

المؤتمر العالمي الحادي عشر لعلماء الشريعة في المالكة الإسلامية

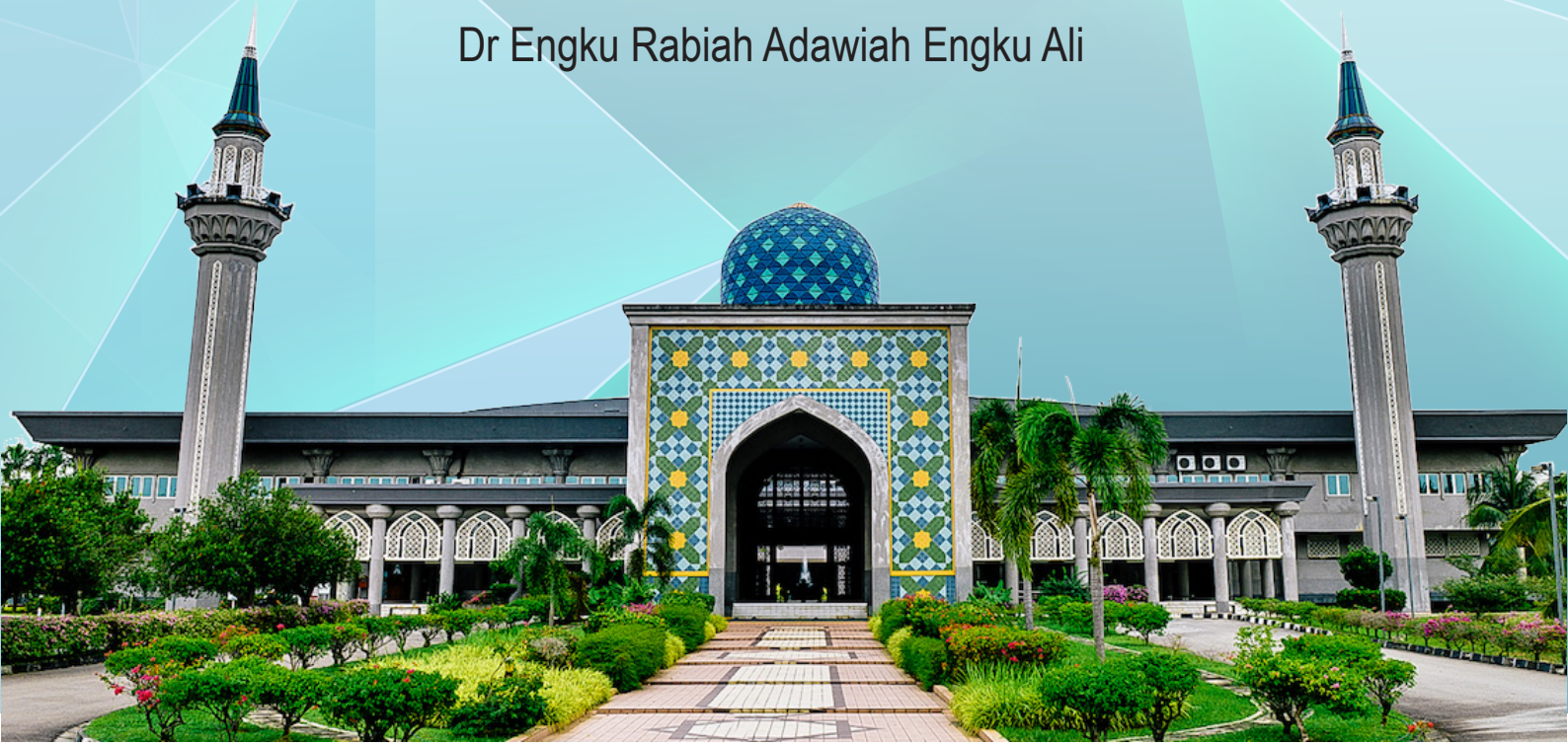


سوف رأس المال الإسلامي والمصرفية الإسلامية: تقوية القضايا العالقة

ISLAMIC CAPITAL MARKET & ISLAMIC BANKING: AN APPRAISAL OF UNRESOLVED ISSUES

PROCESSES AND LEGAL REQUIREMENTS OF SELECTED PRACTICES ON PLATFORMS FOR TRADING OF FINANCIAL PAPERS AND THEIR INSTRUMENTS

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PROCESSES AND LEGAL REQUIREMENTS OF SELECTED PRACTICES ON PLATFORMS FOR TRADING OF FINANCIAL PAPERS AND THEIR INSTRUMENTS[©]

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1. Introduction

First of all, I have to admit that the topic given to me is very wide and it is very challenging for me to even put a reasonable scope to the paper that can do justice to the topic. At the end, I decided that I would focus on the processes and legal requirements of certain selected practices on platforms for trading of financial papers and instruments as regulated in Malaysia, more specifically, by the Central Bank of Malaysia (BNM), Malaysian Securities Commission (SC) and Bursa Malaysia.

In general, the regulation for issuance of financial papers and instruments, and their trading on the dedicated platforms in Malaysia, is shared between the Malaysian Securities Commission and the Central Bank of Malaysia. The Malaysian Securities Commission regulates the capital market varieties of the financial papers and instruments; whilst the Central Bank of Malaysia regulates the banking and money market varieties of those instruments. Since many of the financial papers and instruments are also listed and traded on Bursa Malaysia, the rules and regulations of Bursa Malaysia are applicable to those listed securities and must be accordingly complied with.

The services and practices involving financial papers and instruments are many and of diverse varieties. Accordingly, the related rules and regulations governing these services and practices in term of their issuance and trading on the various platforms are equally diverse and massive. It is not possible for me to discuss all of these practices, and their processes and legal requirements. Therefore,

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I intend to discuss some selected practices¹ only, together with their related rules and regulations. The selected practices are:

- Regulated Short Selling (RSS)
- Securities Borrowing and Lending (SBL)

The selection of these practices is made based on observation of aspects of the practices that may raise some concerns in term of compatibility and compliance with the Shariah principles. However, since the topic given to me is limited to “processes and legal requirements of selected practices”, the paper will not go into the details of Shariah and fiqhi discussions on the said practices. Only brief highlights of possible Shariah concerns will be included, together with any available fiqhi resolutions on the selected practices. The intention is to focus more on legal rules and regulations (as required by the given topic), with some highlights of the possible Shariah concerns in the selected practices so that further research or review can later be done to ascertain their Shariah compatibility or otherwise.

The paper begins with introduction, followed by explanations about the regulatory regime for the issuance and trading of financial papers and instruments in Malaysia, which is shared by BNM, SC and Bursa Malaysia. The next section discusses some of the rules and processes for the platforms regulated by BNM and Bursa Malaysia. This is followed by discussion on the processes and legal requirements of the two selected practices on the platforms, with some highlights of the Shariah concerns observed in the said practices. Finally, is some observations and recommendation for further research.

2. Regulatory Regimes for the Issuance and Trading of Financial Papers and Instruments in Malaysia

As highlighted earlier in the introduction, three regulators are involved in the regulation of financial papers and instruments, and their trading on the dedicated platforms in Malaysia. The Central Bank of Malaysia or BNM regulates the banking and money market varieties of the financial papers and instruments; whilst the

¹ Originally, the paper intends to select some derivative instruments as well, but due to constraint of time and space, this is rendered not possible.

Malaysian Securities Commission (SC) regulates the capital market varieties. Since many of the financial papers and instruments are also listed and traded on platforms provided by Bursa Malaysia, the rules and regulations of Bursa Malaysia are also applicable to those listed securities and must be accordingly complied with. Each of these regulatory regimes will be discussed below, beginning with BNM, followed by SC and finally Bursa Malaysia.

2.1. Regulatory Regime of BNM for Issuance and Trading of Financial Papers and Instruments

BNM (the Central Bank of Malaysia) is a statutory body governed by the Central Bank of Malaysia Act 2009. The main regulatory role of BNM is to promote monetary and financial stability. BNM's monetary policy stance is to maintain price stability while remaining supportive of growth. BNM is also responsible for financial system stability. This is achieved by developing a sound, resilient, progressive and diversified financial sector, which serves to support the sectors of the real economy. BNM also plays an important function in implementing initiatives to deepen and strengthen the financial markets, including the foreign exchange market.²

The roles of BNM are supported by 39 departments/units in the Bank covering seven functional areas: (i) economic and monetary policy; (ii) investment and operations; (iii) regulation; (iv) payment systems; (v) supervision; (vi) organizational development; and (vii) communications.³

Hence, the Bank's regulatory regime is very wide, covering a lot of areas including licensing, supervision, liquidity support, financial markets, monetary policy and operations, payment and settlement systems, etc. With regard to financial papers and instrument, BNM does not only act as market supervisor and regulator, but also provider of infrastructure in the form of electronic and web-based platforms for the issuance and trading of the financial papers and instruments. The main regulatory objective of this is to facilitate the Bank's performance of its monetary operations function.

