one of many research approaches used to evaluate text data. Hsieh and Shannon (2005) define qualitative content analysis as "systematically categorising and interpreting textual data to identify patterns, themes, and meanings." Using this method, researchers can acquire in-depth insights into the subjective experiences and views of individuals or groups represented in text data. The content analysis of the primary and secondary legal materials provides a solid basis for developing a framework that can be used to resolve financial disputes between the two countries. As discussed in the previous paper of Ali and Lee (2011), comparative legal research methodology draws lessons from both jurisdictions on managing financial disputes effectively. The findings can be used to develop best practices and inform policy decisions.

Figure 2: Flow Chart of Research Methodology



(Source: Ali & Lee, 2011; Hsieh & Shannon, 2005; John W, 2009)

4.0 Findings and Discussion

It cannot be denied that financial disputes occur regularly. Therefore, authorised institutions should implement a proper regulatory framework that protects financial consumers comprehensively. The principal-agent theory is one theory that can be used to build a regulatory framework. According to this notion, financial institutions should behave as agents for their consumers, making decisions in their best interests (Min et al., 2022). Using this idea, authorised institutions can ensure their actions are responsible and transparent, protecting financial consumers from potential misconduct or fraud. Furthermore, introducing behavioural economics features into the

regulatory framework can help address biases and irrational behaviour that may lead to financial conflicts.

4.1 Financial Consumer Protection Regulations in Malaysia

Among all the types of ADR mechanisms in this world, as far as the study is concerned, the ombudsman concept is highlighted as an alternative way to deal with financial disputes in Malaysia. The financial ombudsman is an independent body that helps resolve disputes between consumers and financial institutions. They are impartial and independent and provide a convenient and cost-effective method of resolving disputes between consumers and financial service providers. Their decisions bind the FSP but not the consumers.

Historically, the Insurance Mediation Bureau, founded in 1992, had limited jurisdiction over personal insurance policies up to RM50,000. Later, Malaysia established the Financial Mediation Bureau, which began operations on January 20, 2005 (Chew, 2013). In order to increase public access, the jurisdictional level was raised from RM25,000.00 to RM100,000.00 for banking disputes and from RM100,000.00 to RM200,000.00 for motor and fire insurance disputes. In 2016, the government started implementing the Financial Ombudsman Scheme (FOS), which is expected to revolutionise dispute resolution between financial service providers (FSPs) and their clients, including Islamic FSPs. The Governor of the Central Bank of Malaysia appointed the Ombudsman for Financial Service (OFS) as the FOS scheme operator and the first financial ombudsman service in Malaysia (Ilias et al., 2017).

While the laws aim to ensure fair treatment of consumers, transparency in financial products and services, and effective resolution of disputes, in Malaysia, OFS serves as a proper and equitable treatment for complaints and dispute resolution with FSP regarding financial services or goods (Raja Abdul Aziz & Abdul Hamid, 2017). OFS is a vital consumer protection mechanism that contributes to the integrity of Malaysia's financial system and is a cost-effective solution for both the consumer and the financial service provider. Furthermore, implementing OFS can help boost consumer trust in financial services and promote Malaysia's more transparent and accountable financial sector. FSA 2013 and IFSA 2013 have strengthened business conduct and consumer protection requirements, increasing consumer confidence in financial services and products (Mohd Zain et al., 2022). However, some drawbacks need to be addressed, as discussed in the problem statement. Some of the drawbacks of ombudsman services in Malaysia include limited jurisdiction, a lack of enforcement power, and inadequate resources. These issues can hinder the effectiveness of ombudsman services in resolving disputes.

4.2 Financial Consumer Protection Regulations in Indonesia

Several government organisations, including the Financial Services Authority (OJK) and the Central Bank of Indonesia (BI), oversee the legal framework in Indonesia for financial consumer protection. These institutions are responsible for enforcing regulations that aim to protect consumers from fraudulent practises and ensure fair treatment in financial transactions. Recently, the OJK bolstered consumer and community protection efforts in the financial services industry by issuing Financial Services Authority Regulation (POJK) Number 6/POJK.07/2022, which outlines procedures for resolving disputes between financial institutions and their customers (Atmoko & Liman, 2022). It is acknowledged that Indonesians have utilised financial technologies, or Fintech, to support economic development following global trends and demand, but disputes continue to arise. Therefore, Abubakar and Handayani (2021) and Nurhayati et al. (2022) concur that LAPS SJK may resolve disputes among the parties involved.

While Indonesia has long relied on mediation as its primary alternative dispute resolution mechanism through the LAPS SJK institution, the regulator needs to consider the ombudsman system, like Malaysia and other nations, as an independent and impartial mechanism that ensures financial consumers receive a fair hearing and a resolution to their problem. These services may contribute to the growth of consumer confidence and trust in the financial industry by providing a straightforward and user-friendly method for resolving issues. According to Agus et al. (2022), consumer empowerment should also include teaching customers about their rights and obligations, as well as providing them with accessible means through which to voice their concerns and seek redress. This comprehensive strategy guarantees that customers are protected and equipped with the knowledge and resources necessary to make educated market decisions.

