

The Current Development of Futures Industry Law in Malaysia

by:

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Abstracts

The objective of this paper is to highlight and analyse the recent development and amendment of the law of futures markets in Malaysia with special reference to the Capital Markets and Services Act 2007(CMSA 2007). The CMSA 2007 is the main statute which regulates and provides legal provisions for matters relating to the activities, markets and intermediaries in the capital markets. The CMSA 2007 is an Act which consolidate the Securities Industry Act 1983 and Futures Industry Act 1993(FIA 1993) and a few provisions from the Securities Commission Act 1993. The functions of regulation are (1) to define the key features of the financial system and the role securities and futures market institutions, including the development of new types of market activities; (2) to steer market participants towards the adoption of best practices; and (3) to create disincentives against behaviour that would be detrimental to the market. Therefore, the reformation of law in futures industry is very crucial in order to provide the foundation of effective practices amongst participants of the industry and establish efficient functioning of modern capital markets. The discussion focused on the issues of the establishment of the futures market, the legal licensing requirements, protection of investors in futures market and the development of Islamic Capital Market. The method used in analysing data of this focus research is a combination of comparative and historical approach. Apart from the mentioned method, analytical and critical analysis (Zahraa,1998)(Charterjee, 2000) were also used by the writer. Sources of data for this research are provisions in the CMSA 2007, FIA 1993, SCA 1993 and selected court cases which are relevant to the discussion.

Abstrak

Kertas kerja ini bertujuan untuk mempamir dan menganalisis perkembangan dan pindaan terkini dalam undang-undang pasaran niaga-hadapan di Malaysia dengan rujukan khusus terhadap Akta Pasaran Modal dan Perkhidmatan 2007(CMSA 2007). CMSA 2007 adalah merupakan Akta utama yang meregulasi undang-undang yang berkaitan dengan aktiviti-aktiviti, pasaran dan intermediary dalam pasaran modal. Akta ini juga menggabungkan Akta Industri Sekuriti 1983 dan Akta Pasaran Niaga Hadapan 1993 dan juga beberapa peruntukan dalam Akta Suruhanjaya Sekuriti 1993. Fungsi bagi undang-undang ini adalah untuk (1) untuk mendefinisikan ciri-ciri utama dalam sistem kewangan, (2) untuk memacu peserta-peserta pasaran ke arah pemakaian amalan baik, (3) untuk mewujudkan hukuman untuk perbuatan atau aktiviti yang boleh merugikan pasaran. Justeru, reformasi dalam undang-undang pasaran niaga-hadapan adalah sangat penting bagi mewujudkan asas yang kukuh dalam

amalan perniagaan di kalangan peserta-peserta industri ini dan supaya pasaran modal di era moden boleh berfungsi dengan efisien. Perbincangan kertas kerja ini memfokuskan kepada isu-isu berhubung dengan kewujudan pasaran niaga-hadapan, keperluan pelesenan, perlindungan terhadap pelabur-pelabur dalam pasaran niaga-hadapan dan pembangunan dalam pasaran modal Islam. Metod yang digunakan bagi menganalisis data bagi penyelidikan berfokus ini adalah kombinasi pendekatan perbandingan dan sejarah. Di samping itu, analisis analitikal dan kritikal juga digunakan oleh penulis. Sumber data bagi penyelidikan ini peuntukan dalam CMSA 2007, FIA 1993 dan SCA 1993 dan juga kes-kes terpilih yang relevan bagi perbincangan kertas kerja ini.

0.0 Introduction

The CMSA 2007 is the main statute which regulates and provides legal provisions for matters relating to the activities, markets and intermediaries in the capital markets. The CMSA 2007 is an Act which consolidate the Securities Industry Act 1983 and Futures Industry Act 1993(FIA 1993) and a few provisions from the Securities Commission Act 1993. The functions of regulation are (1) to define the key features of the financial system and the role securities and futures market institutions, including the development of new types of market activities; (2) to steer market participants towards the adoption of best practices; and (3) to create disincentives against behaviour that would be detrimental to the market. Therefore, the reformation of law in futures industry is very crucial in order to provide the foundation of effective practices amongst participants of the industry and establish efficient functioning of modern capital markets.