² BNM, "About The Bank", http://www.bnm.gov.my/?ch=en_about&pg=en_intro&ac=641

³ Ibid.

Monetary operations are discretionary market operations and the main mechanism through which the Bank adjusts liquidity in the banking system by absorbing or adding liquidity via various types of instruments to achieve its operating target, the average overnight interbank rate (AOIR).⁴ The Bank's counterparties for monetary operations comprise the approved interbank institutions in the domestic interbank market. All approved interbank participants are able to participate directly in monetary operations conducted by the Bank, including standing facilities. However, participation in Bank Negara Monetary Notes (BNMNs) auctions is only via appointed Principle Dealers (PDs).⁵

Monetary operations with all interbank participants are conducted daily through electronic auctions on the web-based Fully Automated System for Issuing/Tendering (FAST). The auctions can be undertaken in various forms: competitive variable rates, competitive single rate or non-competitive forms. All auction invitations and auction results are published on the FAST website (<https://fast.bnm.gov.my>). The Bank may also conduct bilateral operations with financial institutions or intervene through agent banks or via money brokers.⁶

The following sub-topics discuss the various electronic and web-based platforms provided and supervised by BNM.

FAST System

Fully Automated System for Issuing/Tendering (FAST) was first launched by BNM in September 1996 to automate the tendering procedure of Government Securities or Bank Negara Papers that are issued via Principal Dealers (PD) network. In July 1997, FAST was further enhanced to include commercial papers and medium term notes which are issued via tender or private placement.⁷

⁴

http://www.bnm.gov.my/index.php?ch=en_fxmm_mo&pg=en_fxmm_mo_overview&ac=446&lang=en&eId=box1

⁵ Ibid.

⁶ Ibid.

⁷ BOND INFO HUB,

http://bondinfo.bnm.gov.my/portal/server.pt?open=514&objID=27257&parentname=CommunityPage&parentid=3&mode=2&in_hi_userid=22874&cached=true

FAST has undergone several phases of enhancement to accommodate the growing needs and sophistication of the domestic money market and debt market. Among the features that have been incorporated since 1999 are Money Market Tender, re-opening of the existing stocks, creation of secondary notes, interface to RENTAS system and execution of Repo transactions between BNM and approved interbank institutions through FAST. With these enhancements, FAST continues to serve as an entry point for primary activities of securities issuance, money market tender and repo tender transactions.⁸⁹

In year 2005, FAST was further enhanced to operate on a web-based application. The main objective of using web-based application is to enhance transparency of market information and improve accessibility to the system. The enhanced features also cater for new instruments to be introduced in the market. The centralised news and information is also accessible to public without the need to become members of FAST. This enables market participants to streamline and improve processes in handling instruments and issuance processes regardless of its mode of offer and at the same time improve overall transparency of Malaysian financial market.¹⁰

The Rules on FAST is issued to provide a uniform set of procedures and practices to govern the issuance/tendering of all instruments captured under FAST. The Rules also sets out broadly the contingency measures in the event that a disaster is declared.¹¹

RENTAS System

RENTAS is the acronym for Real Time Electronic Transfer of Funds and Securities. It was first introduced in July 1999 to replace the previous SPEEDS System for interbank payment and scripless securities. The RENTAS System is a real time gross settlement system (RTGS) for the transfer and settlement of high value ringgit denominated interbank funds and scripless securities transactions. RENTAS System

⁸ Ibid.

⁹ Ibid.

¹⁰ Ibid.

¹¹ Ibid.

enables payment instructions between the participants of the System to be processed and settled individually and continuously throughout the working day. All settled transactions are considered final and irrevocable. Thus, the receiver is able to use the funds immediately without being exposed to the risk of the funds not being settled.¹²

The RENTAS System reduces settlement risk in scripless securities transactions by providing a mechanism for delivery-versus payment (DVP). This mechanism enables transfer instructions for both scripless securities and funds to be effected on a trade-by-trade basis, with final (unconditional) transfer of the securities from the seller to the buyer (delivery) occurring at the same time as the final transfer of the funds from the buyer to the seller (payment).¹³

The RENTAS System is currently operated by MyClear (Malaysian Electronic Clearing Corporation Sdn Bhd), a wholly-owned subsidiary of BNM. Membership of the System is restricted to licensed financial institutions, which includes commercial banks, Islamic banks, Investment banks, Development Financial Institutions and non-bank financial institutions that operate in the money markets or capital market. RENTAS is also used by the government of Malaysia. In September this year, BNM and MyClear improved the RENTAS System by adopting global standards and connecting with Swift to support the settlement of wholesale payments and securities denominated in international currencies.

Islamic Money Market (IMM)

The Islamic money market (IMM) is a dedicated and separate system to provide Islamic financial institutions (IFI) with the facility for funding and adjusting portfolios over the short-term. The IMM also serves as a channel for the transmission of monetary policy by the BNM.¹⁴ The IMM is maintained at BNM and is separated from the conventional market to effect clear segregation of funds between conventional and Islamic banking at the settlement level to ensure

¹² BNM, "Introduction of RENTAS System";
http://www.bnm.gov.my/?ch=en_press&pg=en_press_all&ac=563&lang=en

¹³ Ibid.

¹⁴ <http://iimm.bnm.gov.my/index.php?ch=4&pg=4&ac=22>

compliance with the Shariah. Nonetheless, liquidity in both systems are linked given third-party payments between banking customers in the two sectors, as well as the participation of conventional banking institutions in Islamic banking products.¹⁵

The primary objective of the BNM's monetary operations in the IMM is to ensure sufficient liquidity for the efficient functioning of the Islamic interbank market. Financial instruments and interbank investment would allow surplus banks to channel funds to deficit banks, thereby maintaining the funding and liquidity mechanism necessary to promote stability in the system.¹⁶

Islamic Interbank Money Market (IIMM)

The Islamic Inter bank Money Market (IIMM) was introduced on January 3, 1994 as a short-term intermediary to provide a ready source of short-term investment outlets based on Syariah principle. Through the IIMM, the Islamic banks and banks participating in the Islamic Banking Scheme (IBS) would be able to match the funding requirements effectively and efficiently. BNM issued the Guidelines on the IIMM on December 18, 1993 to facilitate proper implementation of the IIMM.¹⁷

BNM influences Islamic interbank market liquidity through an array of Shariah-compliant instruments, the main instrument being the Wadiah Acceptance (guaranteed custody). Through the Wadiah Acceptance, BNM manages liquidity in the context of a surplus liquidity environment by inviting Islamic banking institutions to place their surplus funds with the Bank, based on the concept of Wadiah Yad Dhamanah (savings with guarantee). BNM also uses Commodity Murabahah Programme (CMP) to manage liquidity. CMP utilises mainly crude palm oil-based contracts as the underlying commodity transactions to facilitate liquidity management via a commodity trading platform such as Bursa Suq Al Sila', or other commodity providers.¹⁸

For longer-term liquidity management, the BNM issues Bank Negara

¹⁵ BNM, Islamic Money Market Operations, accessed on 30 October 2016; www.bnm.gov.my/index.php?ch=en_fxmm_mo&pg=en_fxmm_mo_overview&ac=451&lang=en&eld=box1

¹⁶ Ibid.

¹⁷ <http://iimm.bnm.gov.my/index.php?ch=4&pg=4&ac=22>

¹⁸ BNM, Islamic Money Market Operations, op. cit.

Monetary Notes-i (BNMN-i) which are structured based on Islamic concepts of Murabahah (BNMN-Murabahah), Ijarah (BNMN-Ijarah), Bai Bithaman Ajil (BNMN-BBA) and Istithmar (BNMN-Istithmar). The key objective of issuing BNMN-i is to increase efficiency and flexibility in liquidity management in the IMM by diversifying Islamic financial instrument and expanding the Shariah concept used in BNM's Islamic monetary operation.¹⁹

2.2. Regulatory Regime of SC for Issuance and Trading of Financial Papers and Instruments

The Securities Commission Malaysia (SC) is a statutory body entrusted with the responsibility of regulating and systematically developing the Malaysia's capital markets. It has direct responsibility in supervising and monitoring the activities of market institutions and regulating all persons licensed under the *Capital Markets and Services Act 2007*.²⁰ The SC's many regulatory functions include:

- Supervising exchanges, clearing houses and central depositories;
- Registering authority for prospectuses of corporations other than unlisted recreational clubs;
- Approving authority for corporate bond issues;
- Regulating all matters relating to securities and derivatives contracts;
- Regulating the take-over and mergers of companies
- Regulating all matters relating to unit trust schemes;
- Licensing and supervising all licensed persons;
- Encouraging self-regulation; and
- Ensuring proper conduct of market institutions and licensed persons.

