

## **Muhammad Kamran Shehzad: Commercial mediation in emerging markets – role of State Bank in promoting mediation for resolution of banking disputes**

Speech by Mr Muhammad Kamran Shehzad, Deputy Governor of the State Bank of Pakistan, at the National Conference on Alternative Dispute Resolution (ADR), Lahore, 29–30 April 2010.

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I feel privileged to be here today and share some thoughts on ADR mechanism for the resolution of banking disputes in Pakistan. Let me admit at the outset that Pakistani banking sector is not yet fully geared to avail maximum benefit from mechanism like mediation for settlement of disputes. The main reason seems to be the lack of awareness and perceptions of losing legitimate legal rights especially in the matters of recovery of loans. However, due to world-wide popularity of ADR, these perceptions are changing and both banks and their customers are becoming aware of alternatives available for settling disputes without compromising their interests. Keeping in view the potential of ADR as a viable dispute resolution mechanism, there is always a natural preference for it over litigation. However, there is need to disseminate the pros and cons of ADR in a correct perspective so that parties realize the significance of ADR. I believe that collective efforts of all stakeholders and an integrated approach can familiarize ADR in banking circles and SBP as a regulator on its part is willing to support this initiative.

In the general sense, ADR means out of court settlement of disputes by way of mediation, conciliation, arbitration or expert determination. Arbitration is more relevant in the international context since overseas investors and parties generally require Arbitration clause in agreements. The mediation on the other hand is more relevant, cost effective and speedy way of resolving commercial disputes under which parties agree to ask a third person to help them find a solution to their dispute.

Due to phenomenal growth and expansion of international transactions worth trillion of US dollars across borders and territories, disputes also increased manifold between citizens and governments and citizens of one country with citizens of another country. The cases filed by the parties in courts for resolution of disputes and enforcement of contracts overburdened the legal machinery. The developed countries therefore, introduced the concept of settling disputes outside the court under the name of Alternate Dispute Resolution in 1970s.

The emerging economies and more specifically countries like Singapore, Malaysia, Hong Kong and Indonesia already have developed a certain kind of ADR system as per their local environment and legal systems. Indonesia has particularly established a solid system of ADR for banking system. The central bank – Bank Indonesia has issued detailed circular for banks to avail ADR for settling disputes and hence banking mediation has been institutionalized.

Malaysia has also established Financial Mediation Bureau as an independent body to help resolve disputes between financial institutions and their customers. Monetary Authority of Singapore has been promoting the ADR mechanism through educational supportive programs. The central bank of Morocco created a system of resolving bank and borrowers disputes.

It may be noted that the concept of settling disputes outside court is historically well known to Pakistani society in the form of *Punchayat* and *Jirga* etc. The experience of long consumption of time through formal judicial system is very common phenomenon.

The courts are over-burdened due to huge backlog of cases. It is in this perspective that Law and Justice Commission of Pakistan recommended ADR to provide relief to the parties engaged in litigation. Accordingly, the Government in 2002 had made amendments in Civil

Procedure Code under which Section 89 B was inserted to empower civil court to adopt ADR subject to consent of the parties. A consequential amendment was also made in Order X of C.P.C to empower the court to pass necessary orders for expediting the trial proceedings. Unfortunately, these provisions have somehow not been fully utilized due to which objective and benefit of these amendments is currently not visible.

It would be important to keep in view the fundamentals of banking sector in Pakistan while examining the relevance and significance of ADR in the prevailing circumstances. Besides walk-in customers, over 25 million people currently have regular accounts with banks in Pakistan. The deposits of the banking system stand at about rupees 4.8 trillion whereas loans and advances extended by banks as of December, 2009 were rupees 3.2 trillion. The amount of nonperforming loans at present is rupees 432 billion. The banks have filed 56320 recovery and execution cases in courts involving rupees 215 billion.

The cases filed by borrowers and customers other than recovery suits are in addition to the aforesaid cases.

The foregoing facts amply clarifies that there is overreliance on courts for all disputes which the parties cannot resolve themselves. Due to high stakes, parties are sensitive to protect their rights. Therefore, there is a dire need of putting in place a mechanism of dispute resolution which is speedy, cost effective and just to maintain confidence and continuity of banking transactions.