Since the existence of the CMSA 2007, all provisions in the FIA 1993 have been transferred to the CMSA 2007. These include provisions regarding the establishment of futures markets, licensing and regulation and conduct of business of futures contracts. The provisions regarding fidelity fund and prohibited conduct of futures market also was consolidated in the new Act. The focus of discussion of this paper are on the issues of the establishment of the futures market, the

legal licensing requirements, protection of investors in futures market and the development of Islamic Capital Market.

The method used in analysing data of this focus research is a combination of comparative and historical approach. Apart from the mentioned method, analytical and critical analysis (Zahraa,1998)(Charterjee, 2000) were also used by the writer. Sources of data for this research are provisions in the CMSA 2007, FIA 1993, SCA 1993 and selected court cases which are relevant to the discussion.

1.0 Establishment of the futures markets

According to section 7 of CMSA 2007, a person shall not establish, operate or maintain, or assist in establishing, operating or maintaining, or hold himself out as providing, operating or maintaining, a futures market that is not (a) a futures market of a futures exchange; (b) a futures market of an exchange holding company that is itself approved as a futures exchange;(c) an exempt futures market; or (d) a registered electronic facility under subsection 34(1). Further, the Minister may, by order published in the *Gazette*, (a) declare a particular stock market or futures market, or a stock market or futures market included in a particular class of stock markets or futures markets, to be an exempt stock market or exempt futures market for the purposes of this Act subject to such terms and conditions as he thinks reasonable and appropriate after having regard to, among other things, (i) the types of securities or futures contracts traded or to be traded;(ii) the types of participants; (iii) the types of investors; or (iv) the volume of trading, relating to the particular stock market or futures market, or stock market or futures market included in the particular class of stock markets or futures markets. The Minister also can revoke any declaration made under paragraph (a) or vary any term or condition as may be

specified in the declaration, after having regard to, among other things, (i) any breach of the terms and conditions specified in the declaration; or (ii) such other matters as the Minister thinks fit.

Therefore, a person who contravenes the above requirements commits an offence and shall, on conviction, be liable to a fine not exceeding ten million ringgit or to imprisonment for a term not exceeding ten years or to both.

In approving a body corporate as a stock exchange or futures exchange, the Minister will be based on the following criteria:

(a) the body corporate will ensure that, as far as is reasonably practicable, it will operate an orderly and fair market in relation to securities and futures contracts that are traded through its facilities;

(b) the body corporate will manage any risks associated with its business and operations prudently;

(c) the body corporate, in discharging its obligations under paragraph (a), will not act contrary to the public interest and in particular the interest of investors;

(d) the body corporate is able to take appropriate action against its participating organizations or affiliates to whom the rules apply for any breach of its rules;

(e) the rules of the body corporate make satisfactory provision—

(i) for an orderly and fair market in relation to the securities or futures contracts that are traded through its facilities;

(ii) for the proper regulation and supervision of its participating organizations or affiliates;

(iii) for the exclusion of persons who are not of good character and high business integrity from being recognized as participating organizations or affiliates;