Underpinning all these functions is the SC's ultimate responsibility of protecting the investor. Apart from discharging its regulatory functions, the SC is also obliged by statute to encourage and promote the development of the securities and derivatives markets in Malaysia.²¹

¹⁹ Ibid.

²⁰ Securities Commission Malaysia, "About Us", <https://www.sc.com.my/about-us/>

²¹ Ibid.

More specifically, the SC adopts two main regulatory strategies to protect investors participating in the capital market, i.e., regulation of the intermediaries and regulation of the products. Under the first regulatory strategy, SC regulates the authorization and licensing of intermediaries in the capital market. As pointed out by Nik Ramlah,²² the presence of a robust authorisation or licensing regime for intermediaries is a first step in ensuring investor protection. This may include appropriate licensing requirements, fitness and properness criteria, examinations and continuous professional education for intermediaries. This is followed by continuous supervision of the intermediaries and their activities to ensure proper conduct, fair and diligent dealing with clients, protection of clients' assets from insolvency of or misappropriation by the intermediaries, and to guard against default and sudden disruptions to the market.²³

The second regulatory strategy is the regulation of product to ensure that the products offered are suitable, and that investors are clearly and fully informed of the risks associated with these products through proper disclosure. In many jurisdictions, product regulation is enforced through specific legal provisions, which are complemented with product-specific guidelines.²⁴ Section 212 of the Malaysian Capital Market and Services Act 2007 (CMSA) requires SC's approval before securities are issued or offered to investors. This was previously implemented through various guidelines issued by SC to stipulate specific criteria or requirements which must be met for the issuance or offering of these products. However, since mid-June 2015, the Lodge and Launch (LOLA) framework and the "*Guidelines on Unlisted Capital Market Products*" were introduced to shorten time-to-market by enabling wholesale products to be launched once the required information is lodged with the SC via its online submission system, as compared to the previous 14-21 days approval timeframe. Wholesale products that are covered

²² Nik Ramlah Mahmood, "Developing A Platform For Consumer Protection In The Islamic Financial Services Industry", *SIXTH ISLAMIC FINANCIAL STABILITY FORUM – Promoting Resilience and Stability of the Islamic Financial Services Industry: Strengthening Consumer Protection and Business Conduct*, Jeddah, Kingdom of Saudi Arabia, 12 December 2012.

²³ Ibid.

²⁴ Ibid.

under the framework include wholesale funds, structured products, bonds, sukuk and asset-backed securities. The LOLA framework is in line with SC's new regulatory philosophy that advocates proportionality of regulation and recognises the maturity of Malaysian capital market and the sophistication of investors within the wholesale market. The Guidelines for the LOLA framework supersedes the existing guidelines on the various wholesale products.²⁵

Apart from the two main regulatory strategies, the SC also:²⁶

- Conducts market place surveillance to ensure fair and orderly market activities and prevent abuse;
- Implements investor education, either directly to the investors or indirectly by embedding investor education in the product sales and distribution channels to ensure that meaningful, relevant and timely information is communicated to the investor;
- Facilitates investors' access to the regulator to seek information, highlight issues of concern, lodge complaints on market misconduct or unfair practices, or to make enquiries;
- Provides effective handling of complaints and dispute resolution mechanisms;²⁷
- Facilitates a compensation mechanism to compensate individual investors who have suffered loss due to defalcation, fraud or mis-selling by a licensed intermediary; and the licensed intermediary is unable, or likely to be unable, to pay its investors;²⁸ and

²⁵See https://www.sc.com.my/post_archive/sc-introduces-major-reform-in-approval-regime-with-lodge-and-launch-framework/

²⁶ The explanation here is adapted from Nik Ramlah Mahmood (2012), op.cit.

²⁷ The Securities Industry Dispute Resolution Centre (SIDREC) has been established in 2010 to provide investors with a free and effective independent redress mechanism for the mediation and adjudication of small monetary claims (below RM100,000) against licensed persons. See Nik Ramlah Mahmood, *ibid*.

²⁸ This is done via the Capital Market Compensation Fund (CMCF), which is administered and managed by the Capital Market Compensation Fund Corporation (CMC). The CMCF is funded by contributions made by licensed intermediaries who are dealing in securities, derivatives and fund management. Additional funding is provided to the CMCF by SC, the stock exchange and the derivatives exchange. See Nik Ramlah Mahmood, *ibid*.

- Ensures that effective surveillance and enforcement mechanisms are in place in order to detect, investigate and penalise those in breach of the relevant laws.

All of the above regulations apply equally to both conventional market and Islamic capital market (ICM). In addition, the ICM is further subjected to additional regulation to assure *Shari`ah* compliance at all stages of the product cycle. This additional regulation includes:²⁹

- Registration of Shariah advisers. Licensed intermediaries and issuers must appoint *Shari`ah* advisers to advise on all aspects of ICM products and services offered by them. The Shariah advisers must be registered with the SC. The registration of the *Shari`ah* advisers is regulated through the Registration of *Shari`ah* Advisers Guidelines which set out the criteria for registration and renewal of registration of a *Shari`ah* adviser and the circumstances under which SC can deregister a registered *Shari`ah* adviser.
- Regulation of products and services. The offering or issuance of the ICM products requires the approval of SC and is governed by specific legal provisions and guidelines. Previously, the additional requirements related to Shariah compliance were imposed either in the same guidelines with conventional products or as stand-alone guidelines, such as: Guidelines on Unit Trust Funds; Guidelines on Islamic Real Estate Investment Trusts; Guidelines on Islamic Fund Management; Guidelines and Best Practices on Islamic Venture Capital; Guidelines on Exchange-Traded Funds; *Sukūk* Guidelines; and Guidelines on the Offering of Structured Products. Now, most of these are included in the LOLA framework. The additional Shariah compliance requirements include matters relating to the appointment, duties and functions of *Shari`ah* advisers, application of *Shari`ah* principles, periodic reporting, certification of operations, and disclosures. These product guidelines also require the *Shari`ah* advisers to undertake post-transaction review of ICM products. Penalties for breaches of, or non-compliance with, these guidelines are enforceable under the CMSA and

²⁹ Most of the discussion here are adapted from Nik Ramlah Mahmood, *ibid*.

include civil and criminal penalties.

- Establishment of the Shariah Advisory Council (SAC) at SC level. The *Shari`ah* Advisory Council (SAC) of the SC is established pursuant to the Capital Market Services Act 2007. The functions of the SAC, as stated under the law include: to ascertain the application of *Shari`ah* principles on any matter pertaining to ICM business or transaction and issue a ruling upon reference made to it; to advise SC Malaysia on any *Shari`ah* issues relating to ICM business or transaction; to provide advice to any person on any *Shari`ah* issues relating to ICM business or transaction; and such other functions as may be prescribed by the Minister. The CMSA also allows any licensed person, stock exchange, futures exchange, clearing house, central depository, listed corporation or any person to seek the advice or refer for a ruling of the SAC on any matter relating to its ICM business or transaction in order to ascertain the Shariah compliance of such ICM business or transaction.
- Reference to SAC in dispute resolution. The CMSA allows reference to the SAC for advice or ruling by the courts or arbitrators, and such ruling is binding on them.

The same regulatory strategies are also adopted in relation to SC's regulation of financial papers and instruments that are issued and traded in the capital market. However, unlike BNM, SC does not provide the platforms for the issuance and trading of these financial papers and instruments. The platforms are instead provided by other parties, such as, Bursa Malaysia and BNM. The platforms provided by BNM had been discussed above. The following sub-section will discuss the platforms provided by Bursa Malaysia.

