

**SHARI'AH CAPITAL MARKET ON THE TRADING MECHANISM OF
SECONDARY MARKET SECURITIES IN INDONESIA**

A BACHELOR DEGREE THESIS



Presented as Partial Fulfillment of the Requirements to Obtain the Bachelor Degree in the
International Law Program, Faculty of Law, Islamic University of Indonesia

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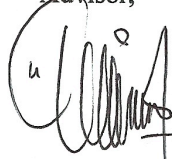
بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ

A BACHELOR DEGREE THESIS

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OF SECONDARY MARKET SECURITIES IN INDONESIA**

This bachelor degree thesis has been examined and approved by the content
advisor to be submitted in the front of the board of examiners in Final
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Yogyakarta, 2nd February, 2012
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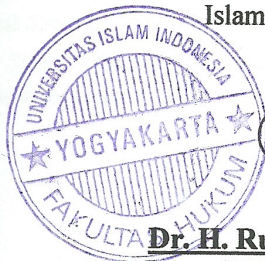
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SHARI'AH CAPITAL MARKET ON THE TRADING MECHANISM OF SECONDARY

MARKET SECURITIES IN INDONESIA

Karya ilmiah ini akan saya ajukan kepada Tim Penguji dalam Ujian Pendadaran yang diselenggarakan oleh Fakultas Hukum UII.

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Selanjutnya berkaitan dengan hal di atas (terutama pernyataan pada butir no 1 dan 2), saya sanggup menerima sanksi baik sanksi administratif, akademik bahkan sanksi pidana, jika saya terbukti secara kuat dan meyakinkan telah melakukan perbuatan yang menyimpang dari pernyataan tersebut. Saya juga akan bersikap kooperatif untuk hadir, menjawab, membuktikan, melakukan pembelaan terhadap hak-hak saya serta menanda-tangani Berita Acara terkait yang menjadi hak dan kewajiban saya, di depan 'Majelis' atau 'Tim' Fakultas Hukum Universitas Islam Indonesia yang ditunjuk oleh pimpinan fakultas, apabila tanda-tanda plagiat disinyalir ada/terjadi pada karya ilmiah saya ini oleh pihak Fakultas Hukum UII.

Demikian, Surat Pernyataan ini saya buat dengan sebenar-benarnya, dalam kondisi sehat jasmani dan rohani, dengan sadar serta tidak ada tekanan dalam bentuk apapun dan oleh siapapun.

Dibuat di : Yogyakarta
Pada Tanggal : 27 Maret 2012
Yang membuat Pernyataan



n & Nama Terang Ybs.

MOTTO

What will grow crooked you can't make straight, it's the price that you gotta pay,

Do yourself a favor and pack your bags, buy a ticket and get on the train,

People get crushed like biscuit crumbs, and laid down in the bitumen,

You have tried your best to please everyone,

But it just isn't happening,

No, it just isn't happening,

Let them go, the noisy behind you, what always people yelling to you,

It's wouldn't bring your dream, they just jealous and bring you down,

Do yourself a favor and pack your bags, be yourself in differences,

Different in your own, different in a beauty,

Lady.

I dedicated this Thesis to:

My beloved parent, R. Agus Dwi Supriyanta and Tatik
Sumaryati, whom always become my guardian angel
My lecturer, Siti Anisah
My family, especially for my sister, Sherly
My yoke-mate, Momo, I hope this thesis can brace up
you dear
My friends and all of the student of Faculty of Law,
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In the name of Allah, the Beneficent, the Merciful. All praises are to Him, the Lord of the Worlds, as benefit His glory and the greatness of His power. I humbly offer the praise of repentant servant who is need of His guidance and help. I am grateful to Him for the blessings bestowed upon me, and for honoring me with His aid to finishing this writing of thesis under title “Shari’ah capital market on the trading mechanism of secondary market securities in Indonesia”.

This thesis is made in order to obtaining the requirements in achieving the title of my scholar for bachelor degree in Islamic University of Indonesia. This thesis has been designed to extend outreach to the international audience, as I believe there is a deep longing for serious, useful thesis in Islamic capital market, especially those combining the *fiqh* (Islamic jurisprudence) perspective with that of finance. Hopefully this thesis will be able to give contribution to the society and especially to the law scholars who have been devoting their time for the sake of law research and education.

The proses of writing this thesis will not able to be finished without any supports given from the people around me. I would to thank everyone that has helped in the preparation of this thesis. Therefore, as the expression of my gratitude, I would like to deliver my appreciations to:

1. Allah *subhanahu wa ta’alaa*, in whom I seek refuge from the sins I have

committed, and to whom I beseech protection to be kept distance from unlawful livelihood. All praises be to Him for all the blessing lavished upon me. It was only with His directions and guidance that I could attempt to tie together and reveal fractions of His knowledge in the world. I am begging to You.

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and received me whoever I am. I love you all.

While, realizing this thesis is far from perfection, I also believe that more detailed and specific writing on Islamic capital market should be made available.

Lastly, I hope that the present of this thesis will be of use to its rider, not only in opening the mind but also the heart towards understanding the beauties of Islamic capital market.

Wallahu'alam bi shawab

Yogyakarta, February 2012

Marlia Tety Gustyawati

ABSTRACT

Indonesian Islamic securities trading in the secondary market on general is of commonly done. Moreover, the securities trading activities from the Islamic aspect are answered by National Shari'ah Board - Committee of Ulama Indonesia (hereinafter referred to as DSN-MUI). DSN-MUI has been issued fatwa on the Shari'ah trading mechanism Number 80/DSN-MUI/III/2011 about the application of Shari'ah principles in trading mechanism of equity securities at stock exchange regular market. This study will discuss on the regulatory framework applied to Shari'ah capital market on the trading mechanism of secondary market securities in Indonesia. In addition it is also seeking issues pertaining to Shari'ah compliance related to the trading mechanism of secondary market securities. This study is also needed as a means to give a trust to investors who concerned about Shari'ah principles in investing in the capital market.

This research is using secondary data which are primary legal material, secondary legal materials, and tertiary legal material. Secondary data also collected from library research and document study such as act, text books, and article. This research is used normative research which identifies legal norms and views. The objective is to understand and answer the object of study by using juridical normative approach method.

The trading mechanism of secondary market securities on Shari'ah capital market in Indonesia, in compliance with Shari'ah principles if they meet specific requirements. Securities that can be traded are only stocks in the List of Islamic Securities (Daftar Efek Syariah-DES) that published by Bapepam-LK or constituent stocks of Indonesia Sharia Stock Index (ISSI). Trading must refrain from activities that are prohibited by Islamic principles. According to the Fatwa, there are 14 activities that fall into categories not in accordance with Islamic principles, for examples insider trading (*ghabn fahisy*), short selling (*bai' al-ma'dum*), margin trading (*riba*), etc.

Fatwa on stock trading Shari'ah mechanism is the answer for people who still question the Shari'ah level of stock transactions in regular market on the Stock Exchange. The fatwa was expected to give a trust to investors who concerned about sharia principles in investing in the capital market. Recommendations this study is need develop accounting standards that adequately and appropriately reflect the nature of Islamic financial transactions and consideration relates to the level of awareness and understanding of investors with regards to Islamic capital market products. Hence, it may wish to consider an expansion of the pool of Islamic capital market experts covering subject matters such as corporate finance, legal, accounting and tax as well as the Shari'ah.

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CHAPTER I

INTRODUCTION

A. Context of Study

There is no doubt that securities markets and products now days continue to evolve and change. This is become the challenge of the regulators to consistently be abreast of and track new market developments. In order to be effective and timely formulation of standards, guidance or best practices where necessary.

Shari'ah capital market is an area that has grown to become an increasingly substantial segment on financial market. Moreover it has gained considerable interest as a viable and efficient alternative model of financial intermediation. Growing awareness of and demand for investing in accordance with Shari'ah principles have been the catalyst towards making the flourishing of Islamic financial services industry. This is also a reflection of the increasing the wealth and capacity of investors to seek and invest of products that serve their need.

Shari'ah financial products also represent products that must comply with strict Shari'ah rules that have religious as well as ethical underpinnings. Indeed, various Islamic organizations, such as the National Shari'ah Council in Indonesia, have been established with the view towards formulating appropriate standards for the Shari'ah financial services industry.

Such as the nascent fast-growing markets experienced, various regulatory issues need to be assessed on a timely basis. This mandate is initiative taken by capital market regulators to study the area of the Shari'ah capital market in order to gain a better understanding of its specific attributes. This is to ensure that the Shari'ah capital market is appropriately regulated. In add any gaps in regulation are identified early to safeguard investor interest and pave the way for the industry to evolve in an orderly manner.

Indonesia, as the biggest Muslim country in the world, is holds an enormous market for the development of Shari'ah finance industry. Shari'ah capital market, which is part of the Shari'ah finance industry, has an important role in increasing the market share of Shari'ah finance industry in Indonesia.

Moreover, the development of Shari'ah capital market until by the end of 2009 can be seen on statistical data in Figure 1. It can be said that the development of Shari'ah capital market is quite encouraging. However, given the still small market share of Islamic products compared to conventional products to date, it would require efforts strategic and tactical ongoing to further enhance the development *Shari'ah* products.¹ Although its development is still new, Indonesia's sharia capital market is expected experience rapid growth along with significant growth in Indonesian capital market industry by such efforts.

Figure 1

¹ Bapepam-LK, *Kajian Pasar Sekunder Efek Syariah di Pasar Modal Indonesia*, Research Division, (Jakarta: Minister of Finance, 2010), p. 1.

Development of Total Issuance of Sukuk and Islamic Investment Fund

1



Source: Statistics Bapepam-LK

Indonesian Islamic securities trading in the secondary market on general is of commonly done. Bapepam-LK already doing some research on Shari'ah capital market related to the trading mechanism in secondary market. Based on the results of the analysis conducted by Bapepam-LK, Islamic securities trading practices that exist today either in Indonesia or abroad generally have procedures and ordinances the same with conventional securities trading. It can be seen on a stretcher execution of customer transactions, the trading system with an auction mechanism continuous (continuous auction), the type of market used and procedures settlement of securities transactions and underwriting.²

² Bapepam-LK, *op. cit.*, p. 111.

Bapepam-LK and the Indonesia Stock Exchange have specific details on some regulations related to securities trading mechanism. However, some among the public and also the market players are still often questioned Shari'ah on the activity. Indeed, it is need a clarity and assertion related to the suitability of Shari'ah Securities trading in the secondary market in Indonesian.

Moreover, the securities trading activities from the Islamic aspect are answered by National Shari'ah Board - Committee of Ulama Indonesia (hereinafter referred to as DSN-MUI). DSN-MUI has been issued fatwa on the Shari'ah trading mechanism Number 80/DSN-MUI/III/2011 about the application of Shari'ah principles in trading mechanism of equity securities at stock exchange regular market. Fatwa on stock trading sharia mechanism is the answer for people who still question the sharia level of stock transactions in regular market on the Stock Exchange.

This study will discuss on the regulatory framework applied to Shari'ah capital market on the trading mechanism of secondary market securities in Indonesia. In addition it is also seeking issues pertaining to Shari'ah compliance related to the trading mechanism of secondary market securities. This study is also needed as a means to give a trust to investors who concerned about Shari'ah principles in investing in the capital market.

B. Statement Question

The problem statements on this study are:

1. How is the trading mechanism of secondary market securities on Shari'ah capital market in Indonesia?
2. How is the implementation of Shari'ah compliance related to the secondary market securities in Indonesia?

C. Objectives of the Study

The objectives of the study are:

1. To get better understanding about the Shari'ah capital market on the trading mechanism of secondary market securities in Indonesia.
2. To get better understanding about the implementation of Shari'ah compliance related to the secondary market securities in Indonesia.

D. Theoretical Frameworks

Islam consists of a set of principles which govern Muslims in various aspects of life, in social, economic, politic, and also spiritual life (*muamalah, jinaya, siyasa, etc.*).³ One of these aspects is economic activity such as banking and finance. As a consequence, Muslims are required to create a certain financial institution which is based on Islamic rules, principles and codes of practices.

Islamic capital market defines as where investment and financing activities and products are structured in accordance with Shari'ah principle.⁴

³ Nurul Huda and Mustafa Edwin Nasution, *Investasi pada Pasar Modal Syari'ah*, (Jakarta: Kencana, 2008), p. 1.

⁴ IOSCO, *Islamic Capital Market Fact Finding Report Islamic*, (Capital Market Task Force of the International Organization of Securities Commissions, 2004), p. 27.

Shari'ah is known as Islamic laws and rules and referred to as Islamic jurisprudence. *Shari'ah* governs all aspects of Islamic matters including faith, worship, economic, social, political and cultural aspects of Islamic societies. The rules and laws are derived from three important sources, namely the Holy *Quran* (the holy book of the religion of Islam), *Sunnah* (the practice and tradition of the Prophet Muhammad s.a.w.) and *ijtihad* (the reasoning of qualified scholars). Further elaboration and interpretation of the rules dictated by the Holy *Quran* and *Sunnah* are provided by qualified scholars in Islamic jurisprudence via *ijtihad* or an interpretative process which is carried out within the framework of *Quran* and *Sunnah*.

Islamic law on commerce is known as *fiqh al-mu`amalat*. Much of the laws, rules and interpretations of Shari'ah takes into consideration issues of social justice, equitability, and fairness as well as practicality of financial transactions. In general, the Shari'ah legal maxim in relation to commercial transactions and contracts state, "they are permissible unless there is a clear prohibition."⁵

١ - الْأَصْلُ فِي الْمُعَامَلَاتِ الْإِبَاحَةُ إِلَّا أَنْ يَدُلَّ دَلِيلٌ عَلَى تَحْرِيمِهَا.

"Basically, anything in *muamalah* is allowed, unless it is declared illegal by an argument (*dalil*)."

Aziz B. Setiawan, one of the researchers of the Indonesia Economic Intelligence, among others, mentioned that in some classical Islamic literature

⁵ Mohammad Hashim Kamali, *Islamic Commercial Law*, (Cambridge: The Islamic Texts Society, 2000), p. 66; Yusuf al-Qaradawi, *The Lawful and the Prohibited in Islam*, (Kuala Lumpur: Islamic Book Trust, 1985), p. 14.

indeed, there are no terms of investment, financing and capital market.⁶ However, as an economic activity, these activities can be categorized as trading activities (*al-bay`*).⁷ Trading activities is one of business transaction. Among the most important teachings of Islam, for establishing justice and eliminating exploitation in business transactions is the prohibition of all sources of unjustified enrichment.⁸

Basically, the aim of investing is to make a profit. In Islam, Capital and labor and in some cases goodwill and credit-worthiness are jointly responsible for creating profits and are jointly responsible to a share in the profits. Therefore, the transaction is taken by investors in trading in the market capital is an activity that is *tijarah muamalah* (for profit).⁹

Profits are concomitant to risk, *al ghurmu bi al ghurmi*.¹⁰ So, the investor also faces potential risks. Investors will get losses if there is capital loss from the sale of securities stocks, bonds, or sukuk and defaults from Securities bond or sukuk.

Islamic equity financing represents a component of the overall capital market activity. Typically, equity-financing is structured through profit-sharing contracts or *`uqud alisytirak*.¹¹ There are two common types of equity

⁶ <<http://www.iei.or.id/publicationfiles/>>, “Perkembangan Pasar Modal Syariah”; Bapepam-LK, *Kajian Pasar Sekunder Efek Syariah di Pasar Modal Indonesia*, Research Division, (Jakarta: Minister of Finance, 2010), p. 38.

⁷ Bapepam-LK, *op. cit.*, p. 38.

⁸ <<http://www.financeislam.com/2010/01/06/islamic-business-contract-a-detailed-study/>>, “Islamic Business Contract a Detailed Study”, last viewed at April, 19th 2010.

⁹ Bapepam-LK, *op. cit.*, p. 42.

¹⁰ *Ibid.*

¹¹ IOSCO, *op. cit.*, p. 9.

financing instruments, *mudharabah* (profit-sharing) and *musharakah* (profit and loss sharing).

In Indonesia, the Bapepam-LK, as the securities of capital market and financial institution supervisory agency, has issued regulation related to the contract that be used in Shari'ah capital market. There is regulation number IX.A.14 on Contracts Used in Issuance of Shari'ah-Based Securities in Capital Market and Law number 19 of 2008 Securities Shari'ah State (SBSN). Based on these, contract that can be used on Shari'ah capital market is described bellows.

1. *Ijarah*

Ijarah is akad which the party that has goods or services (the lessor or servicer provider) promises to tenants or service user to transfer the right of use or utilization on certain goods and or provide services that are owned by the lessor providers or services in a certain period of time with the payment of rent and or wages (*ujrah*), without the transfer of possession rights of goods which become the object of *Ijarah*.¹² In other words, it is leasing contract.

2. *Kafalah*

Kafalah is akad where the insurer (*kafuil/guarantor*) promises to give assurance to the secured party (*makfuul 'Anhu/ashil/debtor*) to meet the obligations of parties which are guaranteed by the other party (*makfuul*

¹² Bapepam-LK, *Contracts Used in Issuance of Sharia-Based Securities in Capital Market*, Regulation Number IX.A.14 of 2006, article 1. a.

lahu/creditor).¹³ *Kafalah* is a form of guarantee contract with an additional obligation to an existing obligation. A contract of guarantee is permissible to secure an established obligation, such as the obligation to pay the price under a credit sale or lease rental in an *ijarah* contract.¹⁴

3. *Mudarabah (Muqaradhah) / Qiradh*

Mudarabah is akad which the parties provide the whole capital (*shahib al-mal*) promised to the manager of the business (*Mudharib*) to transfer the capital and the manager (*mudharib*) promised to managing capital.¹⁵ So, the owner is limits his liabilities to the capital committed. This is a profit sharing venture, where the profit are to be shared based on a pre agreed profit sharing ratio, whereas the losses will be borne entirely by the capital provider.¹⁶ The losses are borne entirely by the *rabb al-maal*. The types of expenses which will be subject to the *mudarabah* agreement, the capital, and definition of terms of quality and quantity and the exact amount, must be identified first. This is because the capital can also be in form of tangible assets in which case a precise valuation must be done to ascertain its value in monetary terms, the capital cannot be in the form of debt.¹⁷

4. *Wakalah*

¹³ *Ibid.*, article 1. b.

¹⁴ Syed Alwi Mohammed Sultan, *A Mini Guide to Shari'ah Audit for Islamic Financial Institutions-A Primer*, (Malaysia: CERT Publication, 2007), p. 61.

¹⁵ Bapepam-LK, *Contracts Used in Issuance of Sharia-Based Securities in Capital Market*, *op. cit.*, article 1. c.

¹⁶ Mohammed Sultan, *op. cit.*, p. 55.

¹⁷ *Ibid.*, p. 56.

