

**CHAPTER II**  
**MUTUAL FUNDS, EXCHANGE TRADED FUNDS,**  
**AND FIDUCIARY DUTIES**

**A. Mutual Funds**

**1. Definition**

It is noted in history that the first mutual fund was introduced in Belgium in 1822, the closed-end mutual fund. Mutual funds are created for investors who want to participate in portfolio of high yielding government debt.<sup>19</sup> The UK and the Commonwealth State mention mutual funds with unit trust names. Australia and Malaysia also use unit trust to understand mutual funds.<sup>20</sup>

Trust means trust, or the value of trust expressed in an agreement or securities or rights participation.<sup>21</sup> Thus, the unit trust refers to participation rights, in which the unit trust is agreed to be invested in the portfolio to ensure mutual interest and mutual benefit.<sup>22</sup> In general, mutual funds are defined as a container used to raise funds from the investors who are then invested in securities portfolio by investment managers.<sup>23</sup>

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<sup>19</sup> Munir Fuady, *Pasar Modal Modern*, Bandung, Citra Aditya Bakti, 1996, p. 106.

<sup>20</sup> Gunawan Widjaja, *Reksa Dana dan Peran Serta Tanggung Jawab Manajer Investasi Dalam Pasar Modal*, Jakarta, Kencana Press, 2006, p. 8.

<sup>21</sup> *Ibid.*

<sup>22</sup> *Ibid.*

<sup>23</sup> Arys Ilyas, "Seluk –Beluk Reksa Dana", Bapepam, *Capital Market Society (CMS), Majalah Uang dan Efek*, Jakarta, 1997, p. 1.

In Indonesia, the phrase of mutual fund comes from the word "mutual" and "fund". Mutual meaningful guard or keep, while the Fund means as (set) money. Thus mutual funds can be interpreted as maintaining the fund set.<sup>24</sup>

In the above statement there are three important elements, namely:<sup>25</sup>

1. The existence of funds from the investors (investors);
2. The funds are invested in securities portfolios;
3. The fund is managed by an investment manager.

Based on the Act No. 8 Year 1995, mutual funds mean as a place to raise funds from the investors to be subsequently invested in the Securities Portfolio by the Investment Manager.<sup>26</sup> Thus, it can be concluded that in mutual funds there is a collection of funds are the common property of investors who are entrusted to the fund to the manager of investment to be managed or invested funds in mutual funds.<sup>27</sup>

Meanwhile, in the United States, mutual funds are meaningful as mutual funds or funds for the same purpose, thereby meaningful as a form of investment where investors jointly invest in a fund set, the fund is invested in portfolios such as stocks and bonds.<sup>28</sup>

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<sup>24</sup> Asril Sitompul, *Reksa Dana; Pengantar dan Pengenalan Umum*, Bandung, Citra Aditya bakti, 2000, hal. 2

<sup>25</sup> *Ibid*;

<sup>26</sup> Act No. 8 Year 1995, art. 1 point 27.

<sup>27</sup> Sapto Raharjo, *Panduan Investasi Reksa Dana*, Jakarta, Elex Media Komputindo, 2004, p.

<sup>28</sup> Ridwan Khairandy, *Hukum Pasar Modal I*, Yogyakarta, FH UII Press, 2010, p. 77

## 2. Types of Mutual Fund

Broadly speaking, based on Indonesian Capital Market Law, it is mentioned that mutual funds are in the form of corporate mutual funds and collective investment contracts.<sup>29</sup> Ridwan Khairandy explains what is meant by mutual fund in the form of Company is an issuer (*emiten*) whose business activities collect funds by selling its shares to investors, which then proceeds from the sale of shares are invested in the form of securities portfolio traded in the capital market and money market.<sup>30</sup>

While the mutual fund in the form of collective investment if the fund raises funds by issuing units of participation to investors for subsequent funds are invested into various types of securities traded in the Capital Market and Money Market.<sup>31</sup> In this case, the mutual fund does not sell the shares of the mutual fund company but only sells the participation units under a collective investment contract, the purpose of a collective investment contract as a contract between the investment manager and the Custodian Bank which binds the holders of the investment units in which the investment manager is authorized to manage collective investment portfolios and custodian banks are authorized to carry out collective custody.<sup>32</sup>

It should be noted among the following contracts:<sup>33</sup>

- a. A collective investment contract is a contract between an investment manager and a custodian bank that binds the holder of an investment unit that authorizes the investment manager to manage the portfolio and to the

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<sup>29</sup> See Act No. 8 Year 1995, art. 18.

<sup>30</sup> Ridwan Khairandy, *op.cit.*, p. 77, See Munir Fuady, *Pasar Modal Modern*, p. 107

<sup>31</sup> Munir Fuady, *op.cit.*, p. 108.

<sup>32</sup> *Ibid.*

<sup>33</sup> *Ibid.*, pp. 108 – 109.