2.3. Regulatory Regime of Bursa Malaysia for Issuance and Trading of Financial Papers and Instruments

Bursa Malaysia is an exchange holding company established in 1973 and listed in 2005. It has several subsidiaries, i.e.:³⁰

³⁰ <http://www.bursamalaysia.com/corporate/about-us/overview/>

- Bursa Malaysia Securities Bhd. This subsidiary provides, operates and maintains the securities exchange.
- Bursa Malaysia Securities Clearing Sdn Bhd. This subsidiary provides, operates and maintains a clearing house for the securities exchange.
- Bursa Malaysia Derivatives Bhd. This subsidiary provides, operates and maintains a futures and options exchange.
- Bursa Malaysia Derivatives Clearing Bhd. This subsidiary provides, operates and maintains a clearing house for the futures and options exchange.
- Bursa Malaysia Bonds Sdn Bhd. This subsidiary provides, operates and maintains registered electronic facility for secondary bond market.
- Bursa Malaysia Depository Sdn Bhd. This subsidiary provides, operates and maintains a central depository.
- Bursa Malaysia Depository Nominees Sdn Bhd. This subsidiary acts as a nominee for the central depository and receives securities on deposit for safe-custody or management.
- Labuan International Financial Exchange Inc. This subsidiary provides, operates and maintains offshore financial exchange.
- Bursa Malaysia Islamic Services Sdn Bhd. Operates all Islamic Markets businesses and activities initiated under Bursa Malaysia.
- Bursa Malaysia Information Sdn Bhd. This subsidiary provides and disseminates prices and other information relating to securities quoted on exchanges within the group.

Bursa Malaysia has more than 900 listed companies coming from diverse economic sectors. These companies are listed either on the Main Market, which is dedicated for large-cap and established companies, or on the ACE Market, which is dedicated for emerging companies of all sizes.³¹

Bursa Malaysia offers a comprehensive range of products that includes equities, derivatives, futures and options, offshore and Islamic assets, as well as

³¹ Ibid.

exchange-related services such as listing, trading, clearing, settlement and depository. In addition, the Exchange offers other investment choices, which includes collective investment schemes such as Exchange Traded Funds (ETFs), Real Estate Investment Trusts (REITs), Exchange Traded Bonds and Sukuk (ETBS) and Business Trust.³²

To regulate the exchange, Bursa Malaysia has a range of rules to govern, among others: the listing of issuers and products on the markets; the obligations of the issuers post-listing; the trading, clearing and settlement of products; and the admission and post admission obligations of participants.

Listing of Securities on Bursa Malaysia

With regard to listing of securities, Bursa Malaysia offers a choice of two markets to companies seeking listing in Malaysia. The Main Market provides an ideal platform for established companies to raise funds. The ACE Market is an alternative sponsor-driven market designed for companies with growth potential from all business sectors.³³

Local and foreign companies seeking primary listing must fulfill both quantitative and qualitative criteria. Under the quantitative criteria, companies seeking primary listing on the Main Market must fulfill: (i) the profit test, market capitalization test and infrastructure project corporation test; (ii) the required portion of public spread at minimum 25% of the company's share capital and minimum 1000 public shareholders holding at least 100 shares each; and (iii) 50% allocation of the public spread requirement to Bumiputera investors on best effort basis.³⁴ On the other hand, companies seeking listing on the ACE market do not have to meet any minimum operating track record or profit requirement, but still have to fulfill: (i) the public spread requirement of at least 25% of the company's share capital and minimum 200 public shareholders holding at least of 100 shares each; and (ii) allocation on best effort basis of 12.5% of their enlarged issued and paid-up

³² Ibid.

³³ <http://www.bursamalaysia.com/market/listed-companies/listing-on-bursa-malaysia/listing-criteria/>

³⁴ Ibid.

share capital to Bumiputera investors within 1 year after achieving Main Market profit track record, or 5 years after being listed on ACE Market, whichever is the earlier.³⁵

Under the qualitative criteria, companies seeking listing on the Main Market must meet the all the prescribed criteria pertaining to: (i) core business; (ii) management continuity and capability; (iii) financial position and liquidity; (iv) moratorium on shares; and (v) transaction with related parties. Companies seeking listing on the ACE Market must also meet similar qualitative criteria as the Main Market, albeit at a lower threshold and with more flexibility. Additionally, the ACE market company must also fulfill another criterion, i.e., the requirement to engage a sponsor to assess the suitability for listing and this sponsorship is required for at least three years post listing.³⁶

For foreign companies, in addition to the above quantitative and qualitative criteria, they must also fulfill further criteria for primary listing and secondary listing on Bursa Malaysia.³⁷

The listing process will typically take seven months to complete, from the time an adviser/sponsor is engaged to the day of listing, depending on the structure and complexity of the listing scheme. Upon approval, the company will be given six months to complete its IPO exercise. However, the approval process may be expedited for applications of large market capitalisation IPOs and ACE Market IPOs.³⁸

In addition to the Bursa Malaysia listing rules, companies seeking listing on the Main Market must also comply with the Securities Commission Malaysia's Equities Guidelines 2009 (up-dated 2013).³⁹ The Guidelines is issued under section 377 of the *Capital Markets and Services Act 2007* (CMSA) and applied by the SC in considering the proposals under section 212 of the CMSA, i.e.,: (a) Issues and

³⁵ Ibid.

³⁶ Ibid.

³⁷ For details, refer to the Listing Criteria on Bursa Malaysia, *ibid.*

³⁸ <http://www.bursamalaysia.com/market/listed-companies/listing-on-bursa-malaysia/listing-process/>

³⁹ https://www.sc.com.my/wp-content/uploads/eng/html/resources/guidelines/equity/gl_equity_131218.pdf

offerings of equity securities; (b) Listings of corporations and quotations of securities on the main market of Bursa Malaysia Securities Bhd (Bursa Securities) (Main Market); and (c) Proposals which result in a significant change in the business direction or policy of corporations listed on the Main Market.⁴⁰ These guidelines, however, do not apply to proposals undertaken by corporations seeking listing or listed on the alternative market of Bursa Securities (ACE Market) (except for a proposed transfer of listing from the ACE Market to the Main Market).⁴¹ Proposals undertaken by these corporations are governed by the *Bursa Securities ACE Market Listing Requirements*. The Equities Guidelines 2009 further provides that in addition to compliance with the Guidelines, any proposal under paragraph 1.01 which involves:⁴²

- (a) bonus issue, rights issue, issuance of preference shares, warrants, options, debt securities and convertible securities must comply with the *Bursa Securities Main Market Listing Requirements*, as applicable;
- (b) price stabilisation mechanism must comply with the *Capital Markets and Services (Price Stabilization Mechanism) Regulations 2008*;
- (c) issuance of listing prospectus or introductory document must comply with the *Prospectus Guidelines* issued separately by the SC;
- (d) valuation of real estate, plant, machinery and equipment must comply with the *Asset Valuation Guidelines* issued separately by the SC; and
- (e) issuance of debt securities and Islamic securities must comply with the *Guidelines on the Offering of Private Debt Securities*, *Guidelines on the Offering of Islamic Securities* and *Guidelines on the Offering of Asset-backed Securities* issued separately by the SC, as applicable.

Trading of Equities on Bursa Malaysia

The trading of equities on Bursa Malaysia typically follows standard trading procedures. A client who wants to trade equities on Bursa Malaysia must first open

⁴⁰ Para 1.01 of the Equities Guidelines 2009.

⁴¹ Para 1.03 of Equities Guidelines 2009.

⁴² Para 1.04.

a trading account and a Central Depository System (CDS) account with a Participating Organisation (PO). Then, the client will be engaged with a licensed dealer or a remisier.⁴³

Upon engagement of the remisier, the client can start giving order(s) to the remisier to buy or sell a specified number of shares of a company at a specified price. This is when the CDS account number need to be given for order entry. The order will then be placed by it being keyed into the Automated Trading System (ATS) at the PO, or via the PO's internet trading system. The order will then be relayed to Bursa Malaysia's trading engine. The order confirmation is immediately routed back to the PO, and onward to client's internet trading system (if any).⁴⁴

Orders are then matched automatically by the system. All prices against which orders are matched are determined by market forces of supply and demand through a process of bids and offers. In every transaction, a security is sold to the highest bidder and purchased at the lowest offer. The price transacted for a buy order will either be at the same price keyed in, or lower if the seller's price is below the buyer's price. For a sale transaction, the price will be the same or higher if the buyer's order is higher.⁴⁵

Once the order is matched, a trade confirmation is printed out, providing details such as the original order number, stock number, price and quantity matched and the counter-party PO. The remisier in turn confirms with his client that he has bought/sold the specified number of shares and the price at which it was bought/sold. To facilitate differentiation and to avoid confusion, the PO has different coloured slips for 'sell' and 'buy' orders. The broking house will then send out contract notes to the client, giving details of the transaction such as brokerage, stamp duty and clearing fees payable as well as the cost of purchase or proceeds of the sale.⁴⁶

The delivery and settlement for all normal transactions is 3 trading days after the transaction date (T), hence, the term T+3. There is no physical delivery of

⁴³ <http://www.bursamalaysia.com/market/securities/equities/trading/trading-procedures>

⁴⁴ Ibid.

