

The Weaknesses in Handling Fraud in The Capital Market Practices

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Abstract. *The weaknesses of the legal substance relating to the handling of fraud in the Capital Market practices are fundamentally contained in the substance of Law Number 8 of 1995 on Capital Market ("UUPM"). Law enforcement has actually become one of the focuses of attention from law enforcers, such as in the case of state losses incurred due to fraudulent acts in the capital market committed by Perusahaan Gas Negara (PGN) is included in the criminal act of corruption because it indicates the elements of corruption. Officials at State-Owned Enterprises (SOEs) who commit fraud in accordance with the provisions can be categorized as corruption. Corrupt practices in the financial markets that cost the state large amounts of money have not gone unnoticed. Internationally, there is currently an effort to mainstream the financial sector into the jurisdiction of anti-corruption laws. This study concerns on the weaknesses of substance, structure, and legal culture regarding the handling of fraud in the Capital Market practices which is still lacking to overcome fraud related to the practices of Insider Trading.*

Keywords: *Corruption; Crime; Fraud; Markets.*

1. Introduction

An effective law should not only offer procedural justice, but also have the ability to identify people's aspirations and be committed to achieving substantive justice. According to Nonet-Selznick, the solution to achieving substantive justice

lies in the use or application of responsive law.¹ The hallmark of responsive law is the attempt to find the implicit values in regulations and policies.

The message and commitment of progressive or responsive law demands that a good legal approach is not only fixated on thought that only uses procedural logic. Instead, the approach should be based on contextual understanding that involves feelings. Satjipto Rahardjo states that thinking with feeling takes into account the environment and habitat, thus involving the dimension of spiritual intelligence.²

Law, whether written or unwritten, is abstract. In written law, abstractions can be seen and read, but in unwritten law, they reside in the minds of the people. Law, because of its abstract nature, becomes static and powerless without human action.³

Friedman has explained that to understand the legal system as a process, three components need to be considered, namely Legal Substance, Legal Structure, and Legal Culture. Social forces constantly influence the performance of the legal system, and through analyzing these components, it is possible to understand how the legal system interacts in society.⁴

When the KPK (Corruption Eradication Commission), POLRI (Indonesian National Police), and Kejaksaan (Attorney) handle fraud cases, it is important to understand that their involvement in conventional investigations may prevent them from effectively unraveling the case. A narrow understanding of corruption can lead to missed oversight of corrupt practices in financial markets.⁵ Internationally, efforts to mainstream the financial sector into the jurisdiction of anti-corruption laws are currently underway.

¹ Philippe Nonet and Phillip Selznick, 1978, *Law and Society in Transition: Toward Responsive Law*, New York, Harper & Colophon Book, Publishers, Inc, p. 73-74

² Satjipto Rahardjo, 2007, *Membedah Hukum Progresif*, Kompas, Jakarta, p. 19

³ Von Benda-Beckmann, F, 1986, *Some Comparative Generalizations About The Differential Use of State and Folk Institutions of Dispute Settlement In People's Law and State Law*, (Eds. Allot, A.N & Woodman, G), Foris, Dordrecht, p. 91.

⁴ According to Lawrence M. Friedman, *"legal substance is what we call the actual rules or norms used by institution (or as the case may be) the real, observable behavior patterns of actor within the system., legal structure is the body, the framework, the long lasting shape of the system, the way courts of police department are organized, the line of jurisdiction, the table of organization., Legal culture refers, then to those parts of general-customs, opinions, way or away of doing and thinking-that bend social forces towards or away from the law and in particular ways."* See L.M. Friedman, 1975, *The Legal System : A Social Science Perspective*, Russel Sage Foundation, New York, p. 6-15.

⁵ Lawrence M Friedman, 1984, *American Law*, W.W. Norton & Company, New York, p. 12.

Weaknesses in legal culture mean that fraud in state administration has become a habit, both by government officials and the private sectors. This fraud can hamper economic growth and cause losses to the state. The disclosure of Insider Trading cases can also be influenced by the attitudes of law enforcement officials in the Capital Market sector, being the third obstacle in dealing with Insider Trading in Indonesia.

2. Research Methods

This study was a type of normative juridical research conducted through literature study, which included analysis of relevant legal materials to the issues. It employed both Conceptual and Statute Approaches. A conceptual approach involved researching the views of experts and theories contained in legal literature as a basis of support. Meanwhile, the legal approach is carried out by examining the legal norms contained in the laws and regulations related to the theme being analyzed.