- (iv) for the expulsion, suspension or disciplining of its participating organization or affiliates and any person acting on behalf of such participating organization or affiliates, for conduct that is inconsistent with just and equitable principles in the transaction of business or for a contravention of or failure to comply with the rules of the stock exchange or futures exchange;
- (v) with respect to the conditions under which securities may be listed for trading in the market proposed to be conducted by the body corporate or under which futures contracts may be traded on the market through its facilities;
- (vi) with respect to the conditions governing dealings in securities or trading in futures contracts by its participating organizations or affiliates;
- (vii) with respect to the class of securities or futures contracts that may be dealt in or traded on its facilities; and
- (viii) generally for the carrying on of the business of the proposed stock exchange or futures exchange with due regard to the need for the protection of investors and public interest;
- (f) the body corporate shall at all times have sufficient financial, human and other resources to ensure the provision of—
- (i) an orderly and fair market in relation to securities or futures contracts that are traded through its facilities;
- (ii) adequate and properly equipped premises for the conduct of its business;
- (iii) competent personnel for the conduct of its business; and
- (iv) automated systems with adequate capacity, security arrangements and facilities to meet emergencies; and
- (g) the interest of the public or the proper regulation of the market will be served by the granting of this approval.

Therefore, under the CMSA 2007, the proper process and procedures of establishment of futures markets has been introduced in order to strengthen the industry from any forms of manipulation and fraudulent act by criminals.

2.0 Legal licensing requirements

According to CMSA 2007, the licence holder are categorized into two i.e. a Capital Markets Services Licence and a Capital Markets Services Representative Licence. Therefore, no person shall whether as a principal or agent, carry on a business in any regulated activity or hold himself out as carrying on such business unless he is the holder of a Capital Markets Services Licence or is a registered person. A person who contravenes this provision commits an offence and on conviction, be liable to a fine not exceeding ten million ringgit or to imprisonment for a term not exceeding ten years or to both. Similarly, no person shall act as a representative in respect of any regulated activity or hold himself out as doing so unless he is the holder of a Capital Markets Services Representative's Licence for that regulated activity or is a registered person with respect to that regulated activity. A person who contravenes the requirements commits an offence and on conviction, be liable to a fine not exceeding five million ringgit or to imprisonment for a term not exceeding five years or to both.

In the case of Phazaluddin bin Abu, the Securities Commission (SC) charged Phazaluddin for holding out as a fund manager without licence, through the internet website www.danafutures.com. Phazaluddin, who is believed to be responsible for the whole internet investment scheme offered by the website, is suspected to have collected up to RM65 million

from investors. He was charged under section 15A of the Securities Industry Act 1983. The charge against Phazaluddin alleged that between 3 January 2007 and 15 June 2007, he had held himself out as a fund manager through the website, without holding a fund manager's license. Upon conviction, the accused person is liable under section 15C of the Securities Industry Act 1983 to a fine not exceeding RM1 million or to imprisonment for a term not exceeding 10 years or to both. A bail sum of RM200,000 was imposed by the Sessions Court on Phazaluddin, with his travel documents to be surrendered to the Court as condition for bail.

In another case, the Securities Commission (SC) obtained a landmark High Court judgement against three defendants involved in the Swisscash investment scam which would ultimately lead to the scam's investors being compensated. The judgement against Albert Lee Kee Sien, Kelvin Choo Mun Hoe and Dynamic Revolution Sdn Bhd, obtained on 25 September 2008, ordered them to pay USD83 million, and any further amounts traced by the SC, for the purpose of compensating investors of the scam. In addition, the defendants were restrained from carrying on the Swisscash business and acting as unlicensed fund managers and/or unlicensed investment advisers. They were also restrained from collecting funds for investments in any investment scheme or hosting any internet investment scheme websites. This judgement is the culmination of two years of intensive efforts by the SC in pursuing the perpetrators of the Swisscash investment scam which involved cross-border investigations spanning seven countries to gather evidence and trace Swisscash monies. Based on its investigative findings, the SC successfully obtained a worldwide Mareva injunction in June 2007 to prevent the defendants from disposing their assets in and outside Malaysia. A court order was also obtained in September 2007,

directing one of the defendants to transfer RM35 million of Swisscash monies back to Malaysia. Since then, the SC has led a meeting of seven regulators to intensify cross-border cooperation and exchange of information on the Swisscash scam. With this judgement, the SC will be able to work with its counterparts in other countries including Switzerland, Isle of Man, Jersey, Australia and Singapore to trace and repatriate Swisscash monies of approximately RM30 million known to be held overseas to satisfy the judgement. Eligible investors will be compensated once these monies have been successfully repatriated. The judgement also enables the SC to take contempt proceedings against the defendants if they continue to conduct Swisscash activities or any other investment schemes.