Wakalah is akad which the party that gave the power (*Muwakkil*) gives power to another party that received power (representative) to perform certain actions or deeds.¹⁸ It is agency contract, where the agent is delegated to undertake certain responsibilities from principal. The rights or obligations as a result of the completion of the task will be assumed by the principal. The agent may be compensated by principal with a fee. *Wakalah* involves a fee as consideration for the services rendered and this fee may be in the form of an absolute amount or computed on a percentage basis.¹⁹

5. *Musharakah*

Musharakah is akad cooperation between the two parties or more to combine capital, both in form of money or any other form, with the aim benefit, which will be distributed in accordance with pre-agreed ratio, while losses incurred will be borne jointly according to the amount of capital participation of each party.²⁰ The specific conditions of *musharakah* are that the capital contribution need not be equal among all partners and the profit sharing ratio need not necessarily be according to the capital contribution, in view of the fact that some partners might be active partners undertaking the role of managing the business.²¹

6. *Salam*

Salam – which belongs to the same pool of contracts as *murabahah* – is a sale of a well-defined commodity to be delivered by the seller in the

¹⁸ Bapepam-LK, *Contracts Used in Issuance of Sharia-Based Securities in Capital Market*, *op. cit.*, article 1. d.

¹⁹ Mohammed Sultan, *op. cit.*, p. 61.

²⁰ Indonesia, *Securities Shari'ah State (SBSN)*, Law Number 19 of 2008, article 1. 8.

²¹ Mohammed Sultan, *op. cit.*, p. 59.

future but for immediate payment.²² In *Salam* contracts, the purchaser makes full payment upfront upon the conclusion of offer and acceptance. The delivery of good is in the future date. *Salam* contracts deal typically with agriculture produce. The exact specification of the goods in terms of quantity, size, etc. must be made clear including the exact date and manner of delivery, as such products do not have a long useful life to be kept as inventory.

7. *Istishna* '

Istishna ' is akad sale and purchase of assets in the form of an object financing between the parties where the specifications, how and duration of delivery, as well as asset prices determined by agreement of the parties.²³ *Istishna* ' is a contract of manufacturing a specified item or article before delivering the item to the purchaser. Hence, the contract is entered into between a manufacturer and purchaser, with an obligation on the part of the manufacturer to deliver the manufactured goods upon completion to the purchaser.²⁴

The mechanism of Securities trading on the Stock Exchange regular market in compliance with shari'ah principles if they meet specific requirements such as stated on Fatwa Number 80. Securities that can be traded are only securities in the List of Islamic Securities (Daftar Efek Syariah –

²² *Ibid.*, p. 51.

²³ Indonesia, *Securities Shari'ah State (SBSN)*, *op. cit.*, article 1. 9.

²⁴ Mohammed Sultan, *op. cit.*, p. 52.

hereinafter referred to as DES) that published by Bapepam-LK or constituent stocks of Indonesia Shari'ah Stock Index²⁵ (hereinafter referred to as ISSI).

Securities that include in Shari'ah capital market are (base on Bapepam-LK Regulation Number II.K.1 on Criteria and Issuance of List of Shari'ah Based Securities):

1. Shari'ah-based securities issued by the Government of Indonesia;
2. Securities issued by the issuer who declares that its business activities as well as its business management are conducted based on the Shari'ah Principles in the Capital Market as clearly stated in its article of association;
3. Sukuk, including Shari'ah Bond that has been issued by the issuer before the enactment of this rule;
4. Shari'ah-based Asset backed Securities;
5. Shari'ah Investment Fund;
6. Shari'ah Investment Fund Participation Unit in the form of Collective Investment Contract;
7. Securities in the form of shares, including shari'ah-based rights and shari'ah-based warrant, issued by the issuer who does not declare that its

²⁵ ISSI is an index consisting of stocks included in the DES issued by the Bapepam-LK once every 6 months (June and December) or other time set by the capital market regulator. ISSI was launched by IDX on May 12, 2011. ISSI issued as a reference for investors to invest in securities, especially shares of Shari'ah (reducing the level of *qharar* - uncertainty). ISSI is a leading indicator of all shares shari'ah. ISSI is computed using the base value in December 2007 (index value 100). The method of calculating the same calculation method that is in IDX indexes now are using the weighted average market capitalization. ISSI reviewed every 6 months in May and November, or whenever there is the DES recently.

business activities as well as its business management are conducted based on Shari'ah Principles in the Capital Market;

8. Other Islamic Securities;
9. Securities/Sukuk that meet the principles of Shari'ah in the Market Capital is traded on the Stock Exchange abroad;
10. Islamic commercial papers (sharia commercial paper) that meet the Shari'ah Principles and Capital Markets have got the rank of the company's rating agency.

Moreover, there are definitions of securities that can be traded on Indonesia base on Bapepam-LK Regulation Number IX.A.13:

1. Shari'ah Securities is securities as defined in Capital Market Law and its implementing regulation in which its contract and issuance method fulfills the Shari'ah Principles in Capital Market;
2. Sukuk is Shari'ah Securities in a form of certificate or proof of ownership which have the same value and represent participation unit which is not separated from or consists of:
 - a. The ownership of particular tangible assets (*a'yan maujudat*);
 - b. The beneficial value of tangible assets (*manafiul a'yan*); that have been exist or not;
 - c. Services (*al khadamat*) that have been exist or not;
 - d. Particular project's assets (*maujudat masyru' mu'ayyan*); and/or
 - e. Particular investment activities (*nasyath ististmarin khashah*).

3. Shari'ah Investment Fund is fund as defined in Capital Market Law and its implementing regulation are not in conflict with Shari'ah Principles in Capital Market;
4. Collective Investment Contract of Assets Backed Securities is contract between investment Manager and Custodian Bank that binding to all Assets Backed Securities holder where investment Manager's Representatives that conduct Investment Fund portfolio management, and Custodian Bank responsible person carrying out the custodian activities are not in conflict with the Shari'ah Principles in Capital Market;
5. Shari'ah-based Asset backed Securities is Collective Investment Contract of Assets Backed Securities that the portfolio is consist of finance asset that are not in conflict with the Shari'ah Principles in Capital Market.

Under the direction of the National Shari'ah Board (hereinafter referred to as DSN)²⁶ and the Regulation of Bapepam-LK Number IX.A.13 on Islamic Securities issuance, a company does not meet the shari'ah business code if:

²⁶ DSN was formed in 1999 under the organization of the Indonesian Council of Ulama, based on the Decision of DSN Number 01 of 2000 concerning the Guidelines of the Indonesian Council of Ulama. (1)Develop the application of shari'ah values in economic activities in general, and specifically in financial activities, (2)Issue edicts concerning the types of financial activities, (3)Issue edicts concerning shari'ah financial products and services, (4)Oversee the implementation of the edicts issued, (5)Issue edicts which are binding on the DPS at every respective Shari'ah Financial Institution (LKS) and serve as a basis for related legal actions, (6)Issue edicts to serve as a basis for provisions/regulations issued by the relevant authorities, such as the Department of Finance and Bank Indonesia, (7)Giving recommendations and/or revoking recommendations for names of members of the DPS at an LKS, (8)Invite experts to provide explanation about certain issues in discussions on shari'ah economy, including domestic as well as overseas monetary authorities/financial institutions, (9)Issue reminders to LKS in order to cease violation of edicts issued by the DSN, (10)Giving recommendation to the relevant authorities to take action if such reminders are disregarded.

1. The company's line of business is related to gambling and games that are considered types of gambling or prohibited trades;
2. The company conducts usurious financial service or trade related to fraud or gambling;
3. The company manufactures, distributes, trades and / or provides:
 - a. Goods or services that are forbidden by Islamic Law (haram) because of the substance (*haram li-dzatihi*);
 - b. Goods and services that are haram not because of the substance (*haram li-ghairihi*), which is determined by the DSN-MUI; and / or
 - c. Goods or services that may bring moral hazards and are harmful;
4. Trading that prohibited base on shari'ah:
 - a. Trading without transfer of goods/services;
 - b. Trading with fake supply/demand;
5. Conventional (*ribawi*) financial institutions:
 - a. Conventional banks;
 - b. Insurance companies;
6. Sale and purchase risk that include uncertainty (*gharar*) and/or gambling (*maysir*), such as conventional insurance;
7. Transaction with briber (*risywah*).

Securities are categorized as shari'ah securities if it meets the criteria as follow:

1. Does not conduct business as described above;

2. Does not perform any trading with fake delivery of goods / services as well as false offer and demand;
3. Does not exceed the following financial ratios:
 - a. Total interest-based debt compared to the total equity should not be more than 82% (interest-based debt compared to the total equity is not more than 45%: 55%);
 - b. Total interest income and other illicit revenue compared to total revenue (revenue) should not be more than 10%.

To set the list of securities included in the calculation of the Jakarta Islamic Index, the following selection process is carried out:

1. Securities will be selected based on the DES issued by Bapepam – LK;
2. Sixty (60) top securities from the DES will be selected based on their last year's market capitalization;
3. From sixty (60) securities selected, thirty (30) top securities will be chosen based on their last year's transaction value in the regular market.

Review conducted once every 6 months, with the determination of the index components at the beginning of June and December each year. While changes in the type of business issuer will be monitored continuously based on public data available.

E. Research Method

1. Objective of the study

The object of this research is:

- a. Trading mechanism of secondary market securities on Shari'ah capital market.
 - b. Shari'ah compliance of trading mechanism of secondary market securities in Indonesia.
2. Classification of data

This research is using secondary data which are from documents or archives related to problems discussed in this study. The purpose of this data is to identify the data systematically in order to answer the problems.

Secondary data are divided into:

- a. Primary legal materials
 - 1) Law of the Republic of Indonesia Number 8 of 1995 concerning Capital Market;
 - 2) Law of the Republic of Indonesia Number 40 of 2007 concerning the Limited Liability Company;
 - 3) Law of the Republic of Indonesia Number 19 of 2008 concerning Securities of Shari'ah State;
 - 4) Government Regulation Number 45 of 1995 concerning Implementation of Activity in Capital Market as revised by Government Regulation Number 12 of 2004 about Implementation of Activity in Capital Market;
 - 5) Regulation Number IX.A.13 on Issuance of Securities Shari'ah;
 - 6) Regulation Number IX.A.14 on Contracts Used in Issuance of Sharia-Based Securities in Capital Market;

- 7) Regulation Number II.K.1 on Criteria and Shari'ah Securities Issuance of List;
- 8) Bapepam-LK Regulations;
- 9) Fatwa Number 80/DSN-MUI/III/2011 on the Application of Shari'ah Principles in Trading Mechanism of Equity Securities at Stock Exchange Regular Market.

b. Secondary legal Materials

- 1) Literatures;
- 2) Text books;
- 3) Law journals;
- 4) Documents related to mechanism of secondary market securities Shari'ah and conventional capital market;
- 5) Articles from newspaper;
- 6) Internet sources.

c. Tertiary legal materials

- 1) Black's law dictionary.

3. Data Collection

Secondary data are collected from library research and document study. It's also taken from collecting, learning and understanding the act, document, text books and articles from newspaper or internet sources which are related to the study.

4. Approach of the study

This research is normative research which identifies legal norms and views. The objective is to understand and answer the object of study by using juridical normative approach method.

5. Data analysis

The data collection is organized by selecting the data related to the problem discussed in this study. It's structured in a descriptive way in order to answer the problem in descriptive analysis. The data are collected, managed and used to answer the problems. The method of analyzing the data is descriptive qualitative method. It means that the data achieved are not in form of numbers and statistic. Collected data are analyzed qualitatively and descriptively that takes data related to the problems that are analyzed so that it can be elaborated. Moreover, it also portrays facts, goes into effect, and bears with the applicable law aspects. The steps are defined as follow:

- a. Classification of data collection based on the problems of the research;
- b. Systematized of data collection;
- c. Systematized data is analyzed to achieve conclusion.

F. Systematic of Writing

Chapter I contains an introduction which encompasses these following parts: context of study, statement question, objective of the study, theoretical frameworks, research methodology, systematic of writing.

Chapter II contains theoretical review on trading mechanism of secondary market securities in conventional capital market which contains conceptual and legal basic, capital market actors on the secondary market, and trading mechanism on the secondary market securities.

Chapter III contains Shari'ah capital market related to trading mechanism of secondary market securities. Furthermore, the implementation of Shari'ah compliance related to the secondary market securities in Indonesia will be analyzed.

Chapter IV provides the conclusion and recommendation which are made base on the previous analysis that has been done.

CHAPTER II
TRADING MECHANISM OF SECONDARY MARKET SECURITIES
IN INDONESIAN CAPITAL MARKET

Shari'ah capital market in Indonesia implemented activities on Capital Markets based on Sharia Principles. Indeed, Shari'ah capital market system cannot be locked out from capital market system in whole. Shari'ah capital market activities in Indonesia are generally no different from capital markets activities which we have known all along.

In order to provide a better understanding on the trading mechanism of secondary market securities in shari'ah capital market, this Chapter discusses trading mechanism of secondary market securities in conventional capital market.

A. Conceptual and Legal Basic

Capital Market plays an important role in the economy of a country. Capital market serves as an alternative for a company's capital resources and also as an alternative for public investment. It is also facilitates the infrastructures needed for the selling and buying process and other related activities.²⁷

Capital market in Indonesia is governed on Law Number 8 of 1995 concerning Capital Market. Base on that law, capital market define as an

²⁷ <[http://www.idx.co.id/Home/Information/introduction to Capital Market/](http://www.idx.co.id/Home/Information/introduction_to_Capital_Market/)>, "Introduction to Capital Market", last viewed at December 9th, 2011.

activity concerned with the public offering and the trading securities, public company relating to the issuance of securities, and agency and professions related to securities.²⁸

In order to create of a sound and efficient capital markets system generally, and implementation of the capital market activities specifically, the Ministry of Finance is set out Government Regulation Number 45 of 1995 concerning Implementation of Activity in Capital Market then amendment by Government Regulation Number 12 of 2004 about Implementation of Activity in Capital Market.

Maintaining a sound capital market system demands a proper system of regulation and supervision. To address the need, Bapepam-LK is working constantly on the development of capital market regulation and supervision. To ensuring the orderly, fair and efficient capital market and protect the interests of investors and the public, Bapepam-LK is providing the guidance, regulation and supervision.²⁹

In general, activities on capital market can be divided into primary market and secondary market activities. On primary market, the company doing capital gained by the public offering. Public offering or go public is the activities of stock or other marketable securities offering by an issuer (going

²⁸ Indonesia, *Capital Market*, Law Number 8 of 1995, article 1. 13.

²⁹ *Ibid.*, chapter III article 5.

public firm) to the public based on the procedures arranged in the capital market law and its implementation rules.³⁰

After the primary market ends, the securities begin traded. The securities issued listed at stock exchange. These activity is defines as the secondary market activities. In this case, exchange transaction contract must be made in accordance with exchange rules concerning on sales and purchases securities, borrowing and lending securities, securities price, etc.³¹

Securities which can be listed at the Stock Exchange are Stocks (Shares); Pre-emptive Rights (HMETD), warrant and its other derivatives include: Stock Options Contract (KOS) and Securities Index Futures Contract; Bonds (Debt) and other Debt-Type Securities include: Sukuk (Syariah Bonds) and Asset-Backed Securities (ABS), Exchange Traded Fund (Unit of Participation).³² The description below will focus on the stocks mechanism.

In Indonesia, the stock could be listed in the Indonesia Stock Exchange (hereinafter referred to as IDX). IDX is performs and provides system and/or facility to match securities sell and buy quotations of other parties for the purpose of transacting securities among them.³³

³⁰ *Ibid.*, article 1. 15.

³¹ *Ibid.*, article 1. 28.

³² Indonesia Stock Exchange, *Fact Book 2011*, (Jakarta: Indonesia Stock Exchange, 2011), p. 37.

³³ Indonesia, *Capital Market, op. cit.*, article 1. 4.

IDX was the result of consolidation of Surabaya Stock Exchange (SSX) and Jakarta Stock Exchange (JSX) in 2007. This consolidation was expected to increase the role of the Capital Market in Indonesia's economy.³⁴

As a facilitator and regulator of the Stock Exchange in Indonesia, IDX has a characteristic that distinguishes it from other Companies in that IDX is the Self-Regulatory Organization (SROs) of the Indonesian capital market.³⁵ IDX as managing stock exchange institution shall create regulations conducting stock exchange activities. It is including stock exchange members, listing, and securities trading on the Stock Exchange.

Bapepam-LK and IDX was issued Trading Regulation Number II-A on Equity Securities Trading and Regulation Number III.A.10 on Securities Transaction in order to regulate securities trading activity.

In order to meet its functions, IDX performs routine monitoring and organizing mechanisms on the Exchange activity and Exchange Members. The adjustments on the regulations are conducted in line with the development of capital markets generally, and the Stock Exchange specifically.

³⁴ Indonesia Stock Exchange, *Annual Report 2010 Indonesia Stock Exchange*, (Jakarta: Indonesia Stock Exchange, 2010), p. 7.

³⁵ *Ibid.*, p. 82.

B. Capital Market Actor on the Secondary Market

People may invest their money on capital market. Someone who buys stock in the capital market defines as investor. In his activities, investor can be categorized as speculators, investors who want to take dividend, investors who want to trade to gained capital gain, and investors who want to be owner of the company.³⁶

An investor can be a public company³⁷ or a person. To enter into securities trading, the investor will become a customer by use services provided by the Financial Service Provider in Capital Market area.³⁸ Customer can be a direct customer of securities exchange member or non-securities exchange member that co-operation with securities exchange member.³⁹

When engaged on securities trading of capital market business, there are Brokerage Company⁴⁰, such as Securities Exchange Members, and other actors that involved. In order to give a better understanding on the securities trading mechanism, bellow described the capital market actors on secondary market.

³⁶ See Siti Annisah, *Capital Market Handout.ppt*, Faculty of Law Universities Islam Indonesia 2011, number of slide 17.

³⁷ Public Company is a Company that has at least 300 shareholders and a paid-in capital of at least three billion rupiah, or such other number of shareholders and paid-in capital that may be stipulated in Government Regulations.

³⁸ Bapepam-LK, *Know Your Customer Principles (Implemented) by Financial Service Providers in Capital Market Area*, Regulation Number V.D.10 of 2007, article 1. c.

³⁹ Bapepam-LK, *Kajian Pasar Sekunder Efek Syariah di Pasar Modal Indonesia*, *op. cit.*, p. 7.

⁴⁰ Brokerage Company is a company that has an active operating license to conduct the activities of broker-dealer/bank.

1. Securities Exchange Member

To become Securities Exchange Member, any Securities Company shall obtain an operating license as a Broker-Dealer from Bapepam-LK and having the Exchange Membership Approval.⁴¹ Therefore, Securities Company on secondary market is engages in the business of Broker-Dealer.⁴² As a Broker-Dealer, Securities Company is conducting buying and selling securities for the account of others or for his own account.⁴³

Indeed, to become an Exchange Member, the Securities Company must fulfill some requirement.⁴⁴ Accordingly, the Securities Company shall has an active operating license as broker-dealer, acquire 1 (one) of the IDX' share, have information technology officer for Remote Trading System, have facilities and infrastructure of Supporting Tools, and must be declared as operationally capable by the Information System Auditor.

In addition, the Securities Company must install the brokerage information system that will allow the company to participate in the remote trading operation. These systems carry out an integrated risk

⁴¹ Indonesia Stock Exchange, *Securities Trading*, Regulation Number II-A of 2003, chapter I article 1.1.

