Corporate Governance Blueprint 2011

Towards Excellence in Corporate Governance

Suruhanjaya Sekuriti
Securities Commission
Malaysia

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FOREWORD

by YB DATO' SERI AHMAD HUSNI HANADZLAH
Minister of Finance II, Malaysia

Malaysia is transforming itself into a high-income nation by 2020. The New Economic Model (NEM) and the Economic Transformation Programme (ETP) provide the economic framework to significantly increase productivity, innovation and creativity. The structural reforms will create a more conducive investment environment and increased business opportunities. The strengthening of corporate governance practices is key in attracting private sector investments.

Corporate governance is also a priority in our drive to increase the competitiveness of Malaysian businesses to tap domestic and international capital. Internationally, governance practices now have a substantial influence on the investment decisions of long-term investors. As the competition for capital intensifies, it is important that Malaysia surpasses international benchmarks of good governance. Good governance is increasingly used to gauge the sustainability of performance and profitability of a business operation. Malaysian companies must therefore demonstrate track records of good governance in order to attract and retain long-term investors.

For the capital market to continue to support the sustainable development of the economy, a sound and balanced regulatory framework which promotes good ethical conduct is necessary. The necessary accountability and high levels of investor protection is a prerequisite. This enviroment must be accompanied by embedding practices into an organisation's goals and business processes.

I express my appreciation to the Securities Commission Malaysia for launching this Corporate Governance Blueprint. This Blueprint is a significant initiative that supports the efforts of the Government in promoting Malaysia as a leading business and investment destination. This Blueprint will, undoubtedly, contribute greatly to our efforts in transforming Malaysia into a high-income nation by 2020.

Thank you.

DATO' SERI AHMAD HUSNI HANADZLAH
Putrajaya
28 June 2011

MESSAGE
from TAN SRI ZARINAH ANWAR
Chairman, Securities Commission Malaysia

The hallmark of the capital market that Malaysia aspires to build is one that will be distinguished by the quality of its governance. Good governance engenders trust and infuses confidence among investors. It increases their willingness to commit capital and to partake in the risks that naturally accompany entrepreneurial ventures which create jobs and promote capital formation. Good governance provides a solid foundation to achieve sustainable growth and our national vision to build a developed economy and capital market.

The journey towards achieving good governance is not without challenges as it involves catering to the diverse interests of a multitude of stakeholders. In addition, the standards which constitute a robust corporate governance framework are not static. There are constant shifts, usually in response to catalytic events. In this regard, lapses in corporate governance have been at the heart of many financial crises with the significant consequences of a diminution in the value of accumulated life savings of many individuals and a loss of confidence that ultimately impacts economic growth.

The Asian Financial Crisis over a decade ago provided the catalyst for the beginning of progressive efforts by regulators who worked closely with industry to promote good corporate governance. Over the years, we have established the building blocks for a strong regulatory framework that now underpins the Malaysian corporate governance ecosystem.

This Corporate Governance Blueprint represents another significant milestone in our journey which recognises that, from time to time, a major review and recalibration of controls is necessary to ensure that Malaysia's corporate governance framework remains relevant and effective. This Blueprint is an affirmation of our commitment to achieve nothing less than excellence in governance.

This Blueprint also represents much more than a document of mere legal prescriptions. With significant input drawn from domestic and international experts, we scanned and reviewed the corporate governance ecosystem to address key components for strengthening self and market discipline. The thrust of our recommendations is to move from the normative tendency which regards corporate governance as a matter of compliance with rules, to one that more fittingly captures the essence of good corporate governance; namely a deepening of the relationship of trust among companies, stakeholders and regulators.

The broad-based approach adopted in this Blueprint encapsulates a wider range of accountabilities and expectations that seek to integrate principles, ethics and sustainability in the decision-making process of a business. This Blueprint therefore outlines strategic initiatives aimed at strengthening self and market discipline. Where regulatory changes are recommended, these are intended to reinforce self and market disciplinary mechanisms.

One major change to highlight is the emphasis on promoting greater internalisation of the culture of good governance. In this context, it is imperative that boards and shareholders expand their focus beyond business outcomes and ensure that business is conducted in a manner which enhances the company's reputation for good governance practices.

Corporate governance is a shared responsibility. It is not the sole preserve of the regulators but the obligation of all participants to exercise greater care and responsibility in promoting value creation and sustainability through mutually-reinforcing efforts. This Blueprint therefore seeks to enrich the governance process through promoting more extensive and proactive participation by a broader range of stakeholders. In this context, the cultivation of excellence in corporate governance will be supported by regulation that empowers market participants to take on greater accountabilities and challenges. Wider stakeholder participation will ensure that boards more earnestly direct their efforts and resources towards the best interest of the companies and stakeholders.

In particular, it is recognised that institutional investors can play a leadership role in ensuring responsible boards. For this purpose boards should place more emphasis on ensuring the timely dissemination of quality information. Effective communication instils greater public confidence in the professionalism and integrity of boards.

The crucial roles of gatekeepers and influencers require them to further strengthen their independence and integrity. More effective public and private enforcement is necessary, from time to time, to provide the dissuasion and deterrence to reinforce good corporate governance culture in the business environment.

Overall, this Blueprint is focused on actions, grounded on principles and ideals, in achieving excellence in corporate governance. It was developed through extensive consultation and we were fortunate that many individuals were willing to spend so many hours to provide us the benefit of their experience and expertise. It is the culmination of the collaboration and common vision of everyone who shares a passion and commitment to corporate governance.

I would like to express my heartfelt gratitude to all the members of the Corporate Governance Consultative Committee for providing strategic direction and valuable guidance in the formulation of this Blueprint.

I would also like to extend my appreciation to the members of the Corporate Governance Working Group and to all the local and international experts and industry players who participated in our various engagements. Finally, I would like to thank the staff of the Securities Commission Malaysia for their dedication, unceasing efforts and hard work in the formulation and publication of this Blueprint.

The implementation work begins with the publication of this Blueprint. As always, I look forward to the support and co-operation of all stakeholders in the capital market in the implementation of this Blueprint to ensure Malaysia takes big strides forward in achieving excellence in corporate governance.

TAN SRI ZARINAH ANWAR
July 2011

INTRODUCTION

> *"Corporate governance is the process and structure used to direct and manage the business and affairs of the company towards enhancing business prosperity and corporate accountability with the ultimate objective of realising long term shareholder value, whilst taking into account the interest of other stakeholders."*
>
> *High Level Finance Committee Report 1999*

The establishment of the High Level Finance Committee marks a significant milestone in Malaysia's journey to address corporate governance issues in the aftermath of the 1997/98 Asian Financial Crisis. The report of the High Level Finance Committee published in 1999 outlined a comprehensive agenda which provided the basis for a holistic and concerted approach to corporate governance reform. The report signaled the beginning of progressive efforts by regulators, working closely with industry, to promote good corporate governance in Malaysia and led to the incorporation of many aspects of corporate governance into a sound regulatory framework.

The *Malaysian Code on Corporate Governance* (CG Code) was introduced in 2000, as a result of which improvements were made to the then Kuala Lumpur Stock Exchange Listing Requirements in 2001. Over the years, Malaysia's corporate governance framework was continuously strengthened through enhancements to securities and companies laws, and regulations focusing on protecting the interests of investors. Whistleblowing provisions were introduced in 2004. The CG Code was revised in 2007 and in tandem with this, the responsibilities of boards and audit committees were augmented.

In 2010, the *Capital Markets and Services Act 2007* (CMSA) was amended to include sections 317A and 320A which gave the Securities Commission Malaysia (SC) the power to act against directors of listed companies who cause wrongful loss to their company and against any person who misleads the public through falsely preparing or auditing the financial statements of companies. The Audit Oversight Board (AOB) was established and became operational on 1 April 2010 to provide effective oversight of auditors of public interest entities. In 2011, the Securities Industry Dispute Resolution Center (SIDREC) was established to facilitate the resolution of small claims by investors. Malaysia has also committed to achieving full convergence with the *International Financial Reporting Standards* (IFRS) by January 2012.

Corporate Governance Milestones

Year	Milestones
1999	• *High Level Finance Committee Report on Corporate Governance*
2000	• *Malaysian Code on Corporate Governance (CG Code)* • Minority Shareholder Watchdog Group (MSWG)
2001	• *Capital Market Masterplan* (CMP) • First *Corporate Governance Report on the Observance of Standards and Codes* (CG ROSC) by World Bank • Corporate governance requirements incorporated into the Kuala Lumpur Stock Exchange Listing Requirements
2004	• Whistleblowing provisions in securities laws
2005	• Second CG ROSC commenced
2007	• Qualification criteria for directors introduced, audit committee strengthened and internal audit function mandated • Enforcement powers for civil and administrative actions expanded to allow recovery of up to three times the amount of losses for a wider range of market misconduct offences • MSWG *Guide of Best Practices for Institutional Shareholders*
2009	• The SC's enforcement powers broadened by the introduction of sections 317A and 320A of the *Capital Markets and Services Act 2007* (CMSA)
2010	• Audit Oversight Board (AOB)
2011	• Securities Industry Dispute Resolution Center (SIDREC) • Capital Market Masterplan 2 (CMP2)

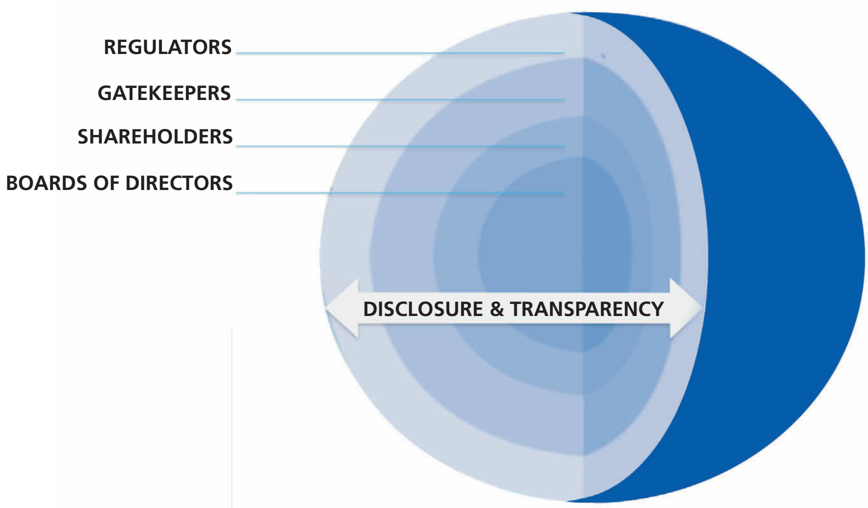
Malaysia's progress in strengthening its corporate governance framework has received international recognition. Malaysia has consistently been ranked 4th for investor protection in the World Bank *Doing Business Report* during 2006–2010. The World Bank *Corporate Governance Report on the Observance of Standards and Codes* (CG ROSC), in 2006, awarded full marks for Malaysia's compliance with IFRS. In 2007, the Institute of International Finance (IIF) ranked Malaysia in the top quartile of emerging market countries surveyed for compliance with the IIF *Corporate Governance Guidelines*. This was reinforced by the SC's acceptance as a signatory to the International Organization of Securities Commission Organisations' (IOSCO) *Multilateral Memorandum of Understanding*, reflective of the recognition of the Malaysian securities regulatory framework and enforcement capabilities. The SC has also been independently assessed to be highly compliant with IOSCO's *Objectives and Principles of Regulation*.

Malaysia continues to move forward with plans to transform into a developed economy by 2020. In tandem with national economic plans, the *Capital Market Masterplan 2* (CMP2) was launched in April 2011 to expand the role of the capital market in invigorating national economic growth. It is a major philosophy of CMP2 that growth is only sustainable if it is underpinned by a proper system of accountabilities and governance. Strengthening corporate governance therefore represents one of the key thrusts to reinforce investor trust and confidence in the Malaysian capital market.

This Corporate Governance Blueprint (Blueprint) represents one of the first deliverables of CMP2. It sets out the strategic directions and specific action plans to be implemented over a five-year period. This Blueprint is premised on the paradigm that boards of companies occupy a central role as agents of shareholders, both retail and institutional, within the corporate governance ecosystem. Boards in turn are directly influenced by shareholders who through exercising their rights as owners can ensure responsible actions by companies. Gatekeepers and influencers, interposed between the company and shareholders, have an important role in promoting self and market discipline, thereby reducing the need for regulatory discipline. Lastly public and private enforcement plays a crucial role in ensuring that corporate governance transgressors are held accountable through actions by the state, regulators or aggrieved parties. Proactive actions by the various parties shape societal norms and this reinforces the corporate governance culture and ultimately strengthens corporate governance.

In this context, good corporate governance cannot be achieved merely on the strength of regulations. Regulation is just one of three core components of corporate governance. Robust corporate governance also requires fully-functioning self and market disciplinary mechanisms, where all stakeholders assume responsibility for their decisions and actions. Proactive and responsible actions by shareholders, gatekeepers and influencers are equally crucial to ensure market discipline instils a corporate governance culture. Therefore there is an urgent need for Malaysia to move beyond reliance on regulatory discipline, to firmly embed corporate governance culture in listed companies and more generally within the entire ecosystem.

THE CORPORATE GOVERNANCE ECOSYSTEM



> "...strengthening self and market discipline, to complement regulatory discipline, and promoting the internalisation of corporate governance culture to underpin the sustainable growth of corporate Malaysia."

In this respect the definition of corporate governance in the *High Level Finance Committee Report* is prescient as it encapsulates the concepts of long-term shareholder value and the interest of broader stakeholder groups that may be affected by the actions of companies. This Blueprint subscribes to the vision of the High Level Finance Committee that good corporate governance also involves promoting corporate growth in a sustainable manner. The "licence to operate" of a company invariably involves the responsibility to operate with genuine concern and understanding of the interactions between sustainability and business, and to incorporate those considerations into the daily operations of the company.

This Blueprint considers approaches aimed at strengthening self and market discipline, to complement regulatory discipline, and promoting the internalisation of corporate governance culture to underpin the sustainable growth of corporate Malaysia. The six chapters of this Blueprint describe how we can attain this objective through the key components of the ecosystem.

Chapter 1 on **Shareholder Rights** advocates the empowerment of shareholders through a fair, efficient and transparent voting process.

Chapter 2 on **Role of Institutional Investors** exhorts institutional investors to take a leadership role in governance by exercising responsible ownership.

Chapter 3 on **The Board's Role in Governance** amplifies the role of boards as active and responsible fiduciaries.

Chapter 4 on **Disclosure and Transparency** emphasises the enhancement of disclosure standards and practices to promote informed decision-making by shareholders.

Chapter 5 on **Role of Gatekeepers and Influencers** gives recognition to their critical role in fortifying self and market discipline.

Chapter 6 on **Public and Private Enforcement** reinforces the critical and complementary roles of public and private enforcement in maintaining market confidence.

The section on **Implementation** sets out the specific recommendations and means through which the recommendations will be implemented.

Shareholder Rights

Chapter 1
SHAREHOLDER RIGHTS

Empowering shareholders through fair, efficient and transparent voting process

1.1 OVERVIEW

Good corporate governance promotes the effective confluence of otherwise conflicting interests of a company's varying stakeholders. It sustains public confidence and facilitates maximisation of shareholder value. Thus good corporate governance is a shared responsibility, with shareholders of companies having equal responsibility for protecting and advancing their own interests by exercising the rights accorded to them to ensure that the companies they invested in are well governed.

The Organisation for Economic Co-operation and Development (OECD) *Principles of Corporate Governance (2004)* states that shareholders should have the right to participate in, and to be sufficiently informed on, decisions concerning fundamental corporate changes such as:

- Amendments to the statutes, or articles of incorporation or similar governing documents of the company;
- The authorisation of additional shares; and
- Extraordinary transactions, including the transfer of all or substantially all assets, that in effect result in the sale of the company.

The law accords shareholders various rights to enable them to perform their role and exercise their responsibility for corporate governance. These include the rights mentioned in the OECD *Principles of Corporate Governance* above. Rights that come in the form of shareholder approvals are effected through resolutions that are voted for in general meetings. As owners, shareholders must engage, debate and challenge in order to ensure that the board pursues a strategy that is focused on sustainable value creation. It is essential therefore that shareholders exercise their right to participate in the company's decision-making process by participating and voting at general meetings. Boards on the other hand have a duty to ensure that they facilitate shareholder participation and voting at general meetings.