Let us look at some elements of existing mechanisms of dispute resolution where SBP is wholly or partially involved. The events like privatization of financial institutions, liberalization in the economy, stiff competition among the market players, advancements in information technology and telecommunication have brought about newer aspects of complexities along with growth of the banking sector. The increasing complexity in the products being offered by banks and substantial growth in consumer credit has caused a significant increase in the number of complaints with diverse nature of disputes. Although SBP continued to redress public grievances against banks, the increasing number of complaints require a reliable and independent source of complaint redressal. Therefore, institution of Banking Mohtasib Pakistan was established in 2005 under Part VI A of Banking Companies Ordinance, 1962. It may be clarified that jurisdiction of Banking Mohtasib is well defined and not restricted to maladministration of public sector banks only. The Banking Mohtasib is competent to entertain complaints from customers, borrowers, banks or from any concerned person. In the first instance, the Banking Mohtasib has been mandated, under the law, to try and facilitate an amicable resolution or settlement by resorting to mediation, failing which he can pass an order that if not appealed against within a defined timeframe becomes final and operative.

As per Report of Banking Mohtasib, it has disposed off 2879 complaints in 2009.

While it is a very modest beginning, State Bank is assisting Banking Mohtasib to increase its capacity and outreach to facilitate the aggrieved customers of the bank.

**SBP' Consumer Protection Department:** Besides direct complaints received from general public, State Bank is appellate authority against decisions of Banking Mohtasib under the same Part VI A of Banking Companies Ordinance. Till 2008, SBP was handling public complaints through Banking Policy and Regulations Department. However, in the wake of increasing number of complaints as also due to its enhanced responsibility as appellate authority against decisions of Banking Mohtasib, SBP created a specialized department namely, Consumer Protection Department to resolve banking disputes in a more focused and professional manner. The department was able to dispose of 8000 complaints during the year 2008 whereas during 2009 a total number of 13000 complaints were handled. The very objective is to provide a faster, cheaper and efficient way of redressing public grievances and resolving disputes. SBP feels that it has contributed toward reduction of court cases which in the absence of the mechanism were sure to go in courts.

In addition, various courts have been sending cases to SBP where matters involved technical scrutiny and analysis of facts. As per court orders, SBP successfully resolved a number of disputes involving banks and customers. It is pertinent to mention that SBP had issued directive under Circular No. 17 of 2004 in terms of which banks are required to put in place a complaint handling system. The objective is to promptly resolve the issues received directly by banks or referred by other quarters including SBP. However, the mechanism cannot be relied since bank being a party to the dispute would have natural inclination to prejudice the other party.

In a related development, High Court while disposing of several Writ Petitions relating to recovery of finance had emphasized the importance of ADR. The Hon'ble Court observed that litigation is not only time consuming but also has adverse implications for business environment. The Court further desired SBP to issue instructions to banks that before approaching courts, attempt should be made to resolve disputes through mediation/reconciliation.

Subsequent to Court Orders, Karachi Centre for Dispute Resolution (KCDR) met SBP and desired issuance of instructions to banks for availing remedies available through the Centre and support holding of seminar for banks. Accordingly, SBP circulated aforementioned Court Order to banks on March 09, 2009 with the view to let the banks know about availability of ADR mechanism and give an indication that both the Courts and SBP support the use of ADR. A seminar was also held for banks through Pakistan Banks Association in SBP in May, 2009.

The foregoing facts fully explain that SBP supports the idea of resolving disputes outside the court. The expeditious settlement of issues would be in the interest of banking system in particular and economy in general. The bank management would be able to devote their time to business and other prioritized areas instead of being bogged down in lengthy time consuming disputes with their customers. Likewise customers would also be able to settle their cases and move forward with their businesses. It is, therefore, a win-win proposition for all stakeholders.

Unfortunately as per feedback received from KCDR (Karachi Centre for Dispute Resolution), the number of cases referred by banks to it is extremely low on one hand and even the referred cases were haplessly non-productive due to non-traceability of parties or issues involving willful defaults. The customers of banks also prefer to lodge complaint against banks either with Banking Mohtasib or directly with SBP. The exact reasons of low number of fit cases not being referred to KCDR cannot be explained; prima facie it could be partially due to the following factors.