⁴² A securities company may do businesses as an underwriter, a broker-dealer, and/or investment manager. For these activities, a securities company should (1) obtain a separate license from BAPEPAM-LK; (2) set up as limited liability corporation; (3) must meet the paid-up capital requirements based on whether the company is an underwriter, a broker-dealer or an investment management; (4) All of the directors and dealers/marketing staffs of a securities company must have appropriate individual licenses, either as an underwriter, a broker-dealer or an investment management; (5) A director of a securities house cannot hold any positions, at all time, in any other companies.

⁴³ Indonesia, *Capital Market*, *op. cit.*, article 1. 18.

⁴⁴ Indonesia Stock Exchange, *The Exchange Membership*, Regulation Number III-A of 2011, chapter II.

management system between front and back end system and front end system which has order management and transaction monitoring functions.

All Securities Companies that are Exchange Members must submit a daily report of the availability of the minimum Net Adjusted Working Capital (hereinafter referred to as NAWC).⁴⁵ NAWC of Broker-Dealer is Rp 25 billion. The deadline for submission is 9:00 AM every day. An Exchange Member who fails to submit this report or fails to fulfill NAWC requirement, will be suspended⁴⁶ from trading. However, if for more than 30 consecutive days or more than 60 days within a 12-month period NAWC still fails fulfilled, Bapepam-LK will revoke operational license of an Exchange Member.

2. Non-Exchange Members

Non-Exchange Member is an agent for Securities Exchange Member. In this case, Non-Exchange Member refers to Securities Company which no longer to be Securities Exchange Member or/and Securities Company that no qualified to be Securities Exchange Member. Non-Exchange Member does not have a voting right in the General Meeting of Shareholders.⁴⁷ Therefore, the Securities Company which no longer to be Securities Exchange Member must transfer its share to

⁴⁵ Net Adjusted Working Capital (NAWC) means the Net Adjusted Working Capital as mentioned in the Bapepam-LK Regulation Number V.D.5. Concerning the Maintenance and Reporting of Net Adjusted Working Capital.

⁴⁶ On the suspended condition, Securities Company temporarily prohibited to conduct trading activity at the Exchange.

⁴⁷ Indonesia, *Implementation of Activities in Capital Market*, Government Regulation Number 45 of 1995, article 10.

another Securities Company qualified to be a Securities Exchange Member.⁴⁸

3. Other Participant

Not only Securities Company that can enter into securities transaction, but also other participant. The participant is an investor or other that not qualified as Securities Company, such as insurance companies, Investment Funds, banks or other financial institutions.

There are some requirements for participant who will enter into securities transaction.⁴⁹ First, the company must obtain an active operating license to conduct the activities of broker-dealer/bank or approval letter from Bapepam LK in case of not having licensed to conduct the activities of broker-dealer/bank. Then, the company must possess at least two personnel that have completed training by the bourse to operate Centralized Trading Platform-Beneficiary of Securities Transaction Report (hereinafter referred to as CTP-PLTE) and also has completed CTP-PLTE reporting system fee obligation. Surely, the company must provide computer hardware's and network communication facility to conduct transaction reporting.

4. Transaction Actors

⁴⁸ *Ibid.*, article 8.

⁴⁹ Indonesia Stock Exchange, *Fact Book 2011, op. cit.*, p. 82.

On conducting securities transaction there are specific actors that involved. First, Order and Trading Authorizer (hereinafter referred to as PJPP).⁵⁰ PJPP is a party that responsible on the offer and bid order to be entered into JATS⁵¹. PJPP is appointed by the Securities Exchange Member or Securities Company that has filed the application for the Securities Exchange Membership and has been registered in the Exchange.

Second, Information Technology Officer for Remote Trading (hereinafter referred to as IT Officer-RT). IT Officer-RT has duty to ensure the readiness and smoothness of operation of the Supporting Tools⁵². IT Officer-RT is appointed by the Securities Exchange Member.⁵³

5. The Indonesian Clearing and Guarantee Corporation (hereinafter referred to as KPEI)⁵⁴

KPEI's activity is to provide services for clearing settlements of scrip trading of securities, as well as clearing and guarantee services for settlements of stock exchange transactions on scripless trading of securities. KPEI also provides services for clearing and guarantee of derivative securities transactions such as stock index futures trading, stock option trading, services for securities lending and borrowing and corporate

⁵⁰ Indonesia Stock Exchange, *Securities Trading, op. cit.*, chapter I article 1. 27.

⁵¹ Jakarta Automated Trading System (hereinafter referred to as JATS) means the Securities trading system applied in the Exchange for automatic trading by means of computer facilities.

⁵² Supporting Tools means router, software and hardware of JONEC and other equipment in accordance with the specification as determined by the Exchange and provided by the Securities Exchange Member for the operation of securities trading through Remote Trading.

⁵³ Indonesia Stock Exchange, *Securities Trading, op. cit.*, chapter I article 1. 14.

⁵⁴ *Ibid.*, chapter I article 1. 33.

bond. KPEI is conducting duties in accordance with Bapepam-LK rules. Yet, KPEI is making rules on the activities. Its service is in charges. KPEI is obtained business license from Bapepam-LK. This company is domiciled in Jakarta.

6. The Indonesian Central Securities Depository (hereinafter referred to as KSEI)⁵⁵

Central Securities Depository is acts as a central Custodian⁵⁶ services for Custodian Bank⁵⁷, Securities Company and other parties. The activity is relating to the settlement of transactions. Similar with KPEI, KSEI make rules on the activities, and its service charges. This company domiciled in Jakarta and obtained business license from Bapepam-LK.

C. Trading Mechanism of Secondary Market Securities

In general, securities transactions in the secondary market can be grouped in several types base on the transaction taken places, sources of finance, and derivatives transaction.⁵⁸ Base on place, there are Stock Exchange

⁵⁵ *Ibid.*, chapter I article 1. 34.

⁵⁶ Custodian is a Person who provides safe-keeping services with respect to Securities and Securities -related assets and other services, including collection of dividends, interest, and other entitlements, the settlement of Securities Transactions, and agency services for clients who are account holders as mentioned in the Law Number 8 of 1995 Concerning Capital Market.

⁵⁷ Custodian Bank is a Commercial Bank that is granted approval from the Capital Market and Financial Institutions Supervisory Agency (CMFISA) as a Custodian as mentioned in the Government Regulation Number 45 of 1995 Concerning Implementation of Activities in Capital Market.

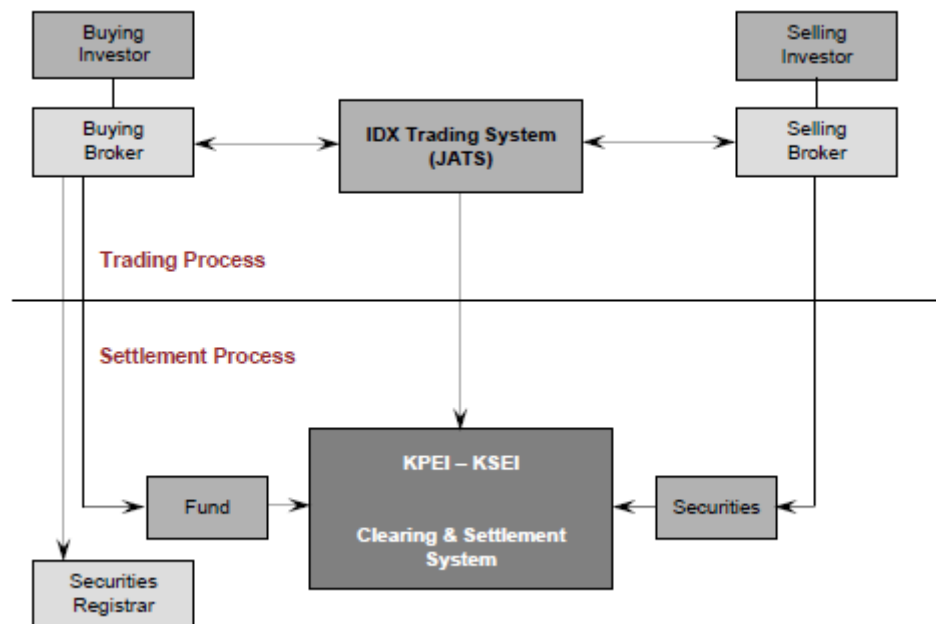
⁵⁸ Bapepam LK, *op. cit.*, p. 5.

transaction and Foreign Stock Exchange or the so-called Over the Counter (OTC) transaction. Both transactions are common used in the trading mechanism. Margin transactions and Short Selling transactions are transaction that differ base on the source of finance. At last, derivatives transactions consist of lending and borrowing securities transaction and repurchase (repo) transaction.

1. Trading in the Stock Exchange

The stock or securities is traded on the stock market (stock exchange) base on continuous action mechanism. It can be illustrate on figure bellow.

Figure 2



Source: Indonesia Stock Exchange, Fact Book 2011

Procees of securities trading on the exchange:

a. Opening Account

Before making transaction, the investor must open account by signing an open account contract with the Securities Company.

The contract between Securities Company and customer is set out on Bapepam-LK regulation Number V.D.3 article 5 concerning Internal Control of Securities Companies and Bookkeeping Organization by Securities Companies.

The opening account contract is obliged except on the Mutual Fund trading, public offering order, and trading for beneficiary purpose of Securities Company and affiliated parties with financial institutions.⁵⁹

The contract must contain terms and conditions of Securities account. Securities and funds may be used as collateral for client obligations to the Securities Company, used as implementation transaction, used as collateral on the financial institutions in the matter of negative balance client

⁵⁹ Bapepam-LK, *Internal Control of Securities Companies and Bookkeeping Organization by Securities Companies*, Regulation Number V.D.3, article 5.

account. Securities Company has right to purchase securities to cover the negative balance effect in the short position⁶⁰. Securities can be kept in the Custodian division under Securities Company responsibility.⁶¹

The opening document of the account encompasses complete customer's identity (name, address, telephone number, number facsimile and TIN), financial condition, investment objectives, and some information regarding the transaction (power attorney regarding securities account). However, individual customer at least contains employment, marital status, investment objectives, and financial conditions.⁶²

Whereas, in Regulation Number V.D.10, supporting document for individual customer shall include specimen of signature.⁶³

For the other participants such as legal entity, cooperative, association, or organized group the document identity consist of business license; taxpayer number; article of

⁶⁰ Short Position is the balance of securities in a specific account in Securities Ledger that indicates the amount of securities sold by Securities Company for its own or client's interest, that, at the time of transaction, has not been owned by the Securities Company and nor delivered by the client to the Securities Company as mentioned in the Bapepam-LK Regulation Number V.D.6 concerning Financing Securities Transactions by Securities Companies for Their Clients and Short Selling Transactions conducted by Securities Companies.

⁶¹ *Ibid.*

⁶² *Ibid.*

⁶³ Bapepam-LK, *Know Your Customer Principles (Implemented) by Financial Service Providers in Capital Market Area, op. cit.*, article 9. c.

association; management structure and document identity; financial report; name, specimen of signature, power attorney to Securities Company by appointed person to act on behalf of the company, and investment objectives.⁶⁴

Approval for opening account may be given after cross checking to ensure validity identity and supporting documents, and considering factor enable Customer to conduct money laundering activities, such as records, documents, lists, information regarding violations and or crimes. The opening account is done without direct face to face interaction with potential Customer.⁶⁵

Meanwhile, in transaction through Non-Exchange Member, the opening account contract must be signed by customer, Securities Exchange Member, and Non-Exchange Member. The contract must refer to Regulation Number V.D.3 article 5. Securities Exchange Member must carry out all written order related to customer securities account which is forwarded by Non- Exchange Member through a manual or safe electronic form, although the order by customer is performed verbal or in written form. Customer securities account is kept under Securities Exchange Member

⁶⁴ *Ibid.*

⁶⁵ *Ibid.*, article 9. d.

responsibility. Securities Exchange Members is not responsible in default forwarding order. Copy of the contract must be kept in the both marketing division. Above all, must be including on the provisions of contract.⁶⁶

After officially registered as a customer, the investor can start making transactions. Usually the Security Company requires depositing a certain amount of money as a guarantee to do the transaction. The amounts of the deposit are various. It is depend on the Securities Company.

b. Submission of Order

The activity of buying and selling shares is started with the instruction given by the investor to the broker. The order is conducting by some mechanism. It can be manual, remote, and online.

Manual trading mechanism means the order is done directly, in which the investor come straightly to the broker on the trading floor or through means of telecommunication such as the telephone. Every order that comes, by the Sales⁶⁷ will be

⁶⁶ Bapepam-LK, *Guidelines for Agent Agreement of Member of Stock Exchange Securities Company*, Regulation Number V.D.9 of 2000, article 4. d.

⁶⁷ Sales means a person represents the Securities Exchange Member on the selling end of a deal.

sent in the slip order form to the dealer⁶⁸ in the brokerage company. Slip order contains information, such as securities code, volume, and price order. In this case, dealer with risk management division will check and confirm funds, securities, and limit trading of the customer. Exchange Members can only execute limit orders, or orders entered at a specified limit price set by their clients.⁶⁹ Then, order will be sent to the trader on the Trading Floor known as the Floor Trader. Floor Trader will then make an entry of every order they received in the JATS⁷⁰.

In the remote trading mechanism, the trader is replaced by e-SPis system. By this system, the limit trading of customer is automatically determined. Whereas, the mechanism order to the brokerage company is similar.

Online trading is simple one. The customer is input the order by mobile phone, pc, etc. through online trading application from the brokerage company. The order automatically will be sent to e-SPis then by-pass to JATS through remote mechanism. On October 23rd, 2008, IDXmobile service was officially launched as response to

⁶⁸ Dealer means a person represents the Securities Exchange Member on the dealing order or selling.

⁶⁹ Indonesia Stock Exchange, *Securities Trading, op. cit.*, chapter II article 4. 2.

⁷⁰ The JATS can handle all financial products (stocks, bonds, and derivatives) in one platform. The implementation of the new system is carried out in several stages, started from the implementation of the system for stock trading, and followed by the implementation for derivatives (options and futures) and bonds trading on the following years.

investors needs for direct Exchange trading information (real time and online) can be accessed anywhere by cellular phone.⁷¹

Exchange Members can access JATS directly from their offices through JONEC (Jakarta Stock Exchange Open Network Environment Client) on broker's site and JONES (Jakarta Stock Exchange Open Network Environment Server) on IDX's site. This system is named as JATS Remote trading (JATS RT) and utilizes a host-to-host model using FIX, so that IDX Members can develop their business, for example, developing on-line trading or Direct Market Access (DMA) system.⁷²

IDX current trading system, Jakarta Automated Trading System – Next Generation 1.10.1 (hereinafter referred to as JATS-NextG 1.10.1), was improved version as a continuing of the development JATS.⁷³ Stock Options traded in JOTS (Jakarta Options Trading System). Index Futures traded in FATS (Futures Automated Trading System). Fixed Income

⁷¹ IDXmobile service is a service application (software) that provides direct information services (real time and online) for the price movements of stock and stock index that directly connected with Indonesia Stock Exchange (IDX). IDXmobile application is using the GPRS-based technology using the Java platform, which is the platform most widely used by cellular phone.

⁷² To ensure safety and availability, the remote trading is supported by a dedicated and redundancy link. The IDX also cooperates closely with the application service provider (ASP), to ensure that IDX Members receive full supports and services. After implementing the current JATS version, IDX provided only 150 terminals for stock traders at Trading Floor, which is located at the Ground Floor of the IDX Building. Since 1 September 2010, IDX had removed these facilities and provides only 20 terminals for IDX Members, only when they have problem with their link to JATS.

⁷³ Indonesia Stock Exchange, *Annual Report 2010 Indonesia Stock Exchange*, *op. cit.*, p. 59.

Trading System (FITS) is a trading system for bond listed in Indonesia Stock Exchange that allows the bonds to be traded in retail basis (retail bond).

c. Processing Order

All transactions above are processed through JATS. All securities transactions other than the pre-emptive rights can only be executed by the Securities Exchange Member in the Regular Market. There is exception if their client has specifically instructed them or agreed on paper that their orders should be executed at the Cash or Negotiated Markets.

Trading in the Indonesia Stock Exchange is based on an order-driven market system where only limit order with day or session order duration is accepted.⁷⁴ Only IDX Members who are already registered as the KPEI Members can input the orders into the JATS. They may also buy and sell securities using their own names as part of the investment portfolio. The trading system will check or validate the order entry on the kinds of order, round lot, price step, and auto rejection.

1) Order

⁷⁴ Indonesia Stock Exchange, *Fact Book 2011, op. cit.*, p. 16.

As mentioned above, the Securities Exchange Members can only execute limit orders. Principally, there is no minimum limit of the amount of fund used to buy the shares.

2) Round Lot⁷⁵

In securities trading, the amount of shares traded uses a trading unit called as lot. Currently, 1 lot is equal to 500 shares. Stock trading at the Regular and Cash Market have to be in a round lot of 500 (five hundred) unit or it's multiply, while the stock trading at the Negotiated Market does not have to be in a round lot (odd lot).

3) Price Step⁷⁶

Table 1

Price	Step Value	Maximum Price Step
< IDR 200	IDR 1	IDR 10
IDR 200 – < IDR 500	IDR 5	IDR 50
IDR 500 – < IDR 2,000	IDR 10	IDR 100
IDR 2,000 – < IDR 5,000	IDR 25	IDR 250
≥ IDR 5,000	IDR 50	IDR 500

The maximum price step is 10 times of the step value, should be below the limit of Auto Rejection, and is not valid on the pre-opening.

⁷⁵ Indonesia Stock Exchange, *Securities Trading, op. cit.*, chapter II article 5. 1.

⁷⁶ *Ibid.*, chapter II article 5. 2. 1.

Stock step value and its maximum price step are valid for one entire trading day and will be adjusted on the next day if its closing price falls on a different price range. The maximum price step should not exceed the percentage of Auto Rejection limit.

4) Auto Rejection

The transactions price orders entered into the JATS have to be in a certain price range. If a Broker inputs a price order above or below the stock's price range, the JATS will automatically reject the price order.⁷⁷

JATS will automatically do the Auto Rejection to the price orders input into the JATS at the Regular and Cash Markets if the securities order is price less than the minimum price limit of IDR 50 and the selling or buying order is more than 10% (ten percent) above or below the Reference Price. For IPO shares, Auto Rejection Percentage is twice the normal percentage. Auto Rejection is not valid for Derivatives (Warrant and Rights). In Corporate Action condition, for three days after the end of equity trading that has right (cum period) in Regular Market, Auto Rejection refers to the Previous Price of each market (Regular or

⁷⁷ *Ibid.*, chapter I article 1. 2.

Cash). In regular condition for the first order, Maximum Price Movement refers to the previous price of Regular Market.⁷⁸

d. Implementation Transactions

Securities Exchange Members have the responsibility to settle all the transactions they make as stated in the Exchange Transaction List (DTB). Instead, there are some exceptions thus: the errors of supporting tools or Remote Trading applications of the Securities Exchange Member, except JONEC software errors that provided by the IDX; and/or a mistakes caused by the carelessness of the PJPP when orders input into the JATS; and/or a mistakes caused by the carelessness of the IT Officer-RT when operating their supporting tools or applications; and/or invalid access into the Exchange Member's supporting tools or applications.⁷⁹

Securities trading at the Regular Market starts with a Pre-opening session. This session allows Exchange Members to input their purchase and sell orders according to the provisions of the stock unit, step value and Auto Rejection limit.