3.0 Protection of investors in futures market.

Under the CMSA 2007 states the futures markets offences in sections 202 until 208 such as false trading, bucketing, dissemination of information about false trading, manipulation of price of futures contract and cornering, employment of devices to defraud, false or misleading statements and prohibition of abuse of information obtained in official capacity.

In order to combat all futures markets offences and protection of investors, the CMSA 2007 has introduced different methods to make sure the above objectives are achievable as discussed below.

Administrative actions

Under the new Act, the SC has a power to take an administrative and civil action against a person¹, who has committed a breach under this Act. Types of administrative actions that are listed down in section 354(3):-

- (a) direct the person in breach to comply with, observe, enforce or give effect to such rules, provisions, written notice, condition and guideline;
- (b) impose a penalty in proportion to the severity or gravity of the breach on the person in breach, but in any event not exceeding RM500.000;
- (c) reprimand the person in breach;
- (d) require the person to remedy or mitigate the effect of such breach;
- (e) refuse to accept or consider any submission;
- (f) in the case of promoter or a director of a corporation: impose a moratorium or prohibit any trading and issue a public statement.

Civil actions

In a case of a person who suffers loss or damage by reason of or by relying on the conduct of another person who has contravened any provisions under this Act, may recover the amount of the loss or damage by instituting civil proceedings against the other person.² Another alternative is that the SC can, if it considers in the public interest to do so, recover on behalf of a person who suffers loss or damage by reason of or by relying on the conduct of another person who has contravened any provisions of the Act.³

¹ As listed in section 354 (2) (a)-(u), CMSA 2007.

² Refer to section 357, CMSA 2007.

³ Refer to section 358, CMSA 2007.

The new law also covered the civil remedies for the victim of futures trading which suffers loss and damage by reason of or relying on the conduct of another person who has committed futures market crimes such as false trading, bucketing, dissemination of information about false trading, manipulation of price, cornering and others.⁴ This sanction was not part of the law in the previous Act. The new law gives protection to the investors especially to the victim of the illegal trading in futures markets similar to the victim of securities markets.

The Fidelity Fund

Under section 159 of the CMSA 2007, a futures exchange shall establish and maintain a fidelity fund. This fund can be used to compensate a person suffers monetary loss because of a defalcation or fraudulent misuse of monies or other property, by a director, officer, employee or representative of the holder of CMSL. Further, it can be used to compensate the loss suffered in respect of monies or other property that was in connection with the holder's trading in futures contracts. This fund is also can be paid out for other purposes as stated in section 162.

4.0 The Development of Islamic Capital Market (ICM)

Malaysia has made significant strides in the area of ICM. ICM products and services are now an integral component of the Malaysian capital market, offering viable and competitive financing and investment tools as alternatives to conventional products and services. Indeed developments similar to those in Malaysia are also being seen in other parts of the world. Globally, Islamic

⁴ Refer to section 202-208 of CMSA 2007.

finance is growing at phenomenal rates. In 2000, there were only three sukuk available worldwide worth USD336 million. As at end June 2007, the size of the global sukuk market stood at USD57 billion. The market capitalisation of the Dow Jones Islamic Index now totals more than USD10 trillion. The Islamic Financial Services Board estimates that assets that will be managed under Shariah principles will triple to USD2.8 trillion by 2015.

