

**BEST PRACTICES IN ISLAMIC STOCKBROKING  
SERVICES UNDERTAKEN BY PARTICIPATING  
ORGANISATIONS**

**\*\* 2007**

# BEST PRACTICES IN ISLAMIC STOCKBROKING SERVICES

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## **BEST PRACTICES IN ISLAMIC STOCKBROKING SERVICES**

### **A. BACKGROUND**

1. In pursuit of developing a comprehensive Islamic capital market, the Securities Commission has emphasized on the importance of establishing an effective Shariah regulatory framework to govern the shariah compliant services or business that are available in the capital market. The framework thereof is aimed amongst others to ensure uniformity of the industry practices that are shariah compliant which will ultimately contribute and facilitate the orderly development of a strong and competitive environment of intermediation services undertaken by the industry players, in particular, the Participating Organisations.
2. A Participating Organisation who conducts its stockbroking business in accordance with shariah principles whether on a full fledge basis or ‘window’ basis (“Islamic Participating Organisation”) is required to adhere to the same regulatory framework and requirements as that of a conventional Participating Organisation.
3. In line with SC’s objectives as mentioned above Bursa Malaysia Securities Bhd is issuing herein a set of industry best practices with the objective of providing guidance and assistance to the Islamic Participating Organisation in observing the desired practices when carrying out its stockbroking business in accordance with the shariah principles whether on a full fledge basis or ‘window’ basis (“Best Practices”). Compliance with these Best Practices is voluntary in nature, thus, it is strongly recommended for the Participating Organisations to adopt these Best Practices in carrying out the Islamic stockbroking business or services.

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4. When implementing these Best Practices, the Islamic Participating Organisations should implement them flexibly and sensibly to suit their respective needs and circumstances. Therefore the Best Practices enumerated herein should not be read as prescriptive nor construed in a rigid or literal manner. Nevertheless, the application of shariah principles in the operations of the Islamic Participating Organisations must not be compromised in any circumstances. In this respect, the flexibility lies in the ingenuity of the respective Islamic Participating Organisations to apply the relevant shariah principles and concepts in carrying out their business or services.

### **B. KEY OBJECTIVES**

The key objectives of the Best Practices include among other things:

1. to provide guidance to the Islamic Participating Organisations in respect of practices recommended to be observed in the carrying out of Shariah compliant stockbroking services undertaken by the Islamic Participating Organisations whether on a full fledge basis or ‘window’ basis; and
2. to meet the national aspirations to further develop the Islamic Capital Market to strengthen Malaysia’s position as an international Islamic financial centre by strengthening the role of Islamic market intermediaries in the domestic intermediation process.

### **C. DEFINITION:**

1. In these Best Practices:

**“Bursa Securities”** means Bursa Malaysia Securities Berhad

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“**contra losses**” means all or any losses suffered by clients in the course of dealings in contra transactions and shall include all charges, costs and expenses.

“**contra transaction**” means a transaction where a Participating Organisation allows its client to settle outstanding purchase positions against outstanding sale positions of the same securities where the orders in respect of the purchase and sale transactions are transacted within the period stipulated by the FDSS.

“**Dealers Representatives**” shall have the meaning as ascribed thereto in the Rules of Bursa Securities.

“**FDSS**” shall have the meaning as ascribed thereto in the Rules of Bursa Securities.

“**hibah**” means a gift awarded to a person. For the purpose of this Best Practices, the term “hibah” defined herewith will be used together with the term “token” for ease of reference.

“**ibra**” means an act by a person to withdraw his rights i.e. his rights to collect payment from a person who has the obligation to repay the amount borrowed from him.

“**Islamic Participating Organisation**” means a Participating Organisation who conduct its stockbroking business in accordance with shariah principles whether on a full fledge basis or ‘window’ basis.

“**Islamic stockbroking services**” means the business of trading in securities carried out by an Islamic Participating Organisation on the

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stock market of Bursa Securities whether on full fledged basis or via an Islamic window services.

“**Islamic window services**” means Islamic stockbroking services provided by the Participating Organisations, other than on a full fledge basis.

“**Murabahah**” means a contract that refers to the sale and purchase transaction for the financing of an asset whereby the cost and profit margin (mark-up) are made known and agreed by all parties involved. The settlement for the purchase can be settled either on a deferred lump sum basis or on an installment basis, and is will be specified in the agreement.