Custodian Bank is authorized to perform the day care. KIK is only used for non-corporate mutual funds;

- b. The Fund Management Agreement is a contract between an investment manager and a Director of a Mutual Fund Company (if a mutual fund is a company) or with a Custodian Bank (if a mutual fund is a KIK) to manage funds from a mutual fund;
- c. The Custodian Agreement is a contract made between the Custodian Bank and the Board of Directors of a Mutual Fund company (for a corporate mutual fund) or with an Investment Manager (for KIK mutual funds);
- d. Distribution Agreement is a contract with an agent or a broker or dealer.

Gunawan Widjaja explains about characteristics of mutual funds as stated as follow:<sup>34</sup>

- a. Open-end Fund

An open-ended mutual fund allows investors to buy shares or equity units from mutual funds and can sell back to mutual funds without being limited to how many shares or units of shares are issued. Open-end mutual funds can sell stocks or units of inclusion continuously as long as there are investors who want to buy, so the form of mutual funds is open to receive investors at any time.

- b. Closed-end Fund

This type of mutual fund exists only in mutual funds in the form of a limited liability company, in this type of mutual fund performs operations with a fixed number of shares and does not regulate regularly issuance of

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<sup>34</sup> Gunawan Widjaja, *Reksa Dana... op.cit.*, hal. 10 - 15

new shares. Thus, it can be concluded that closed-end fund is a mutual fund whose total shares of stock are unchanged, so that only sells mutual fund shares to investors up to the amount of authorized capital in the articles of association.

c. Investment Trust Unit

UIT is an investment company that buys a securities portfolio (based on a Trust Indenture agreement) using a pool of funds (assets) from shareholders or equity units. The bond portfolio will then be deposited with the Trustee (usually the Bank) as a direct custodian until the maturity date of the bonds. After maturity is paid to the shareholders or UIT units, which have purchased shares or units of participation from UIT at the time of the initial public offering of the UIT. UIT does not grant the right to speak out as well as shares in a limited liability company.

In UIT there is no possibility of an exchange of securities belonging to Participation Unit holders except as authorized by the Securities Exchange Commission. In addition, the Investment Trust Unit is also not traded but can only be redeemed to the trustee. The redeemed UIT can be resold by a trustee to an interested investor.

### 3. The establishment of Mutual Funds

Mutual funds that allow for the collective investment of certain properties which may consist of stocks, bonds or securities of the money market or other capital market, whether or not guaranteed.<sup>35</sup>

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<sup>35</sup> Gunawan Widjaja, *Reksa Dana... op.cit.*, p. 37

Collective investment scheme could be classified into two legal forms, such as:<sup>36</sup>

- a. Unit trusts consisting of units, which are not listed on the stock exchange, are not a legal entity managed by a management company and a custodian.
- b. Investment (trust) company which is a legal entity, an independent legal subject, owns listed and traded shares on the stock exchange, and is administered by two individuals or legal entities.

Regarding the establishment of mutual fund law, Gunawan Widjaja in his book explains there are six (6) legal form of mutual fund that is:<sup>37</sup>

- a. Type A - Trustee Trust Manager in this structure The Unit Trust is established with one declaration or statement, with the manager as trustee. Separate storage functions by the custodian are basically just delegations of the trustee's authority internally;
- b. Type B - Captive Trustee Trust is formed based on declaration or statement with company or individual as trustee. Trustee is an affiliate, partner, or employee of a more complex form of mutual fund. In this context, settlor is a fund manager or a holding company of a fund managers with a trustee in the corporate cove (which is entirely under the control and owner of the fund manager or parent of the fund manager), or individual trustee who is an employee or associate in the fund manager or its parent as a trustee;
- c. Type C - Compliant Trustee Trust is a type similar to type B, only in this structure trustee is a company independent of fund managers;

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<sup>36</sup> *Ibid.* pp. 38 - 39

<sup>37</sup> *Ibid*; p. 40 - 41

Type D - New Trust within the structure of the manager 's management structure is not a delegation based management authority. Type E - Mutual Fund Corporation This structure takes the form of a limited liability company incorporated. Beneficiary is a shareholder of this limited liability company, except that it is different from liability company Type F - Mutualized Mutual Fund where in the structure this manager who executes the fund management in mutual fund owned by mutual fund investors. there is no special form of this structure.

In addition to the above Gritman and Jaehank as already quoted by Budi Untung in his book explains that there are eight (8) types of mutual funds:<sup>38</sup>

- a. Growth funds are mutual funds with the main goal of growth is the creation of capital gains and long-term growth;
- b. Aggregate growth funds are mutual funds targeting aggressive growth aim to create high yield;
- c. Equity income funds are mutual funds with revenue targets and the goal is to create long-term dividends and short-term income or invest in low-risk effects;
- d. Balanced fund is a mutual fund with the target balance of proportion of securities. The goal is to create a balanced return in both current account income and long-term capital gain;
- e. Growth income fund is a mutual fund with a target revenue growth goal to create capital growth;
- f. Bond funds are bond mutual funds whose goal is to obtain high yields;

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<sup>38</sup> Budi Untung, *Hukum Bisnis Pasar Modal*, Yogyakarta, Penerbit Andi, 2011, pp. 213 – 214

- g. Money Fund is a mutual fund with target money market aim to obtain yield from short term money market instruments such as certificate of deposit and SBI;
- h. International fund is mutual fund with an international target market aimed at gaining higher capital gain.