⁴⁵ Ibid.

⁴⁶ Ibid.

shares under the CDS. Instead, the CDS uses a simple book entry system to keep track of the movement of shares that arises from trades affected on Bursa Malaysia. For example, if the client is a buyer of share A, his/her CDS account will be credited with Share A and the seller's account will show a debit of Share A. Sellers must have adequate shares in their CDS accounts by 12.30 pm on day 2 after the transaction (T+2) and buyer's account will be credited on T+3 with the shares.⁴⁷

Bursa Malaysia Rules

Other than the above processes, procedures and legal requirements for listing and trading on Bursa Malaysia, there are also a number of other rules issued by Bursa Malaysia. The Bursa Malaysia Rules can be divided into four main categories: (i) Securities; (ii) Derivatives; (iii) Bonds (OTC); and (iv) Islamic Markets. There are three main rules for securities: Rules of Bursa Malaysia Securities, Rules of Bursa Malaysia Securities Clearing, and Rules of Bursa Malaysia Depository. For derivatives, there are two main rules: Rules of Bursa Malaysia Derivatives and Rules of Bursa Malaysia Derivatives Clearing. For Bonds, there is the Rules of Bursa Malaysia Bonds. For Islamic Markets, there are: Rules of Bursa Malaysia Islamic Services and Bursa Malaysia-i Best Practices. Diagram 1 below illustrates the division and sub-divisions of Bursa Malaysia Rules.

⁴⁷ Ibid.

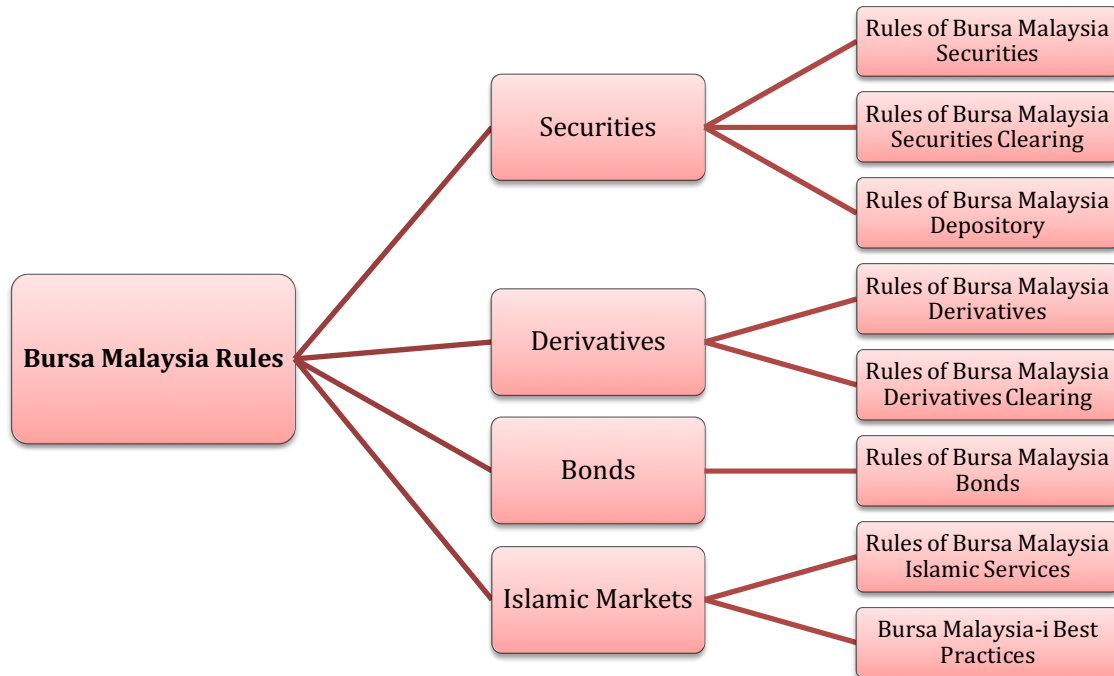


Diagram 1: Bursa Malaysia Rules

The Bursa Malaysia rules are detail and massive. They provide comprehensive rules for a lot of things as can be seen in Diagram 1. The Rules of Bursa Malaysia Securities alone are divided into 15 Chapters, plus appendices and schedules. The Rules cover among others: Participating Organisations and Registered Persons, Market Makers, conduct of business, dealings in securities, trading, delivery and settlement and many others. The Rules of Bursa Malaysia Securities Clearing have 8 Chapters, whilst the Rules of Bursa Malaysia Depository have 8 Parts plus Appendix. The rules for derivatives, bonds and Islamic markets are also equally detail and massive. It will not be possible to cover all these rules in the limited space of this paper. Thus, focus is given only to selected rules that relate to the selected practices that will be discussed in the following section.

3. Selected Practices on Platforms for Trading of Financial Papers and Instruments

3.2. Permitted Short Selling & Regulated Short Selling

Short selling involves the sale of an asset that is yet to be owned by the seller. This is normally done when the seller is expecting a decline in the price of the asset and wants to take advantage of that decline. Hence, the short-seller makes a profit when he sells high and buys low later to deliver the asset sold, provided the price actually falls in line with his expectation. If the price does not fall, the seller will incur a loss.

In the context of securities law in Malaysia, the practice of short selling was originally prohibited under Section 41(1) of the Securities Industry Act 1983 (SIA) which provides that: “a person shall not sell securities unless at the time when he sells them, he had or believes on reasonable grounds that he has, a presently exercisable and unconditional right to vest the securities in a purchaser of the securities”. A similar provision can now be seen in the more recent Section 98 (1) of Capital Market and Services Act 2007 (CMSA), which reads:

98. (1) Subject to this section and any regulations that may be made, a person shall not sell securities unless, at the time when he sells them—

- (a) he has or, where he is selling as agent, his principal has; or
- (b) he believes on reasonable grounds that he has, or where he is selling as agent, his principal has,

a presently exercisable and unconditional right to vest the securities in a purchaser of the securities.

However, the law has provided several exceptions to the prohibition. The specific exception in SIA is provided in Section 41(4) sub-paragraph (c) which states that subsection (1) does shall not apply to a sale of securities where:

- (1) the rules of the stock exchange expressly provide that sub-paragraph (c) applies to that class of securities;
- (2) the sale is made in accordance with the rules of the stock exchange; and
- (3) at the time of the sale, neither the person who sold the securities, nor any person on behalf of whom that person sold the securities, was an associate, of the body corporate that issued or made available the securities.

Pursuant to this, RSS on approved stocks had been temporarily permitted in 1996 by the Kuala Lumpur Stock Exchange (the old name for Bursa Malaysia) before being banned a year later, as a result of the Asian financial crisis. It was a long ban where the practice of RSS and Securities Borrowing and Lending (SBL) was disallowed for almost a decade, between 1997 through 2006.

The ban on RSS was lifted in 2006 when Bursa Malaysia announced the re-introduction of RSS with more stringent controls and restrictions in place. This resulted in amendments being made to the Rules of the Exchange (now known as Rules of Bursa Malaysia Securities) vide Participating Organisations Circular R/R 16 of 2006 ("R/R 16"). At the same time, SBL was also reintroduced vide the issue of revised Guidelines on Securities Borrowing and Lending by the SC (SBL Guidelines) and amendments to the Rules of Exchange vide R/R 16. The SBL Guidelines and the amendments to the Rules vide R/R 16 took effect on 3 January 2007.⁴⁸

RSS had been defined as “the selling of approved securities where the seller does not at the time of the execution of the sale, have an exercisable and unconditional right to vest such securities in the purchaser but has prior to the execution of the sale, borrowed the approved securities or obtained confirmation from an Authorised SBL Participant that the Authorised SBL Participant has the approved securities available to lend, pursuant to a SBL Agreement as will enable delivery of the same to be made to the purchaser under the said sale, in accordance with the Rules relating to delivery and settlement in Chapter 8 ...”⁴⁹

It is clear from the definition that all RSS must be backed by an SBL arrangement to ensure that the seller is able to fulfill his settlement obligations in respect of the short sale. However, the converse is not necessary and an SBL arrangement can exist independently of, and can be carried out for purposes other than, a RSS.⁵⁰ The RSS that is backed by an SBL arrangement is also known as “covered short selling”; as opposed to a “naked short selling” which is not backed by any SBL.