- First as I mentioned earlier is the lack of awareness about the available mechanism or institutions like KCDR for alternate dispute resolution. This can be taken care of with some workshops and seminars or conferences on ADR.
- Second, high profile cases involving big amounts are directly filed in courts to secure banks' interest in a more formalized way especially to avoid charges of negligence or collusion.
- Thirdly, the failure of mediation results again in continuation of legal proceedings. Since there has been a tendency in defaulters to stretch legal proceedings as much as they can, the banks may have an apprehension that ADR would also be used by such unscrupulous elements to further delay the course of justice.
- Where amounts are small, parties prefer to send a single page application to SBP without incurring any cost. SBP enjoys high degree of public trust and complainant believes that SBP takes action on merit. The customers of banks not only get final decision of the case but interim interaction is also maintained for further information or sometimes meeting in SBP. In this way, customers get relief without incurring any cost or going through any hassle.

- SBP has presence all over Pakistan. Although complaints are handled in Karachi, the field offices of SBP properly guide general public to process their applications.
- Neither Banking Mohtasib nor SBP charge anything for complaint redressals.

The fee charged by KCDR may in some cases be the reason especially in small disputes.

Going forward, there are certain expectations from SBP to promote ADR.

**Setting up an independent mediation centre:** SBP feels that currently institution of Banking Mohtasib and Consumer Protection Department are functioning satisfactorily. Further, SBP considers KCDR as a reliable center. The parallel system of mediation would not be appropriate due to defined role and responsibilities of SBP under the banking legislation. However, SBP would welcome cases referred by Courts or any other quarter involving banking disputes.

**Awareness events from SBP Platform:** SBP supports this and intends to hold meeting of Senior Executives of banks in SBP. KCDR would be invited to explain in detail the facilities and benefits of mediation. Besides, it would be clarified to banks that SBP not only has any reservations over utilization of mediation but supports it due to its advantages over litigation.

#### **Inclusion of mediation in curriculum of banking courses/training**

**Programs:** This is also agreeable. New entrants and existing staff are provided necessary training through NIBAF and inclusion of suitable material on the subject would be helpful in creating awareness and understanding of the mechanism. We would obviously welcome suggestions of KCDR in finalizing curriculum and imparting training.

**Issuance of policy directives to banks:** It would not be appropriate to prescribe a particular way of seeking remedies especially keeping in view the regulatory role of SBP. The directives issued by SBP are binding on banks and as a matter of policy we can facilitate, encourage but not force banks to avail facilities of KCDR. This is the decision which parties have to make themselves. Otherwise, directives issued by SBP run counter to the spirit of ADR/ mediation which is necessarily a mechanism based on mutual consent of the parties.

**Mediation under “terms and conditions” of various products:** We are of the view that Pakistan Banks Association is in a better position to evaluate whether banks should include it as a condition of the agreement or not. SBP is neutral in that it is for banks to decide which option they want to avail in case of disputes.

Taking advantage of this forum, my message today is same as observed by Hon’ble Court that prior to filing cases in courts, the option of mediation/reconciliation should be explored to avoid unnecessary costs, time and inconvenience. This would not only benefit the parties but facilitate release of valuable resources for the businesses which are critically dependent upon timely availability of funds. Further, the court system would be receiving lesser number of cases and hence its efficiency will increase. In my view, mediation has at least the following positive points as compared to formal court litigation:

- ADR enables settlement between the parties with their consent and cooperation. Therefore, unlike court case, none is loser but a win-win situation for the parties.
- The costs of ADR relative to court expenses are substantially low. Further, the cost of ADR is shared by the parties whereas under court decision loser has to pay costs if allowed by the Court.
- ADR provides solutions quickly, cost effectively and privately as against lengthy procedures of court proceedings, high expenses and no privacy.
- ADR not only economizes on case expenses but saves valuable time of human resource and management as well as stress related to Court cases.
- The parties set venue and timing for ADR proceedings whereas Court rules are to be strictly followed for court proceedings.

- vi) The parties use delaying tactics due to which court cases linger on for years. The next date of hearing comes after months. The parties under ADR cooperate and the matter can be resolved even before a week.

Finally, I thank IFC and KCDR for organizing the event which I believe will achieve its objective of disseminating ADR knowledge and creating awareness. SBP will continue to play its due role for early resolution of banking disputes.