This chapter sets out recommendations in respect of having in place a fair, efficient and transparent voting process that will enhance shareholder participation and voting at general meetings.

1.2 STATE OF PLAY

The law recognises the interest of shareholders in the conduct of the affairs of a company and provides rights to them in a variety of situations. The *Companies Act 1965* (CA) provides that shareholders' approval must be obtained before a company:

i. Issues additional shares;[1]

ii. Proceeds to make any amendments to its memorandum or articles of association, whereby at least three-quarters of shareholders attending and voting at the meeting must have voted in favour of the proposed amendments; and

iii. Effects any substantial property transaction involving a director or a substantial shareholder of the company or its holding company or with a person connected with such persons.[2] *Bursa Malaysia Listing Requirements* (Listing Requirements) also provides for additional safeguards against abusive related-party transactions (RPTs).[3] This includes requiring the related party or persons connected with the related party to abstain from voting in the general meeting that was convened to approve the transaction. An independent adviser must also be appointed to advise minority shareholders as to how they should vote in respect of the transaction.

The CA further provides shareholders with the following rights in respect of participating and voting in general meetings:

i. To attend, speak and vote at general meetings;[4]

ii. To requisition the company to convene a general meeting;[5]

iii. To place items on the general meeting agenda;[6]

iv. To appoint up to two proxies when the shareholder is unable to attend the general meeting;[7]

v. For a corporate shareholder, to attend the general meeting through its corporate representative.[8]

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1 Section 132D CA.
2 Section 132E CA.
3 Chapter 10, Bursa Malaysia's *Main Market Listing Requirements.*
4 Section 148 CA.
5 Section 144 CA.
6 Section 151 CA.
7 Section 149 CA.
8 Section 147 (3) (a) CA.

1.3 CASE FOR CHANGE

1.3.1 Facilitating voting through proxies and corporate representatives

While the right of shareholders to attend, speak and vote at general meetings is enshrined in the law, there are many constraints that exist which pose a challenge in the exercise of this right. These include the requirement for voting at general meetings to be cast through the physical attendance of shareholders or proxies.

Proxy voting is intended to facilitate shareholder participation and voting in general meetings. A shareholder who is unable to attend a general meeting can appoint a proxy to attend and vote on his or her behalf. Proxy voting is also intended to enfranchise the beneficial owners of shares who are otherwise unable to attend and vote at general meetings because they are not registered shareholders. Such beneficial owners can participate and vote if they attend the general meeting as a proxy. Given the crucial role of proxy voting in enabling shareholders to exercise their right of participation in the company's decision-making process, it is essential that impediments to proxy voting be removed.

The CA provides that unless otherwise stated in the company's articles of association, a shareholder cannot appoint an outsider to be his or her proxy, unless the outsider appointed is a shareholder of the company, an advocate, an approved company auditor or a person approved by the Registrar of Companies.[9] Although companies can remove these qualitative restrictions by amending their articles of association, this rarely occurs. The Listing Requirements must ensure that companies do not impose any qualitative restrictions on proxy appointment by shareholders which can impede shareholder participation and voting in general meetings.

Currently there is uncertainty as to whether a body corporate can be appointed as a proxy. The argument in support of allowing a body corporate to be appointed as a proxy is that individual shareholders, particularly retail shareholders, can appoint a shareholder representative organisation to exercise their right to vote on their behalf.[10] Clarification is required on whether a body corporate can be appointed as a proxy. This may include the need for the law to be amended.

> "Given the crucial role of proxy voting in enabling shareholders to exercise their right of participation in the company's decision-making process, it is essential that impediments to proxy voting be removed."

[9] Section 149 (1) (b) CA.

[10] Section 249X(1A) *Australian Corporations Act 2001* expressly provides that an appointed proxy can be either an individual or a body corporate.

The CA provides that where a shareholder appoints two proxies, the appointment shall be invalid unless the shareholder specifies the proportion of shareholdings to be represented by each proxy.[11] This provision has resulted in the unintended consequence of companies observing a two proxy restriction rule although this may not have been the intention of the provision. Companies can on their own accord amend their articles of association to provide for the appointment of multiple proxies but this also rarely occurs. Some have taken the view that the appointment of more than two proxies may be contrary to the law. Others may not wish to deal with the cost and administrative issues that are related to the appointment of multiple proxies.

> "...the two proxy rule can pose a problem to institutional shareholders who hold shares for numerous beneficial owners..."

While the two proxy rule may not disadvantage an individual shareholder who has no reason to appoint more than one proxy to attend a general meeting, the two proxy rule can pose a problem to institutional shareholders who hold shares for numerous beneficial owners and the beneficial owners want to directly participate and vote in general meetings. To deal with this challenge and to enfranchise beneficial owners, regulations in other jurisdictions have been amended to clarify that shareholders can appoint more than two proxies.[12] Similarly any quantitative restrictions on the appointment of proxies in the law need to be addressed.

Unless stated otherwise in the company's articles of association, a proxy can only vote by way of poll.[13] It is not common practice for companies to provide otherwise in their articles of association. This issue poses a constraint as in most general meetings, resolutions are usually voted on by a show of hands. To address this, regulations in other jurisdictions have expressly provided that a proxy can also vote by a show of hands. Similar provisions enabling proxies to vote by a show of hands should be incorporated in the law. However to overcome the aberration which can result from a situation where some shareholders appoint only one proxy while others appoint multiple proxies, it is proposed that where more than one proxy has been appointed by a shareholder and voting is to be taken by a show of hands the multiple proxies appointed by that shareholder should not be able to vote by a show of hands. In this instance a poll vote should be demanded and effected.

A corporate shareholder can attend and vote in a general meeting through its corporate representative. Unlike proxies, a corporate representative is not subject to any qualitative requirements and can also vote by a show of hands. The only issue in respect of corporate representatives concerns the

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11 Subsection 149(1)(d) CA.

12 Section 324(2) UK *Companies Act 2006* (UK CA).

13 Section 149(1)(a) CA.

appointment of multiple corporate representatives. While a shareholder can appoint at least two proxies, the law is not clear as to whether or not more than one corporate representative can be appointed by a corporate shareholder.[14] The Listing Requirements should be amended to state that corporate shareholders be allowed to appoint multiple corporate representatives as proposed in the case of proxies. Consequently, the law may also need to be amended.

1.3.2 Moving towards poll voting

Most resolutions passed at general meetings are voted upon by a show of hands as opposed to poll voting. This voting practice is viewed as unfair to shareholders as it does not represent the shareholding position of the respective shareholders. When voting is done by a show of hands, each shareholder physically present has one vote, while voting by poll provided for under section 55 of the CA gives effect to the principle of 'one share one vote'.

In practice, whether a resolution is voted on by a show of hands or poll is dependent on the company's articles of association. The articles of most companies provide that votes are to be taken by a show of hands unless a poll is demanded. Voting by show of hands is common given that it is informal and expeditious.

Corporate governance proponents advocate the need to mandate poll voting as it is consistent with the principle of 'one share one vote', fair and is necessary where the practice of companies passing resolutions on a show of hands is prevalent.

Company law statutes generally do not include provisions that mandate poll voting. However, such manner of voting can be effected via the Listing Requirements, as in the case of Hong Kong. In June 2011, the Singapore Exchange issued a consultation paper expressing the intention to impose poll voting for votes taken at general meetings.

> “Companies must encourage and facilitate poll voting.”

Companies must encourage and facilitate poll voting. To enable this, the Listing Requirements as well as the CG Code must require the chairman of the general meeting to inform shareholders of their right to demand a poll vote at the commencement of the general meeting and also before any vote is taken by a show of hands. This measure will encourage shareholders to demand poll vote.

[14] Section 323 UK CA provides for the appointment of more than one corporate representative.

> "Mandating poll voting for all resolutions can have the effect of not differentiating substantive resolutions from resolutions that are merely administrative or procedural in nature."

While poll voting supports the principle of 'one share one vote', and must be encouraged, mandating poll vote on resolutions which can be resolved efficiently through a vote taken by a show of hands may cause administrative and procedural burden. Voting by a show of hands offers companies an informal and expeditious means of making a decision. Mandating poll voting for all resolutions can have the effect of not differentiating substantive resolutions from resolutions that are merely administrative or procedural in nature. In addition, voting by show of hands can empower minority shareholders as all shareholders will only have one vote to cast.

Hence, poll voting should not be mandated except for resolutions approving related-party transactions. This will enable disinterested shareholders who vote on the transaction to convey to companies that such transactions are not acceptable unless they benefit the companies. Further, the outcome of poll votes must be disclosed and this disclosure can discourage companies from entering into RPTs which are abusive. For other substantive resolutions, a phased approach will be taken in mandating poll voting when the need arises.

1.3.3 Commitment to shareholder rights

Companies that are committed to upholding good corporate governance must explicitly state their commitment to respecting shareholder rights including the shareholders' right to participate, speak and vote at general meetings and to demand poll vote. This commitment should be set out on the websites of companies.

To encourage beneficial owners to take on a more proactive role in governance, legislation such as the United Kingdom *Companies Act 2006* (UK CA) has allowed listed companies to directly provide information to beneficial owners of shares.[15] When shares are held through a nominee, it is the nominee's name that appears on the register of members and therefore the company's dealings are with the nominee as the registered shareholder. Notices, circulars and information are sent to the nominees upon whom beneficial owners are reliant to provide them with the necessary information. The UK provision provides that the nominees can nominate the beneficial owners of shares to enjoy information rights. If nominated, beneficial owners are entitled to receive copies of all communications that companies send to their members generally or to any class of their members that includes the persons making the nomination. A taskforce comprising industry representatives and regulators should carry out a study to determine whether or not the law should be amended to enable companies to directly provide information to beneficial owners of shares.

[15] Section 146 UK CA.

1.3.4 Encouraging electronic voting

The OECD *Principles of Corporate Governance (2004)* states that shareholders should be able to vote in person or in absentia, and be given equal effect. Voting in general meetings requires the physical attendance of shareholders in their own capacity or through their proxies or corporate representatives. Other methods of voting should be looked into to encourage shareholder involvement in corporate decision-making such as facilitating electronic voting by shareholders.

Electronic voting can take the form of electronic proxy voting or direct electronic voting. Electronic proxy voting entails voting instructions being submitted to a proxy collection agency which then passes them on to a person who will execute the instructions at the meeting. Direct electronic voting refers to voting without proxy intervention or physical attendance at meetings. Therefore, shareholders are able to vote from remote computer terminals and votes are received directly by companies without being transferred through an appointed proxy.

The CA does not preclude electronic voting as it provides that a company may hold a meeting of its members within Malaysia at more than one venue using any technology that allows all members a reasonable opportunity to participate.[16] The word "participate" implies that if such a meeting is held, the technology used should also enable shareholders at the same time to speak and vote in the meeting. While the CA does not have any express provisions pertaining to electronic voting, it does not preclude companies from allowing shareholders to vote electronically. Therefore, companies wishing to adopt electronic voting by shareholders may need only to amend their constitution to give it effect. However, virtual meetings are not yet a common occurrence as security and cost issues related to virtual meetings pose a challenge.

Electronic voting will promote shareholder participation in general meetings as it does away with the need for shareholders to be physically present at the general meeting in order to vote. It also has the potential to eliminate many of the issues attributed to the traditional proxy collection process such as votes not being counted. It can encourage poll voting and promote transparency in voting results. A taskforce comprising industry representatives and regulators should be established with a view to working towards providing a credible electronic voting platform that can encourage the use of electronic voting.

> "...companies wishing to adopt electronic voting by shareholders may need only to amend their constitution to give it effect."

[16] Section 145A CA.

RECOMMENDATIONS

I. Facilitate voting through proxies and corporate representatives via amendments to the Listing Requirements

- Ensure listed companies do not impose qualitative restrictions on proxy appointment by shareholders and quantitive restrictions on the number of proxies appointed by shareholders. Consequently, the law may need to be amended to clarify that a body corporate can be appointed as a proxy and that more than one corporate representative can be appointed.

- Where more than one proxy has been appointed by a shareholder, the proxies must not be allowed to vote by a show of hands. The law may need to be amended to clarify this.

II. Mandate poll voting via amendments to the Listing Requirements and CG Code

- Impose obligation for the chairman of the general meeting to inform shareholders of their right to demand a poll vote.

- Resolutions approving related-party transactions must be passed or obtained by poll vote. For other substantive resolutions, a phased approach will be taken in mandating poll voting and a public consultation will be undertaken for this.

III. Reinforce commitment to shareholder rights

- Companies to make public their commitment to respecting shareholder rights and take active steps to inform shareholders of how these rights can be excercised.

- Establishment of a taskforce to determine whether the law should be amended to enable companies to directly provide information to beneficial owners of shares.

- Establishment of a taskforce with a view to providing a credible electronic voting platform.

Role of Institutional Investors

Chapter 2
ROLE OF INSTITUTIONAL INVESTORS

Leadership in governance and responsible ownership

2.1 OVERVIEW

Institutional investors are in a unique position to exercise influence over companies and to hold them accountable for good governance. Given the typically significant stake they hold, they have the ability to demand meetings with the senior management of companies, challenge them on issues of concern, discuss strategies for achieving the companies' goals and objectives and be the leading voice of shareholders in demanding corrective action when wrongdoing occurs.

Thus institutional investors have a critical and proactive role to play in the governance of companies. They have better access to information and possess the resources to build the necessary monitoring capabilities. Given their unique position of influence, there is a need to prioritise their leadership role in governance.

Globally, the concept of "responsible ownership" is gaining momentum, premised on the belief that it is not enough for institutional investors to simply hold shares. They must also play an active role to promote good governance practices in companies by adopting a more long-term strategy to share ownership. Active engagement by institutional investors is an essential component of market discipline. By bringing their voice and lending their reputation to gain the attention of management, they can usher in an ownership culture that ensures management prioritises the best interest of the company at all times.

Institutional investors are professional investors who act on behalf of beneficiaries, such as individual savers or pension fund members.[1] The categories of institutional investors are wide and can include collective investment vehicles, which pool the savings of many, and licensed fund managers to whom these funds are allocated.

Active participation of institutional investors in the exercise of shareholder rights will raise the level of governance as a result of increased shareholder engagement. Institutional investors should therefore continually assess their approach and invest in the necessary expertise and resources that will enable them to play a more effective role in monitoring and engaging the companies they invested in, leading by example and influencing good governance practices.

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[1] As set out in the *ICGN Statement of Principles on Institutional Shareholder Responsibilities.*

2.2 STATE OF PLAY

In Malaysia, the large institutional investors, like the Employees Provident Fund of Malaysia (EPF), Lembaga Tabung Angkatan Tentera (Armed Forces Fund Board), Permodalan Nasional Berhad (National Equity Corporation), Pertubuhan Keselamatan Sosial (Social Security Organisation), Lembaga Tabung Haji (Pilgrimage Board) and Khazanah Nasional, have over the years taken various measures to instil better governance practices in their investee companies. As proactive shareholders, they conduct regular engagements with management of companies and vote on key issues at general meetings.

In 2007, the *Guide of Best Practices for Institutional Investors* (Guide) was issued jointly by the Institutional Investor Committee and Minority Shareholder Watchdog Group (MSWG) in line with the recommendations in the first *Capital Market Masterplan* to complement the CG Code and the *Green Book – Enhancing Board Effectiveness*[2]. The Guide sets out the framework for how institutional investors should discharge their responsibilities on behalf of their beneficiaries and other stakeholders to influence, guide and monitor investee companies in a responsible way.

In 2010, EPF took a major step to instil a higher level of governance best practices and overall adoption of good corporate governance through the release of its *Corporate Governance Principles and Voting Guidelines*. The areas of focus in the guidelines include size and composition of the board, board committees, separation of power between chairman and CEO, re-election of directors, related-party transactions and dividend policy.

Internationally, various statements of principles, guides and codes have been issued to guide institutional investors in the exercise of their role. The International Corporate Governance Network (ICGN) *Statement of Principles on Institutional Shareholder Responsibilities* and the *UK Stewardship Code* are key examples.