#### **4. Management, Representation, and Accountability in Mutual Funds**

There are two sources of mutual fund, as stated as follow:

- a. Mutual Fund born from the Agreement.

Trustee and Manager are parties acting for the benefit of investors, managers perform the functions of management and representation of assets invested by investors into mutual funds, by making decisions about investments. The Trustee is responsible for maintaining and maintaining the effects of mutual funds, how far can it be said that it also performs the management functions.

In this case the management functions undertaken by the trustee and manager are contained in the mutual fund founding agreement, the responsibilities of the trustees and managers are in accordance with the functions and obligations that they undertake respectively.

- b. Mutual Fund born from the Act.

In this case as a limited liability company, a shareholder investor is a beneficiary of any securities owned by the Investment Trust Company. The founders who were the original shareholders at the time the management company was established were subsequently replaced by investors who are



beneficiaries of all income earned by the management company after deducting expenses related to the management of the company.

In this case the functions of management and representation and accountability of the directors in the investment trust are born from the law, in other words already established in law.

c. Fiduciary Duty

Trustee relationship with the beneficiary is a form of trust relationship called fiduciary relation. In relation to mutual fund, fiduciary relation occurs in the trustee relationship (manager and custodian) with the investor.

**A.1 Mutual Fund in The Perspective of Islamic Law**

The development of syariah economics in Indonesia shows a positive trends. In this case, syariah investment is something that is often being the subject of discussion among experts and investors. The development of the existing investment model offers interesting subject to be studied in terms of Islamic law. Capital market as a part of contemporary forms of investment is not regulated both in Qur'an and Hadith. This is because capital market is a form of investment that was born from the development of science, economic practice and also human needs. The main concern is whether activities or transaction in the capital market are lawful or unlawful?

Dr. Wahbah al Zuhaili in *Al-Fiqh Al-Islami wa Adillatuhu* juz 3/1841 states that "Muamallah (by doing transaction) on share is allowed, because the shareholders are the partner in the company in accordance with the shares they own."

The opinion of another ulama who allowed capital market investments was:

“(The second type), are shares in permitted companies, such as permitted trading companies or manufacturing companies. Musahamah and syarikah in the company and trading shares, if the company is known and does not contain significant uncertainty and unclearly the law may. That is because shares are part of capital that can provide benefits to their owners as a result of business and manufacturing business. That is lawful without doubt.<sup>39</sup>”

The Indonesian Ulama Council (MUI) through The National Sharia Board (Dewan Syariah Nasional) states that capital market is an activity that is concerned with initial public offering and trading of securities, public companies related to the issuance of securities, and institutions and profession related to securities. The capital market and all its mechanism of activity, especially regarding issuers, the types of securities, and their trading mechanism are deemed to be in accordance with sharia if they have compiled with sharia principles.<sup>40</sup>

Types of activities that are contrary with the principle of sharia include:<sup>41</sup>

1. Gambling and games or activities belonging to gambling which is prohibited;
2. Conventional financial institutions (Ribawi), including conventional banking institutions and insurance;
3. Producers, distributors, and traders of haram food and beverages

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<sup>39</sup> Dr. Muhammad ‘Abdul Ghaffar al-Syarif (al-Syarif, *Buhuts Fiqhiyyah Mu’ashirah*, [Beirut: Dar Ibn Hazm, 1999], h.78-79); Dr. Muhammad Yusuf Musa (Musa, *al-Islam wa Musykilatuna al-Hadhirah*, [t.t.: *Silsilah al-Tsaqafah al-Islamiyah*, 1958], h. 58); Dr. Muhammad Rawas Qal’ahji, (*Qal’ahji, al-Mu’amalat al-Maliyah al-Mu’ashirah fi Dhaw’i al-Fiqh wa al-Syari’ah*, [Beirut: Dar al-Nafa’is, 1999], h.56). Syaikh Dr. ‘Umar bin ‘Abdul ‘Aziz al-Matrak (*Al-Matrak, al-Riba wa al-Mu’amalat al-Mashrafiyyah*, [Riyadh: Dar al-‘Ashimah, 1417 H], h. 369-375

<sup>40</sup> Article 2 Fatwa Dewan Syariah Nasional Number 40/DSN-MUI/X/2003 Concerning Capital Market and General Guideline for The Application of Sharia Principle In Capital Market

<sup>41</sup> Ibid Article 3 Verse 2

4. Manufactures, distributors, and/or suppliers of goods or services that are morally harmful
5. Investing in issuers that at the level of transaction (ratio) of the company debt to ribawi financial institutions is more dominant than the capital.