3. Results and Discussion

By examining the components of substance, structure, and legal culture that affect the performance of law enforcement, it can be understood a situation of how the law works as a system in society.

3.1. The Weaknesses in the Legal Substance of Handling Fraud (Fraudulent Practices) in The Capital Market Practices

The substance of law is divided into substantive legal regulations and legal regulations regarding the behavior of institutions formed by substantive legal regulations. According to HLA Hart, the legal system has two main components, namely primary legal rules, which include norms of behavior, and secondary legal rules, which involve norms about norms of behavior, including validity, enforcement, and so on. The Capital Market Law in Indonesia normatively regulates and provides a technical format for the prohibition of Insider Trading through Article 95, Article 96, Article 97, and Article 98 of the Capital Market Law (UUPM).

Article 95 of the UUPM describes the legal subject of insider trading, which involves commissioners, directors, or employees of the issuer; major shareholders of the issuer; individuals with access to information due to their position, profession, or business relationship with the issuer or public company; or parties who within the last six months have a certain relationship.⁶ Article 96 regulates the obligations of insiders who know material information, including

⁶ Explanation of Article 95 of Laws No. 8 of 1995 on Capital Market (UUPM)

the prohibition of influencing other parties to conduct securities transactions and providing inside information to other parties who can use the information. Article 97 on unlawful attempts to obtain material information.

Although the explanation of commissioners and directors in Article 95 seems clear, the lack of clarity regarding the status of the issuer's employees may lead to different interpretations. This can be a problem in law enforcement as the Capital Markets Law may not be able to impose sanctions on non-permanent employees for securities transactions conducted based on material information inadvertently obtained. Article 96 provides for the duty of care in disseminating material information, but does not provide further guidance on liability if such information is disseminated by other parties, who then conduct securities transactions based on such information.

3.2. The Weaknesses in the Legal Structure for Handling Fraud in The Capital Market Practices

The legal structure includes institutions such as the executive, legislative, and judicial institutions, as well as related entities such as the Attorney Office, Police, Courts, Judicial Commission, Corruption Eradication Commission (KPK), and others. The realization of law enforcement and the application of sanctions against the perpetrators of Insider Trading can occur if the law enforcement authorities have the determination to implement the existing rules in the Capital Market, which includes political will, integrity, and strong commitment.⁷ The lack of seriousness on the part of law enforcement in supporting law enforcement can be seen in insider trading cases, such as those that occurred in the trading of PT Baturaja Multi Usaha shares ("BMU").⁸

Criminal law enforcement efforts by law enforcement are still considered ineffective in overcoming fraud and acts of corruption that often occur in the government and private sectors related to the capital market, especially the practice of Insider Trading. Although the rules related to Insider Trading have been regulated, there has been no case of suspected Insider Trading revealed and followed up by BAPEPAM-LK (Capital Market and Financial Institutions Supervisory Agency) and OJK (Financial Services Authority) since the enactment of UUPM. Some of the issues noted include the material substance of Articles 95, 96, 97, and 98 of the UUPM, which is an obstacle.

With the examination and investigation authority possessed by BAPEPAM, they can take action against parties suspected of violating the provisions in the capital

⁷ Donald Black, 1976, *Behavior of Law*, New York, San Fransisco, Academic Press, London, p. 2.

⁸ Bismar Nasution, "Insider Trading" (Online), available in [www: https://bismarnasution.com/insider-trading/](http://www.bismarnasution.com/insider-trading/) (January 11, 2021).

market and impose sanctions in accordance with their authority. The possibility of market manipulation and fraud in short selling transactions authorizes BAPEPAM and LK to conduct examinations and consider the consequences of such violations, and proceed to the investigation stage.

In the case of short selling, short sellers or even issuers may commit fraud by disclosing or not disclosing material facts to influence the share price. In addition, investors who engage in short selling transactions may also use inside information to take actions that violate the provisions of Insider Trading.