A facilitative enabling environment has been cited as an important prerequisite to the practice of responsible ownership. This includes, among others, internal capacity building of institutional investors, addressing the high cost of engagements and allocating the time and resources to monitor companies.

As large institutional investors may hold diversified portfolios of stocks, resource limitations can hinder their ability to effectively monitor investee companies. In this regard, proxy voting and corporate governance advisory agencies can supplement institutional investors' capacity to discharge their role as responsible share owners. The use of proxy voting and corporate governance advisory agencies can therefore provide greater opportunities to facilitate more substantive and constructive engagements with boards of companies. While the use of such services may be costly, such cost can be reduced if there is sufficient demand within the industry to create a critical mass.

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[2] Issued by the Putrajaya Committee on GLC High Performance.

The ICGN Statement of Principles on Institutional Shareholder Responsibilities

The International Corporate Governance Network (ICGN) brings together some of the largest institutional shareholders with estimated assets under management exceeding US$10 trillion. The ICGN approved the *Statement of Principles* (Statement) in 2007. The Statement sets out the ICGN's view of the responsibilities of institutional investors both in relation to their external role as owners of company equity, and also in relation to their internal governance. Both are of concern to beneficiaries and other stakeholders.

The key areas covered under the broad ambit of internal governance of institutional investors relate to oversight, transparency and accountability, conflict of interest and expertise; whereas the key areas under external governance with the investee company relate to engagement with the companies, voting and addressing corporate governance concerns of the investee company which relate to transparency and performance, board structures and procedures and shareholder rights.

The statement also observes that institutional investors which comply with these principles will have a stronger claim to the trust of their end beneficiaries and the exercising of the rights of equity ownership on their behalf.

The UK Stewardship Code

The *UK Stewardship Code* (Stewardship Code) was published in July 2010. It aims to enhance the quality of engagement between institutional investors and investee companies to help improve long-term returns to shareholders and the exercise of governance responsibilities by setting out good practices on engagement with investee companies to which the Financial Reporting Council believes institutional investors should aspire.

The Stewardship Code operates on a 'comply or explain' basis and the Financial Reporting Council encourages all institutional investors to report publicly the extent to which they observe the Stewardship Code.

Disclosures made pursuant to the Stewardship Code will assist investee companies to understand the approach and expectations of their major shareholders. The disclosures will assist institutional investors issuing mandates to asset managers to make informed choices, assist asset managers to understand the expectations of clients, and may help investors interested in collective engagement to identify like-minded institutions.

2.3 CASE FOR CHANGE

2.3.1 Effective exercise of ownership rights

Exercise of ownership rights ranges from contributing to improvements to the functioning of boards, to promoting information disclosure and transparency as well as supporting market discipline by rewarding better governed companies.

According to the Government-linked Companies (GLC) Transformation Programme Progress Review[3], the total shareholder returns of the 20 largest GLCs controlled by Government-linked Investment Companies generated a five-year compound return of 14.2% to February 2010, outperforming the FTSE Bursa Malaysia KLCI by 2.9% per annum. This positive performance is reinforced by ensuring heightened governance in investee companies.

To a large extent the performance of the role of institutional investors is influenced by their mandates. The differences in investment objectives and strategies can lead to different approaches and levels of shareholder activism. Performance evaluation systems and incentive structure of fees and commissions which encourage short-term strategies will discourage any meaningful levels of shareholder engagement. Thus, where permitted by their mandate, a revamp of the performance metrics can encourage long-term thinking and active ownership.

“Responsible ownership requires high standards of transparency, probity and care on the part of the institutions...”

Responsible ownership requires high standards of transparency, probity and care on the part of the institutions which may be met by adhering to a set of over-arching principles in the form of a code for institutional investors. There is a need for institutional investors to review their existing practices in the light of growing recognition of the significance of their role and heightened expectations to monitor management and moderate managerial discretion.

The formulation of a new industry-driven code can strengthen the accountability of institutional investors to their own members and investors. The new code will require institutional investors to explain how corporate governance has been adopted as an investment criteria and the measures they have taken to influence, guide and monitor investee companies. It is also important for institutional investors to include governance analysis in their investment appraisal to help identify better governed companies.

The following areas exemplify best practices to be considered in the new code for institutional investors.

3 Released in March 2010.

Expectations of best practices under new code for institutional investors

Commitment to engagement

The code for institutional investors must address the issue of transparency with regard to institutional investors and their agents' commitment to meaningful engagements and whether such engagement policies are effectively implemented.

Incorporate corporate governance into the investment decision-making analysis, and ensure effective communication between asset owners and fund managers

Specific good practices that should be encouraged include integrating corporate governance considerations into the investment decision-making analysis. In addition, institutional investors should also assess whether the company takes a view on the sustainability of its business.

Exercise of voting rights

The diligent exercise of voting rights is a key indicator that an institutional investor is effectively implementing its engagement policy. Publishing a voting policy will give both beneficiaries and investee companies a better understanding of the criteria used to reach those decisions. Publishing information on voting records after shareholder meetings also gives the beneficiaries greater clarity on how the votes are cast. Disclosure of the institutional investors' voting record is also a way of demonstrating that conflicts of interest are being properly managed.

Establishing a 'focus list'

Corporate governance may be used as a tool for extracting value for shareholders from underperforming and undervalued companies. A number of global institutional investors have established 'focus lists' where they target underperforming companies and include them on a list of companies which have underperformed a main index. Underperforming the index would be the first point of identification, while other factors would include not responding appropriately to the institutional investor's enquiries regarding underperformance, and not taking into account the institutional investor's views. By targeting companies which are underperforming and analysing their corporate governance practices, improvements can be made which could unlock the hidden value. These can include replacing poorly performing directors and ensuring companies comply with best practices in corporate governance.

Expectations of best practices under new code for institutional investors *(con't)*

Monitoring performance

Institutional investors should monitor performance of investee companies regularly, communicate the outcomes clearly and periodically review the monitoring process for effectiveness. Monitoring performance would include reviewing annual reports and accounts, circulars, and resolutions as well as attending company meetings. In particular, institutional investors should satisfy themselves that the investee company committees are structured effectively. They should ensure that independent directors provide adequate oversight and maintain a clear audit trail of their meetings and of votes cast on company resolutions, in particular for contentious issues.

Intervention

Institutional investors should intervene when there are concerns about issues such as the investee company's strategy, its operational performance and acquisition or disposal strategies, failure in internal controls, inadequate succession planning, inappropriate remuneration packages and failure of independent directors to hold executive management properly to account.

Commitment to the code

Institutional investors must be encouraged to adopt the code and consider publishing their commitment to the code or to explain why their business model precludes adherence to the code. In addition, institutional investors are encouraged to attend customised training programmes to help them engage effectively with boards.

2.3.2 Network of institutional investors

It is important for institutional investors to harness their resources to co-ordinate and network as a group in order to actively promote governance practices. A dedicated umbrella body could represent the common interest of all institutional investors and be a platform to shape and influence a wider sphere of corporate governance culture.

In jurisdictions such as the UK and Australia, dedicated institutional investor representative groups play a leading role, not only in formulating the code of best practices for institutional investors, but in monitoring its effectiveness and providing advice to its members. Institutional investors in these jurisdictions will generally, in addition to their own research and analysis, consult their representative group on whether a particular company is complying with good corporate governance practices.

An example of such a representative group is the Institutional Investor Committee in the UK.

The Institutional Investor Committee (IIC) in the UK is a group of trade associations which represent institutional investors and comprises the Association of British Insurers, the Investment Management Association and the National Association of Pension Funds.

The terms of reference of the IIC are to provide a forum through which its member organisations may:

- Consider relevant matters where it is felt a co-ordinated approach or representation may have a greater impact with the UK Government and regulators; European institutions; and, any other relevant international legislative, regulatory or standard setting bodies.
- Make joint representations/recommendations on occasion and by mutual agreement.
- Present a single voice for the institutional investment industry on matters affecting its role as investors in companies.
- Encourage compliance with appropriate codes from regulatory or other relevant bodies.
- Consider any matter affecting or likely to affect the interests of investors in companies to ensure that there is a better outcome for savers and investors.

Given the strategic role of institutional investors in promoting governance, a dedicated umbrella body of institutional investors will bring together the collective voice of institutional investors more effectively and will provide a platform to address governance issues, address impediments and seek solutions.

RECOMMENDATIONS

I. Formulate a new code for institutional investors

- Institutional investors to drive the formulation of a new code and publish their commitment to the new code for institutional investors.

II. Create an industry driven umbrella body for institutional investors

- Institutional investors to work together towards the establishment of an umbrella body.

The Board's role in Governance

Chapter 3

THE BOARD'S ROLE IN GOVERNANCE

Boards as active and responsible fiduciaries

3.1 OVERVIEW

In an increasingly globalised market where competition and scrutiny are intense, good corporate governance is essential to reinforcing public confidence in companies and their boards. Boards that observe good governance are a critical safeguard against unethical conduct, mismanagement and fraudulent activities.

Boards play the role of stewards and guardians of the company and are key to raising corporate governance standards. They are often the first line of defence against corporate governance infractions given their unique position at the helm of the company.

There is evidence in corporate debacles that boards devote much attention to compliance in form rather than actually doing the right thing. While achieving compliance with the regulatory requirements, boards therefore often fail on the ethics dimensions.

Good corporate governance cannot be legislated. This does not mean that the legal framework is not important. Legislation prescribes the minimum. The ideal board builds on the legal framework to raise standards beyond compliance to a level where the spirit of best practices and their intent are fully embraced. The board is responsible for the internal culture that promotes good corporate governance.

> "...boards to move away from their role as mere advisers to become active and responsible fiduciaries..."

Boards need to recognise that good corporate governance culture adds value to the company. They can no longer be reactive, dependent and accommodating, as there are pressures on boards to accomplish more in a shorter time and in the right way.

In this regard, our overall objective is for boards to move away from their role as mere advisers to become active and responsible fiduciaries. A culture of good governance in the boardroom therefore needs to be inculcated as much as the rules themselves and this requires education and persuasion.

To achieve this objective, the following are five major thrusts that boards must recognise:

1.	Boards must recognise their role in establishing ethical values that support a culture of integrity, fairness, trust, and high performance.	Roles & Responsibilities of the Board
2.	Boards must recognise their role in ensuring that the company not only operates successfully but sustains growth over the long term.	Roles & Responsibilities of the Board
3.	Boards must ensure that they have no interest or ties in the company that could adversely affect independent and objective judgement and place the interest of the company above all other interests.	Independence of the Board
4.	Boards must ensure the right mix of members with the appropriate skills, and experience to cope with the 3Cs – Complexities, Competition and Changes.	Composition of the Board
5.	Board members must devote sufficient time and fully commit to drive the company and undertake continuous development of skills to enable fulfillment of their responsibilities to the company.	Commitment of Board Members

3.2 ROLES AND RESPONSIBILITIES

3.2.1 State of play

The board's role is to govern and set the strategic direction of the company rather than to manage it. In discharging its governance function, the board must act in the best interest of the company. It is the role of senior management to manage the company in accordance with the strategic direction and delegations of the board. The responsibility of the board is to oversee the activities of management in carrying out these delegated duties. Malaysia has encapsulated the roles and responsibilities of directors under the CA and the CG Code.

Board's fiduciary duties and strategic responsibilities

Legal Obligation	Best Practice
Under common law, the board owes a fiduciary duty to the company. The term 'fiduciary', being derived from the Latin 'fiduciarius' meaning 'of trust' – requires each individual director to act in good faith, with a reasonable degree of care and diligence, without self interest, and in the best interests of the company and its shareholders. The most important of these duties are now contained in section 132 of the CA. These duties of directors, arising both out of common law and statute, are owed to the company as a whole and are the same for each individual director. The CA defines 'officer' to include any director, secretary or employee – it does not distinguish between executive and non-executive directors and holds that all directors owe the same duties to the company.	The CG Code provides that every board should assume the following six specific responsibilities: • Reviewing and adopting a strategic plan for the company; • Overseeing the conduct of the company's business to evaluate whether the business is being properly managed; • Identifying the principal risks and ensuring the implementation of appropriate systems to manage these risks; • Succession planning, including appointing, training, fixing the compensation of and where appropriate, replacing senior management; • Developing and implementing an investor relations programme or shareholder communications policy for the company; and • Reviewing the adequacy and the integrity of the company's internal control systems and information systems, including systems for compliance with applicable laws, regulations, rules, directives and guidelines.

3.2.2 Case for change

While the general roles and responsibilities of boards are well founded, the expectations have evolved significantly owing to changes in the corporate and regulatory landscapes. Driven in part by financial crises and corporate scandals as well as growing shareholder activism and societal expectations, shareholders and the public today are increasingly pressing boards for greater accountability on a wider range of issues.

What shareholders and the public look for most from boards over and above compliance with the rules and regulations is assurance and accountability of a company's integrity in the broadest sense. This includes taking into account the company's continuing viability as an enterprise, its cognisance of risks, values which embrace ethical conduct and creation of sustainable value.

Corporate governance failures are not the result of a lack of rules and regulations but are due to an implementation gap, namely a good corporate governance culture. While certain rules and best practices can be further improved, they are not the main problem as such improvements should be accompanied by a culture which promotes ethical business conduct and sustainable value creation. In practice the ethical dimension of having in place such a culture is lacking.

To address this deficit, there are three critical areas which the boards themselves need to prioritise:

I. Promoting ethical values and standards in the workplace;
II. Overseeing strategies that address sustainability and stakeholder interests; and
III. Setting a general statement of intent and expectations through board charters.

I. Promoting ethical values and standards in the workplace

A key role of the board is to establish a corporate culture which engenders ethical conduct that permeates throughout the company. To integrate this culture in the company, boards need to formalise ethical values through a code of conduct and ensure the implementation of appropriate internal systems to support, promote, and ensure its compliance. This includes having in place appropriate communication channels which facilitate whistleblowing by employees, customers, suppliers or other stakeholders to raise concerns on potential or suspected infractions of the code of conduct, or any failure to comply with the laws and regulations governing the company.

> "...boards need to formalise ethical values through a code of conduct and ensure the implementation of appropriate internal systems to support, promote, and ensure its compliance."

There is no single code or system which works for every board and every company. The onus lies with the board to design its own code and system based on the values it prizes as appropriate business conduct. The code should be actively and effectively communicated across the company, and there should be appropriate training programmes to enable staff to understand the code and apply it effectively. The code should also be disclosed to the shareholders and the public and to ensure the code continues to remain relevant and appropriate, boards should review it regularly.

II. Overseeing strategies that address sustainability and stakeholder interests

Boards today are expected to take into account longer term considerations and the interests of a wide range of constituents. This is attributable to the rapidly growing nature of businesses and their impact on the environment and the community in which they operate. Boards must recognise that the environmental, social and governance aspects of business can benefit both the company and its operating environment. Navigating and balancing the interests of numerous stakeholders is difficult but essential to enhancing investor perception and public trust.

Businesses globally have to look beyond financial stewardship as the sole means of creating shareholder value. Boards must ensure that the companies they govern remain competitive by having in place a robust strategy that focuses on sustainable value creation. In internalising their strategy, boards must formalise their policies on sustainability and stakeholder management. To enhance accountability, these policies should be disclosed to the public.

III. Setting a general statement of intent and expectations: board charters

Given their expanding roles and responsibilities, boards must adopt a formal charter that sets out their strategic intent, outlining their various functions and responsibilities. In establishing a charter, it is important for the board to set out the key values, principles and ethos of the company, as policies and strategy development are based on these considerations. The charter should also disclose the division of responsibilities and powers between the board, the different committees established by the board, the chairman and CEO.

A BOARD CHARTER

Source: Securities Commission Malaysia, 2011.

In this regard, the charter serves not only as a reminder of the board's roles and responsibilities, but also as a general statement of intent and expectation as to how the board will discharge its duties. It serves as a source reference, providing insights to prospective board members as well as the primary induction literature for new board members and senior managers. The charter will be of assistance to the board in its assessment of its own performance and that of individual directors.

The board should be responsible for reviewing this charter and determining its appropriateness to the needs of the company from time to time. It is also important that such charter be disclosed in the company's annual report as part of the statement of corporate governance.[1] Board committees also play an important role in the governance process and each committee of the board should have a written charter, which has been approved by the board and disclosed in the annual report.