Instrument traded in capital market include stock, bonds, and other derivative product such as mutual fund, warrants, etc. Sharia mutual funds are defined as mutual funds that operate according to sharia rules and principles, both in the form of contracts between investors as owners of the assets (shahib al-mal / rabb al-mal ) and investment managers, as well as investment fund management as shahib al-mal representatives, and investment managers as shahib-al mal representatives with investment user (investor).<sup>42</sup>

In the implementation to regulate and to protect investors from the element of dhahar, ghahar, riba, maisir, risywah, maksiat, and dzalim there are several barriers to shariah-compliant capital market transaction.

1. Najsy, it means making a fake offering
2. Bai' al-ma'dum , selling goods (sharia bond / securities) that are not yet owned
3. Insider Trading , using information from the insider to obtain information on prohibited transaction.
4. Giving misleading information
5. Margin Trading, conduct transaction on sharia securities with an interest-based loan facility with the obligation to settle the purchase os sharia securities.

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<sup>42</sup> Article 4 Verse 4 Article 2 Fatwa Dewan Syariah Nasional Number 40/DSN-MUI/X/2003

6. Ihtikar , purchase and/or collects sharia securities to cause changes in sharia securities prices, with the aim to influencing other parties.
7. And other transaction that contains above principles

To ensure that sharia portfolio management complies with sharia principles, then the investment manager who manages customers fund must be Sharia Investment Manager. The sharia investment manager is required to have a sharia supervisory board as regulated in OJK regulations regarding the application of sharia principles in capital market.

## **B. Exchange Traded Funds**

### **1. Understanding**

Exchange Traded Funds (ETF) was first developed in Canada in the 1990s. ETF is basically the characteristic of two products: the open-shaped mutual fund and the stock.<sup>43</sup> ETFs are traded on the stock exchange just like shares, but ETFs have the same structure as mutual funds that represent ownership of securities in the portfolio.<sup>44</sup>

The Securities Exchange Commission defines EFT as "An Exchange Traded Funds, or ETFs is a type of investment company which aims to achieve the same return as a particular market index".<sup>45</sup> While the Malaysian Security Commission defines ETFs as "ETFs means exchange-traded funds, which are listed as index-tracking funds structured as a unit of trust scheme, the primary objective is to

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<sup>43</sup> Gunawan Widjaja, *Exchange Traded Funds di Indonesia*, Jakarta, Raja Grafindo Persada, 2008, hal. 7

<sup>44</sup> *Ibid.*

<sup>45</sup> *Ibid.*, hal 9

achieve the full return or substantially all (strategic sampling) of its all assets in the constituent securities of the index ".<sup>46</sup>

Unlike most mutual funds, ETF investors do not buy or redeem their investment units to investment managers. Investors actually buy or sell ETF shares in an exchange.<sup>47</sup> ETFs are mutual funds whose units of participation or shares are listed and traded on stock exchanges whose primary purpose of investment is to obtain the same level of income as the targeted index referred to.<sup>48</sup>

Broadly speaking ETFs are categorized into two:<sup>49</sup>

1. Index of Exchange Traded Funds is an ETF that invests its managed funds in a set of securities portfolios contained in a particular index with the same proportion of weights in a targeted index with a view to reflecting the index image of the index in the stock or in other words creating the same level of income with reference index.
2. Close-end Exchange Traded Funds is a stock exchange-traded fund that is in the form of an investment company, closed, and actively managed by an investment manager. Close-end Exchange Traded Funds offers its shares to the public through an initial public offering (IPO) mechanism, then the funds raised are invested in various types of securities in accordance with the investment policy.

Based on the above explanation can be concluded things - things as follows:<sup>50</sup>

1. ETF is a collective investment unit in the form of a mutual fund;

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<sup>46</sup> *Ibid*;

<sup>47</sup> *Ibid*; hal. 8

<sup>48</sup> *Ibid*;

<sup>49</sup> Gunawan Widjaja, *op.cit.*, hal. 8

<sup>50</sup> Gunawan Widjaja, *op.cit.*, hal. 10 -11

2. Portfolio of equity participation / ETF shares generally represents / represents from stock exchange traded securities index;
3. Participation unit / shares of ETF are listed and traded on the exchange;
4. ETF is an instrument that has a characteristic hybrid nature, namely:
  - a. A closed-ended nature that is not a transaction (redemption) by retail investors directly to the investment manager;
  - b. Be closed (close-ended) means that investors who want to conduct transactions or resale must through the mechanism of selling securities in the stock exchange and transact like a share sale and purchase transactions;
  - c. Be closed (close-ended, which means the purchase price of units of participation is determined by demand and supply (demand and supply);
  - d. Open-ended, which means the value of net assets is calculated and announced daily on the exchange.