“**Participating Organisation**” shall have the same meaning as is ascribed to it in the Rules of Bursa Securities.

“**recognized stock exchange**” means the stock exchanges listed as the recognized stock exchanges in the Participating Organisations Circular No. R/R 15 of 2005.

“**Shariah**” means Islamic law, originating from the *Qur`an* (the holy book of Islam), as well as practices and explanations rendered by the prophet Muhammad ( *pbuh* ) and *ijtihad* of ulamak (personal effort by qualified Shariah scholars to determine the true ruling of the divine law in a subject matter on which the revelation is not explicit).

“**SAC**” means **Shariah Advisory Council**” established by the Securities Commission under section 18 of the Securities Commission Act 1993.

“**SC**” means Securities Commission established under the Securities Commission Act 1993.

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“**Shariah Member**” represent shariah individuals registered with the SC.

“**Shariah Advisers**” represent shariah companies registered with the SC.

“**riba**” means an increase, which in a loan transaction or in exchange of a commodity, accrues to the owner (lender) without giving an equivalent counter value or recompense in return to the other party. It covers interest both on commercial and consumer loans, and is prohibited according to Shariah. For the purpose of this Best Practices, the term “**riba**” defined herewith will be used together with the term “interest” for ease of reference.

“**Takaful operators**” shall have the meaning as is ascribed thereto in section 2 of the Takaful Act 1984.

“**ta'widh**” means penalty agreed upon by the contracting parties as compensation that can rightfully be claimed by the creditor when the debtor fails or is late in meeting his obligation to pay back the debt. For the purpose of this Best Practices, the term “**ta'widh**” defined herewith will be used together with the term “compensation” for ease of reference.

“**uqud muawadha**” means contracts of exchange.

“**wadiyah yad amanah**” means Goods or deposits, which have been deposited with another person, who is not the owner, for safekeeping. As *wadiyah yad amanah* is a trust concept to safeguard clients and remisiers trust money. The depositors are not entitled to any of the profits but the depository may provide returns to the depositors as a token of appreciation. For the purpose of this Best Practices, the term “**wadiyah**” defined herewith will be used together with the term “custody” for ease of reference.

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### **D. INTERPRETATION**

1. Unless the context otherwise requires-
  - (b) words denoting the singular shall also include the plural where applicable and vice versa;
  - (c) word importing the masculine gender shall include the feminine and neuter genders and vice versa.

### **E. BEST PRACTICES IN CARRYING OUT ISLAMIC STOCKBROKING SERVICES**

#### **1. Adequate human resources with the necessary qualification, expertise and experience to manage and administer the provision of Islamic stockbroking services**

- 1.1 An Islamic Participating Organisations should, at all time, has adequate human resources with the necessary qualification, expertise and experience to manage and administer its provision and affairs in respect of its Islamic stockbroking services.
- 1.2 An Islamic Participating Organisation should provide adequate and proper training whether internal or otherwise for all of its employees, not only to equip and familiarise its employees with the necessary knowledge in conducting the Islamic stockbroking services, but also to enhance the technical knowledge of its employees in respect of all the applicable legal and regulatory requirements, as the case may be, in conducting Islamic stockbroking services as well as the operational and the internal control and policies of the Participating Organisations in its conduct of Islamic

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stockbroking services. Training should also be conducted for its employees involved in its front office activities such as Dealers Representatives in order to enhance their skills and professionalism, and apprise them of the developments of the Islamic capital market to enable them to give accurate, adequate and updated information or advice to the clients.

- 1.3 Particular attention should be given to the training of the Compliance Officer, who should be responsible to monitor the activities carried out and services provided, in relation to the Islamic stockbroking services, are in compliance with Shariah principles. In this respect, the Islamic Participating Organisation is encouraged to appoint a Compliance Officer who has exposure to Shariah knowledge.

### **2. Compliance with Shariah principles, regulations, standards or rulings issued by the SAC or SC.**

- 2.1 An Islamic Participating Organisation should ensure that its Islamic stockbroking services are carried out in such way that it adheres to and complies with the Shariah principles and regulations, standards or rulings issued by the SAC or SC, as may be amended from time to time.