⁴⁸ Jessie Tan Shin Ee, “Regulated Short Selling”, <http://www.skrine.com/regulated-short-selling>

⁴⁹ Rule 704.1(1) of the Rules of The Exchange (now known as Rules of Bursa Malaysia Securities).

⁵⁰ Jessie Tan Shin Ee, op. cit.

Short selling is currently governed by Section 98 of CMA 2007 and Rules of Bursa Malaysia Securities. Under the Rules, “naked short selling” is not allowed. Other forms of short sale are allowed, including: (i) Permitted Short Selling (PSS); (ii) Regulated Short Selling (RSS); and (iii) intraday short selling.

3.2.1. Permitted Short Selling (PSS) under SC and Rules of Bursa Malaysia Securities

Permitted Short Selling (PSS) is a special category of short sale, which is limited to the short selling of units of an Exchange Traded Fund (ETF) and/or its constituent securities by market makers in the ETFs only. The PSS is not subject to the up-tick rule.

PSS is regulated under Part D of Chapter 4 of the Rules of Bursa Malaysia Securities. Rule 4.11 provides:

- (1) A Market Maker may execute Permitted Short Selling for an ETF for which it is registered as a Market Maker, in the manner set out in Part D of this Chapter 4 and the Capital Markets Services (Non-Application of Subsection 98(1))(Exchange Traded Funds) Order 2009.
- (2) Unless it is otherwise provided in Part D of this Chapter 4, all other provisions in these Rules apply to Permitted Short Selling, as if they were normal sales of securities.
- (3) In Part D of this Chapter 4, ETFs refer to Equity-based Exchange Traded Funds which are Specified Securities only.

Under Rule 4.12, A Market Maker may commence PSS only if the Market Maker has:

- (a) established Internal Guidelines for Permitted Short Selling;
- (b) put in place systems and infrastructure that include front office and back office systems which are operative and have all the relevant functionalities, requirements and controls in place for the carrying out of Permitted Short Selling in accordance with Part D of this Chapter 4; and

- (c) notified the Exchange that it intends to carry out Permitted Short Selling and provided to the Exchange the form stipulated in Appendix 5, 2 Market Days prior to the commencement of Permitted Short Selling.

Additionally, a Market Maker must have borrowed the ETF units or the constituent securities needed for the creation of the ETF units prior to executing an order for PSS to ensure settlement of the sale. Rule 4.13 provides:

- (1) A Market Maker must comply with the following conditions prior to executing an order for a Permitted Short Selling:
 - (a) if the Market Maker intends to shortsell ETF units, it has borrowed the ETF units or the Constituent Securities needed for the creation of the ETF units to settle the sale or has obtained a confirmation from the Authorised SBL Participant that the above ETF units or Constituent Securities, are available for borrowing to settle the sale; or
 - (b) if the Market Maker intends to shortsell the Constituent Securities, it has borrowed the Constituent Securities or the ETF units needed to redeem the units of Constituent Securities to settle the sale or has obtained a confirmation from the Authorised SBL Participant that the above Constituent Securities or ETF units, are available for borrowing to settle the sale.
- (2) If the Market Maker is not an Authorised SBL Participant, it must execute all its borrowings through an Authorised SBL Participant.
- (3) All Permitted Short Selling must be executed in the designated trading accounts and Securities Accounts stipulated in Rule 4.06.
- (4) A Market Maker must not execute Permitted Short Selling by way of a Direct Business Transaction.
- (5) A Market Maker must execute the following purchases through the designated trading accounts and Securities Accounts as stipulated by the Exchange after a shortsale for ETF units or Constituent Securities is executed:

- (a) a purchase of any of the Constituent Securities or derivatives for the purposes of hedging of the short sale of ETF units within the same Market Day, if the short sale is in relation to ETF units; or
- (b) a purchase of ETF units or derivatives for the purposes of hedging of the short sale of the Constituent Securities within the same Market Day, if the short sale is in relation to Constituent Securities.

There are also limits prescribed for PSS under Rule 4.14, where: (a) the total value of short positions of ETF units must not exceed the total value of the purchase positions for the Constituent Securities and derivatives purchased for purposes of hedging the shortsale of ETF units, by 10%, when calculated at the end of the Market Day; (b) the total value of short positions of Constituent Securities must not exceed the total value of the purchase positions for ETF units and the derivatives purchased for purposes of hedging the shortsale of Constituent Securities by 10%, when calculated at the end of the Market Day; and (c) the total quantity of short positions for each Constituent Securities must not exceed the quantity of each Constituent Securities required for the creation of the ETF units by 15%, when calculated at the end of the Market Day.

3.2.2. Regulated Short Selling (RSS) under SC and Rules of Bursa Malaysia Securities

In contrast to PSS, RSS is more general, where any person may short sell approved securities provided that the seller has, prior to the execution of the short sale, borrowed the approved securities. Also, unlike PSS, RSS is subject to the up-tick rule.

RSS is regulated under Part C of Chapter 8 of the Rules of Bursa Malaysia Securities. Rule 8.22 provides:

- (1) A Participating Organisation may execute Regulated Short Selling if the same is carried out in accordance with this Part C of Chapter 8 and Section 98(4)(c) of the Capital Markets and Services Act.
- (2) A Participating Organisation must not execute Regulated Short Selling if the Client of the Participating Organisation or the person on whose behalf the

Client of the Participating Organisation is executing the Regulated Short Selling, is associated with the body corporate that issued or made available the Approved Securities.

- (3) All other provisions in these Rules apply to Regulated Short Sales as if they were normal sales of securities.
- (4) Regulated Short Selling can only be carried out for Approved Securities.
- (5) The Exchange may declare any securities that meet with such criteria as prescribed by the Exchange as Approved Securities.

Based on the above, it is clear that RSS can only be transacted on approved securities. Under the Bursa Securities Rules, a security must fulfil the following criteria to qualify as an "approved security" for RSS: (a) its average daily market capitalisation must exceed RM500 million for the preceding 3 months; (b) there must be at least 50 million shares in public float; and (c) its average monthly traded volume must exceed 1 million units for the preceding 12 calendar months. This is to ensure liquidity and availability of the securities. As at 5 August 2016, there are 244 securities approved for RSS by Bursa Malaysia. The list is to be reviewed by Bursa Malaysia approximately every six months.

Similar with PSS, Rule 8.23 also prescribed requirements that must be complied with by a Participating Organisation (PO) prior to execution of a RSS. Under the Rule, a PO must: (a) establish internal guidelines for RSS; (b) put in place systems and infrastructure which have all relevant functionalities and controls to carry out RSS; and (c) submit a declaration in the prescribed form to the Exchange confirming its compliance with the foregoing requirements at least 2 market days before it commences RSS.

A client who wishes to participate in RSS must open a designated RSS trading account (RSS Account) with a PO. All short selling transactions are to be executed through a RSS Account.⁵¹ Additionally, Rule 8.26 provides for SBL requirement before execution of RSS:

⁵¹ See Rule 8.25 of Rules of Bursa Securities.

- (1) A Participating Organisation must comply with the following before executing an order for a Regulated Short Sale whether for itself or a client:
- (a) if the order is executed for the Participating Organisation itself, the Participating Organisation:
 - (i) has borrowed the Approved Securities to be short sold from an Authorised SBL Participant or has obtained a confirmation from the Authorised SBL Participant that the Approved Securities to be short sold are available for borrowing to settle the sale; and
 - (ii) is not associated in the manner referred to in Rule 8.21 with the body corporate that issued or made available the Approved Securities in relation to which the order for short sale is to be executed;
 - (b) if the order is for a Client, the Participating Organisation has obtained confirmation from the Client, that:
 - (i) the Client has borrowed the Approved Securities to be short sold from an Authorised SBL Participant or that the Client has obtained a confirmation from an Authorised SBL Participant that the Approved Securities to be short sold are available for borrowing to settle the sale; and
 - (ii) the Client or if the Client is acting on behalf of another person, the person for whom the Client is acting for, is not associated in the manner referred to in Rule 8.21 with the body corporate that issued or made available the Approved Securities in relation to which the order for short sale is to be executed.
 - (c) the order price of the Approved Securities to be entered into the ATS is higher than the Last Done Price of the Approved Securities prior to the intended entry of the above order;⁵² and
 - (d) the order is entered into ATS⁵³ through the screen designated in the ATS for Regulated Short Sale.