For the first 6 months of 2007, RM10 billion or 41 per cent of bonds approved in the Malaysian capital market were sukuk. The size of outstanding corporate sukuk as at July of 2007 stands at RM166 billion. In the equity market, 875 of the companies listed on Bursa Malaysia are Shariah compliant. They make up 62 per cent of the total market capitalisation of the Exchange. In the area of investment management, there are 116 Shariah-based unit trust funds with total net asset value in excess of RM12 billion, or over 8 per cent of the total net asset value of our unit trust industry. Although this figure is rather modest, it has grown very rapidly over the past decade and in fact represents almost 40 per cent of the net asset value of the global Islamic unit trust industry.

There were no provisions regarding Islamic securities in the previous neither SIA 1983 nor FIA 1993. But, under the new Act, a specific provision was introduced in relation to Islamic securities. Section 316 highlights the power of the Minister to give prescription in respect of Islamic securities. Further, the SC also may specify in guidelines made under section 377 in giving full effect to the principles of *Shariah* in relation to a transaction in respect of Islamic securities on the following:

1. Any model agreement or documentation relating to a transaction or arrangement in

respect of Islamic securities.

2. The duties and responsibilities of the different parties involved in a transaction or arrangement in respect of Islamic securities; and
3. Any other matter as may be deemed appropriate.

The recent amendment in 1st April 2010 to the CMSA 2007 in relation to regulations of Shariah Capital Markets includes defining the scope of Islamic Capital Market business or transaction, functions of Shariah Advisory Council, qualification of Shariah Advisory Council, power of court or arbitrator to refer to Shariah Advisory Council for ruling, and power to establish a secretariat or committees.

According to the CMSA, Islamic capital market business or transaction means:-

- (a) the business of carrying on any regulated activity;
- (b) any proposal that falls within subsection 212(2);
- (c) any transaction relating to a futures contract; or
- (d) the establishing, operating or maintaining of a stock market or a futures market,

which does not involve any element that is inconsistent with the principles of Shariah as may be determined by the Shariah Advisory Council;’.

According to section 316A the Commission may establish a Shariah Advisory Council for Islamic capital market which shall be the authority for the ascertainment of the application of Shariah principles for the purposes of Islamic capital market business or transaction.

The Shariah Advisory Council may also determine its own procedures. The Shariah Advisory Council have the following functions as stated in section 316B:-

- (a) to ascertain the application of Shariah principles on any matter pertaining to Islamic capital market business or transaction and issue a ruling upon reference made to it in accordance with this Division;
- (b) to advise the Commission on any Shariah issue relating to Islamic capital market business or transaction;
- (c) to provide advice to any person on any Shariah issue relating to Islamic capital market business or transaction; and
- (d) such other functions as may be prescribed by the Minister.

According to section 316C , the Yang di-Pertuan Agong may, on the advice of the Minister after consultation with the Commission, appoint persons as members of the Shariah Advisory Council who are qualified in—

- (a) fiqh muamalah;
- (b) Islamic jurisprudence;
- (c) Islamic finance; or
- (d) any other relevant discipline.

If a judge of the High Court, the Court of Appeal or the Federal Court, or a judge of the Shariah Appeal Court of a State or Federal Territory, is to be appointed under subsection (1), such appointment shall not be made except—

(a) in the case of a judge of the High Court, the Court of Appeal or the Federal Court, after consultation by the Commission with the Chief Justice of the Federal Court; and

(b) in the case of a judge of the Shariah Appeal Court of a State or Federal Territory, after consultation by the Commission with the Chief Shariah Judge of that State or Federal Territory, as the case may be.

(3) A member of the Shariah Advisory Council appointed under subsection (1) shall hold office on such terms and conditions as may be provided in their respective letters of appointment, and shall be eligible for reappointment.

(4) The members of the Shariah Advisory Council shall be paid such remuneration and allowances as may be determined by the Commission.

Under section 316D the SC may (a) establish a secretariat and such other committees as it considers necessary to assist the Shariah Advisory Council in carrying out of its functions under section 316B; and (b) appoint an officer of the Commission or any other person to be a member of the secretariat or any of such committees.