For example, dealings in securities traded on the Bursa Securities by an Islamic Participating Organisation should be limited to the Shariah compliant securities, as determined and endorsed as such by the SAC or SC. A list of the Shariah compliant securities, which is amended from time to time by SC with the advice of SAC, can be obtained from the SC.

- 2.2 Dealings in securities traded on the stock exchanges other than Bursa Securities should be allowed to be undertaken by the Islamic

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Participating Organisations only in respect of securities traded on any of the recognised stock exchanges, which are endorsed to be Shariah compliant securities by the recognised stock exchange or by a competent shariah standard setting body or a reputed or competent shariah scholar, either in Malaysia or elsewhere.

- 2.3 An Islamic Participating Organisation should, in respect of dealings under item no. 2.2 above, maintain or retain all records relating to the dealings thereof, including the relevant advice or confirmation or publication given or made by the recognised stock exchange or the competent shariah standard setting bodies or shariah scholar, either in Malaysia or otherwise that the securities is Shariah compliant securities.

### **3. Independent Shariah Member or Shariah Adviser**

#### **3.1 Engagement:**

- 3.1.1 It is recommended that the Islamic Participating Organisation engages independent Shariah Member(s) and/or Shariah Adviser either from or within the Islamic Participating Organisation or its group of companies for the purpose of advising the Islamic Participating Organisation on Shariah principles and Shariah requirements as set out in item 2 above.

#### **3.2 Independence:**

- 3.2.1 The Participating Organisation should take reasonable steps to ensure that the Shariah Member (s) or Shariah Adviser are independent and not subject to any conflict of interest with the Participating Organisation's business or operations thereto,

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whether in respect of the Islamic stockbroking services or otherwise.

### **3.3 Functions of Shariah Member (s) or Shariah Adviser**

- 3.3.1 The functions of the Shariah Member(s) and/or Shariah Adviser is to advice on adherence to Shariah principles in relation to the business or services offered by the Islamic Participating Organisations which have been identified and/or represented by the Islamic Participating Organisations to be adhering to Shariah principles.
- 3.3.2 The Shariah Member(s) and/or Shariah Adviser should also be responsible to provide interpretation and clarification, as and when requested by the Islamic Participating Organisation relating to Shariah principles and any regulations, standards or rulings either issued by the SAC or SC from time to time or any other competent Shariah standard setting bodies or shariah scholars, either in Malaysia or elsewhere.
- 3.3.3 In this respect, the Shariah Member(s) and/or Shariah Adviser are encouraged to be consistent and objective in performing its duties, especially in the areas involving interpretation or clarification of the Shariah principles, regulations or requirements as aforementioned.
- 3.3.4 In the event that there is ambiguity or uncertainty as to the Shariah principles applicable in relation to the Islamic stockbroking services, the Islamic Participating Organisation is advised to refer the matter to and consult the Shariah Member(s) and/or Shariah Adviser for advice and resolution. The Shariah Member(s) and/or Shariah Adviser may also refer any ambiguity or uncertainty in relation to any matters

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pertaining to the Islamic stockbroking services to the SAC or SC, as the case may be, for consultation.

3.3.6 In order to ensure that the Shariah Member(s) and/or Shariah Adviser of the Participating Organisation discharges its duties or functions effectively, the Islamic Participating Organisations are encouraged to take the following steps:

- (a) provide assistance to the Shariah Member(s) and/or Shariah Adviser as it reasonably requires;
- (b) give right of access to the Shariah Member(s) and/or Shariah Adviser in respect of all relevant documents and information, as may be requested by the Shariah Member(s) and/or Shariah Adviser from time to time;
- (c) ensure that it does not interfere with the Shariah Member(s) and/or Shariah Adviser in its ability to discharge or in the course of discharging its duties; and
- (d) ensure that the information provided to the Shariah Member(s) and/or Shariah Adviser at all times are accurate and not misleading.

### 3.4 **Records of advice given or issued by the Shariah Member(s) and/or Shariah Adviser to the Islamic Participating Organisation**

3.4.1 Records of all advice given by the Independent Shariah Member(s) and/or Shariah Adviser, whether adopted or implemented by the Islamic Participating Organisation or not, should be maintained or caused to be maintained by the Islamic Participating Organisation.