RECOMMENDATIONS

I. Formulate ethical standards and a system of compliance through the company's code of conduct

- Establish and maintain a code of conduct.
- Establish and maintain appropriate systems to support, promote and ensure its compliance.
- Establish and maintain an internal whistleblowing mechanism.

II. Formulate strategies that address sustainability and stakeholder interests through internal policies

- Establish and maintain policies governing the company's relationship with other stakeholders.
- Establish and maintain environmental, occupational health and safety policies.

III. Mandate the formalisation of the board charter in the annual report

- Delineate the roles and responsibilities of the board, chairman and CEO.
- Set out key values, principles and ethos of the company.
- Disclose the charter in the company's annual report.

[1] Chapter 15, Part E *Corporate Governance Disclosure* of the Listing Requirements.

3.3 INDEPENDENCE OF THE BOARD

3.3.1 State of play

Boards are expected to be active and responsible fiduciaries in the exercise of their oversight responsibilities. It is essential for the company to be able to rely on the independent judgement of their boards. Independence allows directors to be objective and to evaluate the performance of the company without any conflict of interest or undue influence from interested parties.

Persons appointed as independent directors must satisfy the definition of independent director set out in Paragraph 1.01 and Practice Note 13 of the Listing Requirements. There are seven criteria for an independent director under the Listing Requirements. In summary, a director needs to be independent of management and free from any business or other relationship which could interfere with the exercise of independent judgement or the ability to act in the best interests of the company.

Although defined by regulatory standards, independence in thought and action should always be evaluated qualitatively and on a case-by-case basis by the collective board. The Listing Requirements states that boards have to give effect to the spirit, intention and purpose of the independence definition. When a person satisfies the said definition, it does not mean that the person will automatically qualify to be an independent director. The director concerned as well as the board must still apply a subjective or qualitative test of whether the said director is able to exercise independent judgement and act in the best interest of the company.

The basis for the presence of an independent voice on the board is to ensure that objectivity in decision-making of the board is achieved and that no single party can dominate such decision-making in the company. To achieve this, each board must have a sufficient number of independent directors which is prescribed by the Listing Requirements as being at least two board members or one-third of the board members, whichever is higher.

The requirement on the number of independent directors is consistent with the rules and requirements set by other Asian countries. The general trend in more developed markets is skewed towards a majority independent composition and is recommended as best practice.

Rules on the number of independent directors on boards of companies in Asia

Country	Exchange Rules/Requirements
Singapore	At least two independent directors
Hong Kong	At least three independent directors
India	At least one-third of the board
Thailand	At least one-third and no less than three

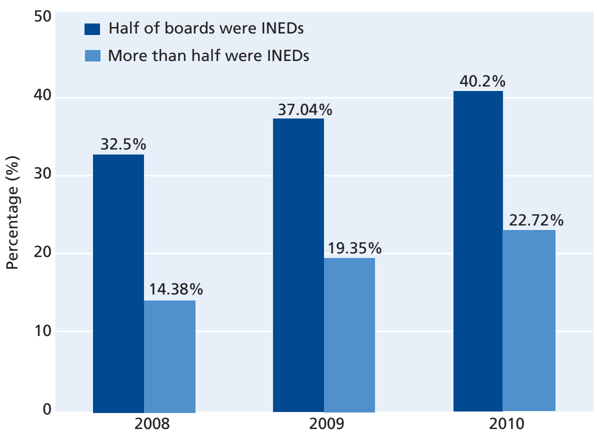
Source: Asian Corporate Governance Association (ACGA) 2010.

Number of independent directors in other jurisdictions

Country	Best Practices
UK	The Combined Code recommends that at least half the board, excluding the chairman, comprises independent non-executive directors (INEDs)
Australia	A majority of the board should be independent directors – 2nd edition, ASX Corporate Governance Council

From the MSWG CG Report, over 40% of our companies have gone beyond the minimum requirements set by Bursa Malaysia. Of this 40%, 22.72% have a majority of independent directors on their boards. The Report observes that the figures have been on an uptrend for the last three years.

Chart 1
MSWG Malaysian Corporate Governance Report 2010
Trend of independence of boards



There is no absolute approach to determining the ideal independent composition of boards. Given the encouraging trend, the one-third independent requirement as the prescribed minimum is maintained and boards are encouraged to exercise judgement in determining the appropriate number of directors which will fairly reflect the interests of their shareholders and other stakeholders.

3.3.2 Case for change

Whether a director is independent is inherently situational and is, more than anything, a state of mind. It is not possible to anticipate all situations in which independence may be compromised as reliance on the qualitative aspects of independence takes it beyond the regulatory standards. In considering independence, it is necessary to focus beyond a director's background, current professional activities, and economic and family relationships. The review should take into account whether the individual can perform a director's duties without being subject to the influence of management.

While the quantitative aspects have been dealt with under the Listing Requirements, the qualitative aspects rest mainly with the boards themselves to assess. The challenge of the qualitative aspects lies in the high degree of subjectivity. Boards in their assessment will have to consider various factors including character, values, and skills of the individual director as well as the given situation.

The board must establish a formal process in the selection of independent directors. The goal is to ensure that the board remains independent and that, collectively, it has the right skills to steer and oversee the company. The process is also intended to ensure that there is no concentration of power in any one group.

There are a significant number of companies with independent directors who have served on boards for long durations of time. This may compromise the independence of the directors. It also raises the question of whether the length of service of an independent director should be considered in an assessment of the board's independence.

Based on the MSWG CG Report, few boards carried out evaluations on independent directors, and amongst those few that did, there is little public disclosure on board assessments.

Intrinsic to our Asian context, there is a sizeable number of companies in the hands of founding families. Given the proximity of controlling shareholders and management of these family-owned companies, issues of related-party transactions and independence can arise. Of particular concern are the strong familial ties between the chairman who helms the board and board members with executive powers.

In order to address these challenges and issues, we have focused our efforts on the following areas:

I. Tenure of independent directors;
II. Independent assessment and disclosure; and
III. Separation of the role of the chairman and the CEO.

I. Tenure of independent directors

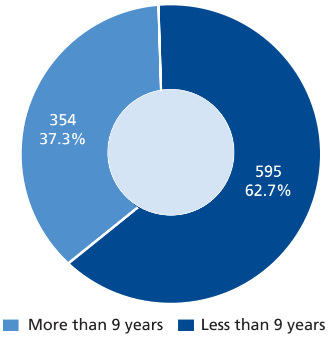
There is no limit imposed by law or recommended as best practice on a director's term of appointment. Under Paragraph 7.26 of the Listing Requirements, every director appointed by the board is subject to re-election by shareholders at the next annual general meeting and each director is subject to re-election at least once every three years.

The *SC Survey on Malaysian Boards 2009* (Survey) reveals that 37.3% of companies had independent directors who served on boards for more than nine years. Long stretches of service may prejudice a director's ability to act independently and in the best interest of the company.

THE SC SURVEY ON MALAYSIAN BOARDS 2009
Tenure of independent non-executive directors (INEDs)

Tenure	No. of companies		Total
	Main	ACE	
INEDs serving more than 9 years	350	4	354
INEDs serving less than 9 years	482	113	595
Total	832	117	949

Main Market and ACE Market



Other jurisdictions generally mandate tenure limits on independent directors serving on financial institutions with an average tenure of nine years. India proposed a six-year ceiling on any persons serving as independent director on a company's board. It also proposed a cooling-off period of three years for an independent director to be reinducted in a company.[2] The Survey reveals that over 60% of our companies have independent directors who have served on boards for less than nine years, while the average length of service across all companies was approximately six years.[3]

Given the potential adverse effects of tenure on independence and the practice of a majority of companies which already recognise this, as well as trends in other jurisdictions, we are of the view that a cumulative term of up to nine years should be imposed on independent directors.

While the position of the independent director is subject to a cumulative term limit of up to nine years, this does not preclude the director from continuing to serve on the board subject to the director's redesignation to non-independent director. In any event, the continuance of service by any director should always be subject to the prior assessment by the board.

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2 *India's Companies Bill 2009.*

3 *SC Survey on Malaysian Boards 2009.*

II. Independent assessment and disclosure

While regulatory standards provide an objective definition of independence, it is incumbent on every board to annually assess the status of the independent directors. In our view, true independence emanates from intellectual honesty, manifested through a genuine commitment to serve the best interests of the company.

Boards themselves should establish a set of criteria for the assessment of all directors including independent directors. In establishing these criteria, attention should be given to the values, principles and skills required for the company. These criteria will serve as a source of reference for prospective and incumbent directors for board assessment. These criteria should also be reviewed regularly to maintain their relevance. This set of criteria should be encapsulated in the board charter.

Boards should be responsible for assessing independence annually, upon readmission and when any new interest or relationship develops. In keeping with transparency, boards should disclose they had carried out the assessment in the company's proxy form and annual report.

III. Separation of the role of the chairman and the CEO

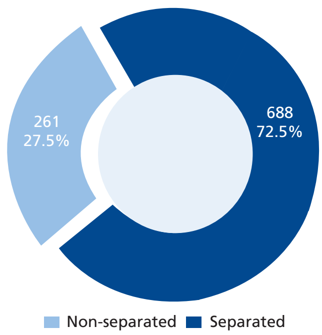
The underlying principle of the division of responsibilities in boards is to ensure a balance of power and authority such that no one has unfettered power of decision. The CG Code recommends the separation of the roles of chairman and CEO and recognises that where the roles are combined there should be a strong independent element on the board and a decision to combine those roles should be publicly explained. Currently, there is no regulatory requirement for the roles of chairman and CEO to be separated.

The Survey found that 72.5% of all the companies reviewed had the role of the chairman and CEO separated.

THE SC SURVEY ON MALAYSIAN BOARDS 2009
Separation of the chairman & CEO

Status	No. of companies		Total
	Main	ACE	
Separated	609	79	688
Non-separated	223	38	261
Total	832	117	949

Main Market and ACE Market



> **"The separation of the roles between the chairman and CEO will allow them to focus on their respective responsibilities."**

While a large majority of companies have complied with the CG Code, 100 or approximately 15% of those companies have strong family presence and direct familial relationships between the chairman and the executives. Combining these positions concentrates too much power in a single person, often the CEO. The cultural holdover from Asia's history has seen CEOs across the region regarded as the highest authority in the company when the CEO is a member of the controlling shareholder's family. This raises concerns on whether the potential for real conflicts of interest exist when the roles are combined and whether there is an appropriate balance of power between the CEO and the independent board members. These situations also give rise to the perception that the independent directors are beholden to the management and are therefore not capable of exercising independent judgement. To reduce the possibility of this occurring, the position of chairman and CEO must be separated and the Chairman must be a non-executive.

Accordingly, the division of responsibilities between the chairman and CEO must be clearly defined and disclosed in the board charter. The separation of the roles between the chairman and CEO will allow them to focus on their respective responsibilities. This is crucial for corporate performance where the chairman focuses on governance and compliance while the CEO focuses on the business and the day-to-day operations of the company.

> *Directing an enterprise through a board is a more difficult form of governance than is commonly supposed. It is a fundamental error to regard committees of any kind as natural forms of governance or to believe that if you sit competent people of goodwill around a boardroom table, they will function as an effective board. Building an effective board takes time and patience on the part of board members, but especially on the part of their chairs. It is the chair's task to weld a group of capable individuals into an effective board team.*

Source: Cadbury, Sir A. (2002), Corporate Governance and Chairmanship. A personal view, Oxford: Oxford University Press.

Strong independent leadership of the board is critical to striking the right balance between ownership and control. An independent chairman will be in a position to marshal the board's priorities more objectively and provide a voice for the independent directors. Encouragingly, the practice of independent chairmanship is gaining wider acceptance among the business community. The MSWG CG Report revealed that 30% of companies had chairs who were independent non-executive directors. Given the trend, a consultation on mandating independent chairmanship will be undertaken.

RECOMMENDATIONS

I. Mandate the limit on the tenure of independent directors

- A cumulative term limit of up to nine years will be imposed on independent directors. Directors may continue to serve thereafter, but will be redesignated as non-independent directors.

II. Mandate assessment on independence and its disclosure

- Boards must undertake an assessment on independence annually, upon readmission and when any new interests or relationships surface – based on a set of criteria established by the boards.
- Boards must disclose in the company's proxy form and annual report that such an assessment has been carried out.

III. Mandate the separation of the position of the chairman and the CEO

- The position of chairman and CEO must not reside with the same person.
- The chairman must be a non-executive member of the board.
- A consultation on mandating independent chairmanship will be carried out.

3.4 COMPOSITION OF THE BOARD

3.4.1 State of play

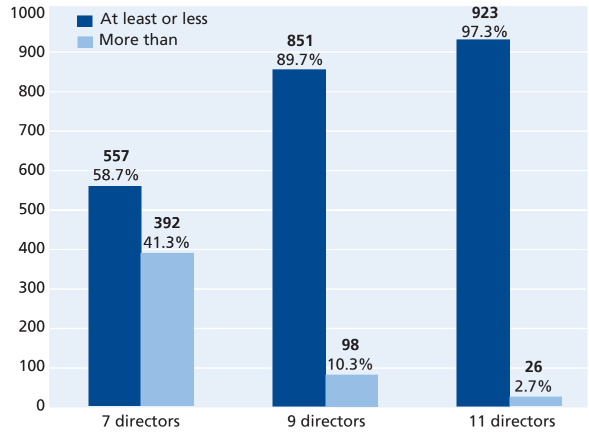
Boards should comprise directors with the requisite range of skills, competence, knowledge and experience as well as diversity of perspectives, to set the context for appropriate board behaviour and to enable them to discharge their duties and responsibilities effectively.[4] Companies which take a strategic view of their board composition will recognise the importance of bringing a wide range of skills and experience to mirror the direction and aspirations of the company.

Companies have to respond to growing complexities, competition and changes to the financial and regulatory landscapes by expanding the expertise of their boards. The CG Code provides the criteria which a Nominating Committee should consider when recommending candidates for directorships as well as places importance on the process carried out by the Nominating Committee in evaluating members of the board, including the independent directors, chairman and the CEO.

[4] ICGN *Global Corporate Governance Principles: Revised (2009).*

An optimal board size needs to accommodate the necessary skill sets and competencies, while promoting cohesion, flexibility, and effective participation. In Malaysia, size varies from board to board, depending on factors such as the nature of business, the size of the company and the board culture. Based on the Survey, the average board size of a Main Market company was seven (7.4) while on the ACE Market it was six (6.4).

Chart 2
SC Survey on Malaysian Boards 2009
Board size



Boards need to regularly examine their size in the context of effective decision-making and define their optimal range or number depending on the type of expertise required and group dynamics. Board size does not seem to be an area of concern. On governance issues, size may be a contributory factor but not the root cause.

3.4.2 Case for change

An ideal board will benefit from a diverse mix of knowledge, background and expertise in its composition. Driven by a progressively complex market place, boards must have the ability to draw on a wide range of viewpoints, skills, expertise and background to make the best decisions.

Experiences drawn from past financial crises and corporate scandals demonstrate that strong boards are distinguished by their calibre, integrity and values. The degree to which a director participates in board deliberations depends to a large extent on the balance between collegiality and creative tension that members of a diverse board bring to bear amongst each other. Judgement is dependent to a large extent on the willingness of the chairman, CEO and other members of the board to hear all points of view. It also depends on the willingness, commitment and courage of the individual directors to speak up. The challenge for companies is to find those directors who are skilled and experienced to provide a healthy scepticism to board deliberations. This is not a straightforward task, for two main reasons.

Firstly, boards in practice do very little to widen their composition. Boards tend to draw members from a close circle of friends or supporters. Often a network of individuals dominates the board resulting in directors' reluctance to question the performance of their peers. As a result, boards have a propensity for 'group think'. The nominating process from within the board could serve to arrest this to achieve a positive outcome and change of attitude on the part of those boards.

Secondly, companies find it increasingly difficult to recruit qualified and competent directors due to a limited pool of such candidates. This issue deserves to be pursued quickly and more appropriately through the private sector. The other contributing factor arises from the much wider recognition of liability associated with being directors today and compensation that does not commensurate with the responsibilities of a director.