⁵² This is what is known as the up-tick rule, where the order price of the approved securities must be higher than the last traded price of the said securities.

There are also limits imposed on RSS, where the total short position of an Approved Security is limited to 10% of the total outstanding shares or securities on a particular market day.⁵⁴

In addition to the above requirements, the Rules further prescribe the following:⁵⁵

- If there is a breach of any of the rules on RSS or where the Exchange suspects that RSS is being used for manipulative activities, the Exchange may, amongst other actions, suspend or restrict the short selling activities carried out by a PO, whether for itself or its clients.
- The Rules prohibit a RSS from being executed in respect of an Approved Security which is the subject of a take-over during the 21-day period immediately following the take-over announcement.
- The Exchange may also direct that RSS be suspended during the period where an Approved Security has been declared, and remains a Designated Security, i.e. a security in respect of which there has been manipulation or excessive speculation.

3.2.3. Regulated Short Selling under BNM’s Policy Document on Regulated Short-Selling of Securities in the Wholesale Money Market 2014

The BNM’s Policy Document (PD) covers the regulated short-selling (RSS) framework for Malaysian Government Securities (MGS), which is currently accorded to interbank participants to achieve the following benefits:

- (a) facilitate market making activities;
- (b) facilitate portfolio hedging of interest rate risks; and
- (c) promote repo and securities borrowing and lending activities.

Under the PD, “short selling transaction” has been defined as: a sale of Eligible

⁵³ ATS stands for Automated Trading System.

⁵⁴ Rule 8.31 (1)(b).

⁵⁵ See Jessie Tan Shin Ee, *op.cit.*

Securities where the seller does not have presently exercisable and unconditional right to vest the Eligible Securities in a purchaser at the time of the sale. Specifically:

- (a) “Covered short selling” - short-selling activities with borrowed securities, obtained via reverse repo or securities borrowing and lending facilities on the short selling trade date;
- (b) “Naked short selling” - short-selling activities without borrowed securities where eligible market participants close-out the naked short-selling position by conducting an offsetting deal at a later date.

Under the PD, RSS is only permitted for Eligible Market Participants.⁵⁶ An Eligible Market Participant must have executed the Global Master Repurchase Agreement or the Securities Borrowing and Lending Agreement with at least 2 other market participants (excluding the Bank) to ensure reasonable access to borrow Eligible Securities to cover short positions and mitigate settlement risk.⁵⁷ Eligible Market Participants may also borrow Eligible Securities from BNM via the securities lending or repo facilities to cover short sale positions.⁵⁸ An Eligible Market Participant’s short position shall not exceed 10% of the outstanding nominal amount of each Eligible Securities issue.⁵⁹

In addition, Eligible Market Participants shall establish internal guidelines for short- selling, taking into account the risks involved and their financial capacity to assume such risks prior to conducting short-selling transactions. The internal guidelines of Eligible Market Participants shall consist of internal control systems and procedures for the supervision and monitoring of covered short-selling activities by the Eligible Market Participants to ensure compliance with this policy document. The Bank may revoke the eligibility of any Eligible Market Participant to conduct short-selling activities where the Bank is of the view that the Eligible Market Participant has weak internal controls systems and procedures.⁶⁰

⁵⁶ See Para 8.1.

⁵⁷ See Para 9.1.

⁵⁸ Para 13.1.

⁵⁹ See Para 11.1.

⁶⁰ See Para 12.

3.3. Securities Borrowing and Lending (SBL)

Securities Borrowing and Lending (SBL) is an essential pre-requisite for Regulated Short Selling (RSS). SBL is regulated under guidelines and rules issued by BNM, SC and Bursa Malaysia. The relevant guidelines and rules are as follows:

- BNM’s Guidelines on Securities Borrowing and Lending Programme under RENTAS of December 2001, which was later superseded by Guidelines on Securities Borrowing and Lending of RENTAS Securities of July 2016.
- SC Guidelines on Securities Borrowing and Lending of December 2006, which was later revised in August 2009 to include the SBL through negotiated transactions.
- Rules of Bursa Malaysia Securities, under Part F of Chapter 7.

3.3.1. SBL Authorized by BNM for RENTAS Securities

SBL regulated under BNM is meant for securities that are traded on the electronic platform provided by BNM, i.e. RENTAS.⁶¹ SBL transaction is defined under BNM’s Guidelines on SBL of RENTAS Securities 2016 as: “any borrowing and lending of the Securities for a limited period of time, in exchange of collateral and lending fee”. Whereas, Securities is defined under the same BNM’s Guidelines as “Ringgit-denominated debentures, bills, notes, bonds and any other debt securities deposited under the RENTAS system with a minimum outstanding amount of RM1 billion”.

3.3.2. SBL Authorized by SC and Bursa Malaysia

SBL regulated under SC and Bursa Malaysia is meant for securities that have been approved by SC and are listed and traded on Bursa Malaysia.

⁶¹ RENTAS means “the Real Time Electronic Transfer of Funds and Securities System which is the real time gross settlement system operated by Malaysian Electronic Clearing Corporation Sdn. Bhd. on behalf of BNM which provides for: (a) interbank funds transfers in Malaysia; (b) scripless securities transfers on delivery-versus- payment mode; and (c) such other transactions as may be approved by the Bank from time to time.” (BNM’s Guidelines on SBL of RENTAS Securities 2016)

There are currently two models of SBL that are authorized by SC and Bursa Malaysia: (i) Central Lending Agency SBL (SBLCLA); and (ii) Negotiated Transaction SBL (SBLNT). The SBLCLA is a model whereby Bursa Malaysia acts as the Central Lending Agency for all SBL transactions between Authorised Lender and Authorised Borrower, and where Authorised Lenders and Authorised Borrowers have to comply with Bursa Clearing's SBL CLA Terms and Conditions. On the other hand, SBLNT model provides both Approved Lenders and Approved Borrowers the avenue to agree SBL transactions on an over-the-counter basis (OTC) and report such transactions to Bursa Malaysia via on-shore lending representatives or borrowing representatives.⁶²

The SBLCLA had been introduced earlier in 2007 and was regulated under the revised Guidelines on Securities Borrowing and Lending (Guidelines) issued in 2007. Under the 2007 SBL Guidelines, Bursa Malaysia Securities Clearing is authorised by the SC to be the central lending agency for all SBL activities conducted in Malaysia. It also serves to ensure that short-selling transactions can only be undertaken if accompanied by authorised SBL arrangements. The issuance of the revised Guidelines of 2007 complements the rules on SBL and RSS which were released by Bursa Malaysia Berhad on 22 December 2006.⁶³

The SBLNT was introduced a bit later in August 2009. The SBLNT is an enhanced SBL model that offers an option to borrow and lend on an over-the-counter (OTC) basis. The SC again revised its SBL Guidelines in 2009 to cater for SBLNT; while Bursa Malaysia issued the relevant rules, procedures and guidelines to provide for SBLNT. Under the SBLNT framework, any eligible person who is approved by Bursa Malaysia Securities Clearing may borrow and lend securities. The lender and borrower are now given the flexibility to enter into SBL agreements, hence they can negotiate and agree on the terms of borrowing and lending

⁶² Bursa Malaysia, Securities Borrowing & Lending (SBL), <http://www.bursamalaysia.com/market/products-services/securities-borrowing-lending-sbl/>

⁶³ Securities Commission Malaysia, https://www.sc.com.my/post_archive/sc-issues-revised-guidelines-on-securities-borrowing-and-lending/

directly.⁶⁴

These SBL transactions must, however, be reported via on-shore borrowing and lending representatives and facilitated through Bursa Malaysia Securities Clearing as the approved clearing house. This reporting is imperative for the movement of the loaned securities to take effect from the lender's depository account to the borrower's depository account. In addition, only securities that are specified by the approved clearing house are eligible for borrowing and lending transactions; and the purposes for which the borrowing and lending must also be specified. The SBLNT framework also enables Bursa Malaysia Securities Clearing to ensure orderly and transparent borrowing and lending.⁶⁵

The SBLNT model complements the SBLCLA model, where both models will operate concurrently. Together they form the framework within which SBL and short-selling are permitted to operate in the Malaysian capital market. Short-selling activities transacted outside this framework remain a breach of securities laws.

3.4. Shariah Issues in RSS and SBL?

Short selling, whether naked or covered, regulated or otherwise, has always been a contentious practice. SBL is also an equally contentious practice. There are available Shariah resolutions on the issue. This paper will only discuss the resolutions of AAOIFI Shariah Standards and those of the SAC of SC and SAC of BNM. In general, the resolutions of AAOIFI Shariah Standards are opposite of those by SAC of SC and BNM. This may trigger a need to further review and re-deliberate the arguments of both sides to better understand the real issue to perhaps arrive at a common view on the matter.