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3.4.2 Such records stipulated under clause 3.4.1 should be maintained or caused to be maintained in such a form that is readily accessible and convertible to writing.

3.4.3 There should be regular meetings with the Shariah Member (s) or Shariah Adviser to resolve any inhouse matter arising from day-to-day operations.

3.4.4 The Shariah Member (s) or Shariah Adviser must endorse and approve the operations of the Participating Organisation to be shariah compliant.

### **4. Operations, Systems and Procedures comply with Shariah principles, and regulations, standards or rulings issued by the SAC or SC**

4.1 Participating Organisations should establish and implement adequate policies, systems, operational procedures and internal controls in relation to the company's day to day business operations in respect of the Islamic stockbroking services to ensure that it complies with the Shariah principles. This is also to ensure that the risk associated with such affairs relating to the Islamic stockbroking business is properly managed.

4.2 In respect of a Participating Organisation who operate an Islamic window services, the systems and controls should be in place to ensure appropriate separation of the Islamic stockbroking services from the conventional stockbroking services and other conventional business of the Participating Organisation.

4.3 For the purposes herein, an Islamic Participating Organisation should, at all times, adhere to Shariah principles in carrying out its Islamic stockbroking services which principles include but not limited to the following :

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### 4.3.1 No *riba* or interest

**(a) *Riba* or interest on accounts opened, operated or maintained by the Participating Organisation:**

Under no circumstances, unless otherwise expressly allowed by the SAC or SC, that any accounts opened, operated or maintained by the Islamic Participating Organisation, either for its clients or for the Islamic Participating Organisation itself accrue or be attributed with interest. The trust accounts maintained by the Islamic Participating Organisation pursuant to section 44 of the Securities Industry Act 1983 (“SIA”) will be placed under *wadiah yad amanah*. *Hibah* is usually given by the licensed Islamic banks at their discretion.

**(b) **Financings:**** All financings undertaken for the Islamic Participating Organisation itself or offered by the Islamic Participating Organisation to its clients e.g. margin financing and discretionary financing, in connection with the Islamic stockbroking services provided by the Participating Organisation, should be confined to the financings which adheres to Shariah principles e.g. financings which are based on *Murabahah*.

**(c) **No interest on settlement of trade:**** Interest or any other charges which operates as an interest or penalty in relation to any amount outstanding pursuant to settlement of trade should be prohibited. For settlement of trade on contra transactions, in the

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event that there are losses arising from such contra transactions i.e. contra losses, no interest should be charged against the client for the amount due to the Islamic Participating Organisation pursuant to the contra losses thereof. The Islamic Participating Organisation is only entitled to recover the principal amount in connection to the contra trade thereof. Thus, for settlement on trade on contra transactions resulting in the contra profits, the client enjoys the full amount of the profit and no interest should be imposed on such profits.

### 4.3.2 Segregation of funds:

- (a) All funds maintained by the Participating Organisation whether for itself or its clients in respect of the Islamic stockbroking services should be segregated from those funds maintained by the Participating Organisation in respect of its conventional stockbroking services. This is to avoid co-mingling of the funds derived from the Islamic stockbroking services and funds derived from conventional stockbroking services. In the event the assets mentioned herein are, co-mingled, such co-mingling will result in the former to become non Shariah compliant.
- (b) For Islamic window services the Islamic Participating Organisation should ensure that the trading account of the clients within the Islamic window services is clearly tagged and used as

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trading account for the purpose of Islamic window services only.

### 4.3.3 ***Ta'widh* or compensation on late and default payment:**

For clients who defaulted in its payment or delay in making payment to the Islamic Participating Organisation in respect of trades executed by the Islamic Participating Organisation, the Islamic Participating Organisation may impose a *ta'widh* on the late payment. *Ta'widh* or compensation can be imposed if it is found that deliberate delay in payment is present on the part of the investor to settle payment of the principal or profit at the rate in the manner prescribed by the SAC of SC. The rate cannot be compounded and in addition, upon request by the client for an early settlement, a rebate (*ibra'*) will be allowed.