To address these issues and challenges, efforts must be directed at the following:

I. Mandating the Nominating Committee;
II. The creation of a directors' registry;
III. A diversity agenda; and
IV. A study on directors' compensation.

I. Mandating the Nominating Committee

Over 90% of companies have established Nominating Committees since it was introduced as best practice. Since then, more attention is being focused on the independence, recruitment, assessment, training, composition and diversity of boards. Given the integral role that the Nominating Committee plays in the assessment of the quality, performance and recruitment of members of the board, there is a need to entrench its position more firmly in the company. As such, the Nominating Committee must be made mandatory.

We also believe that the chair of the Nominating Committee should be an independent director, and where a senior independent director position exists, the senior independent director should assume the position of chair of the Nominating Committee.[5] The senior independent director is best suited to facilitate the Nominating Committee's deliberations on board performance including the succession of the chairman and evaluation of the CEO.

The CG Code encourages companies to identify a senior independent director whose primary function is to facilitate any concerns of the shareholders. Almost 50% of all companies have a senior independent director.[6] Given the increasing demands on the board, chairman and CEO, the senior independent director serves to strengthen a company's relationship and interactions with shareholders.

The Nominating Committee must focus on recruitment, assessment and training. It needs to develop, maintain and periodically review the criteria to be used in the recruitment and screening process that takes into account the diversity of prospective directors including the CEO. The Nominating Committee must conduct an assessment on independent directors annually, upon a director's readmission to the board and when any new interest or relationship surfaces, as well as review the individual director's time commitment and ability to fulfil their responsibilities. The Nominating Committee should also look into the training needs of directors.

II. The directors' registry

Boards must add value by bringing independent and fresh perspectives, setting and meeting goals, and enhancing individual contributions. This can be attained by recruiting board members beyond conventional sources.

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5 The CG Code states that the Nominating Committee should comprise exclusively of non-executive directors, a majority of whom are independent.
6 MSWG CG Report 2010.

An approach to address this is through the creation of a directors' registry. Such registries existing in other countries are administered by the private sector. These bodies manage the registry and offer matching and referral services to companies looking to populate their boards of directors. Strict screening criteria are employed to ensure only qualified candidates are listed in the registry. Consistent with practices in other jurisdictions such an approach can be adopted in Malaysia, driven by the private sector rather than by government or regulators.

III. A diversity agenda

Diversity is a critical attribute of a well-functioning board and an essential measure of good governance. A diverse board facilitates optimal decision-making by harnessing different insights and perpectives and challenging conventional wisdom to enable companies to maximise business and governance performance. Thus diversity signals that the company is well positioned to meet the needs of a diverse market, improving the company's reputation as well as its financial performance.

Board diversity includes experience, skills, competence, race, gender, culture and nationality to ensure that different perspectives are brought to bear on issues. A balanced board in this regard can help dispel stereotyping, make commercial decisions that are aligned to customer and investor needs and catalyse efforts to recruit, retain and promote the best people, including women.

Gender is not the only aspect of board diversity but it has received global attention as an important component of inclusive growth. Investors today are paying more attention to corporate performance in terms of gender diversity. For example, investment funds such as Calpers (US) or Amazone (Europe) include gender diversity among their investment criteria. It has been shown that a company with a critical mass of women leaders is more likely to be well-governed.[7] A 2010 survey of directors[8] concluded that buy-in to corporate governance is significantly more widespread amongst women compared to men.

The MSWG CG Report revealed that over 56% of listed companies did not have any women directors while the remaining had at least one. A closer examination revealed that only 36% of those companies had women on the board as independent directors. The pool of women candidates with a wide range of skills and experience in Malaysia is not small. However, the figures on boards reveal that women continue to remain under-represented forming only 8.2% of all directors on boards of listed companies.[9]

Given the increasing importance of boardroom diversity, boards may wish to establish a policy formalising their approach to diversity. Specifically, boards through their Nominating Committee should take steps to ensure that women candidates are sought as part of their recruitment exercise. In addition, boards should explicitly disclose in the annual report their gender diversity policies and targets, and the measures taken to meet those targets. The goal is for women participation on boards to reach 30% by 2016 and the progress towards this goal will be monitored and assessed in 2013.

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7 *Women Matter,* 2007, McKinsey & Company.
8 Commissioned by Women Corporate Directors (WCD) and Heidrick & Struggles.
9 MSWG CG Report 2010.

IV. A study on directors' compensation

Directors should be adequately compensated for the risks and responsibilities they assume. The compensation information we reviewed suggests that compensation levels in Malaysia lag behind our regional peers.[10]

Remuneration packages should remain competitive to attract and retain talent while being linked to performance. This issue deserves to be pursued and a study undertaken on directors' compensation in Malaysia. Such a study would be appropriately undertaken by the private sector, professional bodies or academia who are proponents of corporate governance.

RECOMMENDATIONS

I. Mandate the Nominating Committee

- All boards must establish a Nominating Committee.
- The chair of the Nominating Committee must be an independent director, and where a senior independent director position exists, the senior independent director is encouraged to assume the chair of the Nominating Committee.
- The role of the Nominating Committee must be enhanced – specific focus areas include recruitment, assessment, training and diversity.

II. Create a directors' registry

- A registry of directors should be created and driven by the private sector. To ensure quality recruits, it should adopt a robust screening criteria, and have in place a process and criteria for registering and deregistering candidates.

III. Mandate the formulation and disclosure of gender diversity policies and targets

- Companies must disclose in their annual reports' policies and targets with respect to composition of women on their boards.

IV. Carry out a study on directors' compensation

- A study to be undertaken on directors' compensation in Malaysia by the private sector.

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[10] PricewaterhouseCoopers (PwC) Malaysia: *Board Remuneration & Practices 2007.*

3.5 COMMITMENT OF BOARD MEMBERS

3.5.1 State of play

The law requires that each director must act in good faith, with a reasonable degree of care and diligence, without self interest, and in the best interests of the company. Similarly the onus is on directors to upgrade their skills set because failure to do so would run the risk of them being liable for failing to exercise reasonable care and skill in directing the affairs of the company.

The law does not prescribe the amount of time that directors need to devote to overseeing the affairs of the company. However the onus is on directors to ensure that they spend sufficient time, for failing to do so can result in directors being in breach of their fiduciary duties.

The Listing Requirements provides the number of directorships that individual directors can hold, and requires disclosure of those directorships. This provides guidance to directors on the time commitment expectation. The Listing Requirements also recognises that directors need to continuously upgrade their skills set, through continuous training.

Over the years, the legal landscape has seen a rising trend in litigation involving directors. This is further underscored by Bursa Malaysia taking increased enforcement action against companies and directors who have breached the Listing Requirements. In 2010, the total number of sanctions was 280 and included reprimands and fines amounting to nearly RM7.5 million.

These responsibilities are not simply about meeting the regulatory requirements. Regulations are by nature not exhaustive and therefore cannot address every conceivable situation. We believe that embracing the law, both in letter and in spirit, is the foundation on which boards' ethical standards can be built.

3.5.2 Case for change

As a result of the increased responsibility of the director, serving on a board has become a significant and onerous commitment, both in terms of time and attention required. Not only must directors participate in board meetings and be willing to serve on committees, they are also expected to dedicate time to reviewing relevant materials and preparing a thoughtful contribution to the discussion and deliberation process.

While a director must be aware of the legal parameters that define their duties in law, individual directors are also expected to commit themselves to ethical and lawful conduct, including the proper use of authority and appropriate boardroom decorum when acting as board members.

Overcommitted directors with multiple directorships are likely to compromise their ability to devote sufficient time to their duties. The lack of attention and focus by directors is a contributing factor to non-compliance with regulatory requirements in a number of enforcement actions. The enforcement actions also revealed that some directors were neither aware of their legal obligations nor understood how to discharge their fiduciary duties.

In our view, there are two major components that need to be addressed:

I. Multiple directorships in listed companies; and
II. Continuing professional development for directors.

I. Multiple directorships in listed companies

Membership on boards represents a significant time commitment and it is expected that directors allocate sufficient time to the company to perform their duties effectively. Under the Listing Requirements, a director is prohibited from holding more than 10 directorships in listed companies.[11] The following table shows that a large number of individual directors hold no more than five directorships.

Number of Directorships	Number of Individuals
1	4,192
2	848
3	245
4	76
5	35
6	22
7	10
8	5
9	3
10	1

Source: Bursa Malaysia December 2010

From the statistics, it appears that the directors have found their own comfort level as the number of directors holding more than five directorships is extremely small. This issue is therefore not about multiplicity of directorships held, but of capacity and commitment by directors. Taking both these points into account, we believe that the number of directorships held in listed companies should be limited to a maximum of five.

A director must also seek the approval of the board which will assess the director's incumbent responsibilities before accepting an invitation to serve on another listed company's board. In tandem with this, the Nominating Committee of the prospective board will be assessing the director's appointment based on its own selection criteria. Boards must disclose that they had carried out the assesment in the company's proxy form and annual report. While it is not necessary to disclose the results of this assessment, there should be disclosure that an assessment has been carried out.

Given that the objective is for individual directors to commit to the board as a whole, the boards should set out their expectations on time commitment and protocols for accepting other external appointments in their board charter.

[11] 15.06 of the Listing Requirements – to be read in conjunction with Part III of Practice Note 13.

II. Continuing professional development for directors

It cannot be overemphasised that today's pace of change is rapid, the complexities of modern business are increasing, and that continuing education and lifelong learning are critical for directors.

The Listing Requirements states that companies must continuously evaluate and determine the training needs that are relevant to their directors. It requires boards to disclose the training programmes they have attended for the financial year in the annual report. Where a director has not attended training, the reasons for non-attendance must be stated.

One of the defining characteristics of professional directors is intellectual honesty. This calls for sustained intellectual and active participation on the part of the director, to remain relevant in the changing business environment. An individual director's commitment to continuing development will foster intellectual honesty which is a crucial part of good governance and is by extension a part of each director's fiduciary duties. Continuing development will equip directors to best serve the interests of the company. The mandatory Continuing Education Programme for directors will be reintroduced.

We believe that it is important to emphasise the significance of continuing education for directors and the urgent need to reintroduce the Continuing Education Programme as a requirement.[12] However, to ensure that progress is evolutionary, we intend for these recommendations to take effect in phases; to first apply to only all new initial public offering (IPO) directors, chairmen and CEOs as well as to all newly appointed directors. It is our expectation that eventually all boards will comply with the above requirements by 2016.

"One of the defining characteristics of professional directors is intellectual honesty. This calls for sustained intellectual and active participation on the part of the director, to remain relevant in the changing business environment."

[12] The mandatory Continuing Education Programme was repealed in 2005. Since then continuing education for directors has been a self-directed process.

RECOMMENDATIONS

I. Limit the number of directorships held by individual directors

- Directors are permitted to serve up to only five listed companies in Malaysia.
- Directors must advise the chairman or senior independent director in advance of accepting any invitation to serve on another company board.
- Assessment through the Nominating Committee, and approval of the existing board is required prior to accepting any new appointments on boards of other listed companies.
- The board must disclose in the company's proxy form and annual report, that such an assessment has been carried out by its Nominating Committee.

II. Set out expectations on time commitment including protocols for accepting other external appointments

- Boards should set out their expectations on time commitment including protocols for accepting other external appointments in their board charter.

II. Mandate continuing professional education for directors

- Reintroduce the mandatory Continuing Education Programme on a phased basis.

Disclosure and Transparency

Chapter 4
DISCLOSURE AND TRANSPARENCY

High quality disclosure for informed decision making

4.1 OVERVIEW

Disclosure of reliable, timely information that is readily accessible contributes to liquid and efficient markets by enabling investors to make investment decisions based on all the information that would be material to their decisions[1].

Disclosure and transparency are critical elements of a robust corporate governance framework as they provide the basis for informed decision-making by shareholders, stakeholders and potential investors with respect to capital allocation, corporate transactions and financial performance monitoring. High quality disclosure, through its influence on investors and lenders who must assess risks and returns and decide where best to place their money, strengthen the efficiency of capital allocation as well as offer the benefit of reducing the costs of capital. Furthermore high quality corporate disclosure provides clarity on the extent to which companies meet legal and ethical requirements.

High quality disclosure and transparency is in fact a prerequisite for the exercise of ownership responsibilities by shareholders. It also helps the public understand the company's activities, policies and performance with regard to environmental and ethical standards as well as the relationship of the company with the stakeholders and communities which are affected by its operation. This is likely to lead to a more conducive environment for the adoption of policies that are oriented towards sustainable growth.

The Global Financial Crisis has demonstrated how poor quality disclosure and lack of transparency can mask excessive risk-taking and leveraging by global financial institutions. Hence, high quality disclosure and transparency not only serves to protect investors but helps regulators in maintaining market confidence and systemic stability.

The strengthening of disclosures and transparency involves actions by a range of market participants, from boards, gatekeepers, influencers and other stakeholders as it covers processes from verification, the determination of information for publication and communication. Quantitative and qualitative corporate information is then disseminated through various periodic reports – such as the annual and quarterly reports, other disclosures and through various media or other stakeholder engagement sessions. Boards and gatekeepers have an obligation to ensure that the statements and supporting

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1 IOSCO (2010), *Principles for Periodic Disclosure by Listed Entities*, Final Report.

information provided are accurate and complete. In this context, the quality of disclosures can be assessed in terms of how useful the information provided is in assisting investors and other stakeholders to make judgements on a comparable basis across a wide range of investment opportunities.

Given the criticality of high quality disclosure and transparency in strengthening corporate governance, it is necessary that a review be undertaken to identify areas for improvement and measures to address gaps. This chapter sets out our recommendations to enhance the standards of disclosure and transparency to promote informed decision-making.

Five pillars of disclosure and transparency

- **Truthfulness** – information disclosed must provide accurate description of circumstances.
- **Completeness** – information disclosed must be sufficient to enable investors to make informed decisions. The information must include financial as well as non-financial matters.
- **Materiality of information** – information disclosed must be material i.e. information which can influence investment decisions.
- **Timeliness** – information disclosed must be timely to enable investors to react as quickly as possible.
- **Accessibility** – information disclosed must be easily accessible, and available to the investors at low cost.

4.2 STATE OF PLAY

Malaysia has long subscribed to the principles of disclosure and transparency and this is encapsulated in various laws and regulations such as the CA and the *Financial Reporting Act 1997* (FRA). The CA requires companies to hold an annual general meeting to approve the audited profit and loss account and balance sheet; as well as reports of the auditors and directors.

The FRA established the Malaysian Accounting Standards Board (MASB) to develop and issue accounting standards. Since October 2005, MASB has published new and revised MASB-approved accounting standards for application in relation to financial statements with a view to providing a true and fair view of the company's financial position and results. These accounting standards prescribe methods for identification of changes to accounting policies and disclosures, alignment of internal management reporting systems with the new rules, and how financial information is to be presented.

In addition, the CG Code emphasises overall accuracy and timeliness of disclosures by listed companies. Boards are required to provide, within an appropriate timeframe, information which is of high quality to encourage more active participation by shareholders in the corporate governance process.

These initiatives were further reinforced through the Listing Requirements which require listed companies to announce relevant financial reports at prescribed intervals and to fulfil continuous disclosure obligations.

In addition to regulations, various non-regulatory initiatives have also been undertaken to promote the quality of disclosures by companies. In 2007, Bursa Malaysia issued an investor relations guide that clarified what constitutes material information and identified potential areas for disclosure of information beyond the minimum reporting requirements.

Work has also commenced to review the *Statement on Internal Control – Guidance for Directors of Public Listed Companies*. The objective of the review is to improve corporate disclosures on risk management systems and internal controls including addressing specific issues such as internal processes to highlight emergent risks to boards. A taskforce co-chaired by the Institute of Internal Auditors Malaysia (IIAM) and the Malaysian Institute of Accountants (MIA), comprising representatives from the SC, Bursa Malaysia, Companies Commission of Malaysia (CCM), professional bodies, industry organisations and audit firms, is undertaking this review.

“In addition to regulations, various non-regulatory initiatives have also been undertaken to promote the quality of disclosures by companies.”