The main issue in short-selling is the sale of securities that is not owned by the seller at the point of sale, in short, the issue of bay' al-ma'dum where the sold asset is not in the liability of the seller. The AAOIFI Shariah Standard No. 12, 4/1/2/7 resolved that: "It is not permitted for someone to sell shares that he does

⁶⁴ Securities Commission Malaysia and Bursa Malaysia Bhd, https://www.sc.com.my/post_archive/securities-borrowing-lending-model-enhanced-for-more-flexibility/

⁶⁵ *ibid.*

not own and the promise of a broker to lend the shares to him at the date of delivery does not constitute ownership or possession of the shares. This is not allowed especially if the broker stipulates that the seller must pay the price of the shares so that he can deposit it and earn interest in return for such a loan". Similarly, Shariah Standard No.21, 3/6 resolved that: "It is not permissible to sell shares that the seller does not own (short sale), and the promise of a securities intermediary to lend these shares at the time of delivery is of no consequence". The basis for the impermissibility of selling shares that the seller does not own in both Shariah Standards 12 & 21 is that this constitutes selling of an item that is not in the liability/risk (daman) of the seller nor in his ownership, which is prohibited by Shariah.

In AAOFI Shariah Standard 21, 3/11, it is further resolved that: "the contract of salam is not permitted in shares". The basis for the impermissibility of salam in shares is that the subject matter of salam is a debt and not an ascertained thing. Shares in corporations are ascertained through the name of the issuing corporations and thus is an ascertained thing and not a liability or debt. Further, there is also no guarantee on the constant availability of specified shares in the market, nor the ability of the seller to deliver them at the end of the period.

In relation to SBL, the AAOIFI Shariah Standards have also generally prohibited the practice. Shariah Standard 21, 3/9 clearly says: "it is not permitted to lend shares of corporations (by way of qard)." The basis for the impermissibility of lending shares is that the share at the time of its repayment, does not represent the same thing that it did at the time of lending due to the constant change in the asset of the corporation. Additionally, Shariah Standard 21, 3/15 provides that: "it is not permissible to rent shares, whether this is for pledging them or for the purpose of selling the rented shares, and returning shares similar to them..." The basis for the impermissibility of renting shares is not given in the said Shariah Standard. However, Standard 21, 3/16 provides: "it is permitted to lend shares by way of i'arah for the purpose of pledging them or for the purpose of granting their profit to the borrower as is done in the stock market. The borrower does not have the right

to sell the shares except for the execution of the terms of the pledge.” Again, no specific basis is given for this permissibility in the relevant Shariah Standard.

In short, all practices of short-selling, regulated or otherwise are not permissible according to AAOIFI Shariah Standards. With regard to SBL, the AAOIFI Shariah Standards also disallow the (i) lending of securities via qard contract; and (ii) renting of securities via ijarah contract. However, the AAOIFI Shariah Standard allows the lending of securities via i’arah contract.

In contrast, the SAC of SC has resolved that the practices of RSS and SBL are permissible. In relation to SBL, the SAC in its 13th Meeting in March 1998 resolved to accept the existing SBL principles as practiced in the securities industry. However, to make it compliant with the Shariah principles, SBL will be aligned to ijarah (leasing contract) principles. Nevertheless, the istihsan methodology is used as an exception to the general ijarah principle. This means, the ijarah relationship between the lessee and the shareholder is not severed even though the lessee has to surrender the leased asset. The bases given by the SAC for their resolution are as follows:

- The SAC in several of its meetings attempted to identify a Shariah principle that can be used as a basis for the implementation of SBL. As a result of the studies and discussions, the SAC decided that the istihsan principle should be instilled in the ijarah methodology to form the basis for SBL after evaluating that other methods such as i`arah (asset borrowing), hawalah (debt assignment contract) and bai` wafa' (selling and buying back) were found to be unsuitable for the concept and implementation of SBL.
- The use of ijarah contract with istihsan allows the use of ijarah contract with the consent of the owner for the lessee to sell the leased shares, to be used as a basis for SBL. Although the original rule for ijarah contract dictates that the ijarah contract be terminated when the leased asset is sold, the application of istihsan that take into consideration the maslahah and specific customary practice ('urf iqtisadi khas) in SBL results in the SAC deciding that the selling of leased shares to a third party in the SBL practice does not nullify the ijarah

contract because it is done with the consent of the original owner and brings benefit (maslahah) to him as well as provide liquidity to the share market.

- Additionally, the practice of SBL is similar to the terms in ijarah contract in many situations, such as the authority of the owner to recall the leased asset, evaluation of the asset according to current market value and so forth. Hence, the SAC resolved that the ijarah contract, with the consent of the owner for the lessee to sell the leased shares, can be applied to SBL in the Islamic capital market.

In a recent development, the SAC of BNM⁶⁶ has been asked to consider a proposal to allow third party institutions to lend securities to the Central Bank using 'ariyah or i'arah contract, to facilitate BNM's use of the securities as collateral in monetary instruments transactions with the Islamic Financial Institutions (IFI). The use of the borrowed securities as collateral can potentially benefit BNM in term of cost savings. The SAC of BNM has resolved that such an arrangement is permissible. This resolution provides an alternative basis for SBL where the borrowed securities are meant to be used as third party collateral. Nevertheless, the resolution is not intended for SBL that is used to back a RSS transaction.

On the specific practice of RSS, the SAC of SC has resolved⁶⁷ that it is in line with the Shariah as the inclusion of RSS eliminates the element of gharar. The bases for the resolution are as follows:

- In general, short selling involves the selling of shares not owned by the seller. As a result, such transactions fall under the category of bai` ma`dum. Islam prohibits such transactions involving bai` ma`dum since the delivery of the subject matter cannot be effected and this brings about the prohibited element of gharar. However, the issue of gharar can be overcome in RSS – the inclusion of SBL principles in RSS eliminates the element of gharar.
- In other words, the introduction of SBL can increase the probability that the shares sold will be delivered. When the probability of delivery is high, then the element of gharar will no longer be significant. Consequently, when an

⁶⁶ In its 171th meeting on 25th October 2016.

⁶⁷ In its 69th Meeting on 18th April 2006.

obstacle that hinders the recognition of a certain activity as Shariah compliant is overcome, then that activity can be classified as Shariah compliant. This fulfils a fiqh methodology: which means: “When an issue that impedes (the permissibility) is removed, then the activity which was initially forbidden becomes permissible.

The stark difference in the Shariah resolutions above call for a revisit of the arguments by both sides, in the light of the real practice observed in these instruments.

4. Some Observations and Recommendation for further study

The focus of this paper is legal requirements and processes, hence, there are less concentration on the deliberation of Shariah aspects. More in-depth deliberation on the Shariah aspects may be undertaken in separate future study.

Apart from the practice of RSS and SBL, there are other practices on the platforms that may attract a number Shariah concerns. They essentially include the various uses of derivatives instruments, which are issued and traded on the platforms, such as, options, forward, futures, and swaps. Although Shariah resolutions have been made on the permissibility or otherwise of these practices, there are again differences of views observed. It is suggested that efforts be taken to revisit these practices to understand their exact nature and the various diversifications in the instruments used, in order to arrive at more convincing and well grounded conclusions.

It should also be noted that some markets, like Malaysia has gone a long way in term of product development and introduction of new instruments. The more recent efforts in this regard include:

- The recent launching of Bursa Malaysia-i that seeks to offer a holistic range of innovative Islamic Market products from equities and commodities to sukuk. Investors who wish to experience comprehensive end-to-end Shariah Investing are able to choose to invest in Shariah compliant securities listed on the Main Market and ACE Market through the Bursa Malaysia-i platform

by interfacing with Islamic Participating Organisations (Islamic POs). As at September 2016, there are nine (9) Islamic POs offering Islamic stockbroking services, either on full-fledged or window basis

- The introduction of framework for equity crowd-funding and peer-to-peer (P2P) lending that can also be structured to be Shariah compliant, riding on the advancement in financial technology or fintech.
- The introduction of web-based Investment Account Framework by BNM
- The recent launch of Regulatory Sandbox for Fintech by BNM, that also covers Islamic finance to allow for digital innovation in the Islamic Finance space.

All of these developments will obviously attract Shariah related considerations and deliberation to see that the transactions and instruments used in the Islamic markets are compliant with the Shariah principles.