⁷⁸ *Ibid.*, chapter II article 6. 2.

⁷⁹ *Ibid.*, chapter II article 1. 7.

The Pre-opening price is formed from the accumulation of the total highest bids and asks matched by the JATS during the Pre-opening session. The bids and asks will be processed by the JATS by considering:

1) Price priority⁸⁰

Higher bids have more priority than lower bids. On the contrary, lower asks have more priority than higher asks.

2) Time Priority⁸¹

If the bids and asks are on the same price, JATS will give priority to the first submitted bids and asks.

Reduction on the number of purchase or sell order processed into the JATS will not cause time priority lose. On the other hand, addition on the number of purchase or sell order processed into the JATS will be treated as a new order.⁸² Securities trading in the Regular and cash Market will occur and bind when JATS matches the sell and purchase

⁸⁰ *Ibid.*, chapter II article 7. 1. 3.

⁸¹ *Ibid.*, chapter II article 7. 1. 4.

⁸² *Ibid.*, chapter II article 7. 1. 7.

orders.⁸³ The transactions only can be cancelled on the same days before clearing takes place.⁸⁴

All bids and asks that have not been matched during the pre-opening session will be processed in the first session of the trading day, except if the price of the bids and asks has exceeds the Auto Rejection limit.⁸⁵

In Negotiated Market, prices of each security are bargained out between Securities Exchange Members or Investor and one Securities Exchange Member or Securities Exchange Members and KPEI. The results of the negotiation will be processed through the JATS. The Exchange Members can submit their bids and asks through the ad board, and they can change or cancel them before they are matched with other bids and ask in the JATS. Once they are matched, a transaction is made and will be carried out.⁸⁶

e. Clearing, Guarantee, and Settlement Transactions

Transaction settlements between the sellers and buyers in the Regular and Cash Markets are guaranteed by the KPEI.

Transactions in Regular Market have to be settled on the third

⁸³ *Ibid.*, chapter II article 7. 1. 9.

⁸⁴ Bapepam-LK, *Securities Transaction*, Regulation Number III.A.10, article 2. f.

⁸⁵ Indonesia Stock Exchange, *Securities Trading*, *op. cit.*, chapter II article 6. 6.

⁸⁶ *Ibid.*, chapter II article 8.

Exchange day⁸⁷ after the trade (T+3). Transactions in Cash Market have to be settled on the same day as the trade (T+0).

Settlement process in the Regular and Cash Market is carried out by the KPEI through the Netting⁸⁸ process and book-entry on the Exchange Members' accounts in KSEI.

If an Exchange Member fails to fulfill its obligations to deliver the securities as determined, it has to pay an Alternate Cash Settlement (ACS) amounted to 125% (one hundred twenty five percent) of that securities' highest price in The Regular and Cash Market, which deadline of settlement falls on the same date; and The first session of the Regular Market at the settlement date.

If an Exchange Member fails to fulfill its obligation to pay the service fees to the KPEI, the Exchange Member needs to settle the matter according to the KPEI Regulations.

Exchange Member who fails to fulfill its obligations to pay the settlement fees will be suspended from the market activities until IDX receives a confirmation from the KPEI

⁸⁷ Exchange Day means a day when Securities trading takes place at the Exchange namely Monday to Friday, except the national holiday or declared as the Exchange holiday by the Exchange.

⁸⁸ Netting means a clearing activity causing any Clearing Member to submit and or receive a certain balance of any type of transacted Securities and to receive or pay any amount for the entire transacted Securities as set forth in the provision of article 1. b of Bapepam-LK Regulation Number III-A.10 Concerning Exchange Transaction.

stating that the Exchange Member has fulfill all its obligations. The Exchange Member might also receive other sanctions according to the Exchange Regulations.

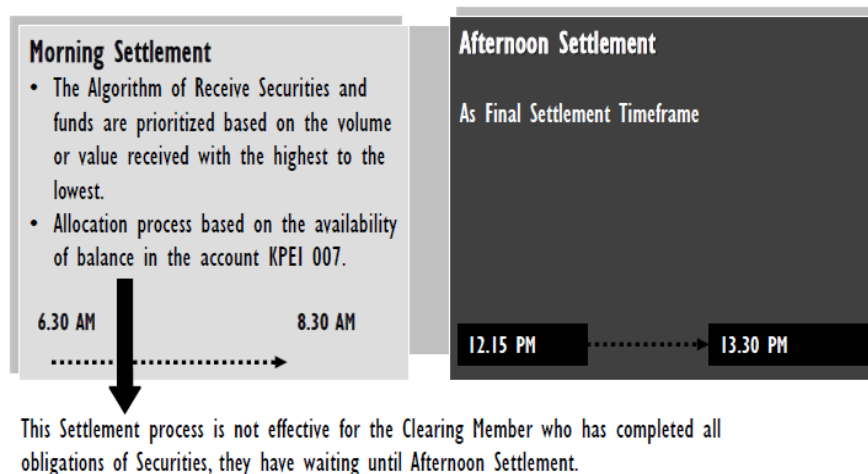
The settlement date in the Negotiation Market is decided based on the agreement between the seller and buyer, and is settled Trade by Trade (without Netting). If the date has not yet been decided, the transaction settlement has to be settled on the third Exchange day after the trade (T+3) at the latest, or on the same day as the transaction (T+0), if the trade took place on the last day of pre-emptive rights trading. The transaction settlements in Negotiated market are settled by direct transfer accounts between the buyers and sellers and are not guaranteed by the KPEI.

For every transaction, the Exchange Members have to pay fees to the IDX, KPEI and KSEI based on the value of each transaction. The fees have to be paid to the Exchange account every month, or on the twelfth day of the following month at the latest. If the twelfth day of the following month falls on Saturday, Sunday or holiday, the fees should be paid on the next Exchange day. Late payments will be subjected with 1% of penalty for every one day delay.

The Exchange Member who doesn't fulfill its obligations at least 5 days after the payment deadline will not only receive penalty, but also will be suspended until it has settled its payment obligations and the penalties.

Prior to the Continuous Settlement, Settlement process is done in two stages of morning settlement and afternoon settlement.

Figure 3



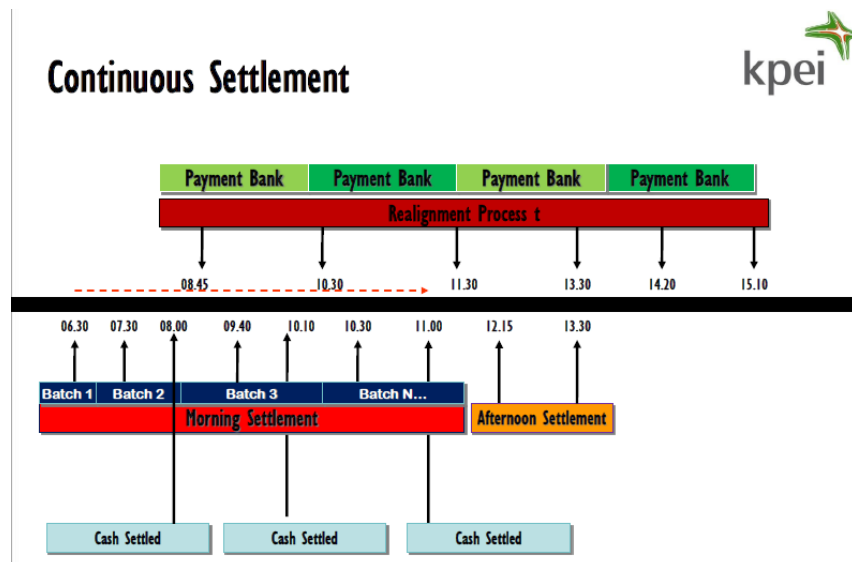
Source: www.kpei.co.id

There is uncertainty of cash settlement even if Clearing Member fulfills their Securities Obligation. The availability of funds to the Clearing Member is very dependent on the payment of other Clearing Member funds. The priority for fulfillment rights of clearing member funds was done by order

of the largest amount to the smallest amount without regard to the fulfillment of obligations in advance.

Continuous Settlement Process is occur start from 06.30am - 12.15pm. Cash Payment will be done for the clearing member who completed all obligations of securities. KPEI use intraday Facility (source of fund) from Bank to fulfill of funds for clearing member. Settlement of funds by clearing member to its customers can be done early. To complete the obligations of securities, it is supported by Securities Lending Facility.

Figure 4

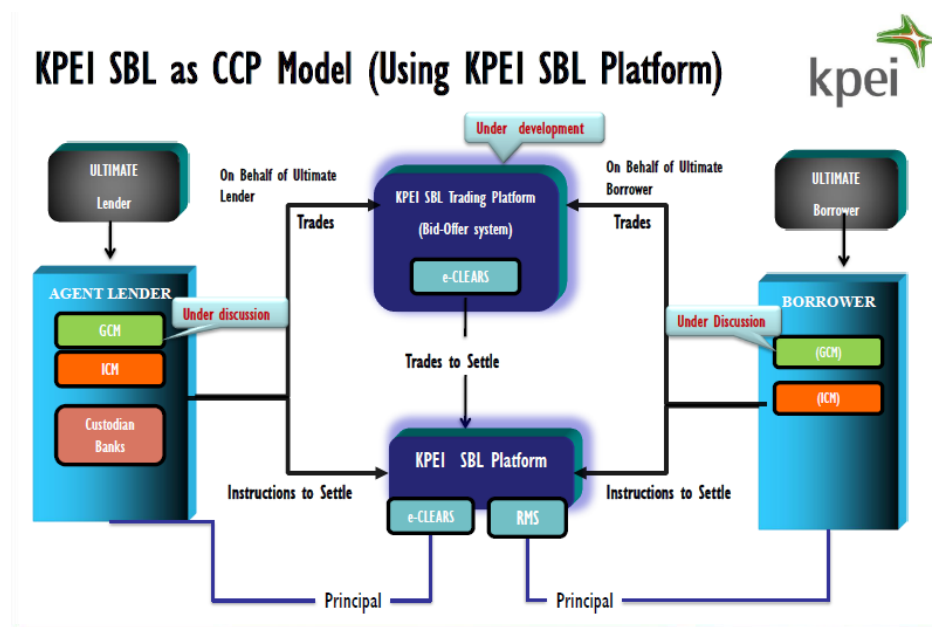


Source: www.kpei.co.id

Benefit of continuous settlement are on the liquidity reason for Clearing member, the accelerate Settlement Process, and reduce financing cost by Clearing Member alternatively can borrow securities to receive cash in advance.

KPEI is also role on Securities Borrowing and Lending.

Figure 5



Source: www.kpei.co.id

On the Bid Offer Securities Lending and Borrowing, KPEI facilitates Lenders and Borrowers to have bid/offer Securities Borrowing and Lending trades. Securities Borrowing and Lending fees will be based on matched Securities Borrowing and Lending trades. KPEI acts as a principal and

KPEI Keep Collateral. KPEI guarantees the return and manufactured dividend payment.

Whereas, on Bilateral Securities Borrowing and Lending, KPEI facilitates Lenders and Borrowers to have a negotiated Securities Borrowing and Lending trades. Negotiation includes fees rate, collateral rate, upper limit and lower limit for margin call. KPEI acts as a Third Party Agent Models of Bilateral KPEI Securities Borrowing and Lending are first, KPEI will maintain Borrower's collateral and guarantees the margin call payment. Second, collateral will be passed through to Lenders and Mark to Market.

By this KPEI can reduce of counterparty Risk Exposure, can eliminate of need for multiple agreements and credit evaluation because KPEI as Central Counterparty (hereinafter refer to as CCP) is counterparty to all transaction, can guaranteed redelivery of collateral, can access to a wider market because more borrowers and lenders, efficiencies of Front and Back-office (Timely settlement of month-end fees), and the transactions cleared through the CCP.

In this process Membership is limited. The borrowers are only Brokers, Lender Brokers and limited Custodian Bank. Most of them only used it for exchange settlement coverage.

This process is lack of supply because Pension fund, Investment Management, and Insurance are prohibited. There are limited eligible stocks for regulated short selling, non negotiable model/ Non Bilateral scheme, collateral keep by CCP is place in Bank. The fee basis is depends on rebate.

2. Trading in Foreign Exchange (Over The Counter) Mechanism

Gurong Jiang, Nancy Tang and Eve Law defines fforeign Securities exchange transactions as a transaction between two parties to the bid price (quotation) is not standardized whether conducted either through intermediaries or not.⁸⁹ Meanwhile Leigh Tesfatsion defines the OTC Markets, is a transaction managed by the dealer who usually does not have a trading facility and clear mechanisms.⁹⁰

The meaning of the Non-Exchange Transaction in Indonesian Capital Market was described in Bapepam-LK Regulation Number III.A.10, Non-Exchange Transaction are transactions between Securities Companies or between a Securities Company and another Person that are not regulated by a Securities Exchange, and transactions between Persons that are not Securities Companies.⁹¹

From above all can be explained that Foreign Exchange transactions are transactions that the trading and settlement mechanisms is

⁸⁹ Bapepam-LK, *op. cit.*, p. 25.

⁹⁰ *Ibid.*, p. 26.

⁹¹ Bapepam-LK, *Securities Transaction, op. cit.*, article I. d.

agreed by the parties without refers to the provision or the Stock Exchange trading system in particular. Therefore, in OTC, continuous auction mechanism is unknown.

The process of trading mechanism on OTC described below.

a. Opening Account and Submission Order

The process of opening account and submission order on OTC through Securities Company are similar with the Exchange trading mechanism as regulate on Regulation Number V.D.3.

Instead, possessed of securities account is not obliged in transactions without the involvement of Securities Company. This is for securities that unrecorded in the Exchange and un-kept in Securities Company or Custodian Bank. Institutional client such as insurance companies, Investment Funds, banks or other financial institutions also not obliged to have securities account, as provided in article 5. 3) Regulation Number V.D.3.⁹²

Submission order divided into:

- 1) Transactions between Securities Company or between a Securities Company and another Person

⁹² Bapepam-LK, *Securities Transaction, op. cit.*, article 1. g.

Securities Company must send an order to the other Securities Company or other Person that involved in the transaction. Transaction is bound with respect to the number and type of Securities, the price, and the settlement date of the transaction.⁹³ Client orders can be refused or cancelled by Securities Company through writing inform on the same day. Customer is responsible to the cancelled order if the instruction was received by Securities Company 30 minutes or more before transaction was executed in Indonesia and 24 hour or more in foreign country.⁹⁴

2) Transactions between Persons that are not Securities Company

Orders are sent by the securities owner, including institutional client, to the other person in accordance with the terms and conditions in the agreement between both. The agreement must consist of term and conditions of refused, cancelled, and bind order.

b. Implementation Transactions and Obligation

⁹³ *Ibid.*, article 3. c.

⁹⁴ *Ibid.*, article 3. g.

1) Transactions between Securities Companies or between a Securities Company and another Person

In connection with Client Account Transactions⁹⁵, the client is only liable to the Securities Company that executes the transactions and not liable to the others.⁹⁶ It means the customer only has rights and obligations to the Securities Company. Securities Company must record the transaction on the day the transactions binding. Else, Securities Company must record a late settlement in Fails to Receive or Fails to Deliver account, on the contractual settlement date. Moreover, Securities Company must send a confirmation to the other Securities Company or other Person that involved in the transaction on the day the transaction is executed.⁹⁷

2) Transactions between Persons that are not Securities Company

The implementation and obligation transaction is depends on the terms and conditions that agreed by the parties. In the Institutional Client Transaction, Securities

⁹⁵ Client Account Transactions are Securities transactions that are executed by Securities Companies for the account of clients in accordance with a contract between the Securities Company and the client, that is made in conformance with article 5 Regulation Number V.D.3 and article 4 Regulation Number V.D. 6.

⁹⁶ Bapepam-LK, *Securities Transaction, op. cit.*, article 3. b.

⁹⁷ *Ibid.*, article 5. c.

Company obliged to record the day the transaction becomes binding, late settlement in Fails to Receive or Fails to Deliver account on the contractual settlement date, and send confirmations to the institutional clients on the day the transaction occurs.⁹⁸

c. Settlement Transaction and Delivery Securities Transactions

1) Transactions between Securities Companies or between a Securities Company and another Person

Client Account Transactions must be settled by debiting or crediting Securities and funds to the client's Securities account on the settlement day that agreed between Securities Company and by the client, whether or not transaction has been settled between the Securities Company and other parties. Securities Company becomes Custodian for the Securities that recorded in client's account and debtor for Credit Balances in the account when transaction has been settled. Client's is liable for Short

⁹⁸ Confirmation is consist of the name and address of Securities Company; the name and address of client; the number of Securities account; the date transaction was executed; the date transaction must be settled; details transaction, such as number, type, denomination, and price of Securities; the Securities Exchange or market where the transaction was executed; an explanation as to whether the Securities Company was acting as a broker or as a dealer; the commission and or fee for transaction, if any; and the net value of transaction as mentioned on Bapepam-LK Regulation Number III.A.10 article 3. p.

positions and Debit Balances in the Securities account when transaction has been settled.⁹⁹

2) Transactions between Persons that are not Securities Company

The settlement transaction is depends on the terms and conditions that agreed by the parties. For Institutional Client Transaction, Securities Companies must record late settlement in Fails to Receive or Fails to Deliver account on the contractual settlement date.

Exchange traded contracts have standardized specifications in terms of contract specifications, the way they are traded and the way they are administered. Securities Administration Agency can maintains ownership records of an Issuer's Securities and distributes entitlements on such Securities under the contract that agreed by the parties. Similarly, KSEI is conducting those activities. The form and manner of payment by delivering money and Securities at the same time (delivery/receive vs. payment), or in any other way that is agreed by the parties (delivery/receive free of payment).¹⁰⁰ Their prices are widely quoted and they are more likely to be liquid. The

⁹⁹ Bapepam-LK, *Securities Transaction, op. cit.*, article 3. h.

¹⁰⁰ *Ibid.*, article 6. b.

hour and date for settlement of the transaction also agreed freely by the buying Exchange member and the selling Exchange member, must considering KSEI schedule.

In practice, Foreign Exchange transactions are generally occurred on debt securities such as bonds, and sukuk, which issued by governments or private. To monitor the implementation of debt securities transactions and sukuk in Foreign Exchange, Bapepam-LK issued Regulation Number X.M.3. Base on Regulation, Securities that can be reported are bond and sukuk that have been sold through public offering, SUN (Government's bond), and other securities that traded on the secondary market.

The types of transaction that can be reported are sale and purchase, grant, leasing, repo, buy-back, and book-entry with the same identities party. In addition, it can be transferring Securities with respect to borrowing or lending, a gift, inheritance, or court order.

Transaction Reporting Procedures that conducted by the participants, whether performed on the transaction through or not through the participants, but the solution performed by the participants. The transacting parties shall designate certain participants to report such transactions in terms of the settlement that made by non-participants.

3. Margin Transaction

The IDX implemented regulation on Margin Trading since August 1997 under the Regulation Number II-9. Then, replaced it with Regulation Number III-I concerning Stock Exchange Membership for Margin and Short Selling, and Regulation Number II-H concerning Requirements on Securities Trading in Margin Transaction and Short Selling Transaction.