### **C. Publishing, Recording and Trading.**

In the implementation of issuance of units of ETF shares / shares is done as follows:<sup>51</sup>

"ETF unit participation / shares are issued through a process called creation unit. The process is undertaken if there is an institutional investor, in which case acting as sponsor deposits a set of securities into the fund (collective investment fund pool) and in return the investor obtains an ETF share unit in the specified amount ".

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<sup>51</sup> Gunawan Widjaja, *op.cit.*, hal. 14 – 15

While the mechanism of record and ETF trading can be done below.<sup>52</sup> Part or all of the units of shares / shares of the proceeds of the creation are subsequently recorded in the stock securities for trading between retail investors. In the process of trading on the exchange, there is market marking mechanism conducted by institutional investors (sponsors), which have units of ETF shares in large quantities and act as market maker. It aims to maintain the level of ETF liquidity, the market maker has the task to include quotes to buy or sell every day so that if there is an excess demand to buy or sell ETF shares, the market maker can absorb the request. With this market maker the movement of ETF unit / share price in the stock does not move too far from the net asset value (NAV) of the securities underlying the issuance of the ETF.

Basically ETFs are managed passively where ETFs are "collections of effects" of a particular index that has been determined from the start. So the picture of the performance of ETF is a reflection and a description of the performance of the effects - an effect that is used as an index at the time the ETF is made.<sup>53</sup>

There are two methods used to produce ETF performance close to or equal to the performance of the reference index.<sup>54</sup>

- a. A full replication method, in which the ETF will invest its funds in constituent sustenance with the same weight as the weight of the stock in the reference index so that the performance of the fund is equal to the performance of the reference id.

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<sup>52</sup> *Ibid*;

<sup>53</sup> *Ibid*;

<sup>54</sup> *Ibid*; hal. 16 -17

- b. A representative sample method, which means the ETF will invest its funds in multiple stock samples that have the same features that are considered representative of the benchmark index, for example in terms of market capitalization, industry weight and liquidity. ETFs using representative sample methods tend to have a larger tracking error than those using full replication methods.

#### **D. Parties of ETF and its Functions**

In the implementation of ETF activities of course supported by various parties who have functions and tasks that are different from each other, it is a form of execution of tasks and functions so that ETF activities can be launched. The parties and functions attached to such parties are:<sup>55</sup>

a. Sponsor

Sponsors are instrumental in initiating ETF publishing and trading and supporting cooperation at the managerial level of various parties. Sponsors may come from exchanges: stock exchanges, investment managers, investment banks and government agencies responsible for developing the exchange.

b. Advisor

Advisors play a role in providing technical and operational guidance in the ETF issuance process. Advisors should come from a financial institution engaged in an integrated investment bank with comprehensive technical expertise from different areas including banking

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<sup>55</sup> Gunawan Widjaja, *op.cit.*, hal. 17 - 30



advisory services, fund management, stock market / market maker and operations / settlement.

c. Regulator

Regulators play a role in making ETF publishing guidelines.

d. Stock Exchange

Stock Exchange plays a role in preparing infrastructure for the process of recording, trading, and facilitating the process of publishing and repayment in kind.

e. Fund Manager/ Investment Manager

Investment Manager plays a role in the management of funds collected from the issuance of ETFs and facilitates the publishing and repayment process in kind. Broadly speaking, in a prospectus, the issuance of the ETF mentioned the duties and responsibilities of the investment manager in it.

f. Custodian

Based on the prospectus the ETF issuance mentioned duties, authority and custodian responsibilities include:

- 1) Keeping in safety all the securities and other such instrument belonging to the fund segregated from the other assets of the custodian and from the assets of other client of the custodian and shall be held in the name of the Trustee a/c fund or scheme or custodian a/c scheme or in such other manner as may be mutually agreed;

- 2) Ensuring smooth inflow/outflow of securities and such other instruments as and when necessary in the best interest of the investor;
- 3) Ensuring that the benefits due the holdings of the fund are recovered in time;
- 4) Responsibility for loss of/or damage to the securities due the fraud, bad faith, negligence, willful neglect, default, or willful default on his part on the part of its approved agents.

g. Trustee

Basically a trustee is a custodian in a broad sense, but in some countries the function of custody as a physical store of collective investment property with a trustee is a specialized company that is responsible and listed itself as the collective owner.

h. Market Maker

Market makers play a role in providing ETF trading liquidity on the exchange and maintaining a balance between the ETF price and net asset value (NAV).

i. Seeding Party

Seeding party is the earliest capital provider or initial securities portfolio to form ETFs.

### **E. Exchange Traded Fund as a Form of Collective Investment.**

ETF is a form of collective investment similar to that of a mutual fund whose portfolio of equity units / shares is taken from the index traded on the exchange. The

SEC defines the collective investment scheme as "collective term constructions in which investment is made on a collective basis"<sup>56</sup>

The Financial Supervision Act of 1988 defines the collective investment scheme as:<sup>57</sup>

“Any arrangement with respect to property of any description. Including money, the purpose of effect of which to enable person taking part in arrangements (whether by becoming owners of the property or any part of it or otherwise) to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sum paid out such profits or income. Further, these arrangements must be such that the persons who are to participate do not have day-to-day control over the management of the property in question, whether or not they have the right to be consulted or to give directions; and the arrangements must also have either or both of the following characteristic:

1. That the contributions of the participants and the profits or income out of which payments are to be made to the are pooled;
2. That the property in question is managed as a whole by or on behalf of the manager of the scheme.”

