



Explanatory Notes

**COMPENSATION CHARGES FOR
ISLAMIC PARTICIPATING ORGANISATION IN
RELATION TO CASH SETTLEMENT OF
FAILED CONTRACTS**

(ICM/iPO-BP1/001)

Version Date: 1 September 2016

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COMPENSATION CHARGES FOR ISLAMIC PARTICIPATING ORGANISATIONS IN RELATION TO CASH SETTLEMENT OF FAILED CONTRACTS

INTERPRETATION

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Circular No. G4/2010 dated 5 March 2010: Directives in Relation to Cash Settlement of Failed Contracts by Bursa Malaysia Securities Clearing Sdn Bhd.

Note:

This document should be read together with the following documents:

- (i) Best Practices in the Islamic Stockbroking Services Undertaken by Participating Organisations
- (ii) Rules of Bursa Malaysia Securities Clearing
- (iii) Directives in Relation to Cash Settlement of Failed Contracts by Bursa Malaysia Securities Clearing Sdn Bhd contained in Clearing Participants' Circular No. G4/2010 dated 5 March 2010.

COMPENSATION CHARGES FOR ISLAMIC PARTICIPATING ORGANISATIONS IN RELATION TO CASH SETTLEMENT OF FAILED CONTRACTS

1. INTRODUCTION

The purpose of this document is to provide explanation in relation to Clause 5.3.5 of the Best Practices in the Islamic Stockbroking Services Undertaken by Participating Organisations that states;

5.3.5 Other compensation: Any anomaly from a normal trade that requires alternative arrangement, the affected Islamic Participating Organisation and/ or investor should be compensated for actual loss and should not benefit or obtain any material gain.

2. COMPENSATION CHARGES IN RELATION TO CASH SETTLEMENT OF FAILED CONTRACTS

2.1. Capital Market & Services Act (CMSA) 2007 provides;

Section 98(1);
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.

Section 98(2);
a person who contravenes subsection (1) commits an offence and shall, on conviction, be liable to a fine not exceeding five million ringgit or to imprisonment for a term not exceeding ten years or to both.

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2.2. Types of investors in securities market, amongst others:

2.2.1. Individuals

| | |
|---|--|
| INVESTORS Individuals or entities who use their own money to purchase equity securities, which offer potential profitable returns in the form of dividend or appreciation in value. | |
| Success | Investors will measure the company's future success by looking at its financial strength and evaluating its future cash flows. |
| Value | Investors are to consider whether a company's shares represent a good value. For example, if two similar companies are trading at different earnings multiples, the lower one might be the better value because it suggests that the investor will need to pay less. |
| TRADERS Individuals or entities engaging in the trading of equity securities, or the transfer of financial assets in any financial market, either for themselves, or on behalf of someone else. | |
| Technical Analyst | Traders will look at past price history in an attempt to predict future price movements. |
| Intra-day | Traders keep close watch on their trades intra-day to see where money is moving. |
| Fading | Traders play on the fears of investors, where they will bet against the crowd after a large move takes place. |
| Market Maker | Traders purposely being hired to provide liquidity through rapid trading. |
| Speculator | Buy or sell a stock solely to reap a typically short-term profit from the price movement of that stock. |

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2.2.2. Institutional

| Type of Institution | Description |
|------------------------------------|--|
| Investment Bank | With allotted higher risk tolerances, there will be a dedicated internal team of traders, known as proprietary traders; <ul style="list-style-type: none"> (i) To trade for the bank's own profit, unrelated to client business. (ii) To help clients carry out trades, where the desk will use the bank's own capital to make a market in a certain instrument, offering itself as a buyer to a client that wants to sell, or a seller to a client that wants to buy. |
| Pension Fund | Manages the compulsory savings plan and retirement planning for the workers. |
| Endowment Fund | Generate high risk-adjusted returns with lower volatility with the donation fund received, usually in the form of real estate. |
| Insurance/ Takaful Companies | The premiums being invested by the insurance companies to provide a source of future claims and a profit. |
| Mutual fund (Unit Trust) | Solicit a pool of capital from the public by issuing a specific quantity of shares or beneficiary certificates and using the capital for professional investments. In other words, this is a mode of investment through the sharing of risks and profits. Diversification of investment risk is a specific feature of this mode of investment to the extent that market risk and volatility could be effectively reduced. |

2.3. When an investor trades (buy or sell) in securities market, the counterpart on the other side can be any type of investor. When there is no delivery of securities, failed trades will occur on settlement day.

2.4. Settlement process of a trade:

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| T day Match trade Conditional Right | T + 1 | T + 2 | T + 3 |
|---|----------|------------------------------------|---|
| Buyer PO: PO – BMSC + Guaranteed Delivery BMSC assumes the role of CCP and provides guarantee of delivery | | | By 10:00 am PO pays BMSC By 10:00 am BMSC Credit Buyer's CDS |
| Seller PO: PO – BMSC + Guaranteed Payment BMSC assumes the role of CCP and provides guarantee of delivery Transfer | Transfer | Transfer M/N Debit CDS ↓ | 10:00 am PO receives payment from BMSC Failed Trade 8.30 am Buying-in ↓ T + 8 |

(Refer to Trading Manual Chapter 6 for more details on Buying-in Transactions)

- 2.5. Upon confirmation of matched trade, the seller must ensure availability of the sold securities in his CDS with the selling PO by 4:00 p.m. T+2.
- 2.6. From Tday up to and T+2, the seller can transfer securities from his account with another PO to the selling PO. In the event of the seller unable to make available the sold securities in his CDS with the selling PO during the end of day processing for trade settlement purposes. a failed trade occurs.
- 2.7. In the case of failed odd lot contracts, there shall be no buying-in on T+3 but the failed contract will be cash settled. In the case of failed board lot contracts, automatic buying-in process will be undertaken by the Exchange from T+3 until T+8. Automatic buying-in will not be fulfilled from T+3 until T+8 if the market condition for that particular securities is illiquid and the automatic buying-in price is unattractive to the existing shareholder of that securities
- 2.8. If buying-in is not successful by T+8 for board lot contracts, the Contract will then be settled by payment of cash in lieu of securities (BMS Rule 9.07).
- 2.9. The substitution of failed shares delivery with cash settlement is to expedite the resolution of outstanding failed contracts (which is the last resort) and act as a deterrent factor.