Margin Transaction means transaction of buying Securities for the interest of the clients financed by Securities Company.¹⁰¹ Securities that used in Margin transaction must accordance with list of Margin securities.¹⁰²

The Exchange shall determine Securities that may be transacted and or collateralized in Margin Transaction. Margin Trading can be implemented by the Exchange Member only after its customer opens a Margin Securities Account¹⁰³ based on the margin contract between the customer and the related Exchange Member. Securities broker's demand that a customer put up money or securities as collateral when the broker finances a purchase of securities is called as margin call. Margin call occurs when the market prices of the securities are falling.

Then, Securities Company opened Securities sub-account on KSEI and all Securities owned has been saved on respective Securities sub-

¹⁰¹ Indonesia Stock Exchange, *Requirements and Securities Trading in Margin Transaction and Short Selling Transaction*, Regulation Number II-H, chapter I article 8.

¹⁰² *Ibid.*, chapter I article 3.

¹⁰³ Margin account is a brokerage account that allows an investor to buy or sell securities on credit, with the usu. serving as collateral for the broker's loan.

account consistently. Clients fund has been placed in Bank account separated from fund owned by Securities Company and implemented consistently.¹⁰⁴

At the beginning of every month, IDX issued a list of marginal and short sale securities. Securities is included in the list based on the criteria of its trading activity for the last 6 months (period of data review) and its Price Earnings Ratio (PER) below¹⁰⁵:

- a. Securities should have a minimum average daily transaction value and daily transaction value in the regular market of IDR 10 billion and IDR 1 billion respectively if the securities has been listed in the Exchange for at least 6 months and IDR 50 billion and IDR 5 billion respectively if the securities has been listed in the Exchange for less than 6 months.
- b. Securities should be traded in the Exchange every day, except when suspension occurs for a maximum of 10 days.
- c. Securities' Price Earnings Ratio (PER) is not three times greater than the market's PER.
- d. Securities' free float market capitalization is more than IDR 1 trillion based on the last data of every month during the data review period.
- e. Securities is owned by at least 600 (six hundreds) shareholders based on the last data of every month during the data review period.

¹⁰⁴ Indonesia Stock Exchange, *Stock Exchange Membership for Margin and Short Selling*, Regulation Number III-I, chapter II article 2. 5.

¹⁰⁵ Indonesia Stock Exchange, *Requirements and Securities Trading in Margin Transaction and Short Selling Transaction*, *op. cit.*, chapter III article 3.

In addition, IDX also determines a number of securities that can be guaranteed. Securities that can be guaranteed are included in the marginal and short sale stocks list, included in the LQ-45 Index, Government Securities and Corporate Bonds that are issued in Indonesia and listed in the Exchange with an A+ rating or equal to that.¹⁰⁶ Thus, the guaranteed securities are calculated based on the fair market value.

4. Short Selling Transaction

Short Selling Transaction means transaction of selling Securities in which such Securities is not owned by seller when the transaction is executed.¹⁰⁷ For instance, borrow securities, sell them, and then later buy the securities back to return it to the lender. If the securities dropped, the short sellers buy back at a low price. Then, return it to the lender.

Securities that used in Short Selling Transaction must accordance with list of Short Selling Securities that determined by the Exchange.¹⁰⁸ Criteria for Short Selling Securities that issued in list are similar with Margin Securities.

The Exchange shall determine Securities that may be transacted and or collateralized in Short Selling Transaction. Any Securities Exchange Member that places selling offers to JATS for Short Selling

¹⁰⁶ *Ibid.*, chapter III article 4.

¹⁰⁷ *Ibid.*, chapter I article 9.

¹⁰⁸ *Ibid.*, chapter I article 4.

transaction is obliged to give Short sign and the selling offers must be higher than the last done price.¹⁰⁹

5. Lending and Borrowing Transactions

Lending and borrowing transaction is performed in the trading mechanism. It happens when the Securities Company cannot finish its duties. This duty is based on transactions in stock exchange. There is no specific regulation on lending and borrowing transaction.

As known in KPEI doing lending to perform its duty. On the Bid Offer Securities Lending and Borrowing, KPEI facilitates Lenders and Borrowers to have bid/offer Securities Borrowing and Lending trades. Securities Borrowing and Lending fees will be based on matched Securities Borrowing and Lending trades. KPEI acts as a principal and KPEI Keep Collateral. KPEI guarantees the return and manufactured dividend payment.

Whereas, on Bilateral Securities Borrowing and Lending, KPEI facilitates Lenders and Borrowers to have a negotiated Securities Borrowing and Lending trades. Negotiation includes fees rate, collateral rate, upper limit and lower limit for margin call. KPEI acts as a Third Party Agent Models of Bilateral KPEI Securities Borrowing and Lending are first, KPEI will maintain Borrower's collateral and guarantees the margin

¹⁰⁹ *Ibid.*, chapter IV.

call payment. Second, collateral will be passed through to Lenders and Mark to Market.action.

6. Repurchase Transactions (hereinafter refers to as Repo)

Repos create a short-term money market between cash investors and securities holders who are looking to take in cash.¹¹⁰

Bapepam-LK defines repo transaction as transaction where Securities Company may sell their securities to the client or other parties which prices was determined and will buyback the securities which day and price was determined.¹¹¹ Whereas, Reverse Repo is a transaction where Securities Company buyback securities on determined prices and sellback to the same party which the day and prices was determined.¹¹²

The repo instrument is a simple two-leg transaction. The securities holder is the cash taker. The securities holder sells securities against cash, simultaneously agreeing to repurchase the same or (in the case of the classic or US-style repo) similar securities at a later date. This temporary purchase of securities is effectively like a cash loan but with enhanced protection against counterparty credit risk provided by the creditworthiness of the securities' issuer. Fed repos can be conducted for terms anywhere

¹¹⁰ <<http://www.investopedia.com/terms/r/repurchaseagreement.asp#axzz1h5wS6wGF>>, "Repurchase Agreement", last viewed at 21st December 2011.

¹¹¹ Bapepam-LK, *Implementation of Accountancy in Repurchase Agreement through Master Repurchase Agreement*, Regulation Number VIII.G.13, article 2. a.

¹¹² *Ibid.*, article 2. b.

from one to 65 business days. They are usually overnight, though rarely longer than 14 days.

There are two main types of settlement methods for repos: triparty and delivery vs payment. Fed repos are done via triparty settlement, which means that the Fed and the primary dealers use a triparty agent to manage the collateral. In a triparty repo, both parties to the repo must have cash and collateral accounts at the same triparty agent, which is by definition also a clearing bank. The triparty agent will ensure that collateral pledged is sufficient and meets eligibility requirements, and all parties agree to use collateral prices supplied by the triparty agent.

The maturity date of the transaction is totally flexible, overnight, term or open, as is deal size. So, odd amounts can be negotiated by the cash investor to exactly match cash surpluses across any required short term. The investment return is determined by the repurchase rate paid by the cash taker.

This transaction is used Master Repurchase Agreement (hereinafter refers to as MRA) as an underlying contract.¹¹³ Securities that used in this transaction are government securities. Securities Company sells the government securities to investors, usually on an overnight basis, and buys them back the following day. Repo rate (interest rate) determined by agreement of the parties, usually above the loan rate bank.

¹¹³ *Ibid.*, article 2. g.

Repos and reverse repurchase transactions are particularly useful in offsetting temporary swings in the level of bank reserves caused by such volatile factors as float, currency held by the public and Treasury deposits at Federal Reserve Banks.

CHAPTER III

SHARI'AH CAPITAL MARKET ON THE TRADING MECHANISM OF
SECONDARY MARKET SECURITIES IN INDONESIA

A. Trading Mechanism of Secondary Market Securities on Shari'ah Capital Market

The history of Islamic Capital Market in Indonesia began with the launched a Danareksa Shari'ah by PT. Danareksa Investment Management on July 3, 1997.¹¹⁴ Then The Jakarta Islamic Index (hereinafter referred to as JII) was launched on July 3, 2000, between Indonesia Stock Exchange and PT. Danareksa Investment Management.

The Shari'ah capital market has started developing in Indonesia since 2000 when PT. Bursa Efek Jakarta (hereinafter referred to as BEJ) in cooperation with PT. Danareksa Investment Management issued a list of companies on the capital market meeting the requirements of Shari'ah.¹¹⁵ The issuance a list of companies is through by JII. Even though PT. Danareksa Investment Management had priory launched a Danareksa Shari'ah in 1997, but due to the IDX has not issued an official instrument related to Shari'ah Securities, the developments of Shari'ah capital market is not yet reckoned until the issuance of JII.¹¹⁶

¹¹⁴ Bapepam-LK, *op. cit.*, p. 49.

¹¹⁵ <<http://www.idx.co.id/MainMenu/TentangBEI/OurProduct/SyariahProducts/tabid/142/language/en-US/>>, "PT Danareksa Investment Management is the Company which has Launched the Jakarta Islamic Index", last viewed at February 20th, 2008.

¹¹⁶ <<http://www.idx.co.id/Home/Product&services/shariah/themiltonesofshariahcapitalmarket/>>, "The

Below are milestone of Shari'ah market development in Indonesia until today:

Table 2

YEAR	EVENT
2000	Jakarta Islamic Index (JII)
2001	Fatwa Number 20/DSN-MUI/IX/2001 concerning Guidelines for the implementation of Investment for Sharia Mutual Funds
2002	Fatwa Number 32/DSN-MUI/IX/2002 concerning Sharia Bonds
	Fatwa Number 33/DSN-MUI/IX/2002 concerning <i>Mudharabah</i> Sharia Bonds
2003	Fatwa Number 40/DSN-MUI/X/2003 concerning Capital Market and Guidelines for the implementation of Sharia Principles in the Capital Market.
	MOU between Bapepam-LK and DSN-MUI
2004	Fatwa Number 41/DSN-MUI/III/2004 concerning <i>Ijarah</i> Shari'ah
2006	Bapepam-LK Regulation Number IX.A.13 concerning Issuance of Shari'ah Securities
	Bapepam-LK Regulation Number IX.A.14 concerning Contracts Used for the Issuance of Shari'ah Securities in Capital Market.
2007	Fatwa Number 59/DSN-MUI/V/2007 concerning <i>Mudharabah</i> Sharia Bonds Conversion
	Bapepam-LK Number II.K.1 Regulation concerning Criteria and Issuance of Shari'ah Securities List.
2008	Fatwa Number 65/DSN-MUI/III/2008 concerning Shari'ah Pre-Emptive Rights
	Fatwa Number 66/DSN-MUI/III/2008 concerning Shari'ah Warrants
	Fatwa Number 69/DSN-MUI/VI/2008 concerning SBSN
	Fatwa Number 70/DSN-MUI/VI/2008 concerning Issuance Method of SBSN

Milestones of the Development of Sharia Capital Market in Indonesia”, last vied at December 9th, 2011.

	Fatwa Number 71/DSN-MUI/VI/2008 concerning Sale and Lease Back
	Fatwa Number 69/DSN-MUI/VI/2008 concerning Sale and Lease Back of <i>Ijarah</i> SBSN
	Law Number 19 of 2008 concerning Government Shari'ah Securities (SBSN)
2011	Fatwa Number 80/DSN-MUI/III/2011 concerning The Implementation of Shari'ah Principles in the Equity Trading Mechanism at the Stock Exchanges Regular Market.
	Indonesia Shari'ah Stock Index (ISSI)

It was only in 2003 that the Shari'ah capital market became officially recognized by signing a memorandum of understanding between the National Shari'ah Board of the Indonesian Ulama' Council (hereinafter referred to as MUI)¹¹⁷ and Bapepam-LK.¹¹⁸

As far known, Shari'ah capital market in Indonesia is associated to the JII. JII was established to provide the market with a list of securities that are in line with the Islamic Shari'ah investment guidelines.¹¹⁹ In determining the criteria for the securities to be included in the JII, the selection process is supervised by the Shari'ah Supervisory Board of the MUI.

¹¹⁷ MUI, which was established in 1975, is the largest Islamic societal organization in Indonesia. This organization is a forum for ulamas and Moslem scholars in Indonesia coming from various Islamic organizations in Indonesia. The Function of MUI is to act as a consultation forum for *ulama, zuama* and Moslem scholars in providing guidance to Moslems and to develop the Islamic way of life; to serve as a forum for friendship among *ulama, zuama* and Moslem scholars in developing and sharing the teachings of Islam and to build *ukhuwah Islamiyah*; and as a forum representing Moslems in inter-faith relations and consultations; and to issue fatwa (edicts) to Moslems and the government, regardless of whether or not it is requested to do so. Shari'ah banking activities, which commenced in 1992, are inseparable from the role of MUI which has helped to materialize them, namely through workshops and seminars focusing on Islamic economy studies. It has been due to the efforts of experts in the field of Islamic economic and Islamic law studies that these activities have been introduced. In order to ensure that shari'ah based economic activities are truly compliant with the shari'ah, MUI through its Leadership Board established an autonomous institution, the DSN.

¹¹⁸ Republika, "Pasar Modal Syariah Resmi Diluncurkan (The Sharia Capital Market Officially Launched)", <<http://www.republika.co.id>>, last viewed at March 15th, 2010.

¹¹⁹ Indonesia Stock Exchange, *Fact Book 2011, op. cit.*, p. 67.

There are 30 securities that have passed the selection. Securities from listed companies whose business activities comply with the Islamic Shari'ah can be included. On the other hand, certain business activities are prohibited by Islamic Shari'ah, therefore making the securities from these businesses as ineligible for inclusion in the JII.

Shari'ah capital market must refrain from activities that are prohibited by Islamic principles. It is required to conduct the Securities trading based on prudent principle and it is not allowed to make speculation, manipulation, and other actions bearing *dharar, gharar, riba, maisir, risywah, maksiat & cruelty, taghrir, ghisysy, tanajusy/najsy, ihtikar, bai' al-ma'dum, talaqqi al-rukban, ghabn, riba, and tadlis*. Below are described some action that prohibited base on fatwa number 80.

1. Actions included in *najsy*¹²⁰

Among others are pump and dump, hype and dump and fake demand/supply. Pump and dump are transaction that initiated by the fluctuation of uptrend price. It is caused by series of buy initiator transactions forming uptrend prices up to the highest level. After reaching the highest price, the parties involving in the uptrend price forming will conduct series of sell initiator transactions in significant volume and encourage price declining. The purpose of pump and dump is to create the opportunity to sell at the highest price for profit.

¹²⁰ *Tanajusy/Najsy* is a bargaining act at a higher price performed by buyer who do not intend to buy it, to make an effect of many parties interested to buy it.

Hype and dump is similar to the pump and dump, aiming at creating the opportunity to sell at the highest price for profit. This transaction activities of Securities initiated by the fluctuation of uptrend price followed by positive information, which are incorrect, excessive, misleading, and it also caused by series of buy initiator transactions forming uptrend prices up to the highest level.

Fake demand/supply is created by one or more parties that input buy/sell order at best price. When the buy/sell order input reach the best price, those orders will be deleted or amended (in terms of volume and/or price) repeatedly. The aim is to give impression to the market as if there is high demand/supply, so the market will get influenced to buy/sell.

2. Actions included in *bai 'al-ma 'dum*¹²¹

Short Selling (*bai 'al-maksyuff*/blank sell) is a method used in the selling of shares not yet owned at a high price with an expectation of buying them at a low price.

3. Actions included in *ghabn fahisy*¹²²

Insider trading is included in this category. Insider trading is illegal activities in financial market industry to earn profit commonly by taking advantage of internal information, e.g. company's plans or decisions which are not published yet.

¹²¹ *Bai 'al-Ma 'dum* is buy-sell process, object (*mabi'*) of which is not available when akad is made, or object (securities) buy-sell in which the seller has not owned the object (securities) being sold.

¹²² *Ghabn Fahisy* is high-level *ghabn*, e.g. object buy-sell at a price far below the market price. *Ghabn* is an imbalance between two objects being exchanged in an akad, either in terms of quality or quantity.

4. Actions included in *tadlis*¹²³

There are front running and misleading information. Front running is an action taken by Stock Exchange Member by performing transaction of certain Securities in advance based on information in which its client will perform the transaction of such Securities in bulk and it is predicted that it will influence the market price. The purpose is to get profit or minimize loss. Whereas, misleading information is to make statement or immaterially provide incorrect or improper information that influence the Securities price in Stock Exchange.

5. Actions included in *riba*

Margin trading is to perform Securities transaction with interest-based loan facility for the Securities buying settlement obligation. This includes *riba*.

6. Actions included in *ikhtikar*¹²⁴

Pooling interest is transaction activities of Securities that seemed liquid, whether or not it is followed by price fluctuation, within certain period of time and only performed by a group of certain Securities Exchange Member (buy or sell). Besides, daily transactions volume within such period is always in the same and/or within certain period of time, the transaction activities suddenly increase significantly. The purpose is to

¹²³ *Tadlis* is an action that conceals akad object defect performed by seller to deceive buyer, as if the akad object has no defect.

¹²⁴ *Ihtikar* is to buy certain objects that are extremely required by the public when the price is up and make it overstock in order to sell them back at a higher price.

create opportunity to sell or collect shares or to turn certain shares activities into benchmark.

In additional, there is cornering. This transaction pattern occurs on shares with limited public ownership. Shareholders majority tries to create fake supply that causes declining price in the morning and makes public investors perform short selling. Then, there will be buying activities performed by shareholders majority that inflict price increase in the afternoon session and cause short sell players experience default or loss for they have to buy at higher price.

7. Actions included in *taghrir*¹²⁵

In this case, there is false trade that does not change the ownership. It is called as wash sale. It is occurred between buying and selling parties that cause no change in the ownership and/or benefit (beneficiary of ownership) of such share transaction. The purpose is to form an increasing, declining, or stable price by giving impression as if such price is formed through fair transaction. Also, it is to give an effect that such Securities are actively traded. In the same way, there is pre-arranged trade. It is occurred through buy and sells order within almost the same time due to predetermined deal between buyer and seller. The purpose is to form the price (increasing, declining or stable) or other purposes, either in or outside the exchange.

8. Actions included in *ghisysy*¹²⁶

¹²⁵ *Taghrir* is an effort to persuade other people, either with falsified statements or actions, in order to encourage them to make transaction.

Actions that categorized are marketing at the close (closing price forming). This buy or sell order placement performed at end trading day, aiming at creating closing price at expected amount. It can make the price closed at higher, lower or similar amount compared to previous closing price. The second is alternate trade. It is transactions of a group of certain Securities Exchange Member as buyer and seller alternately in a fair-impression volume. It can make the price constant, higher, or lower. The purpose is to give an impression that certain securities are actively traded.

In Indonesia, IDX is a facilitator and regulator of the Stock Exchange in capital market activities. Shari'ah capital market in Indonesia is a part of conventional capital market in Indonesia. Therefore, IDX are obliged to provide securities trading system and/or facility on Shari'ah capital market. In this case, including but not limited to exchange regulation and system in accordance with securities trading surveillance, among others are to detect and prevent any activity or action collided with Shari'ah principles.¹²⁷ Surely, IDX is required to set up regulations that forbid any action that may cause danger or harm to other party (*dharar*).¹²⁸

In conventional capital market, securities trading are performed by Securities Exchange Member and other actors. Whereas, Non-Members of Securities Exchange are perform trading through Securities Exchange

¹²⁶ *Ghisysy* is one of the forms of *tadlis*; which is the seller explains/describes the superiority/uniqueness of object being sold and conceals its defect.