Over the years, various awards aimed at incentivising companies to go beyond minimum reporting have been given to provide due recognition to companies which have demonstrated their commitment to high quality disclosure and transparency. Examples of these awards include the National Annual Corporate Report Awards (NACRA), the ACCA Malaysia Sustainability Reporting Awards (MaSRA) and the Malaysian Corporate Governance Index Award.

On the accounting and audit front, it has generally been acknowledged, as early as 2003 with the OECD's *White Paper on Corporate Governance,* that Asian countries including Malaysia have made significant strides in the area of financial reporting as well as convergence with international standards and practices.[2] Generally Malaysia's accounting and audit practices are identical to global practices and Malaysia will fully converge with the International Financial Reporting Standards (IFRS) from 1 January 2012. The move towards a universal accounting language allows measurement and reporting on corporate business performance to be fully comparable on a global basis.

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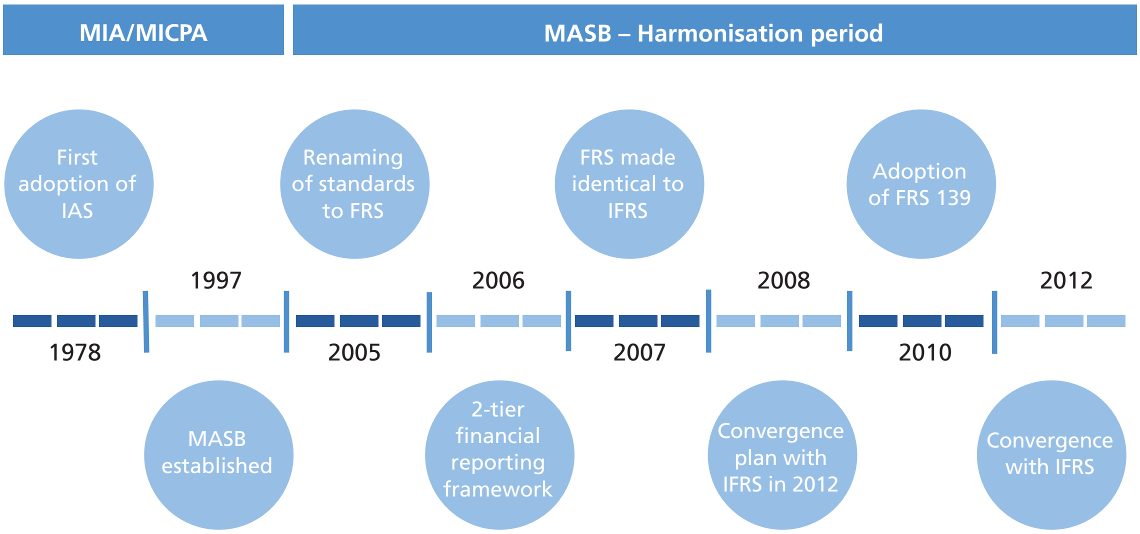
2 OECD (2003), *White Paper on Corporate Governance*, page 37.

Key Malaysia IFRS convergence milestone



IAS	International Accounting Standards
MICPA	Malaysian Institute of Certified Public Accountants
MIA	Malaysian Institute of Accountants
FRS	Financial Reporting Standards

4.3 CASE FOR CHANGE

Beyond minimum reporting

The OECD in its 2011 corporate governance report[3] highlighted that companies have a poor understanding of the merits of greater disclosure and are not convinced that greater disclosure enhances their value. The report observes that companies generally adopt a "boilerplate" approach in their disclosure practices, complying in form rather than substance. To achieve quality disclosure and transparency, it is important that companies are encouraged to make a concerted effort to move beyond meeting the minimum reporting requirements.

The CG Code currently sets out best practices where companies are required through the Listing Requirements to state in their annual report, the extent to which they have complied with the CG Code and to explain the circumstances for any departure. However, we have observed that Malaysian companies tend to adopt an approach whereby compliance with the CG Code is merely declared, with little or no explanation being provided on the extent of compliance.

[3] OECD (2011), *Corporate Governance in Asia: Progress and Challenges, Corporate Governance*, page 50.

In this regard, while the CG Code already expects companies to go beyond the "comply or explain" standard and allows companies the flexibility to develop their own approaches to corporate governance, most boards seem to adopt an approach of ensuring minimum compliance rather than using the flexibility to observe higher standards of governance.

Towards this end, a review will be undertaken to enhance disclosure practices to facilitate a shift from mere conformity towards promoting greater focus on substance in terms of meeting corporate governance requirements. This will include providing more specific requirements for companies to explain how they have applied the principles and best practices of corporate governance.

"Apply or Explain" Approach

In countries such as South Africa, there has been a migration from the "comply or explain" approach to that of "apply or explain". In the *King Report on Corporate Governance for South Africa* (King III Report) adopted by South African listed companies, the "apply and explain" approach requires a greater consideration of how a principle or a recommended practice is applied. Where a listed company has applied the code and best recommendations in the report, a positive statement to this effect has to be made by the board. However, if a board concludes that applying a recommended practice is not necessarily in the best interest of the company, it may apply a different practice provided that it explains the practice adopted and its reasons for doing so. The "apply or explain" principle therefore allows a company to apply the principles of the code as it best meets the objectives of the company and to focus on the substance rather than on the form of application.

Timeliness of information

The value of information, especially financial information, declines over time. The older the information, the less relevant and reliable it is. Therefore, shareholders and other stakeholders must receive information in a timely manner in order to make informed decisions.

Furthermore the capital market industry today is markedly different with the advancement of technology changing the way we communicate and interact with each other. The internet and proliferation of communication devices now allow massive amounts of information to be widely disseminated and shared by investors on a real time basis. While these technologies are widely utilised by information vendors, media and analysts, companies have generally been lagging in terms of their use of new technologies in communicating with their shareholders and stakeholders. In many instances, shareholders and other stakeholders seem to receive information pertaining to a company from media commentators and analysts even prior to companies issuing formal announcements under listing obligations.

Towards this end, there is a need to encourage the wider usage of information technology by companies in communicating with their shareholders.

In addition, there is also a need to consider reducing the timeframe for dissemination of certain information to shareholders. Currently, the timeframe for the submission of quarterly and annual reports is two months and six months respectively. To ensure investors receive critical information in a timely manner, there is a need to consider the possibility of shortening the submission period for these reports.

Relevancy of Quarterly Reporting

In 1999, Bursa Malaysia (then known as the Kuala Lumpur Stock Exchange) introduced the requirement for listed companies to disclose quarterly financial reports within two months from the end of every financial quarter. The introduction of quarterly reporting was aimed at restoring investors' confidence in the aftermath of the Asian Financial Crisis.

Over the years, the merits of quarterly reporting have been debated, with some commentators arguing that a quarter may not provide a long enough period to draw a conclusion about a company's financial position or performance. There are concerns that quarterly reporting promotes a short-term view and are therefore less reliable than half-yearly reporting and that the shorter time period lends itself to manipulative reporting particularly given that these results need not be audited by an external auditor. Countries such as the UK, Australia and New Zealand continue to require companies to report on a half-yearly basis while the European Union issued the European Union Transparency Directive in July 2007 which promotes half-yearly reports combined with Interim Management Statements issued between reporting dates.

While quarterly reporting had been useful in terms of restoring investor confidence following the Asian Financial Crisis, a comprehensive review will be undertaken on the periodic submission of financial reports with a focus on whether to retain the current practice of quarterly reporting.

Enhancing disclosures in relation to general meetings

Quality and timely information on proposed resolutions before general meetings are important to shareholders as it assists them in making informed decisions when exercising their voting rights. In this regard, the use of boilerplate legalistic statements in notices or circulars given to shareholders do not assist them to deepen their understanding of issues and the implication of their decision in voting for or against a resolution. In addition, although the law prescribes various minimum notice periods, this may be insufficient for shareholders to prepare themselves to participate actively in meetings. Companies should, where possible, be guided by international best practices and give longer notices than the minimum prescribed by law. As a reference, the Asian Corporate Governance Association (ACGA) benchmark for best practice in this area is 28 days or more for annual general meetings.

To enable more active participation in shareholder meetings, a review will be undertaken to identify measures that will encourage companies to provide shareholders with clear, comprehensible and timely information through notices and documents. The review will also cover approaches to encourage companies to serve notices for meetings earlier than the minimum notice period provided by the CA.

Effective disclosure of non-financial information – towards integrated reporting

The rise of ethical consumerism and shareholder activism have led to increasing demand for more detailed disclosure of non-financial information so that companies can be more accountable to a broader base of stakeholders. The landscape changes signify that companies can no longer rely solely on their financial performance as an indicator of their overall performance, and need to enhance their reporting of non-financial information. However, progress in ensuring more effective disclosure of non-financial information has generally lagged the improvements in the reporting of financial information.

In this context, companies now need to provide a better account of the effects and outcomes of their business strategies and practices on external stakeholders as well as indicate more clearly their commitment towards environmental, social, governance and sustainability agendas. There is also increasing demand for companies to disclose not only how their activities can benefit communities but also for them to demonstrate their awareness of the negative impact of their business operations and to outline how they intend to manage the negative externalities.

> “...companies now need to provide a better account of the effects and outcomes of their business strategies and practices on external stakeholders...”

Under the current Listing Requirements, companies are only required to disclose in their annual report a description of the corporate social responsibility (CSR) activities or if there is none, a statement to that effect.[4] Although companies generally comply with this requirement, there is still a gap in that companies do not provide an assessment of the impact of their business operations on communities. Countries such as Australia, Canada, South Africa, Norway and Denmark have started to move from CSR reporting towards integrated reporting.

[4] Appendix 9C, Contents of Annual Report, Listing Requirements.

Integrated reporting involves a disclosure of the company's commitment to the environmental, social and governance (ESG) agenda. Best practices for integrated reporting require that the disclosures convey the positive and negative impact of the company's operations from an ESG perspective and how the company intends to manage the negative aspects of its business operations. Such a commitment by companies is clearly becoming an increasingly important consideration given the rising trend of socially responsible investing. However, given that integrated reporting is a recent development and that substantial preparation is required, the initial approach would be to promote greater awareness of integrated reporting and voluntary adoption by companies.

Integrated reporting

What is integrated reporting?

Integrated reporting refers to the integrated representation of a company's performance in terms of both financial and non-financial results such as through the annual report. Key to such reporting is the linkage between an organisation's strategies, governance and financial performance and the social, environmental and economic context within which it operates. By reinforcing these connections, integrated reporting can help companies gain a holistic overview on the sustainability, social and ethical considerations of their business operations and enable more effective communication with a broader group of investors and stakeholders in relation to a company's business strategies and performance.

The significance of integrated reporting

Current reporting standards such as the International Financial Reporting Standards (IFRS) or US Generally Accepted Accounting Principles (US GAAP) focus narrowly on financial information and do not fully consider the social, environmental and long-term economic context within which the business operates. Some companies have progressed further in producing 'Sustainability' or 'Environmental, Social and Governance' (ESG) reports. However, these reports do not necessarily connect the ESG risks and opportunities with the business strategy and model.

Integrated reporting represents an approach that is aimed at bringing together data that is relevant to the performance and impact of a company in a way that will create a more profound and comprehensive picture of the risks and opportunities a company faces, specifically in the context of the drive towards a more sustainable global economy.

Source: International Integrated Reporting Committee website

RECOMMENDATIONS

I. Move beyond minimum reporting

- New CG code to make explicit the requirement for shareholders to be provided with quality and timely information.
- New CG Code and Listing Requirements to ensure a focus on substance rather than form in meeting corporate governance requirements.

II. Ensure timeliness of disclosure

- Promote better use of information technology by companies to communicate with their shareholders.
- Review the current framework for periodic disclosure of financial and non-financial information, including the shortening of the submission period for quarterly and annual reports.

III. Enhance disclosure for general meetings

- Identify measures to encourage companies to provide better quality and timely information through notices and documents.
- Identify measures to encourage companies to serve notices for meetings earlier than the minimum notice period.

IV. Promote effective disclosure of non-financial information

- Establish a taskforce to review developments in integrated reporting and to promote awareness and its adoption by companies.

Role of Gatekeepers and Influencers

Chapter 5

ROLE OF GATEKEEPERS AND INFLUENCERS

Recognising and supporting the role of professionals in corporate governance

5.1 OVERVIEW

The effectiveness of the board in ensuring that all decisions are in the best interest of the company lies at the heart of good corporate governance. Boards however do not function in isolation. They often rely on professionals both within and outside the company, to approve financial statements, interpret laws, assess the company's internal controls and state of compliance, advise on reliability and quality of disclosures, provide corporate finance expertise and the like. These professionals include company secretaries and internal auditors who are typically employees of the company, as well as parties outside the company such as external auditors, corporate advisers, lawyers, rating agencies and valuers. The independence, integrity and professionalism of these advisers are critical in ensuring that decisions made by the board are in the best interest of the company. While the failure of these professionals in carrying out their responsibilities can have adverse consequences on the company, undue or misplaced reliance on them can result in boards being complacent and dependent.

While significant efforts have been pursued in Malaysia and elsewhere to improve the independence and professionalism of external auditors, the ability of the other professionals to influence corporate governance standards has perhaps not been fully recognised. Generically referred to as "gatekeepers", this Blueprint acknowledges the important role that these professionals can play in influencing corporate governance standards and improving corporate governance culture. Consistent with our focus on self and market discipline, these gatekeepers can help lighten the burden of regulatory discipline on companies as well as regulators.

Other than the gatekeepers there is another group whose role and influence in improving corporate governance must also be recognised. Unlike the gatekeepers this group does not have explicit nexus with companies or their boards but they have an important role in promoting corporate governance through their ability to influence public opinion and to highlight poor governance practices. These include the analysts, financial journalists, watchdog groups and other corporate governance advocates. In this Blueprint they are generically described as "influencers" given their ability to influence and shape public opinion on corporate governance issues.

This chapter focuses on the role of these gatekeepers and influencers and how they can contribute towards a culture of transparency, integrity and accountability in companies.

5.2 STATE OF PLAY

5.2.1 Traditional gatekeepers

Company secretaries, internal and external auditors are often viewed as traditional gatekeepers within the corporate governance ecosystem; each has distinct and significant gatekeeping roles with respect to corporate governance. These professionals ensure among others, effective internal controls and auditing mechanisms, and appropriate disclosures, which are central pillars for effective governance of companies.

A company secretary as an officer of the company is accountable to the board. They are best placed to guide boards on proper corporate governance practices given their knowledge and familiarity with the records and charters of the board, the processes and procedures in accordance with the company's memorandum and articles of association, and legal and regulatory requirements. The CA sets out the qualification, duties and responsibilities of a company secretary.

> “Internal auditors focus on risks and controls within the company and therefore have a key role in a company's governance and financial reporting process.”

Internal auditors focus on risks and controls within the company and therefore have a key role in a company's governance and financial reporting process. They should provide independent and objective opinion as to whether risks which may hinder the company from achieving its objectives are being adequately evaluated, managed and controlled. Internal auditors can also advise and advocate improvements to enhance organisational governance structure and practices.

The Listing Requirements and the CG Code underscore the importance of internal audit by mandating this function and requiring listed companies to include information pertaining to this in their annual reports.

External auditors are responsible for auditing the company's financial statements and providing an opinion of the truth and fairness of the financial position as revealed in the accounts. They provide comfort to shareholders and other stakeholders through the assurance that no omissions, material errors or fraud have been detected. External auditors lend credibility to financial reports and reduce risks that reports are biased, misleading, inaccurate and incomplete.

Appointment of auditors is governed by the CA while the establishment of the AOB in 2010 provides the framework for oversight of auditors of public-interest entities which include listed companies.

5.2.2 Transactional gatekeepers

The CA allows directors to delegate powers to, and rely on information or advice provided by, experts, advisers and employees in relation to matters that are within such persons' professional competence or expertise. Depending on the type of expertise required, listed companies may from time-to-time engage the services of corporate advisers, credit rating agencies, lawyers, valuers and other professionals. Hence unlike company secretaries and internal and external auditors these professionals do not ordinarily have a continuing relationship with a company. They are termed as "transactional gatekeepers" in recognition of the fact that their gatekeeping role, whilst important, will be confined to the transactions for which their services have been sought by the company.