3.3. The Weakness of Legal Culture in Handling Fraud (Fraudulent Practices) in The Capital Market Practices

Lawrence M. Friedman first introduced the concept of legal culture as an integral part of the legal system,⁹ and later this idea was developed by Daniel S. Lev in his book "Culture and Politics in Indonesia." Satjipto Rahardjo also put forward the concept of Law and Society Studies which emphasizes the role of legal culture. Legal culture is defined as a force in society that stems from tradition, the value system adopted, and has an important role in determining how the law is accepted and implemented.¹⁰ Hilman Hadikusuma also stated that legal culture is inseparable from the conditions, systems, and structures of the society that brought it about.¹¹

Lawrence M. Friedman defines legal culture as "an element of social attitudes and values." Legal culture refers to parts of the general culture such as habits, opinions, and ways of thinking, which influence the direction of social forces towards or away from the law.¹² A person's legal culture has a role in shaping individual behavior and attitudes toward acceptance or rejection of the law.

One form of fraud that often occurs is corruption, which is often difficult to detect because it involves parties working together to gain benefits. Corruption, according to Black's Law Dictionary, is an act committed with the intent of conferring an unofficial advantage through the use of the rights of another in a manner that violates his office or character. The American Encyclopedia defines corruption as a criminal act that harms the country's finances or economy. Motivations behind corruption can include preferential treatment, excessive

⁹ Robert B. Seidman, in Esmi Warassih, 2005, *Pranata Hukum, Sebuah Telaah Sosiologis*, Suryandaru Utama, Semarang, p. 11.

¹⁰ Satjipto Rahardjo, *Peningkatan Wibawa Hukum Melalui Pembinaan Budaya Hukum*, *Majalah Hukum Nasional* No. 1/1999, Badan Pembinaan Hukum Nasional, Departemen Kehakiman, p. 45

¹¹ Hilman Hadikusuma, 1986, *Budaya Hukum dan Masyarakat*, (in *Antropologi Hukum Indonesia*), Penerbit Alumni, Bandung, p. 51-78.

¹² Lawrence M. Friedman, 1975, *Op.Cit.*

political donations, creation of off-budget funds, and efforts to win government projects.¹³

Corruption is the most common form of fraud in Indonesia, with the average loss per case reaching IDR 100 million to IDR 500 million. Corrupt acts can be detected in less than a year, and reports from internal company employees are often the main medium for detecting fraud. Perpetrators of corruption are generally between 36 to 45 years old, occupy middle management positions, and have a Bachelor and Master level educational background. Losses also often occur to employees with more than 10 years of service, who are familiar with the company's conditions and can easily commit fraudulent acts. The motivation of fraudsters is often related to a luxurious lifestyle and the desire to steal company money to fulfill these needs. In addition, most fraud perpetrators have not been convicted, reflecting difficulties in law enforcement against fraud in Indonesia, which is similar to the global survey results.

4. Conclusion

The weakness of legal substance in dealing with fraud in the capital market can be seen in the Capital Market Law. Although law enforcement has been the focus of attention, state losses caused by fraudulent practices in the capital market, such as those committed by PGN, fall under the crime of corruption because they indicate elements of corruption. Officials at State-Owned Enterprises (SOEs) involved in fraud, in accordance with the provisions, are considered a criminal offense of corruption. Unfortunately, corrupt practices in the financial markets that cost the state large amounts of money often go unnoticed. The legal structure also suffers from weaknesses in dealing with fraud in the capital market. Although there have been criminal law enforcement efforts, it is still considered less effective in overcoming fraud, especially acts of corruption that often occur in the government and the private sector related to the implementation of the capital market, especially in the practice of Insider Trading. Although the rules for Insider Trading have been regulated in the UUPM, until now there has not been a single case of alleged Insider Trading that has been successfully revealed and followed up by BAPEPAM-LK and OJK. Law enforcement efforts are also constrained when the KPK, POLRI, and Attorney place fraud cases that fulfill the elements of corruption on a par with other conventional corruption cases. Their lack of ability to uncover such cases is due to their conventional investigative approach and limited understanding of corrupt practices in financial markets. The weakness of the legal culture is also evident, where fraud has become a habit in the administration of the state, both by government officials and the private sectors. This mode of fraud has an

¹³ M. Nasir Djamil and TB Massa Djafar, *Etika Publik Pejabat Negara dalam Penyelenggaraan Pemerintah yang Bersih*, Jurnal Politik, Vol. 12 No. 01, 2016, p. 1758



impact on the process and results of public services, hampers the country's economic growth, and can cause significant losses. This fraud, in many cases, has the potential to become an act of corruption. The attitude of law enforcement officials in the capital market sector is also an obstacle in measuring the success of disclosing insider trading cases in Indonesia.

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