¹²⁷ National Shari'ah Board, *The Application of Sharia Principles in Trading Mechanism of Equity Securities at Stock Exchange Regular Market*, Fatwa Number 80/DSN-MUI/III/2011, chapter III article 2. d.

¹²⁸ *Ibid.*, chapter III article 2. c.

Member. Shari'ah capital market is allowed to set up those mechanisms.¹²⁹ Conducting its functions, IDX is allowed to impose *ujroh* as a service fee, to the Securities Exchange Members, based on *ijarah* principle.¹³⁰

Securities trading on the secondary market are applied with sale and purchase contract. On *fiqh* sale and purchase contract are considered as *bai'*¹³¹. Specifically, the contract that used in equity securities trading mechanism on regular market on the Stock Exchange is *Ba'i Al Musawamah*¹³².

1. Shari'ah Trading in the Stock Exchange

a. Opening Account and Submission Order

On the process of opening account and submission order of the shari'ah capital market is not substantially different from the conventional capital markets. In this part, someone who wants to invest must become a customer or open an account on one Securities Company of Securities Exchange Member and/or Non-Member of Securities Exchange.

The form and terms of the contract, is made in accordance with the provisions of Regulation Number 5 V.D.3. However, Non-Members of Securities Exchange cannot perform trading directly. In this point, Non-Members of Securities Exchange is transfer or delegate the customer order to Securities Exchange Member to perform the securities trading. Base on fatwa of DSN, the contract that be used

¹²⁹ *Ibid.*, chapter III article 2. a.

¹³⁰ *Ibid.*, chapter III article 2. e.

¹³¹ *Bai'* is an akad of asset exchange aiming at transferring ownership of such asset.

¹³² *Bai' al-Musawamah* is buy-sell akad with fair market price deal through continuous auction mechanism.

between Securities buyer and seller of Non-Members of Securities Exchange and Securities Exchange Member is *ju'alah*¹³³.

The activity of buying and selling shares is started with the instruction order given by the investor to the broker. As known, transactions can be performed by manual, remote, or online trading. On manual trading, the order can be done directly, in which the investor come straightly to the brokerage company. On the remote and online trading the order can be done through e-SPis system. Then, every order will be enter into JATS. There are no differences between Shari'ah mechanisms with conventional mechanisms.

b. The Processing and Implementing Order

In this step, the orders entered into JATS system will be matched with the suitable price. The price is determined based on agreement or a deal that refers to fair market price. Sale and purchase agreement has been considered valid by Shari'ah at the time the transaction occurred.¹³⁴

Then, the order will be registered into JATS system. Therefore, transaction is done. It is means that the buying or selling order has found the right price. After that, the traders in the brokerage office will then inform the investors that their orders have been fulfilled.

c. Clearing, Guarantee, and Settlement Transactions

¹³³ *Ju'alah* is a promise or commitment (*iltizam*) to give certain amount of fee (*ju 'l*) upon proceeds (*natijah*) predetermined from certain work.

¹³⁴ Buy-sell akad is considered valid when a deal occurs on certain price and type as well as volume between buy and sell quotation as mentioned on fatwa of Shari'ah National Board Number 80 chapter III article 1. b.

The Clearing and Guarantee Institution in Shari'ah capital market is no different from conventional capital market. The institution that performed this activity is KPEI.

In performs clearing and guarantee services for Stock Exchange transaction, KPEI performs novation base on *hawalah bil ujah*¹³⁵ principles. In this matter, the right and obligation between seller-Clearing Member and buyer-Clearing Member is transferred into right and obligation between seller/buyer-Clearing Member and KPEI. It is as a result of KPEI as guarantee activity upon securities trading at Stock Exchange.¹³⁶ The settlement date transaction is finished on T+3.

Upon clearing and guarantee services that provided by KPEI, KPEI is imposed fee (*ujrah/rusum*) on Stock Exchange/Clearing Member.¹³⁷

Depository and Settlement Institution on Shari'ah capital market is performed by KSEI. In perform the duties, KSEI also may impose depository and settlement fee (*ujrah/rusum*).¹³⁸

On the fatwa, stated that a buyer may sell securities after buy-sell akad is considered valid even though the settlement of buy transaction is performed a few days later based on *qabdh hukmi*

¹³⁵ Hawalah bil Ujah is an akad of debt transfer from party bearing such debt to other party that is willing to or committed (iltizam) to carry (pay) it with ujah as mentioned on fatwa of Shari'ah National Board Number 80 chapter I article 14.

¹³⁶ Fatwa of National Sharia Board Number 80/DSN-MUI/III/2011, *op. cit.*, chapter III article 2. f.

¹³⁷ *Ibid.*, chapter III article 2. g.

¹³⁸ *Ibid.*, chapter III article 2. h.

principles.¹³⁹ Its means that investor who purchases stocks, is allowed by sharia, to sell back the securities held prior to T+3 based on the *qabdh hukmi* principle.

2. Foreign Exchange Transaction (OTC)

Even though the foreign exchange transaction is performs without refers to the provision or the Stock Exchange trading system in particular, but still obliged to fulfills the Shari'ah principles on trading mechanism in Shari'ah Capital Market. The trading and settlement mechanism are not regulated yet by. Therefore, in performing trading activities in OTC is accommodating with conventional trading mechanism.

3. Margin Transactions

Margin Trading is transaction with financing. In this, trading is to perform Securities transaction with interest-based loan facility for the Securities buying settlement obligation. This action is included actions in *riba* category. *Riba* is included on the actions which collide with Shari'ah principles. Therefore, Margin Trading is prohibited in Shari'ah capital market.¹⁴⁰

4. Short Selling Transactions

Short Selling (*bai' al-maksyuf*¹⁴¹/blank sell) is actions included in *bai' al-ma'dum* category. That is a method used in the selling of shares not

¹³⁹ *Ibid.*, chapter III article 1. c.

¹⁴⁰ *Ibid.*, chapter III article 3. h.

¹⁴¹ *Bai' al-Maksyuf* is a form of *gharar*-bearing buy-sell; which is cash buy-sell upon object (securities) that does not belong to seller and the seller has not permit from the owner to sell, or cash buy-sell upon object (securities) in which the seller has not owned the object (securities) being sold.

yet owned at a high price with an expectation of buying them at a low price. This transaction is prohibited on Shari'ah capital market.

5. Securities Lending and Borrowing Transactions

Lending and borrowing transaction usually happened when Securities Company did not have securities to perform some obligation as the result of transaction. Then, the Securities Company will borrow the securities. This transaction is occurred between buying and selling parties that cause no change in the ownership and/or benefit (beneficiary of ownership) of such share transaction. This transaction is included on wash sale. Wash sale is actions that included in *taghrir* category. This action is collided with sharia principles.

6. Repurchase Agreement (Repo)

Repos create a short-term money market between cash investors and securities holders who are looking to take in cash. Repo transaction is not change the ownership. This transaction is included on wash sale because no change in the ownership and/or benefit (beneficiary of ownership) of such share transaction. This transaction is prohibited on Shari'ah capital market.

B. Shari'ah Compliance of Trading Mechanism of Secondary Market Securities in Indonesia

...وَأَحَلَّ اللَّهُ الْبَيْعَ وَحَرَّمَ الرِّبَا...

“...and Allah has allowed trade and forbidden usury....”¹⁴²

That provision is as the guidance principle that Islam permits and encouraging its followers to involve in trading activities. The Prophet in his early life was a trader. The establish of Shari’ah capital market is right as is in line with the divine revelation, in this involved trading. It is to perform business free from usury, make profit whilst conform Islamic principle.

Chapter 3 verse 132: “Obey Allah and the Messenger, that ye may obtain mercy”. Chapter 4 verse 59: “O ye who believe! Obey Allah and obey the Messenger...”

يَا أَيُّهَا الَّذِينَ آمَنُوا اتَّقُوا اللَّهَ وَذَرُوا مَا بَقِيَ مِنَ الرِّبَا إِن كُنتُمْ مُؤْمِنِينَ.

“O you who believe! Be careful of (your duty to) Allah and relinquish what remains (due) from usury, if you are believers.”¹⁴³

The Hadith require Muslim to uphold justice and virtue. In this Shari’ah capital market operations are based on the concept of honesty, justice, and equity as Prophet practiced.

“Those who rehearse the Book of Allah, establish regular prayer and send (in charity) out of what We have provided for them, secretly and openly, hope for commerce that will never fail.”

يَا أَيُّهَا الَّذِينَ آمَنُوا أَوْفُوا بِالْعُقُودِ ...

“O you who believe! Fulfill the obligations...”¹⁴⁴

¹⁴² Al-Baqarah (2): 275.

¹⁴³ Al-Baqarah (2): 278.

In Islamic law, the starting point in contractual formulation of transaction is permissibility, as propagated by Ibn Taymiyyah¹⁴⁵, he says: “The underlying principle in contracts and stipulations is permissibility (*ibahah*) and validity”. Any contract or stipulation is prohibited and void only if there is an explicit text (from the Quran and the *Sunnah* or the consensus) or a *qiyas* (analogy) proving its prohibition and voiding.¹⁴⁶

In a nutshell, prohibited elements of a commercial transaction first must be removed for it to be Shari’ah-compliant. These clearly stated prohibitions are among others, the prohibitions on *riba* (usurious practices), prohibitions on *gharar* (excessive uncertainty), prohibitions on *maysiar* (gambling) and prohibitions on dealing with products deem sinful such as alcoholic beverages and swine meat.¹⁴⁷ Included in this sense, make a fake offer (*najsy*); transactions on goods that not owned by seller when the transaction is executed (short selling/*bai 'u maa laisa bimamluk*); sell something that is not clear yet (*bai' al-ma'dum*); purchases for stockpiling effects (*ihthikar*) and issued misleading information or doing insider trading.¹⁴⁸

Shari’ah compliant transactions may not have parallels in conventional financing and therefore, there may be significant accounting implications. For example, in the case of *mudharabah* contracts, the transaction is neither equity nor liability in nature as the depositor does not assume the rights of an equity

¹⁴⁴ Al-Maidah (5): 1.

¹⁴⁵ Ibn Taymiyyah is the fourteenth century Hanbali scholar with modern views regarding Shari’ah law.

¹⁴⁶ Mohammed Sultan, *op. cit.*, p. 19.

¹⁴⁷ *Ibid.*, p. 20.

¹⁴⁸ Bapepam-LK, *op. cit.*, p. 37.

holder (i.e., shareholder) of the Islamic financial institution and neither is he guaranteed of returns. Hence, from an Islamic accounting viewpoint, a *mudharabah* account may be presented as an ‘investment account’, appearing as a separate line item from equity or liability on the balance sheet.

In general, the Shari’ah-based principle of equity participation is essentially the same as that for conventional companies. It is based on a form of equity partnership investing called *musharakah*. However, from an Islamic perspective, corporate stocks can only be classified as Shari’ah-compliant if their business activities are not related to prohibited activities as outlined by Shari’ah scholars.

Provisions and the fatwa applied both for issuers and for investors that could form the market capital that does not conflict with Islamic principles to the fulfillment of four aspects, namely:

1. Issuer and the issuance of securities meet the rule of justice, prudence and transparency;
2. Market participants (investors) who have had a good understanding of risks and benefits of capital market transactions;
3. Exchange of information infrastructure in a transparent and equitable timely in public which is supported by the fair market mechanism;
4. Supervision and enforcement by the capital market authority can be carried out effectively.

Some prohibition principles on Islamic finance are as follows:

1. Prohibition of *riba*

Riba in its literal meaning is increase or growth.¹⁴⁹ The other explain that *riba* has the literal meaning of “an excess” and is defined as an increase or excess which accrues to the owner in an exchange or sale of a commodity, or, by virtue of a loan arrangement, without providing equivalent value to the other party.¹⁵⁰

Riba is completely prohibited under Islamic law. National Shari’ah Board of Indonesia also define *riba* as extra amount given in ribawi (*al-amwal al-ribawiyah*) object and extra amount upon debt principal with a compensation of absolute payment deferment.¹⁵¹

Technically, *riba* occurs when an exchange between financial assets/obligations includes an additional amount (normally the interest element) in the counter exchange value as the result of the deferment in the time of exchange.¹⁵² In modern finance, it is normal and can be explained by the theory of time value of money. Base on this concept, relatively the value of money now will be higher than in the future.¹⁵³ Money may increase and decrease according to time. Money is seen not only as a medium of exchange. Money is also seen as a commodity.

Riba is a prominent source of unjustified advantage, because Shariah does not consider money as a commodity such that there should be

¹⁴⁹ Mohammed Sultan. *op. cit.*, p. 21.

¹⁵⁰ IOSCO, *op. cit.*, p. 6.

¹⁵¹ Fatwa of National Sharia Board Number 80/DSN-MUI/III/2011, *op. cit.*, chapter I article 16.

¹⁵² Mohammed Sultan. *op. cit.*, p. 21.

¹⁵³ Cecep Maskanul Hakim, *Belajar Mudah Ekonomi Islam*, (Banten: Shuhuf Media Insani, 2011), p. 5.

a price for its use.¹⁵⁴ *Riba* results in one party having an equal advantage over the other party which has the potential to lead to other social implications such as oppression and coercion.¹⁵⁵ Nevertheless, in Islamic finance, this is *riba* and thus prohibited.

2. Prohibition of activities with elements of *gharar* (uncertainty)

Gharar can be defined as ambiguity and uncertainty present in any contractual relationship, to the extent that it might provide one of the parties of the contract with an unfair advantage over the other.¹⁵⁶ *Gharar* base on National Shari'ah Board of Indonesia is uncertainty in an akad, either related to the quality or quantity of akad object or related to the delivery.¹⁵⁷

Gharar has also been interpreted as the degree of information asymmetry and absence of information that can provoke one of the parties to commit deceit or other fraudulent activities.¹⁵⁸ In a commercial transaction, it refers to either the uncertainty of the goods or price of goods, or deceiving the buyer on the price of goods.¹⁵⁹

In transactions, *gharar* may occur in any of following quantity, quality, price, and delivery time dimensions. Once the certainty in any one or more of the factors is changed into uncertainty, then *gharar* has been

¹⁵⁴ <<http://www.financeislam.com/2010/01/06/islamic-business-contract-a-detailed-study/>>, *op. cit.*

¹⁵⁵ Mohammed Sultan. *op. cit.*, p. 25.

¹⁵⁶ *Ibid.*, p. 26.

¹⁵⁷ Fatwa of National Sharia Board Ref.#: 80/DSN-MUI/III/2011. *op. cit.*, chapter I article

19.

¹⁵⁸ Mohammed Sultan. *op. cit.*, p. 26.

¹⁵⁹ IOSCO, *op. cit.*, p. 7.

committed.¹⁶⁰

Gharar in quantity committed in cases of advance selling of crop produce (*ijon* in Indonesia). *Gharar* in quality such as sells an unborn calf that it still in mother's womb. *Gharar* in price is exemplified a company declares providing *mudarabah* financing for a house, say that the client can determined at a 20% margin per year or 40% margin for 2 year. *Gharar* in delivery of time is when one sells a missing object, at determined price, which buyer agreed. Uncertainty is committed when the object will be delivered or if the object transaction will be found at all.

Several *hadith* of the Prophet Muhammad (s.a.w.) that provided examples during those times of what constitute *gharar*¹⁶¹, have been extended and used to make rulings in present times.

As another example, the execution of the contract with a minor or a person who has not reached the age of being able to make conscious economic decisions, or even with a person, who at the time of the contract was intoxicated to the level of removing any sense of fair judgment from him, are all contract laced with element of *gharar*, hence null and void.¹⁶²

3. Prohibition of *Maysir* (gambling) activities

The following Qur'anic verses describe the prohibition of *maysir*

¹⁶⁰ Adiwarman Azwar Karim, *Islamic Banking 3rd edition Fiqh and Financial Analysis*, (Jakarta: Rajawali Pers, 2005), p. 31.

¹⁶¹ For instance, the sale of fish in the sea, or the sale of items by throwing a pebble are actually cases that had been brought to the attention of the Prophet Muhammad (s.a.w.) during that time and were prohibited.

¹⁶² Mohammed Sultan. *op. cit.*, p. 26-27.

(gambling)¹⁶³:

“O you who believe! Intoxicants and gambling (games of chance or *maysir*), worship of idols and divination by arrows, are an abomination of Syaitan’s handiwork; avoid it then, so that you might prosper! By means of intoxicants and games of chance, Syaitan wants only to sow enmity and hatred among you, and hinder you from the remembrance of God and from prayer. Will you not then desist?”

It is clearly provided in the Divine revelation to avoid gambling. Gambling sow’s enmity and hatred and distracts the faithful from worship. God Almighty also promises prosperity to the faithful who avoiding gambling.

Gambling is referred to as *qimar* or *maisir* in Arabic, which means any activity that involves an arrangement between two or more parties, each of whom undertakes the risk of a loss where a loss for one means a gain for the other, as it is common for gambling activities.¹⁶⁴ *Maysir* was originally applied to pre-Islamic game of arrows in which seven participants gambled for shares of an allotted prize.¹⁶⁵

This games is diverts the player’s attention from productive occupation, and amassing wealth without effort. It is un lawful in Islam. Actually it is the result of immoral inducement by the person involved in expecting to make a profit at the expense of another party.

¹⁶³ Al- Qur’an, 5: 90-91.

¹⁶⁴ IOSCO, *op. cit.*, p. 8.

¹⁶⁵ Mohammed Sultan. *op. cit.*, p. 29.

The moral principle in the prohibition of *maysir* and all other related gambling contract is in the fact that it results in a zero sum effect, where at least one party will end up as a loser by mere chance.¹⁶⁶

4. Prohibitions on dealing in sinful activities and products

There are a number of drinks and foods that are prohibited in Islam. There are wine or alcoholic beverages and non-permissible foods such as pork. In addition, there are also prohibitions against immoral services such as pornography, prostitution, immoral entertainment and others. Moreover, any activity relating to these products and services such as in processing, producing, marketing, supplying and selling are also non-permissible.

As known, capital market instrument is long-term financial instrument with an original maturity exceeding a year. A limited liability company is involved in this matter. Muslim scholar divides limited liability as judicial person or separate legal identity.¹⁶⁷ Shari'ah is permissible juridical person to deal with stock and shares.

Stock is represent a financial claim or little ownership certificate that not constitute money. The ownership is in the object of certificate not certificate itself. Negotiations and transfer of ownership, which is regarded

¹⁶⁶ *Ibid.*

¹⁶⁷ Mei Pheng and Ivan Jeron Detta, *Islamic Banking & Finance Law*, (Kuala Lumpur: Pearson Longman, 2007), p. 147.

from the legal point of view as a proof of the claim is permissible. Therefore, it is legal to undertake stakes, pawning, and donating.