Based on the above understanding can be understood that the form of collective investment is as follows:<sup>58</sup>

- a. There is participation by many investors together in one type of investment;
- b. The investor or the participant in the collective investment receives a proof of participation for his participation;
- c. The investor or party participating in the investment derives a proportionate share of the profits from the participation based on the amount of investment they invest or inculcate in the investment;
- d. Investors have no direct control over the investment in question;

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<sup>56</sup> <http://sec.gov/investor/pubs/inwsmf.html> accessed on June 2012 20.35PM

<sup>57</sup> Gunawan Widjaja, *op.cit.*, hal. 36 - 37

<sup>58</sup> *Ibid*;

- e. The investment is managed by other parties in accordance with the agreement.

So that on the investments made, the parties who participate in the investment are collected in a unity which is stored by another party who performs the function or authority to either deposit the investment property as has been previously attributed.

#### **F. The Role of Investment Managers as Managers of KIK Mutual Funds.**

In the Capital Market Law it is explained that the duty of an investment manager is mandatory in good faith and full responsibility to perform the best possible duties for the benefit of mutual funds and if unable to carry out its obligations then an investment manager is responsible for any losses arising because of the responsibility.<sup>59</sup>

Disclosure of information on the background of investment managers should also be clearly disclosed to investors so that potential mutual fund investors can know the advantages and disadvantages of each investment manager. Whereas in particular the rules on the role of investment managers as managers of KIK mutual funds are not clearly defined in general under the existing rules that are the basis and as a benchmark for the responsibilities and roles of the investment manager.

#### **G. Fiduciary Duties**

Someone has fiduciary duties when they have fiduciary capacity. Fiduciary duties will occur if there's a fiduciary relationship. Concept of Fiduciary relations between the parties (fiduciary) about certain problems that exist within the scope of

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<sup>59</sup> See Act No. 9 of 1995 concerning Capital Market, Article 27 point 1 and 2

that relationship. Paul L. Davies in Gower's Principles of Modern Company Law, stated that:<sup>60</sup>

In applying the general equitable principle to company directors, four separate rules have emerged, these are:

1. That directors must act in good faith in what they believe to be the best interest of the company;
2. That they must not exercise the powers conferred upon them for purposes different from those for which they were conferred;
3. That they must not fetter their discretion as to how they shall act;
4. That, without the informed consent of the company, they must not place themselves in a position in which their personal interest or duties to other person are liable to conflict with their duties.

Related to principle of fiduciary duty, generally there are two things that can be explain here.<sup>61</sup>

1. Directors are a trustee for the company. As a trustee, board of directors is responsible to the Company in connection with the reduction in value of company assets entrusted to be taking care by them.
2. Directors are agent for the company on achieving its goal and interest. As an agent, director representing the company in any legal relationship with the third parties. Directors of the company are bind to the company not be binding to the shareholders. As an agent, the directors also not liable for any act done by him for and behalf of the company.

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<sup>60</sup> Paul L. Davies, *Gower's Principle of Modern Company Law*, London, Sweet Maxwell, 1997, p. 601 as quoted by Gunawan Widjaja, *Risiko Hukum sebagai Direksi, Komisaris & Pemilik PT*, Jakarta, Forum Sahabat, 2008. p.43

<sup>61</sup> Paul L. Davies. *Op. cit.*, p.598-599 as uoted by Gunawan Widjaja, *Op. cit.*, p. 44

Kilpatrick Stockton stated there are four types of fiduciary duty, with two main obligations:<sup>62</sup>

1. Duty of Loyalty, an obligation that requires a director, affirmatively and in good faith, to protect the interest of the company and its stockholders, and to refrain from doing anything that would injure the company or deprive the company of profit or an advantage that might properly be brought to the company for it to pursue. To fulfill duty of loyalty a director must act in a manner that he or she believes in good faith to be in the best interest of the company and its stockholders;
2. Duty of Care, an obligation that requires a director to perform his or her responsibilities with a care that a reasonably prudent person would exercise under similar circumstances, while acting in an informed manner. To fulfill the duty of care a director must proceed with a “critical eye” in assessing information presented to him or her, and with an inquisitive nature in confirming that he or she has been presented with all material information;

And the other of fiduciary duty is acknowledged by the Decision of Delaware Court:

3. Duty of Good Faith;
4. Duty of Disclosure.

Bernard S. Black stated that there are four liabilities upon the fiduciary duty, the four types of fiduciary duty are:<sup>63</sup>

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<sup>62</sup> Kilpatrick Stockton *Director Fiduciary Duties After Sarbanes-Oxley*, p. 7 as quoted by Gunawan Widjaja, *Op. cit.*, p. 45