Professional advisers are employed by companies to advise on a broad range of areas straddling legal, financing and investment issues. As professionals who subscribe to high standards of ethical conduct, they are expected to minimise or avoid risks to their reputation as well as potential liability by declining to give consent or even withdrawing from advising on transactions that they may consider unethical or illegal. By providing their services to the company these professionals put their reputation at risk. It is for this reason that they are sometimes referred to as "reputational agents".

For purposes of regulatory oversight, individuals and firms who act as corporate advisers are licensed by the SC while rating agencies are subject to registration. Both are governed by guidelines stipulating eligibility criteria and their responsibilities to ensure that they meet the required standards of professionalism and integrity. The SC has also issued guidelines to ensure that the reports and advice issued by credit rating agencies and valuers are transparent and objective and that advice provided on corporate transactions meet required standards.

Dedicated industry bodies have been established by the different professional groups with the objective of continuously upgrading professional standards and capabilities. Apart from issuing codes of conduct and guidelines, some of these industry bodies have the ability to regulate and take disciplinary action against their members.

5.2.3 Influencers

While financial journalists, analysts and watchdog groups do not have a direct role in corporate governance, they nonetheless make a valuable contribution in influencing public and investor opinion on corporate governance-related matters. In this regard, opportunities to broaden their role and to increase their effectiveness in shaping societal norms on corporate governance should be explored.

“While financial journalists, analysts and watchdog groups do not have a direct role in corporate governance, they nonetheless make a valuable contribution in influencing public and investor opinion on corporate governance-related matters.”

> "...important to cultivate a more transparent environment for assessing corporate decisions and transactions."

The influence of the media on corporate governance is evident through their ability to report, analyse and debate corporate decisions and transactions through the print, broadcast and online media. There appears to be considerable demand for financial news in Malaysia given the numerous media dedicated to business and finance reporting. Some highly-regarded journalists have established a credible reputation and are avidly read and their views and advice are followed by the investing public.

Apart from reporting and providing commentaries on corporate developments, financial journalists can be encouraged to assume a more significant role in increasing public awareness and influencing opinion on corporate governance through more frequent coverage and in-depth analysis of issues.

Over the years, journalists have played a significant role in highlighting governance failures and managerial malfeasance based on information from whistleblowers or from their own investigations. In several instances, early media exposure of suspicious transactions has prevented potential losses to the company when dubious transactions were aborted following public outcry. It is therefore important to cultivate a more transparent environment for assessing corporate decisions and transactions. Explicitly profiling the actions of companies, boards and individual directors through well researched articles and analysis can prevent ill-considered decisions and can deter others who may be considering schemes of a similar nature.

The terms "financial analysts" and "securities analysts" are often used interchangeably. While operating at arms-length from companies, they can have a substantial influence on retail and institutional investors as well as the general public through their analysis and research reports of the company. Given their in-depth knowledge of companies and the related industries, their role can be expanded to assessing corporate governance issues.

Watchdog groups which provide voting advice and proxy services are also "influencers" of corporate governance. Groups such as the MSWG have played an active role in highlighting issues in the media and at general meetings. They also play a useful role in alerting and educating retail investors by scrutinising and questioning decisions made by companies. Through actively raising issues for clarification by boards, watchdog groups act as the conscience of the companies and assist in raising the standards of transparency and disclosure.

5.3 CASE FOR CHANGE

5.3.1 Empowering gatekeepers

Typically, gatekeepers are paid by the party they are expected to monitor which is the company. While company secretaries and internal auditors are usually employees of the company, external auditors, lawyers and corporate advisers, credit rating agencies and other professionals are paid fees for the services they render to the company. Some of these professionals may over time develop close relationships with, and some degree of business dependency on, these companies. This may result in a lack of incentive for them to serve as vigilant gatekeepers, or worse, could result in their independence and professionalism being compromised. Over the years significant changes have been introduced to address some of these issues. The establishment of the AOB, the introduction of mandatory whistleblowing obligations for auditors, the protection accorded to certain categories of whistleblowers from within the company, the regulation of credit rating agencies, are all intended to enable these professionals to be more effective gatekeepers.

The critical role that gatekeepers can play in ensuring good governance is well documented. The 2009 *KPMG Fraud Survey Report* shows that 55% of respondents indicated internal controls were the most common method of fraud detection, followed by notification by employee (33%), internal audit review (30%) and notification by customer/supplier (25%). Anonymous letters or whistleblowers (25%) were also a major source of information on fraud.

It is therefore important that any impediments which prevent these professionals from acting as effective gatekeepers are addressed. In this regard, section 320 of the CMSA already imposes a mandatory duty on auditors to report breaches of securities laws. The law also provides protection to key officials of a company who whistleblow. These changes have had positive results as between 2007 and 2010, 34 cases were referred to the SC by whistleblowers pursuant to the CMSA.

It is thus appropriate and timely to consider amendments to the CMSA for the purposes of expanding the mandatory obligation for whistleblowing to certain other professionals such as corporate advisors and company secretaries. Considerations should also be given as to whether the statutory protection provided by the CMSA to certain company officials who whistleblow should be extended to others.

“...appropriate and timely to consider amendments to the CMSA for the purposes of expanding the mandatory obligation for whistleblowing to certain other professionals such as corporate advisors and company secretaries.”

5.3.2 Enhancing the role of company secretaries

Over the years, the role of company secretaries has changed from the traditional passive role of preparing the minutes of meetings to a more proactive and strategic role. Increasingly, company secretaries are being consulted by boards on procedural and regulatory requirements. Company secretaries can also play a role in the induction of new directors, and in assisting the chairman of the board in determining the annual board plan and the administration of other strategic issues.

There is increasing recognition of the need to elevate the position and function of company secretaries to allow them take on a stronger role in promoting governance within companies. For this purpose the CG Code should articulate the role of company secretaries in corporate governance.

"There is increasing recognition of the need to elevate the position and function of company secretaries to allow them take on a stronger role in promoting governance within companies."

In the light of the increasing complexity of businesses and the regulatory environment, it is recommended that the relevant professional bodies look into qualification requirements needed to raise the skills and professional standards of company secretaries of listed companies.

5.3.3 Taking responsibility in corporate transactions

Different professionals involved in corporate advisory work are governed by their respective professional bodies or industry associations. As a result common issues relating to their corporate advisory services may be dealt with differently by different groups. Notwithstanding the existing regulations and industry association guidelines on the qualifications and responsibilities of corporate advisers, there is a need to establish a responsibility sharing arrangement among those who are involved in corporate transactions. The responsibility sharing arrangement should clearly set out the respective roles and responsibilities of each professional in corporate transactions. To facilitate this, the SC will initiate a detailed review of the current approach adopted by advisers in corporate transactions and provide appropriate guidance.

5.3.4 Recognising the role and influence of the media

Given the important role of the media in influencing corporate governance culture, it is vital that bespoke corporate governance programmes be developed to meet the needs of financial journalists to equip them with specialised knowledge to expand their role in promoting good corporate governance. One commonly cited programme is the Media Training Programme conducted by the Global Corporate Governance Forum in partnership with the Thomson Reuters Foundation. It covers different areas important for investigative reporting on corporate governance and perspectives on corporate governance from industry leaders, capital markets professionals, regulators and foreign institutional investors.[1] There is room for collaboration with industry associations or bodies to develop similar programmes for financial journalists in Malaysia.

The important work undertaken by financial journalists in highlighting corporate governance issues and their contribution towards educating the public on corporate governance deserves due acknowledgment. Towards this end, the provision of awards and scholarships for outstanding financial journalists in promoting corporate governance should be considered.

5.3.5 Ensuring integrity and ethical conduct

Gatekeepers must serve the broader interests of the public and contribute to promoting a culture of good governance while they serve the interests of their clients. In this context, gatekeepers in the discharge of their roles and responsibilities must aspire to a higher standard of professionalism beyond fulfilling the requirements of the law and expectations of clients.

The independence and objectivity of gatekeepers may be compromised due to long standing relationships with clients. Conflicts of interests may also affect the independence of their advice. Similarly, gatekeepers who have access to confidential price-sensitive information could seek personal gains by dealing in shares using such non-public information.

While the CMSA has strict provisions prohibiting trading by anyone who possesses material information that is not available to the general public (insider trading), nonetheless there is a need to reinforce self discipline by enhancing internal codes of conduct and internal controls of the various categories of gatekeepers and influencers to prevent abuse of market sensitive information and to promote integrity and ethical conduct.

“Gatekeepers must serve the broader interests of the public and contribute to promoting a culture of good governance while they serve the interests of their clients.”

[1] Global Corporate Governance Forum, Winter 2010, Progress Report, pg 12.

RECOMMENDATIONS

I. Expand coverage of whistleblowing provisions

- Explore extending whistleblowing obligations to corporate advisers and company secretaries.

II. Enhance role of company secretaries in corporate governance

- Enhance the role of company secretaries through clarifying their role in the CG Code.
- Relevant professional bodies to look into qualification requirements needed to raise the skills and professional standards of company secretaries of listed companies.

III. Establish a responsibility sharing arrangement for corporate advisers

- The SC to initiate detailed review of the current approaches adopted by corporate advisers in advising on corporate transactions.

IV. Enhance role of media in corporate governance

- Develop corporate governance training programmes for financial journalists.
- Encourage the provision of awards and scholarships for outstanding financial journalists in promoting corporate governance.

V. Enhance internal codes of conduct and internal controls of gatekeepers and influencers to prevent the abuse of market sensitive information, and to promote integrity and ethical conduct

Public and Private Enforcement

Chapter 6
PUBLIC AND PRIVATE ENFORCEMENT

Complementary roles of public and private enforcement for market confidence

6.1 OVERVIEW

Good corporate governance is shaped by the complementary and interdependent efforts of all stakeholders. The efforts of regulators in strengthening the legal and regulatory framework and ensuring effective supervision and enforcement are just one part of the overall measures required to strengthen corporate governance. Companies, shareholders and reputational intermediaries need to step up their efforts in exercising their respective responsibilities for ensuring good governance. In this context, self and market discipline must complement regulatory discipline to ensure integrity, confidence and fairness in the markets.

Regulatory discipline is no substitute for the need for capital market participants to govern themselves responsibly. The cost to the market of over-dependence on regulatory discipline can be disproportionate to the benefits. It can result in regulations being overly prescriptive, additional costs to the market and may fester a box-ticking culture. For this reason the SC is always guided by the principle that there should be no more regulation than necessary. This means however that all stakeholders must make determined efforts to act responsibly and to pre-empt and mitigate failures.

Market discipline must disincentivise poor corporate conduct through its assessment of corporate performance as reflected in stock prices, bond spreads and credit ratings. Companies must embrace the need for ethical practices, and directors must discharge their fiduciary duties by ensuring integrity, transparency and accountability. Above all, shareholders must empower themselves to be more assertive in demanding corporate accountability. Where there is failure in such obligation, action must be taken.

Effective public and private enforcement reinforces self discipline as the real threat of legal action compels companies to tighten their governance processes to ensure conduct consistent with the law.

In this regard, Malaysian laws empower shareholders to seek civil remedies through private enforcement actions. However it is generally observed that the passive nature of shareholders, paired with a habitual reliance on regulators to detect wrong-doing and initiate investigations, puts the burden of enforcement solely on governmental bodies[1].

1 Organisation for Economic Co-operation and Development (OECD), 2011, *Corporate Governance in Asia: Progress and Challenges, Corporate Governance*.

Thus while regulators ensure market confidence by pursuing enforcement action against those who breach the laws, and the SC has wide enforcement powers in this regard, it is essential that measures are introduced to encourage the institution of private enforcement actions by shareholders.

This chapter sets out recommendations to incentivise private enforcement actions to complement public enforcement.

6.2 STATE OF PLAY

Corporate governance transgressions may involve breaches of various laws, regulations and guidelines. These include the CMSA administered by the SC, the CA administered by the Companies Commission of Malaysia (CCM), the *Banking and Financial Institutions Act 1989* administered by Bank Negara Malaysia (BNM), the *Penal Code* which is enforced by the Police and the *Malaysian Anti-Corruption Commission Act 2009* which is enforced by the Malaysian Anti-Corruption Commission (MACC). The stock exchange, Bursa Malaysia, is responsible for ensuring compliance with its Listing Requirements by listed companies.

Enforcement in respect of corporate governance-related offences is therefore undertaken by various enforcement agencies. The agencies have put in place formal and informal mechanisms and arrangements to ensure co-ordinated enforcement. These include joint investigations, sharing of investigation findings and instituting joint charges where offences cut across two or more enforcement agencies.

Over the years, Malaysia has undertaken a series of reforms to strengthen its laws to ensure effective enforcement. These reforms include enabling the SC to pursue civil action for market misconduct offences and empowering individuals to pursue civil action against those who have committed market misconduct offences. In 2010, the SC's powers were widened to enable it to prosecute company directors and officers for causing wrongful loss to the company.

That same year saw the establishment of the AOB. The AOB's mission is to oversee the auditors of public-interest entities and to protect the interest of investors by promoting confidence in the quality and reliability of audited financial statements of public-interest entities which includes listed companies.

Auditors have access to critical financial information and are best placed to detect any corporate misdeeds or breaches of securities laws. Public enforcement efforts were considerably improved after 2003 when securities laws were amended to impose a duty on statutory auditors of listed companies to report breaches of securities laws to the SC[2]. The SC has successfully prosecuted several cases as a result of auditors reporting wrongdoings pursuant to this statutory duty. Auditors have statutory protection against defamation suits for any report submitted by them in good faith and in the intended performance of any duty imposed on them under securities laws[3].

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[2] Section 320 CMSA.
[3] Section 320(2) CMSA.

Additionally securities laws also extend protection to key employees of the company who are privy to critical information, such as the CEO, officers responsible for preparing or approving financial statements, company secretaries and internal auditors.[4] This statutory protection which has seen officers coming forward voluntarily to report breaches of securities laws to the SC, has also led to several successful prosecutions.

The duty to report and protection afforded under securities laws also complement the statutory duty imposed by the CA on auditors to report to the CCM as well as the statutory protection afforded to those who report breaches of the CA to the CCM.

Enforcement action takes time to conclude, not least because of the long queue of cases awaiting hearing in the courts. With the view to expediting prosecution involving white collar crimes, corruption and market misconduct offences, four dedicated sessions courts have been assigned to hear such cases. The first two courts were established in 2004 and another two courts were added in 2009. In September 2009, the High Court established two new commercial courts which are dedicated to hearing commercial cases involving banking, finance and insurance matters.

Under common law, when a wrong is committed against the company it is only the company that can institute an action for that wrong. In such a situation, shareholders do not have *locus standi* to institute an action unless they can establish to the court that the wrong committed was a fraud on the minority. These requirements discourage shareholders from taking action to remedy wrongs that were committed against the company. In 2007, the CA was amended to enable shareholders to institute action on behalf of the company by providing shareholders with the ability to institute statutory derivative action.[5]

“In 2007, the CA was amended to enable shareholders to institute action on behalf of the company by providing shareholders with the ability to institute statutory derivative action.”

The CA also enables shareholders who are oppressed or treated unfairly to petition the court for a remedy to bring an end to the oppression or unfair treatment.[6] The CA also allows shareholders to petition the court for an order to wind-up the company on grounds which can include that it is just and equitable for the company to be wound up or that the directors have acted in the affairs of the company in their own interest.[7] Furthermore, the company's constitution which comprises the memorandum and articles of association has the effect of a contract that is entered into between the company and its shareholders and if the company does not observe its constitution the shareholder can seek an order from the court to enforce the constitution[8]. Apart from these actions shareholders can also claim remedies against the company for any tort that is committed by the company against shareholders.

4 Section 321 CMSA.
5 Sections 181A, 181B, 181C, 181D, 181E CA.
6 Section 181 CA.
7 Section 216 and 217 CA.
8 Section 33 CA.

6.3 CASE FOR CHANGE

6.3.1 Private enforcement

Private enforcement actions involve actions taken by private parties to pursue civil remedy. In addition to tort and contract-based actions, private actions by shareholders in the context of corporate governance can include the following:

- Instituting statutory derivative action against those who have wronged the company; and
- Petitioning the court for a remedy where the affairs of the company are being conducted oppressively or prejudicially against shareholders' interests.[9]

The right to institute private enforcement action is well established. However, there are impediments that discourage shareholders from pursuing such actions, thus perpetuating their reliance on public enforcement.