In Shari'ah, stock must predetermined ratio of profit base on preference dividend based concept. Common stock is made on the basis *mudarabah*. As known, *mudarabah* is committed by some provide capital and some work with capital.¹⁶⁸ Mei Pheng and Ivan Jero Detta also describe in *mudarabah*, capital provider cannot interfere in the management. Profit cannot be fixed amount, must be percentage of profit. The distribution is according to agreed ratio. For loss, it is borne solely by capital provider and the worker does not bear loss unless misconduct or negligent.

In addition to the business activities criteria, certain jurisdictions use financial ratios as additional criteria in classifying Shari'ah stocks. The main financial ratios applied are:

1. debt-to-equity ratio;;
2. cash and interest bearing securities-to-equity ratio;
3. cash-to-asset ratio.

Other than business and financial criteria, some jurisdictions are known to also apply a cleansing mechanism to purify investments that are tainted by prohibited activities.

The cleansing process is normally performed by the individual investors, although in some cases, the Islamic funds would perform the task on behalf of their investors. For instance, if some part of the income from

¹⁶⁸ *Ibid.*, p. 23.

interest-bearing accounts (prohibited by Shari'ah) is included in the income of the company, the proportion of such income in the dividend paid to the shareholder must be given to charity, and must not be retained by the shareholder. This is called purification or dividend cleansing.

Transactions such as *mudarabah*, must be implemented in a contract. Contracts are a cornerstone of *fiqh al-mu'amalat*. In fact one of the component of *Shari'ah*, which in the '*aqidah* (belief system in Islam) is derived from the root word '*aqd*¹⁶⁹, which basically means bond or contract, even though that is in the context of contractual obligations of man with God in recognition and admission of the oneness of the Almighty.¹⁷⁰

Under Islamic law, a contract can be called as '*aqd*, it came from the Arabic language called *Al-'Aqd*, that literally means binding, linking, or connecting (*ar-rabt*).¹⁷¹ '*Aqd* is different with promise (*wa'ad*). *Wa'ad* is promise made by one party to another.¹⁷² It means binding only on one party. Its term and conditions are not yet well defined. There is no party has carry out the obligations if term and conditions defined. According to the article 262 Mursyid al-Hairan, '*aqd* is a companionship of *ijab* submitted by one party with the *qabul* from another one that causing legal consequences on the object

¹⁶⁹ *Aqd* is an agreement on a contract between two parties or more to do or not to do certain legal action as mentioned on second book of Shari'ah Economic Law Compilation (KHES) article 20. 1.

¹⁷⁰ Mohammed Sultan. *op. cit.*, p. 34.

¹⁷¹ Ahmad Abu Al-Fath on Syamsul Anwar, *Hukum Perjanjian Syariah (Studi tentang Teori Aqd dalam Fikih Muamalat)*, (Jakarta: PT. Raja Grafindo Persada, 2007), p. 68.

¹⁷² Adiwarmarman Azwar Karim, *op. cit.*, p. 63.

of 'aqd.¹⁷³ It can conclude from those understanding that define 'aqd as an obligation between *ijab* and *qabul* by the way justified by *syara*' that causing the existence of legal consequences of its object.¹⁷⁴

The aims of forming transactions into contract are to protect the rights and liabilities of the parties. Moreover, it would prevent them to any undue uncertainties or ambiguities. Therefore, Islamic law allows for the freedom of entering into contracts, and further also – as it is generally agree by majority of jurist – allows for the freedom of innovating new contracts that meet the objectives of the transaction as the long as the provisions of *Shari'ah* are not violated.¹⁷⁵

Therefore, Islamic law on finance is quite flexible. As long as they avoid prohibitions in the Qur'an and *Sunnah*, it's allowed to undertake of any form of contractual relationship.

Based on the definition of contract/'aqd stated above, we can classify the elements or formations of 'aqd as bellows:¹⁷⁶

1. There is agreement, which is there should be *ijab* and *qabul*, *ijab* means an offer offered by one party, and *qabul* means the acceptance from another party stating the acceptance to the offer from another party;

¹⁷³ H. A. Djazuli et. Al, *Kompilasi Hukum Ekonomi Shari'ah (KHES)*, (Bandung: Rajawali Pers 2007), p. 65.

¹⁷⁴ Ahmad Azhar Basyir, *Asas-asas Hukum Muamalat (Hukum Perdata Islam)*, (Yogyakarta: UII Press), p. 65.

¹⁷⁵ Mohammed Sultan. *op. cit.*, p. 35.

¹⁷⁶ Ahdiana Yuni Lestari, Endang Heriyani, *Dasar-dasar Pembuatan Kontrak dan Aqad*, (Yogyakarta: Mocomedia, 2009), p. 31.

2. There should be legal action conducted by two parties or more;
3. There should be the purpose to make legal consequences.

The contracts in existence in Islamic law consist of a set of rules for the various specific contracts, such as rules of sale, lease, pledge, etc.¹⁷⁷ In understanding the formation of contract, there are essential elements and some conditions that make the contract are valid in Islamic law.

The essential elements are the pillars (*arkan*) that make a certain activity or transaction to come into existence.¹⁷⁸ Article 22 KHES stated the pillars of *'aqd*, it is appropriate to the doctrine of Islamic law, the pillars are the parties (*al-'aqidain*), consensual agreement (*Sighat 'aqd*), the object of *'aqd*, and the purpose of *'aqd*.¹⁷⁹

Conditions are the fundamentals that determine the validity of a certain activity or transaction.¹⁸⁰ If the elements do not fulfill the rightful conditions, the transaction is still invalid. Complete and valid contract together with all essential elements and conditions are important to determine the rights of the buyer on the ownership of the assets or goods, and the rights of the seller, on the price or consideration.¹⁸¹

The presence of the essential elements and necessary conditions establishes the validity of the contract, putting all other things constant.¹⁸²

¹⁷⁷ Mohammed Sultan. *op. cit.*, p. 35.

¹⁷⁸ *Ibid.*

¹⁷⁹ Ahdiana Yuni Lestari, and Endang Heriyani, *op. cit.*, p. 31-36.

¹⁸⁰ Mohammed Sultan. *op. cit.*, p. 35.

¹⁸¹ *Ibid.*, p. 36.

¹⁸² *Ibid.*

Hence, different contracts have different sets of essential elements and necessary conditions.

Contract of sale is the most definite and widely utilized contract in Islamic finance transactions. While, the nature or conditions of all the form of business contracts are different from each other, the essential elements of contract of sale in Islamic finance are almost same. The five elements to a contract of buy and sell are as follows:

1. The contracting parties (seller and buyer)

The seller must have legal capacity to enter into contract. In *mudarabah* there is *shahib al-mal*, in *musyarakah* there is *syarik*.¹⁸³ The conditions of seller are¹⁸⁴:

- a. They must be of sound mind (*'aql*), have achieved the age of majority (*bulugh*) and possess an intelligent mind (*rushd*);
- b. They are not a declared bankrupt or an extravagant spendthrift;
- c. Not force to enter into the contract.

The conditions of buyer are same as seller. Buyer also must have legal capacity to enter into contract. In agency agent or trustee is called as *mudharib* and the principal or financier is called *rabb al mal*.

2. Goods or object of trade

Conditions for the goods of trade are¹⁸⁵:

- a. The object must be in existence at the time of entering into contract (exceptions for this condition appears in the contract of *salam* and

¹⁸³ Cecep Maskanul Hakim, *op. cit.*, p. 93.

¹⁸⁴ Mohammed Sultan. *op. cit.*, p. 38.

¹⁸⁵ *Ibid.*, p. 39-41.

istisna', because these two contracts are based on future delivery of goods);

- b. The object must belong to the seller;
- c. The object must be of pure and lawful in its attributes;
- d. The object has a nominal price (value);
- e. There delivery of goods must be made at the same meeting of the contract made, either in fact or what the law considered as such;
- f. The object of the contract doesn't change after the contract is signed; whether by sight and description (once again there is an exception from the condition for *salam* and *istisna'* contracts);
- g. The place of delivery is determined by the parties by agreement;
- h. All expenses for the delivery are borne by the seller and all expenses for the payment are born by the buyer;
- i. Any broken things happened in the object before delivery is borne by the seller.

3. Price

Conditions for price are¹⁸⁶:

- a. The price must be mentioned explicitly in absolute amount when the contract takes place;
- b. The currency being used must also to be discloses during contract (*'aqd*).

4. Offer and acceptance (*sighah*)

¹⁸⁶ *Ibid.*, p. 41.

Conditions for *sighah* are¹⁸⁷:

- a. *Sighah* is the offer and acceptance (*ijab* and *qabul*);
- b. The reason is to make legal effect. That's mean to evidence the willingness of both parties to transact and face the consequence of the activity that they are transacting. Therefore, every means of the transacting, by the spoken word or written language or by why of sign language (for the dumb and deaf) should give the meaning of a transaction of buy and sell.¹⁸⁸ Legal effect happened after communicated to the offeror;
- c. The *sighah* is invalid if the words give the meaning of a promise to transact in the future i.e.; "I will sell" or "I will buy" etc.¹⁸⁹ In order to be a valid and operative contract, the law makes it essential that there should be the presence of cause. The purpose of the contract is taken into account because it may affect its validity;
- d. The words used in *sighah* must be standardized to avoid ambiguity (to describe the goods, price etc.);
- e. Many good can be contracted together at one go with only one contract and the buyer must accept all the goods stipulated to the contract.

As known, the contract that used in equity securities trading mechanism on regular market on the Stock Exchange is *Ba'i Al Musawamah*. Thus, securities trading in Shari'ah capital market is used continuous auction

¹⁸⁷ *Ibid.*, p. 41-42.

¹⁸⁸ *Ibid.*, p. 42.

¹⁸⁹ *Ibid.*

mechanism as same as in conventional. According to hadith driven a bargaining is permitted.

عَنْ أَنَسِ بْنِ مَالِكٍ أَنَّ رَسُولَ اللَّهِ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ بَاعَ حِلْسًا وَقَدَحًا وَقَالَ مَنْ يَشْتَرِي هَذَا الْحِلْسَ وَالْقَدَحَ فَقَالَ رَجُلٌ أَخَذْتُهُمَا بِدِرْهَمٍ فَقَالَ النَّبِيُّ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ مَنْ يَزِيدُ عَلَيَّ دِرْهَمٍ مِنْ يَزِيدُ عَلَيَّ دِرْهَمٍ فَأَعْطَاهُ رَجُلٌ دِرْهَمَيْنِ فَبَاعَهُمَا مِنْهُ. قَالَ أَبُو عِيسَى هَذَا حَدِيثٌ حَسَنٌ. (أخرجه الترمذي في سننه/ الكتاب : البيوع، الباب : ماجاء في بيع من يزيد، رقم الحديث : ١١٣٩)

Recited by Anas bin Malik r.a. that: the Prophet s.a.w. sold a sheet of hils (small carpet used to be spread out at home) and a qadah (glass). The Prophet said: Who shall buy these hils and qadah? Someone said: I'm ready to buy both for 1 (one) dirham. The Prophet said it again, twice: Man yazid-ala dirhamin? (Who intends to buy them more than 1 dirham)? Someone gave 2 dirham to the Prophet. And the Prophet sold both of them to him. (Hadith recited by Tirmidzi).

In Securities trading, it is not allowed to perform activities and/or actions which collide with Shari'ah principles.

يَا أَيُّهَا الَّذِينَ آمَنُوا لَا تَأْكُلُوا أَمْوَالِكُمْ بَيْنَكُمْ بِالْبَاطِلِ إِلَّا أَنْ تَكُونَ تِجَارَةً عَنْ تَرَاضٍ مِنْكُمْ...

“O you who believe! do not devour your property among yourselves falsely, except that it be trading by your mutual consent;...”¹⁹⁰

دَرُءُ الْمَفَاسِدِ أَوْلَى مِنْ جَلْبِ الْمَصَالِحِ (السيوطي، الأشباه والنظائر، القاهرة: دار السلام، ٢٠٠٤، ط ٢، تحقيق وتعليق: محمد محمد تامر و حافظ عاشور حافظ، ج ١، ص ٢١٧)

¹⁹⁰ QS. al-Nisa' (4): 29.

“Preventing *mafsadah* (damage) should take precedence over taking *mashlahat*.”¹⁹¹

مَا أَدَّى إِلَى الْحَرَامِ فَهُوَ حَرَامٌ

“Anything that served as intermediary (media) for illegal acts, shall be against the law as well.”¹⁹²

الضَّرَرُ يُدْفَعُ بِقَدْرِ الْإِمْكَانِ (أحمد بن محمد الزرقا، شرح القواعد
الفقهية، دمشق: دار القلم، ١٩٨٩، ط ٢، ص ٢٠٧)

“Wherever possible, all *madharat* (danger, harm) must be avoided.”¹⁹³

الضَّرَرُ يُزَالُ (السيوطي، الأشباه والنظائر، القاهرة: دار السلام،
٢٠٠٤، ط ٢، تحقيق وتعليق: محمد محمد تامر و حافظ عاشور
حافظ، ج ١، ص ٢١٠)

“All *madharat* (danger, harm) must be eliminated.”¹⁹⁴

On exchange trading, the customer cannot directly perform trading. Customer is delegate order to the Securities Exchange Member. As known, firstly customer open account in the Securities Company. Customer must fill application form. In that, must be a provision term and condition of contract.

¹⁹¹ Al-Suyuthi, *Al-Asybah Wa Al-Nadza 'Ir*, juz 1, p. 217; Fatwa of National Shari'ah Board Number 80/DSN-MUI/III/2011.

¹⁹² Yusuf Qardhawi, *Al-Halal Wa Al-Haram Fi Al-Islam*, (Kairo: Maktabah Wahbah, 1993), p. 31; Fatwa of National Shari'ah Board Number 80/DSN-MUI/III/2011.

¹⁹³ Ahmad bin Muhammad al-Zarqa, *Syarh al-Qawa'id al-Fiqhiyah*, p. 62; Fatwa of National Shari'ah Board Number 80/DSN-MUI/III/2011.

¹⁹⁴ Al-Suyuthi, *op. cit.*, juz 1, p. 210; Fatwa of National Shari'ah Board Number 80/DSN-MUI/III/2011.

In issuing stock, the investor must be aware that the contract is governed by the principle of *mudarabah*. The distributing returns and institution which will utilize the proceeds of the issued financial instrument must also be clearly stated on contract. The stock must be sold at face value. The permissible date is concurrent with the date the stock listed. It is permitted as long as the assets are known to buyer. The price is determined by market forces.

However, Non-Members of Securities Exchange also cannot perform trading directly. In this point, Non-Members of Securities Exchange is transfer or delegate the customer order to Securities Exchange Member to perform the securities trading. Base on *fiqh*, this transaction categorized as *wakalah*. In *wakalah*, it is involving a fee as consideration for the services rendered and this fee may be in the form of an absolute amount or computed on a percentage basis.

...فَإِنْ أَمِنَ بَعْضُكُم بَعْضًا فَلْيُؤَدِّ الَّذِي أُؤْتِمِنَ أَمَانَتَهُ، وَلِيَتَّقِ اللَّهَ رَبَّهُ...
 رَبَّهُ...
 رَبَّهُ...

”...and if one of you trusts another, then he who is trusted should deliver his trust, and let him be careful (of his duty to) Allah, his Lord....”¹⁹⁵

قَالَتْ إِحْدَاهُمَا يَا أَبَتِ اسْتَأْجِرْهُ، إِنَّ خَيْرَ مَنْ اسْتَأْجَرْتَ الْقَوِيُّ
 الْأَمِينُ.

¹⁹⁵ Al-Baqarah (2): 283.

“Said one of them: O my father! Employ him, surely the best of those that you can employ is the strong man, the faithful one.”¹⁹⁶

...وَتَعَاوَنُوا عَلَى الْبِرِّ وَالتَّقْوَىٰ وَلَا تَعَاوَنُوا عَلَى الْإِثْمِ وَالْعُدْوَانِ
وَاتَّقُوا اللَّهَ إِنَّ اللَّهَ شَدِيدُ الْعِقَابِ

”...and help one another in goodness and piety, and do not help one another in sin and aggression; and be careful of (your duty to) Allah; surely Allah is severe in requiting (evil).”¹⁹⁷

Perspectives of the Ulama, among others bellow.

وَيَجُوزُ التَّوَكُّلُ بِجُعْلِ وَعَيْرِ جُعْلٍ، فَإِنَّ النَّبِيَّ صَلَّى اللَّهُ عَلَيْهِ وَآلِهِ
وَسَلَّمَ وَكَلَّ أَنْبِيَّاً فِي إِقَامَةِ الْحَدِّ، وَعُرْوَةَ فِي شِرَاءِ شَاةٍ، وَأَبَا
رَافِعٍ فِي قَبُولِ النِّكَاحِ بِعَيْرِ جُعْلٍ؛ وَكَانَ يَبْعَثُ عُمَّالَهُ لِقَبْضِ
الصَّدَقَاتِ وَيَجْعَلُ لَهُمْ عُمُولَةً (المعنى لابن قدامة، [القاهرة: دار
الحديث، ٢٠٠٤]، ج. ٦، ص. ٤٦٨)

”*Taukil akad (wakalah)* is allowed, with or without fee. It is because the Prophet s.a.w. once gave authority to Unais to give punishment, to Urwah to buy a goat, and to Abu Rafi‘ to carry out *qabul nikah*, (all) without giving any fee. The Prophet also sent his employees to take alms (zakat) and gave them fee.”¹⁹⁸

وَأَجْمَعَتِ الْأُمَّةُ عَلَى جَوَازِ الْوَكَالَةِ فِي الْجُمْلَةِ، وَلِأَنَّ الْحَاجَةَ
دَاعِيَةً إِلَى ذَلِكَ، فَإِنَّهُ لَا يُمَكِّنُ كُلَّ وَاحِدٍ فَعَلُ مَا يَحْتَاجُ إِلَيْهِ،
فَدَعَتِ الْحَاجَةَ إِلَيْهَا، (المعنى/٥/٥١)

¹⁹⁶ Al-Qashash (28): 26.

¹⁹⁷ Al-Ma‘idah (5): 2.

¹⁹⁸ Ibn Qudamah, *Al-Mughni*, (Kairo: Dar al-Hadis, 2004), juz 6, p. 468; Fatwa of National Shari’ah Board Number 80/DSN-MUI/III/2011.