### 4.3.4 **Investments:** The proprietary investments, either short-term or long-term investments of an Islamic Participating Organisation should be confined only to Shariah-approved investments instruments, as issued or approved by SAC, SC or the securities endorsed to be Shariah compliant securities by recognized stock exchange or a competent Shariah standard setting bodies or a competent shariah standard setting body or a shariah scholar, either in Malaysia or elsewhere

### 4.3.5 **System:** The system that is being applied and operated by the Islamic Participating Organisation should where possible facilitate and support the conduct of the activities and operations of the Islamic Participating Organisation in

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a Shariah compliant manner. For example, the trading system applied and operated by the Islamic Participating Organisation should be able to identify/tag Shariah compliant securities from the list of securities that are available to be traded on Bursa Securities. The finance module applied and operated in the back-office system, should be one that facilitates the keeping of the Islamic Participating Organisation's financial matters in accordance with Shariah principles.

### **5. Responsibility of the management of Participating Organisations**

- 5.1 The responsibility for ensuring that the Islamic Participating Organisation complies with Shariah principles and the regulations, standards or rulings issued by the SAC or SC in the provision of the Islamic stockbroking services should ultimately rest with the board of directors of the Islamic Participating Organisation.

### **6. Audit**

- 6.1 The department that is carrying out the internal audit functions for the Islamic Participating Organisation should conduct audit in relation to the Islamic stockbroking services of the Participating Organisation for the purposes of examining, reporting and evaluating on the adequacy and efficiency of the Islamic Participating Organisation's management, operations and internal controls to ensure that the quality and integrity of the Islamic stockbroking services provided to its clients and its adherence to these Best Practices, the Shariah principles and all regulations, standards and rulings issued by the SAC or SC.

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- 6.2 For the purpose stipulated in paragraph 6.1, the Islamic Participating Organisation should ensure that there are adequate audit policies, procedures and resources for the carrying out of the functions stipulated in paragraph 6.1
- 6.3 The internal audit personnel are encouraged to equip themselves with the required knowledge in connection with the activities pertaining to the Islamic stockbroking services, these Best Practices, Shariah principles and all regulations, standards and rulings issued by the SAC or SC from time to time in order to perform their duty effectively.

### **7. Compliance Functions**

- 7.1 The Compliance Officer of the Islamic Participating Organisation should monitor compliance of the Islamic Participating Organisation with these Best Practices, the Shariah principles and all regulations, standards and rulings issued by the SAC or SC, as amended from time to time.
- 7.2 However, reporting of the compliance as stated in para 7.1 need not be reflected in the monthly compliance report required to be submitted by a Participating Organisation under the Rules of Bursa Securities. Thus, the Islamic Participating Organisation is strongly encouraged to report whatever findings by the Compliance Officer directly to its Board of Director.

### **8. Written Confirmation**

- 8.1 A written confirmation should be obtained by the Islamic Participating Organisation from the Shariah Member or Adviser on an annual basis

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stating that it is providing an Islamic stockbroking services and that it complies with these Best Practices, the Shariah principles and all regulations, standards and rulings issued by the SAC or SC, as amended from time to time.

- 8.2 In the absence of the annual written confirmation under para 8.1 above, a Participating Organisation should not describe itself as an Islamic Participating Organisation or advertises the Shariah compliant stockbroking services.

### **9. Transparency**

- 9.1 An Islamic Participating Organisation should in relation to its Islamic stockbroking services indicate very clearly to all its clients whether it is offering a full-fledge Islamic stockbroking services or Islamic window services. For example, the letter head of the Islamic Participating Organisation should indicate that it is operating a full-fledge Islamic stockbroking services or Islamic window services.,

### **10. Memorandum &Articles of Association**

- 10.1 The Memorandum and Articles of Associations of an Islamic Participating Organisation who is providing Islamic stockbroking services on a full fledge basis should stipulate amongst others that it is providing the Islamic stockbroking services and that its corporate mission is amongst others to achieve its commercial objectives within the confines of Shariah principles.

### **11. Advertisement**

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- 11.1 An Islamic Participating Organisation may advertise their Islamic stockbroking services provided that it complies at all times with the requirements prescribed by Bursa Securities pertaining to advertisement.

### **12. Insurance**

- 12.1 An Islamic Participating Organisation is encouraged to procure any arrangement akin to an insurance policy from *Takaful* operators covering amongst others comprehensive crime and professional indemnity.