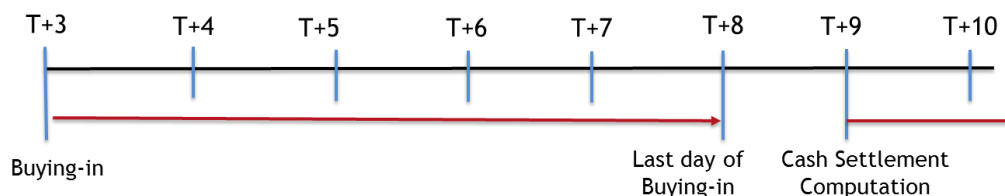
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2.10. Cash Settlement Amount (i.e. the amount to be paid in lieu of delivery of securities) may include such fee or charge as the Clearing House thinks fit, and calculated and paid in the manner the Clearing House specifies from time to time in its directives.

2.11. Calculation of Cash Settlement amount:

2.11.1. Detailed calculation is provided by Bursa Malaysia Securities Clearing Sdn Bhd as Clearing House via the Clearing Participants circular number G4 of 2010 dated 5 March 2010 on Directives in Relation to Cash Settlement of Failed Contracts.

2.11.2. Summary of the calculation steps with an example is provided below. This assumption is for computation of cash settlement where there is no further onward selling on T+8.



- (i) Compare previous day closing price (the contract price or last recorded sale at the close of trading on previous market day) with contract price, take whichever is higher;
- (ii) Factor in brokerage equivalent, i.e. 0.6% of the contract price or last recorded sale at the close of trading on previous market day or RM40 whichever is higher; and
- (iii) Factor in Administrative Charge of RM50.

Notes: "Administrative Charge" of RM50 shall be charged by the Clearing House to the defaulting selling Trading Clearing Participant. The buying Trading Clearing Participant(s) shall be entitled to 50% of the Administrative Charge or a percentage not exceeding 50% as may be determined by the Clearing House from time to time.

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Example:

- Buyer: Client A
- Islamic Participating Organisation (iPO) for Client A: iPO-Y
- Seller: Client B
- Islamic Participating Organisation (iPO) for Client B: iPO-X

1. iPO-X (Client B) sells 10,000 units of M shares to iPO-Y (Client A) on 6 January 2016 @ RM0.335 where iPO-Y is the buying Trading Clearing Participant;
2. Settlement between iPO-Y and iPO-X will fall on 11 January 2016;
3. Last recorded sale price on 18 January 2016 is RM0.445.

Cash Settlement Amount for iPO-X (Client B): -

Cash Settlement Price + Brokerage Equivalent + Admin Charge - Contract Price

Cash Settlement Price = {RM0.445 (which is the higher of the two prices, RM0.335 or RM0.445) + 10 ticks} x 10,000 (Quantity)
 = {RM0.445 + (10 x RM0.005)} x 10,000
 = {RM0.445 + RM0.05} x 10,000
 = RM0.495 x 10,000
 = RM4,950.00

Brokerage Equivalent = RM4,950.00 x 0.6%
 = RM29.70, or RM40 (whichever is higher)

Administrative Charge = RM50.00 (50% of the Administrative Charge will be made payable to iPO-Y, and the balance 50% will be made payable to BMSC)

Contract Price = RM0.335 x 10,000 units
 = RM3,350.00

Amount payable = RM4,950.00 + RM40.00 + RM50.00 – RM3,350.00
 = RM1,690.00 (to be paid by Client B through iPO-X to iPO-Y)

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Cash Settlement Amount for iPO-Y (Client A): -

In a normal scenario;

- ➔ Client B (Seller of failed contract) will not receive cash but has to pay Cash Settlement Amount for failure to deliver shares
- ➔ Client A (Buyer of failed contract) will not get shares but Cash Settlement Price

i.e.;

- Amount made payable to Client A through iPO-Y: $RM3,350 + RM1,600 = RM4,950.00$.
- Amount made payable to iPO-Y: Brokerage Equivalent of RM40.00.
- Amount made payable to iPO-Y: Administrative Charge of RM25.
- Amount made payable to BMSC: Administrative Charge of RM25.

To comply with Shariah principles;

- ➔ Client B (Seller of failed contract) will not receive cash but has to pay Cash Settlement Amount for failure to deliver shares
- ➔ Client A (Buyer of failed contract) will not get shares but cash returned up to the amount of Contract Price only since Client A, the affected investor should only be compensated for actual loss and should not benefit or obtain any material gain.

i.e.;

- Amount made payable to Client A through iPO-Y: RM3,350.00.
- Amount made payable to iPO-Y: Brokerage Equivalent of RM40.00.
- Amount made payable to iPO-Y: Administrative Charge of RM25.
- Amount made payable to BMSC: Administrative Charge of RM25.
- iPO-Y will need to manage the amount of RM1,600.00 which should not be given to Client A, e.g. channelling to charitable bodies, etc.

APPENDICES

Appendix 1:

Circular No. G4/2010 dated 5 March 2010: Directives in Relation to Cash Settlement of Failed Contracts by Bursa Malaysia Securities Clearing Sdn Bhd.