“The followers (*ulama*) have resolved that *wakalah* is principally legal. And every person cannot directly get what he/she wants. Consequently, there is a need for such *wakalah*.”¹⁹⁹

تَصَحُّهُ الْوَكَالَةُ بِأَجْرٍ وَبِغَيْرِ أَجْرٍ، لِأَنَّ النَّبِيَّ صَلَّى اللَّهُ عَلَيْهِ وَآلِهِ وَسَلَّمَ كَانَ يَبْعَثُ عُمَّالَهُ لِقَبْضِ الصَّدَقَاتِ وَيَجْعَلُ لَهُمْ عَمُولَةً... وَإِذَا كَانَتْ الْوَكَالَةُ بِأَجْرٍ أَيْ (بِجَعْلِ) فَحُكْمُهَا حُكْمُ الْإِجَارَاتِ. (تكملة فتح القدير، ج. ٦، ص. ٢؛ الفقه الإسلامي وأدلته للدكتور وهبة الزحيلي ج. ٥، ص. ٤٠٥٨)

“*Wakalah* is legal, with or without fee, it is because the Prophet s.a.w. once sent his employees to take alms (zakat) and he gave them fee.... When *wakalah* is carried out with fee, its legality is similar to *ijarah*.”²⁰⁰

أَذِنَ (الْمُوكَّلُ) لَهُ (الْوَكِيلُ) فِي التَّوَكُّلِ فَيَحْوِزُ لَهُ ذَلِكَ، لِأَنَّهُ عَقَدَ أَذِنَ لَهُ بِهِ، فَكَانَ لَهُ فِعْلُهُ. (المعنى لابن قدامة، [القاهرة: دار الحديث، ٢٠٠٤]، ج. ٦، ص. ٤٧٠)

“(If) *muwakkil* allows agent to represent (to other person), it is allowed; for it is an *akad* that has been rendered to agent; therefore, he/she may do it (represent it to other person).”²⁰¹

إِنَّ اللَّهَ يَأْمُرُكُمْ أَنْ تُؤَدُّوا الْأَمَانَاتِ إِلَىٰ أَهْلِهَا وَإِذَا حَكَمْتُمْ بَيْنَ النَّاسِ أَنْ تَحْكُمُوا بِالْعَدْلِ...

¹⁹⁹ The perspective of Imam Syaukani when he explained a hadith of Burs bin Sa'id on Fatwa of National Shari'ah Board Number 80/DSN-MUI/III/2011.

²⁰⁰ Fath al-Qadir, juz 6, p. 2; Wahbah al-Zuhaili, *Al-Fiqh Al-Islami Wa Adillatuh*, (Dimasyq; Dar al-Fikr, 2002), juz 5, p. 4058; Fatwa of National Shari'ah Board Number 80/DSN-MUI/III/2011.

²⁰¹ Ibn Qudamah, *op. cit.*, juz 6, p. 470; Fatwa of National Shari'ah Board Number 80/DSN-MUI/III/2011.

“Surely Allah commands you to make over trusts to their owners and that when you judge between people.. you judge with justice;...”²⁰²

Base on fatwa of DSN, the contract that be used between Securities buyer and seller of Non-Members of Securities Exchange and Securities Exchange Member is *ju'alah*.

وَيُسْتَأْنَسُ لِلْجُعَالَةِ بِقَوْلِهِ تَعَالَى { وَلِمَنْ جَاءَ بِهِ حِمْلُ بَعِيرٍ } وَكَانَ
الْحِمْلُ مَعْلُومًا عِنْدَهُمْ، كَالْوَسْقِ، وَإِنَّمَا كَانَ هَذَا اسْتِنَاسًا، لَا دَلِيلًا،
لَأَنَّهُ فِي شَرْعٍ مَنْ قَبْلَنَا، وَهُوَ لَيْسَ شَرْعًا لَنَا، وَإِنْ وَرَدَ فِي شَرْعِنَا مَا
يُقَرَّرُهُ عَلَى الرَّاجِحِ.

Ju'alah akad (agreement/contract) can become *isti'nas* of Allah words: “...and he who shall bring it shall have a camel-load...” (Yusuf 12: 72). “Camel-load (*himl*)” is a measurement form familiarly known among followers of the Prophet Yusuf, similar to *wasaq*. This words of Allah is considered only as *isti'nas*, not *dalil* for they cope with shari'ah of people before us; and they - according to *rajih* (strong) perspective – shall not become our shari'ah (followers of the Prophet Muhammad), even though there is *dalil* (hadith) in our shari'ah determining it (as our shari'ah).²⁰³

وَإِنْ اشْتَرَى أَحَدُ الشَّرِيكَيْنِ حِصَّةَ شَرِيكِهِ جَائِزٌ لِأَنَّهُ يَشْتَرِي مِلْكَ غَيْرِهِ

“When one of the parties buys the portion of the other party in partnership, it is legal for he/she buys other's right.”²⁰⁴

²⁰² An-Nisa (4): 58.

²⁰³ Ulama's perspective of Syafi'i *mazhab* concerning *Ju'alah*; among others al-Dimyathi al-Bakri in *Hasyiyah Tanah al-Thalibin*, juz III, p. 256 (Hadith Tahqiq and Takhrij: 'Abd al-Hakim Muhammad 'Abd al-Hakim), (Kairo: al-Maktabah al-Taufiqiyah); Fatwa of National Shari'ah Board Number 80/DSN-MUI/III/2011.

²⁰⁴ Ibnu Qudamah, *op. cit.*, juz V, p. 56; Fatwa of National Shari'ah Board Number 80/DSN-MUI/III/2011.

... أَنَّ الْحَاجَةَ تَدْعُو إِلَى ذَلِكَ (الْجُعَالَةَ)، فَإِنَّ الْعَمَلَ قَدْ يَكُونُ مَجْهُولًا كَرَدِّ الْأَبْقِ وَالضَّائِلَةِ وَغَيْرِ ذَلِكَ، وَلَا تَنْعَقِدُ الْإِجَارَةُ فِيهِ وَالْحَاجَةُ دَاعِيَةٌ إِلَى رَدِّهِمَا وَقَدْ لَا يَجِدُ مَنْ يَتَبَرَّعُ بِهِ، فَدَعَتِ الْحَاجَةُ إِلَى إِبَاحَةِ الْجُعْلِ فِيهِ مَعَ جَهَالَةِ الْعَمَلِ.

“Public need requires *ju‘alah*; as the work (to achieve certain objective) is occasionally in-obvious (the form and the implementation), e.g.: bringing a lost slave back, lost animal, etc. This kind of work requires no *ijarah* akad (rent/wage), but (the person/owner) wants both of the lost possessions back, and he/she finds nobody who intends to return them back voluntarily (without fee). Therefore, public need encouraging akad *jua‘lah* for such purpose is allowed, though (the form and the implementation) such work is in-obvious.”²⁰⁵

In performing trading, the parties paid by fee. In exemplified is IDX fee, Securities Company, KPEI, and KSEI. IDX fee (*ujrah/rusum*) is based on *ijarah*²⁰⁶ principles. Fee is permissible in Islamic law.

عَنْ عَبْدِ اللَّهِ بْنِ عُمَرَ قَالَ قَالَ رَسُولُ اللَّهِ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ
أَعْطُوا الْأَجِيرَ أَجْرَهُ قَبْلَ أَنْ يَجِفَّ عَرَقُهُ. (أَخْرَجَهُ ابْنُ مَاجَهَ فِي
سُنَنِهِ / كِتَابِ: الْأَحْكَامِ، الْبَابِ: أَجْرُ الْأَجْرَاءِ، رَقْمُ الْحَدِيثِ :
(٢٤٣٤)

Hadith recited by Ibnu Majah from Ibnu Umar: Recited by Ibnu Umar r.a. that: the Prophet s.a.w. said: “pay the workers’ wages before their sweat dried up.”(Hadith recited by Ibnu Umar).

²⁰⁵ Ibnu Qudamah, *op. cit.*, juz VIII, p. 323; Fatwa of National Shari’ah Board Number 80/DSN-MUI/III/2011.

²⁰⁶ *Ijarah* is an akad of tenure/benefit transfer of certain object or service/work performance within certain period of time with wage/*ujrah*.

مَنْ اسْتَأْجَرَ أَجِيرًا فَلْيُعَلِّمَهُ أَجْرَهُ.

The Prophet s.a.w. said: “Anyone who employs workers, let them know their wages.”²⁰⁷

وَفِيهِ أَيْضًا دَلِيلٌ عَلَى أَنَّ مَنْ نَوَى التَّبَرُّعَ يَحُوزُ لَهُ أَخْذُ الْأَجْرَةِ
بَعْدَ ذَلِكَ (نيل الأوطار للشوكاني، [القاهرة: دار الحديث،
٢٠٠٠]، ج: ٤؛ ص: ٥٢٧)

The perspective of Imam Syaukani when he explained a hadith of Burs bin Sa'id: “Hadith of Burs bin Sa'id also showed that one carrying out a thing with *tabarru* intention may receive fee.”²⁰⁸

The matching transaction is based on JATS system. The used of JATS is permissible. JATS can be categorized as technology that increased *mashlahah* or benefit to the parties. Securities which serve as the trading object are only Shari'ah Equity Securities.

أَنَّ رَسُولَ اللَّهِ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ قَضَى أَنْ لَا ضَرَرَ وَلَا ضِرَارَ
(أخرجه ابن ماجه عن عبادة بن الصامت في سننه / الكتاب :
الأحكام، الباب : من بني في حقه ما يضر بجاره، رقم الحديث :
٢٣٣١، ورواه أحمد عن ابن عباس، ومالك عن يحيى)

Hadith of the Prophet as recited by Ibnu Majah from 'Ubadah bin Shamit; Ahmad from Ibnu 'Abbas, and Imam Malik from Yahya: “The Prophet s.a.w. has resolved: do not endanger/harm others, and do not avenge any danger (harm caused by others) with danger (harmful acts).”

²⁰⁷ Hadith recited by Abd ar-Razzaq from Abu Humairah and Abu Sa'id al-Khudri.

²⁰⁸ Al-Syaukani, *Nail al-Authar*, (Kairo: Dar al-Hadith, 2000), juz 4, p. 527; Fatwa of National Shari'ah Board Number 80/DSN-MUI/III/2011.

تَصَرَّفُ الْإِمَامِ عَلَى الرَّعِيَّةِ مُنَوِّطٌ بِالْمَصْلَحَةِ (السيوطي، الأشباه
والنظائر، القاهرة: دار السلام، ٢٠٠٤، ط ٢، تحقيق وتعليق:
محمد محمد تامر و حافظ عاشور حافظ، ج ١، ص ٢٧٦)

“Any conduct or policy of an Imam (the regulator) toward the people, must be oriented on *mashlahat*.”²⁰⁹

In clearing and guarantee, KPEI perform novation. Novation is questioned by the Bapepam-LK on its research. Fatwa is answered this question by permitted novation. KPEI performs novation of Securities Trading performed by Stock Exchange Member based on *hawalah bil ujah* principles.

Derivative transaction is prohibited in Islamic law. It is required to conduct the Securities trading based on prudent principle and it is not allowed to make speculation, manipulation, and other actions bearing *dharar*, *gharar*, *riba*, *maisir*, *risywah*, *maksiat & cruelty*, *taghrir*, *ghisysy*, *tanajusy/najsy*, *ihtikar*, *bai' al-ma'dum*, *talaqqi al-rukban*, *ghabn*, *riba*, and *tadlis*.

عَنْ أَبِي هُرَيْرَةَ قَالَ نَهَى رَسُولُ اللَّهِ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ عَنْ بَيْعِ
الْحَصَاةِ وَعَنْ بَيْعِ الْغَرَرِ (أخرجه مسلم في صحيحه/الكتاب:
البيوع، باب: بَطْلَانِ بَيْعِ الْحَصَاةِ وَالْبَيْعِ الَّذِي فِيهِ غَرَرٌ، رقم
الحديث: ٣٧٨٣)

“Recited by Abi Hurairah r.a., he said: the Prophet s.a.w. forbids *hashah* trade and *gharar*-bearing trade.”²¹⁰ (Hadith recited by Muslim).

²⁰⁹ Al-Suyuthi, *op. cit.*, juz 1, p. 276; Fatwa of National Shari'ah Board Number 80/DSN-MUI/III/2011.

عَنْ حَكِيمِ بْنِ حِزَامٍ قَالَ أَتَيْتُ رَسُولَ اللَّهِ -صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ-
فَقُلْتُ يَا نَبِيَّ الرَّجُلُ يَسْأَلُنِي مِنَ الْبَيْعِ مَا لَيْسَ عِنْدِي أَتَبَاغُ لَهُ مِنْ
السُّوقِ ثُمَّ أَيْعُهُ قَالَ « لَا تَبِعْ مَا لَيْسَ عِنْدَكَ ». (سنن الترمذي،
١٣٩/٥)

Hadith of the Prophet as recited by Tirmidzi from Hakim bin Hizam
Recited by Hakim bin Hizam, he said: I came to the Prophet s.a.w. and
said: a man came to me and asked me to sell goods I did not have, I
shall buy it for him at the market and then sell it to him. The Prophet
answered: “Do not sell anything you do not have.”

عَنْ ابْنِ عُمَرَ أَنَّ رَسُولَ اللَّهِ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ نَهَى عَنِ التَّجَشُّشِ.
(أَخْرَجَهُ الْبُخَارِيُّ فِي صَحِيحِهِ / الْكِتَابُ : الْخَيْلُ ، الْبَابُ : مَا يَكْرَهُ
مِنَ التَّنَاجُشِ ، رَقْمُ الْحَدِيثِ : ٦٤٤٨)

Hadith of the Prophet as recited by Imam al-Bukhari: “Recited by Ibnu
Umar r.a. that: the Prophet s.a.w. forbids *najsy* (false bids),” (Hadith
recited by Bukhari).

The volume of Islamic investments – with a preference for Sharia’
compliant instruments – has grown to form a critical mass that can support a
well-functioning and efficient capital market. Furthermore, Muslim
stakeholders in middle-income countries, such as Indonesia, are increasingly
expressing their preference for Shari’ah-compliant financing.

²¹⁰ Hadith of the Prophet as recited by Muslim from Abu Hurairah.

While the overall market background appears promising, certain obstacles and constraints may lie ahead and market participants and regulators need to take concrete steps to support market take-off.

Firstly and most importantly, market development requires a strong sponsorship and leadership of the government, especially on legal and regulatory issues.

An effective legal, regulatory and supervisory framework provides the essential foundation for the functioning of a modern capital market. For a rapidly growing market like the Islamic capital market, it is important to ensure that an enabling and conducive regulatory environment exists to adequately regulate the Islamic capital market.

The Shari'ah approval process or certification process is carried out through two different methods. This includes determining whether the information is material information and relevant to an investment decision. The first is through a market approach whereby financial institutions have their own in-house independent Shari'ah advisory bodies that screen and endorse their Islamic capital market products and services.

The second method takes an approach whereby the regulatory authority assesses Shari'ah compliance and issues the appropriate Shari'ah certification for all Islamic capital market products and services under its purview. The jurisdictions Indonesia use this approach as the Shari'ah certification process is undertaken at the regulator's level, whereby the regulatory authorities have established their own Shari'ah advisory bodies, to

formally advise the relevant regulatory authorities on issues pertaining to Islamic capital market products and services.

Shari'ah compliance issues are taken into consideration in the regulator's functions such as product approval, eligibility criteria for intermediaries, reporting requirements of regulated entities, and enforcement of regulatory requirements. If interpreted as such, the general disclosure requirements can therefore be applied to the offer documents or similar documents in relation to Shari'ah compliance. This would imply a need to ensure that the duties and liabilities of advisers and officers of the issuer with regards to their exercise of due diligence in the provision of this additional information is appropriately regulated.

Furthermore, it should be noted that the requirement for Shari'ah compliance is a continuous process. It is possible that the business activities of the issuer may change over time, e.g., arising out of mergers and acquisitions, and result in a company or investment product no longer being Shari'ah compliant. For this purpose, Shari'ah assessments need to be conducted continuously. Disclosures in relation to this are critical for an investor to be fully informed of the product and to ensure that the investor receives a product that is true to its label. This may be particularly relevant in jurisdictions where the Shari'ah approval process or the need for a Shari'ah Board is not embedded within the regulatory framework.

Investors, on the other hand, can significantly support market development. Investors can express their preference for Sharia' compliant

instruments more concretely, namely in terms of their bid prices. For intermediaries, they can lead the process to reduce transaction costs, perhaps through further standardization of transaction schemes and instruments.²¹¹

As mentioned, Islamic capital market transactions involved the sale and purchase of an underlying asset (e.g. properties). It was recognized that the unique underlying structure of Islamic transactions inadvertently triggers taxes such as a real property gains tax, income tax and double stamp duty. The tax framework's structure should ensure that there is tax neutrality between Islamic and conventional capital market products. Without a specific tax framework for Islamic capital market transactions, product development and innovation would be impeded, and participation in Islamic capital market transactions may also be discouraged. It should be noted that the tax treatment for certain Islamic capital market transactions is dissimilar with that of conventional transactions.

²¹¹ For example, in the Malaysian market, market participants have developed a few well standardized structures, such as *Bai' Bithaman Ajil*. Structuring as well as distribution costs for these standardized Islamic deals in Malaysia are now reduced to a competitive level, making them a viable alternative to conventional debt instruments.

CHAPTER IV

CONCLUSIONS AND RECOMMENDATIONS

A. Conclusions

Base on analyzing and consideration above all, finally it has surfaced point to the conclusion.

1. The trading mechanism of secondary market securities on Shari'ah capital market in Indonesia, in compliance with Shari'ah principles if they meet specific requirements. Thus, using sale and purchase agreement (*Akad Bai'*), agreement (*Akad*) that used in the Equity Securities trading mechanism on regular market on the Stock Exchange is *Ba'i Al Musawamah*, sale and purchase agreement (*Akad*) has been considered valid by sharia at the time the transaction occurred. Investor who purchases stocks is allowed by sharia to sell back the securities held prior to T+3 based on the *qabdh hukmi* principle. SROs are allowed to impose *ujroh* (service fee) for each step in the trading mechanism on regular market on the Stock Exchange.
2. Fatwa on stock trading Shari'ah mechanism is the answer for people who still question the Shari'ah compliance of stock transactions in regular market on the Stock Exchange. The fatwa was expected to give a trust to investors who concerned about sharia principles in investing in the capital market. Shari'ah compliance is the key distinguishing feature of the Islamic capital market. In order to be deemed as Shari'ah-compliant,

Islamic capital market products and services need to undergo a pre-defined vetting and approval process by Shari'ah advisers. It is importance of having an appropriate Shari'ah approval process. In addition, its need to have formal regulatory requirements for the establishment of Shari'ah advisory bodies to act as central reference points in assessing Shari'ah compliance of Islamic capital market products and services.

B. Recommendations

Base on conclusion above, to give certainty and clarity about the trading mechanism of secondary market securities on Shari'ah capital market, some recommendations is described.

1. The need to develop accounting standards that adequately and appropriately reflect the nature of Islamic financial transactions was viewed as an important step to enhance the reliability, consistency and clarity of financial reporting by Islamic financial institutions which would also enhance investor confidence in Islamic finance. Another equally important consideration relates to the level of awareness and understanding of investors with regards to Islamic capital market products. Investor education is critical to improving investor activism as well as enhancing investor protection and scrutiny of Islamic capital market activities. Discerning investors typically demand higher standards of service, and this in turn would contribute to the development of higher standards being applied by market practitioners.

2. Hence, it may wish to consider an expansion of the pool of Islamic capital market experts covering subject matters such as corporate finance, legal, accounting and tax as well as the Shari'ah. Intensified efforts are required to promote greater dialogue between Shari'ah scholars and market professionals, which can be reinforced by encouraging greater research on Islamic finance. In addition, educational institutions like universities, colleges and private training providers may wish to increase the supply of relevant courses while financial institutions could also take the initiative to offer in-house courses and professional training modules on the Islamic capital market. Apart from that, greater collaboration between institutions and training providers could also be beneficial in providing and organizing training programmers on the Islamic capital market.

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