4.3 Comparative Analysis of the Strengths and Weaknesses

Malaysia and Indonesia have invested heavily in financial dispute resolution institutions. These institutions aim to improve trust in consumer and business dispute resolution and financial systems. This section compares the benefits and drawbacks of each approach.

In brief, this study compares both countries' approaches to protecting financial consumers, considering their similarities and differences in regulatory approaches, consumer rights, and enforcement mechanisms. The findings of this study can provide insights for policymakers and regulators in both countries to establish a clear regulatory framework, increase accessibility and transparency, and decrease administrative expenses. There are opportunities for both nations to learn from each other's experiences. By sharing their experiences, both nations can identify strategies and best practises that have been successful in the other nation's market. It may result in more efficient institutions and regulations, benefiting consumers and businesses in both countries. In addition, this study implies that cross-country knowledge sharing can lead to mutual benefits regarding regulatory effectiveness and efficiency. This can foster a more conducive environment for economic growth and innovation in both nations.

Table 2: The financial dispute resolution institutions in Malaysia and Indonesia

Element	Malaysia	Indonesia
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Current institutions concerning financial disputes	ADR	1. Ombudsman for Financial Services (OFS)	I. The Alternative Institution for Dispute Resolution in the Financial Services Sector (LAPS SJK)
		2. Securities Industry Dispute Resolution Centre (SIDREC)	II. Consumer Dispute Resolution Institution (BPSK)
		3. Tribunal for Consumer Claims (TCC)	III. The National Consumer Protection Agency (BPKN)
Regulatory body		1. Central Bank of Malaysia (CBM)	I. Financial Services Authority (OJK)
		2. Security Commission (SC)	II. Central Bank of Indonesia (BI)
Legislation		1. Financial Services Act 2013	I. Law Number 4 of 2023 (Development and Strengthening Financial Sector (PS2K Law))
		2. Islamic Financial Services Act 2013	II. Law Number 21 of 2011 (the Financial Services Authority)
		3. Financial Services (Financial Ombudsman Scheme) Regulations 2015	III. Law Number 8 of 1999 (Consumer Protection Act)
		4. Islamic Financial Services (Financial Ombudsman Scheme) Regulations 2015	IV. Law Number 30 of 1999 (Arbitration and Alternative Dispute Settlement)
		5. Capital Markets and Services Act 2007	V. Financial Services Authority Regulation (POJK) Number 6/POJK.07/2022 (Consumer and Public Protection in the Financial Service Sector)
		6. Capital Market and Services (Dispute Resolution) Regulations 2010.	VI. Financial Services Authority Regulation (POJK) Number 61/POJK.07/2020 (Alternative Institutional for Dispute Resolution in Financial Service Sector)
		7. Consumer Protection Act 1999	
Strengths		1. An independent body to resolve financial disputes.	I. Protect consumers from fraudulent practises.
		2. The decision is only binding on the financial service provider.	II. Ensure fair treatment.
		3. Convenient and cost-effective method	III. Reliable platform to voice disputes
Weaknesses		1. Limited and small monetary jurisdiction	I. Not adopting the ombudsman system
		2. Lack of accessibility	II. Dualism and legal uncertainty
		3. Inadequate human resources	III. Lack of resources and expertise
		4. Lack of transparency	IV. Lack of accessibility

(Source: Abubakar & Handayani, 2021; Atmoko & Liman, 2022; Mohd Zain et al., 2022; Nurhayati et al., 2022; OJK, 2020; Raja Abdul Aziz & Abdul Hamid, 2017)

5.0 Conclusion and Recommendations for Improvement

The comparative analysis of the Malaysian and Indonesian legal systems for resolving financial disputes may improve financial consumer protection in both nations. This study contributes by identifying the strengths and weaknesses of each legal system, enabling policymakers to implement necessary reforms. In addition, it can facilitate collaboration between Malaysia and Indonesia through the exchange of best practices and the development of common regulatory frameworks to promote a more robust financial sector in both countries. It is recommended that the government take various steps to make the financial institutions associated with ADR methods more user-friendly while enhancing consumer protection. For Malaysia, there is much room for improvement in operating OFS institutions, such as increasing the monetary jurisdiction to RM500,000.00, establishing more offices in other states to ensure easy access to its services for all Malaysians, increasing its human resources, and providing entire report cases accessible online. In improving financial dispute resolution in Indonesia, it is time to adopt a similar ombudsman system as in other nations and regularly monitor and evaluate it to ensure its efficacy and identify areas for improvement.

Future research should reassess the limits of this study. This study exclusively examines qualitative data, potentially constraining its ability to offer a complete comprehension of the subject matter. Hence, it is recommended that future studies consider the inclusion of quantitative data and the enlargement of the sample size to augment the validity and reliability of the findings. Additionally, this study relies predominantly on existing research rather than empirical investigations. The authors did not address additional disputes in the realm of Islamic finance. Hence, future scholars must delve into additional Islamic finance issues, as this would provide a more exhaustive examination of the industry's encountered obstacles and potential prospects.

In the end, it is crucial for regulatory bodies and financial institutions to carefully consider the implementation of all the recommendations for achieving more comprehensive changes to the institutional framework for dispute resolution in both nations.

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Paper Contribution to Related Fields of Study

This study enhances the body of knowledge in alternative dispute resolution, financial consumer, financial disputes, and institutional framework.

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