<sup>63</sup> Bernard S. Black, *The Principal Fiduciary Duties of Boards of Directors*, presented in The 3<sup>rd</sup> Asian Roundtable on Corporate Governance, Singapore April 4<sup>th</sup> 2001, p. 2 as quoted by Gunawan Widjaja, *Op. cit.*, p. 46

1. Duty of loyalty as stated that the decision makers within the company should act in the interest of the company, and not in their own interest;
2. Duty of care where in situation where they do not have a conflict of interest, the duty of care – the duty to pay attention and try to make good decision;
3. Duty to disclosure is disclose all materials information when seeking shareholder approval, or when conflict of interest exists;
4. Duty to extra care when selling company.

Henry R. Cheeseman explains on understanding and responsibility of directors which has connection upon the concept of fiduciary duty.<sup>64</sup>

1. Fiduciary Duties is a duty of loyalty, honesty, integrity, trust, and confidence owed by directors, and officers to their corporate employers.
2. Duty of Obedience is a duty that directors and officers of a corporation have to act within the authority conferred upon them by the state corporation statute, the articles of incorporation, the corporate by laws, and the resolutions adopted by the board of directors.
3. Duty of Care is a duty that corporate and officers have to use care and diligence when acting on behalf of the corporation.

According to Article 27 clause 1 and 2 Law No. 8 Years 1995 stated that every investment manager should good faith and full responsibility perform tasks for the benefit of the beneficiary.<sup>65</sup>

Anthony Collins in *The Duties and Responsibilities of Directors* stated there are seven types of fiduciary duty, namely:<sup>66</sup>

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<sup>64</sup> Henry R. Cheeseman, *Business Law*, New Jersey, USA, Prantice Hall, 2001, p. 759 as quoted by Munir Fuady, *Perseroan Terbatas Paradigma Baru*, Bandung, Citra Aditya Bakti, 2003, p. 84

<sup>65</sup> See Article 27 clause 1 and 2 Law No. 8 Years 1995

1. Duty to act in good faith;
2. Duty to manage the company's affairs with the proper degree of skill and care;
3. Duty to act strictly within the provisions of the constitution and to satisfy yourself of its terms;
4. Duty to act within the scope of any given authority for proper purpose;
5. Duty to act personally;
6. Duty not to take personal benefit/profit;
7. Duty to secure the proper and effective use of property.

On Collins point of view, which mean with *duty to act in good faith* are:<sup>67</sup>

1. Act on the best interest of the company;
2. Not put yourself in a position where your personal interest or a duty you owe to another conflicts with the duties you owe to the company;
3. Only use company property for the benefit of company and not for your own benefit.

Based on the understanding of *duty to act in good faith* can be seen that the director has an obligation for prioritizing the interest of the company. Director must use their powers for the purposes, i.e. for the benefit of the company and not to further their own interest.<sup>68</sup>

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<sup>66</sup> Anthony Collins, *The Duties and Responsibilities of Directors*, June 2007, RNRP Document Suite, p. 1 as quoted by Gunawan Widjaja, *Op. cit.*, p. 47

<sup>67</sup> *Ibid*;

<sup>68</sup> Denis Keenan and Joshepine Biscare, *Company Law*, London, Pearson Education Limited, 2002, p.336



Philip Lipton and Abraham Herzeberg divide fiduciary duty into duty of loyalty and good faith and duty to exercise care and diligence. Further duty of loyalty and good faith categorized in to:<sup>69</sup>

1. To act bona fide in the interest of the company;
2. To exercise power for their proper purposes;
3. To retain their disclosure powers;
4. To avoid conflicts of interest.

Based on the principle of fiduciary duty above any circumstances that might be obliged to all directors are the necessarily step that they are responsible upon the taking care of the companies. The director has been liable upon the fiduciary relationship with their position on the companies. The essence is for maintain the fairness where the director applied any matters for the benefit of the company.

Any director may not act which not accordance with article of association or any existing law that govern about it. Because there are several term that any director duties are for maintain the existing of the companies. The directors will liable as personal when they neglect when they do their duties. Article 97 paragraph 3 Law No. 40 of 2007 stated that:<sup>70</sup> “Each member of Board of Directors is personally liable for losses of the company if such person guilty or negligent upon their duties in accordance with the provision referred to paragraph 2.”

In accordance on article 97 paragraph 5 the director may not liable upon their act which affects to the losses of companies if they can prove:<sup>71</sup>

1. Loss was no fault or negligence;

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<sup>69</sup> Philip Lipton and Abraham Herzeberg, *Understanding Company Law*, Brisbane, The Law Book Company Ltd, 1992, p. 297 as quoted by Gunawan Widjaja, *Op. cit.*, p. 50

<sup>70</sup> See Article 97 paragraph 3 Law No. 40 of 2007

<sup>71</sup> See Article 97 paragraph 5 Law No. 40 of 2007

2. Have made arrangements in good faith and prudence for the benefit and in accordance with the aims and objectives of the Company;
3. Have no conflict of interest, whether directly or indirectly on management that affect the losses.
4. Has taken any measurement act to prevent such losing.