Section 316E states that any licensed person, stock exchange, futures exchange, clearing house, central depository, listed corporation or any other person may (a) seek the advice; or (b) refer for a ruling, of the Shariah Advisory Council on any matter relating to its Islamic capital market business or transaction to ascertain whether such Islamic capital market business or transaction involves any element which is inconsistent with the Shariah.

The new amendment gives power to the court or the arbitrator to refer to Shariah Advisory Council for ruling. This is stated in section 316F (1) where in any proceedings before any court or arbitrator concerning a Shariah matter in relation to Islamic capital market business or transaction, the court or the arbitrator, as the case may be, shall—

- (a) take into consideration any ruling of the Shariah Advisory Council; or
- (b) refer such matter to the Shariah Advisory Council for its ruling.

Any request for advice or a ruling of the Shariah Advisory Council under this Act or any other law shall be submitted to the secretariat. Any ruling made by the Shariah Advisory Council under section 316E or 316F shall be binding on the licensed person, stock exchange, futures exchange, clearing house, central depository, listed corporation or any other person referred to in section 316E; and (b) the court or arbitrator referred to in section 316F. Where a ruling given by a registered Shariah adviser to a person engaging in any Islamic capital market business or transaction is different from the ruling given by the Shariah Advisory Council, the ruling of the Shariah Advisory Council shall prevail. For the purpose of this section, registered Shariah adviser means a person who is registered under any guidelines issued by the Commission under section 377.

5.0 Concluding Remarks

The major legislative reform in 2007 was the introduction of the Capital Markets and Services Act to consolidate the securities, futures and fundraising laws into a single legislation. The CMSA 2007 was significant in terms of new provisions to strengthen investor protection, the introduction of a single licensing regime and a framework for recognition and oversight of Self-Regulatory Organisations (SROs) to promote a market-based approach to regulation.

Guided by the vision of the Capital Market Masterplan (CMP) to position Malaysia as an internationally competitive capital market, the Securities Commission has transformed the entire spectrum of the capital market value chain during this decade. At this juncture, about 82% of the 152 CMP recommendations have been implemented.⁵

Malaysia also has made significant strides in the area of Islamic Capital Markets (ICM) which full complement of products, infrastructure, institutions, intermediaries and investors. Therefore, the introduction of new provisions with regards to ICM in the CMSA 2007 is in line with the global needs and development of ICM throughout the world.⁶ This is seen as a good start even though the writer is of opinion that a comprehensive Islamic Capital Markets and Services Act should be initiated and introduced by the responsible authority.

The other aspect covered in the CMSA 2007 is the key element of a competitive capital market that is a strong corporate governance framework. This should come through increasing accountability of industry, professionals and public listed companies for ethical conduct. They must inculcate strong internal compliance and corporate governance cultures.

⁵ Zarinah Anwar (2007). "Powering the Malaysian Market To New Heights". The 12th Malaysian Capital Market Summit ,13-14 November 2007. Securities Commission Malaysia.

⁶ Securities Commission (2007). Annual Report 2007. Securities Commission: Kuala Lumpur.

The culture of good corporate governance must be imbued into the Board and management. Industry must embrace the tenet that doing business within a moral framework helps companies prosper and serve society at the same time. There is profit from ethics and premium in share value of companies with good corporate governance. Hence, provisions concerning securities and futures industry offences still maintain in the new Act, in order to curb illegal trading in this industry. Furthermore, dual sanction i.e. a criminal and civil which is enshrined in the CMSA not only serves as a punishment to the criminal but also as a protection to investors of the capital markets.

Corporate transparency is one of the key elements in good corporate governance. It is very much related to a sound regulation and enforcement, shareholder activism and professional and ethical management. The new law seems to cover all areas with the implementation of a broad-based approach which consists of enforcement, rules and regulations, planning, standards and best practices and professional & ethical management.

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