Even though the directors may not liable toward certain circumstances as long as they can prove they're not related with any decision where have decide and make some losses to the company. This shown that the liabilities of directors are not absolute if they can prove that the decision is not causes the losses of the company.

The fiduciary duties are coming from the business judgment rules, where the rules are deriving to maintain the function of directors toward the essence of duty of cares. The function of fiduciary duties are delegated to the board of directors where the board of directors chosen by shareholders to manage the corporation.<sup>72</sup>

The liabilities of directors are based on the civil liability where it derives from the performance of directors. The performance itself are manage by the fiduciary duties theory, the duties of directors is maintaining the company in appropriate term to make a stabilize condition of company and will not harm the company itself.

Any act of the directors should maintain the fiduciary duties principle, where on that principle the directors are obliged to perform the act in good faith where stated on the regulation and the article of association. Thus are the guidance of directors to maintain the efficiency and to prevent any harm where may occurs to the company. In condition that directors are chosen by the shareholders it is be logic

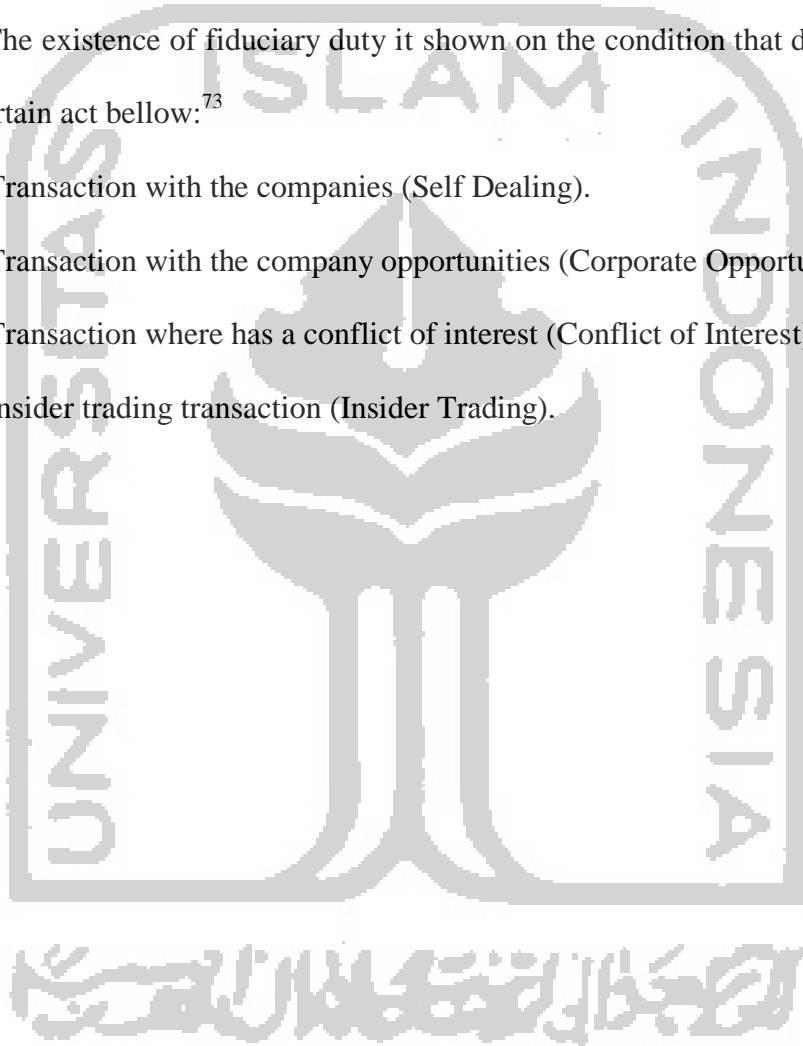
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<sup>72</sup> Robert W. Emerson, J.D., *Business Law; Fifth Edition*, New York, Barron's; Business Review Book's, 2009, p. 374

when the directors should maintain the company with carefulness, and good faith. Because any damage that happened to company direct on indirectly will affect to the shareholders.

To prevent any effect that may harm company and shareholders directors should perform their duties based on fiduciary principle which have been stated above. The existence of fiduciary duty it shown on the condition that directors doing some certain act bellow:<sup>73</sup>

1. Transaction with the companies (Self Dealing).
2. Transaction with the company opportunities (Corporate Opportunity).
3. Transaction where has a conflict of interest (Conflict of Interest).
4. Insider trading transaction (Insider Trading).



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<sup>73</sup> Munir Fuady, *Doktrin – Doktrin Modern Dalam Corporate Law & Eksistensinya dalam Hukum Indonesia*, Bandung, Citra Aditya Bakti, 2002, p. 62