A statutory derivative action enables a shareholder to institute an action on behalf of the company against any persons who have wronged the company. Despite the availability of this avenue of recourse, there has only been one reported case of statutory derivative action. This may be attributed to the high cost of pursuing such action and the fact that any remedy obtained from a derivative action goes directly to the company.

The need to promote private enforcement actions by shareholders has also caused some common law countries to consider facilitating shareholders class action. Shareholders class action is not a cause of action but is a procedure to facilitate private action. Through class action, individual shareholders aggregate their common claims and pursue the action as a group. In a class action, shareholders will enjoy the fruits of a successful litigation.

"Through class action, individual shareholders aggregate their common claims and pursue the action as a group. In a class action, shareholders will enjoy the fruits of a successful litigation."

In Malaysia, class actions are provided for by the *Rules of High Court 1980*[10]. However, the high cost of litigation and the absence of a contingency fee framework do not provide shareholders with the economic incentive to pursue class actions. A contingency fee arrangement involves a client agreeing to pay their lawyer a specified percentage of any verdict or settlement. If the case is lost, the lawyer usually gets nothing.

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[9] Section 181 CA.

[10] Order 15 rule 12 of the *Rules of High Court 1980.*

The "cost follow event" rule which results in the losing party paying the winning party all costs, applies to both derivative and class actions. This rule is also a powerful disincentive to shareholders in instituting derivative or class actions.

In order to overcome these constraints and to provide greater recourse to remedy for wrongdoings, there is a need to explore means of funding private actions. Some common law-based countries have removed barriers to the funding of litigation by a third party by eliminating old common law doctrines of "champerty" and "maintenance". Champerty is the process whereby one person bargains with a party to a lawsuit to obtain a share in the proceeds of the suit. Maintenance is the support or promotion of another person's suit initiated by intermeddling for personal gain.

In common law jurisdictions, litigation funding by third party is frowned upon because it goes against the doctrines of "champerty" and "maintenance" and therefore is against public policy. Firstly, litigation funding by third party may be speculative in nature and can result in abuses of court processes by inviting frivolous and vexatious litigations. Secondly, such funding may also foster a litigious culture. Finally, there are also concerns pertaining to potential conflicts of interest that may arise between the funder and the funded litigants.

Whilst this may be the case, in 2006, the High Court of Australia in *Campbells Cash and Carry Pty Limited v Fostif Pty Ltd* (2006) 229 CLR 386, had the opportunity to consider the legality of litigation funding. The court held by a majority that litigation funding was not an abuse of process or contrary to public policy.[11]

Further, in some common law countries, government agencies have provided funding to assist investors to institute private actions. This is done with the view to providing access to funding individual plaintiffs who may otherwise have no recourse to the law arising from wrongdoings caused to them.

Access to funding must be considered if we are to motivate private actions by aggrieved parties. Funding of litigation by third parties needs to be studied further in order to facilitate private action. In this regard, a working group should be established to carry out a study on litigation funding.

6.3.2 Quasi public enforcement

There are times where regulators may be compelled to step in the shoes of private individuals seeking recourse through the court systems.

This may arise in any one of the following situations:

- No economic incentive for private parties to proceed with action;
- Limited access to information to support action by private parties; or
- Actionable conduct may have impact on wider public interest and market confidence.

[11] The joint judgment of Gummow, Hayne and Crennan J.J. indicated that existing doctrines of abuse of process and the courts' ability to protect their processes would be sufficient to deal with funder conducting themselves in a manner 'inimical to the due administration of justice'.

Under securities laws, there are provisions which enable the SC to initiate actions on behalf of aggrieved individuals. For example, the CMSA enables the SC to institute civil proceedings for market misconduct offences if the SC considers it is in the public interest to do so and the amount recovered from this action may be used to compensate persons who have suffered loss or damage as a result of the defendant having committed a market misconduct offence.[12] The SC has successfully instituted several actions pursuant to these powers, enabling restitution to be made to aggrieved investors. In 2009 for example, the court upon application by the SC, ordered a director of a company who had misused the company's funds for his personal benefit to restitute company funds in the amount of RM2.49 million.[13] The same year also saw the largest settlement in the amount of RM31 million being ordered by the court to restitute individuals who have suffered losses as a result of an internet investment scam.[14] In 2010, 14 foreign investors were restituted RM2.2 million by a court order following the SC's cross-border investigations involving an investment scam.[15]

The CMSA also provides the SC with powers to disqualify unfit directors and CEOs of listed companies. For example, the SC may apply to the court to remove a director or a CEO who has been convicted of an offence under securities laws.[16] In these situations, allowing such persons to continue serving on the company may be detrimental to the interest of the shareholders.

In Hong Kong, the power to assist aggrieved individuals has been further widened to allow the Hong Kong Securities and Futures Commission (HKSFC) to petition the court for a remedy where the affairs of a listed company are being conducted in a manner which is oppressive or unfairly prejudicial to the interest of its shareholders[17]. In such circumstances, the court can make any order it considers appropriate to bring an end to the oppression or unfair prejudice. In a recent exercise of its powers pursuant to this provision, the HKSFC petitioned the court for an order compelling a company to sue its delinquent directors for damages for breach of fiduciary duties and conduct unfairly prejudicial to the interest of the shareholders by entering into transactions which resulted in significant losses. The court in that case ordered the company to recover the losses attributable to the alleged misconduct.[18]

The Hong Kong case illustrates the instances where regulators may be compelled to initiate action on behalf of shareholders to reinforce public confidence in the market. While such powers to petition the court can reinforce self discipline and ensure fair treatment of shareholders, there may be possible drawbacks. Firstly there is concern over regulators running the risk of intervening in the affairs of the company and secondly, such actions by regulators may result in shareholders becoming over reliant on regulators to take action on their behalf thus exacerbating the reluctance to institute private action.

To ensure a balanced approach that will engender investor protection and market confidence, the SC will conduct a study on whether securities laws should incorporate a provision to enable it to petition the court for a remedy in cases where the affairs of a listed company are being conducted in a manner oppressive or unfairly prejudicial to the shareholders' interest.

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12 Section 200 CMSA.
13 SC press release, 17 November 2009.
14 SC press release, 13 November 2009.
15 SC press release, 28 April 2010.
16 Sections 318 and 360 CMSA.
17 Section 214 *Hong Kong Securities Futures Ordinance.*
18 Securities and Futures Commission v Cheung Keng Ching and others (18/3/2010) (Hcmp1869/2008).

RECOMMENDATIONS

I. Undertake a study on litigation funding

- Establishment of a working group to study the feasibility of litigation funding by third party to assist investors in instituting private enforcement actions.

II. Undertake a study on initiating action for oppression and unfair prejudice

- The SC to undertake a study on whether it should be empowered to initiate action for oppression or unfair prejudice.

Implementation

IMPLEMENTATION

This Blueprint contains a total of 35 recommendations which will be implemented over a five-year period. In developing the Blueprint, extensive research and international benchmarking were undertaken to ensure that the recommendations are sufficiently robust to bring about positive changes to the Malaysian corporate governance landscape. Intensive engagements and syndications were conducted with both local and international stakeholders to test the reasonableness, efficacy and validity of the recommendations.

The implementation table which follows summarises the recommendations and outlines the means by which the recommendations will be carried out. The recommendations which will be implemented through a new CG Code and changes to the Listing Requirements will be effected in early 2012.

A number of recommendations will need to be examined and further studied through the formation of taskforces and working groups expected to be driven by industry in collaboration with the SC. Legislative changes where required will be worked on accordingly.

The SC will monitor the progress of implementation and where necessary and appropriate, make adjustments to ensure that our objective of achieving excellence in corporate governance is met. This may include fine-tuning of the recommendations and even the addition of new recommendations. Through the collective effort and commitment of all stakeholders, it is envisaged that all the recommendations of this Blueprint will be implemented and our objectives realised. An assessment of the progress of implementation will be undertaken in 2013 and a full post implementation review will be carried out at the end of the five-year period.

“The SC will monitor the progress of implementation and where necessary and appropriate, make adjustments to ensure that our objective of achieving excellence in corporate governance is met.”

We welcome feedback on this Blueprint and invite comments on the recommendations.

CHAPTER 1: SHAREHOLDER RIGHTS

Summary of recommendations	Implementation	
1. Ensure listed companies do not impose any qualitative restrictions on proxy appointment by shareholders and any quantitative restrictions on the number of proxies appointed by shareholders.	This is a new standard and will be effected through changes to the Listing Requirements. Consequently the law may need to be amended to clarify that a body corporate can be appointed as a proxy and that more than one corporate representative can be appointed.	LR L
2. Clarify that where more than one proxy has been appointed by a shareholder, the proxies appointed by that shareholder must not be able to vote by a show of hands.	This is a new standard and may need to be effected through amendments to the relevant laws.	L
3. Impose obligation for the chairman of the general meeting to inform shareholders of their right to demand a poll vote.	This is a new standard and will be effected through the new CG Code and changes to the Listing Requirements.	C LR
4. Mandate poll voting by shareholders for related-party transactions.	This is a new standard and will be effected through changes to the Listing Requirements. A public consultation will be undertaken on whether poll voting should also be mandated for other substantive resolutions.	LR PC
5. Mandate companies to make public their commitment to respecting shareholder rights and take active steps to inform shareholders of how these rights can be exercised.	This is a new standard and will be effected through the new CG Code and changes to the Listing Requirements.	C LR
6. Enable companies to provide information directly to beneficial owners of shares.	A taskforce of industry and regulators will be formed to undertake this.	TF
7. Encourage the use of electronic voting by providing a credible electronic voting platform.	A taskforce of industry and regulators will be formed to undertake this.	TF

LR Listing Requirements | C New CG Code | L Law | TF Taskforce | WG Working Group | PC Public Consultation

CHAPTER 2: ROLE OF INSTITUTIONAL INVESTORS		
Summary of recommendations	**Implementation**	
8. Formulate a new code for institutional investors.	Institutional investors to form a working group to undertake this.	WG
9. Create a dedicated umbrella body for institutional investors.	Institutional investors to form a working group to undertake this.	WG

CHAPTER 3: THE BOARD'S ROLE IN GOVERNANCE		
Summary of recommendations	**Implementation**	
10. Mandate boards to formulate ethical standards and a system of compliance through the company's code of conduct.	To be effected through the new CG Code.	C
11. Mandate boards to formulate strategies that address sustainability and stakeholder interests through internal policies.	To be effected through the new CG Code.	C
12. Mandate formalisation of the board charter and disclosure of the charter in the annual report.	To be effected through changes to the Listing Requirements.	LR
13. Mandate a cumulative term limit of up to 9 years for an individual to serve as an independent director.	This is a new standard and will be effected through changes to the Listing Requirements.	LR
14. Mandate boards to undertake an assessment on independence annually, upon re-admission and when any new interests or relationships surface – based on a set of criteria established by the boards.	This is a new standard and will be effected through the new CG Code and changes to the Listing Requirements.	C LR
15. Mandate separating the position of chairman and CEO and for the chairman to be a non-executive member of the board.	This is a new standard, building on best practices in the current CG Code and will be effected through changes to the Listing Requirements. A public consultation will be undertaken as to whether the chairman should be an independent director.	C LR PC

Summary of recommendations		Implementation	
16.	Mandate boards to establish a Nominating Committee with enhanced roles chaired by an independent director.	This is a new standard, building on best practices in the current CG Code. To be effected through the new CG Code and changes to the Listing Requirements.	C LR
17.	Encourage the creation of industry driven registry of qualified directors based on robust screening criteria.	A taskforce of industry and regulators will be formed to undertake this.	TF
18.	Mandate disclosures in annual reports of policies and targets on women composition on boards.	This is a new standard to be effected through changes to the Listing Requirements.	LR
19.	Undertake an industry study on directors' compensation.	A taskforce of industry and regulators will be formed to undertake this.	TF
20.	Limit the number of listed company directorships held by individual directors to five, and the director to seek approval of the board before accepting any new appointments in other listed companies.	To be effected through changes to the Listing Requirements.	LR
21.	Mandate boards to set out their expectations on time commitment including protocols for accepting other external appointments in their board charter.	To be effected through the new CG Code and changes to the Listing Requirements.	C LR
22.	Reintroduce mandatory Continuing Education Programme	To be effected through changes to the Listing Requirements, starting with directors of new listed companies and new directors appointed to existing listed companies. This will be extended to all directors by 2016.	LR

CHAPTER 4: DISCLOSURE AND TRANSPARENCY

Summary of recommendations		Implementation	
23.	Move beyond minimum reporting by making explicit the requirement for shareholders to be provided with quality and timely information.	To be effected through the new CG Code.	C
24.	Mandate companies to focus on substance rather than form in meeting corporate governance requirements.	To be effected through the new CG Code and the Listing Requirements.	C LR

Summary of recommendations	Implementation	
25. Promote better use of technology by companies to communicate with their shareholders.	To be effected through the new CG Code.	C
26. Review the current framework for periodic disclosure of financial and non-financial information, including the shortening of the submission period for quarterly and annual reports.	A taskforce of industry and regulators will be formed to undertake this.	TF
27. Encourage companies to provide better quality and timely information through notices and documents and to serve notices for meetings earlier than the minimum notice period.	To be effected through the new CG Code.	C
28. Review developments in relation to integrated reporting.	A taskforce of industry and regulators will be formed to undertake this.	TF

CHAPTER 5: ROLE OF GATEKEEPERS AND INFLUENCERS

Summary of recommendations	Implementation	
29. Explore extending whistleblowing obligations to corporate advisers and company secretaries.	To be effected through changes in the law.	L
30. Enhance the role of company secretaries through clarifying their role and look into qualification requirements needed to raise the skills and professional standards for company secretaries of listed companies.	To be effected through the new CG Code and driven by the relevant professional bodies.	C
31. Establish a responsibility sharing arrangement for corporate advisers in advising on corporate transactions.	A working group will be formed to undertake this.	WG
32. Develop corporate governance programmes for financial journalists and encourage provision of awards and scholarships for outstanding financial journalism in promoting corporate governance.	A working group will be formed to undertake this.	WG
33. Gatekeepers and influencers to enhance internal codes of conduct and internal controls to prevent the abuse of market sensitive information, and to promote integrity and ethical conduct.	A working group will be formed to undertake this.	WG

CHAPTER 6: PUBLIC AND PRIVATE ENFORCEMENT		
Summary of recommendations	**Implementation**	
34. Study the feasibility of litigation funding by third parties to assist investors in instituting private enforcement actions.	A working group will be formed to undertake the study.	WG
35. Study whether the SC should be empowered to initiate action for oppression and unfair prejudice.	A working group will be formed to undertake the study.	WG

LR	To be effected through the Listing Requirements	TF	Formation of a taskforce
C	To be effected through the new CG Code	WG	Formation of a working group
L	Amendments to the relevant laws	PC	Public consultation will be undertaken

The SC will put in place a dedicated team to monitor progress of implementation as well as facilitate the taskforces and working groups to be formed under the recommendations. While SC will facilitate and play a leadership role, the success of this Blueprint is dependent upon the collective effort and commitment of all stakeholders in the corporate governance ecosystem.

ACRONYMS AND ABBREVIATIONS

ACGA	Asian Corporate Governance Association
AOB	Audit Oversight Board
Blueprint	Corporate Governance Blueprint
BNM	Bank Negara Malaysia
Bursa Malaysia	Bursa Malaysia Bhd
CA	*Companies Act 1965*
CCM	Companies Commission of Malaysia
CG Code	*Malaysian Code on Corporate Governance*
CG ROSC	World Bank *Corporate Governance Report on the Observance of Standards and Codes*
CMSA	*Capital Markets and Services Act 2007*
CMP	Capital Market Masterplan
Companies	Public-listed companies in Malaysia (also used interchangeably with listed companies)
CRA	Credit rating agency
EPF	Employees Provident Fund
ETP	Economic Transformation Programme
GLC	Government-Linked Companies
INED	Independent non-executive director
IOSCO	International Organization of Securities Commissions
ICGN	International Corporate Governance Network
IFRS	International Financial Reporting Standards
IIC	The Institutional Investor Committee
IIF	Institute of International Finance
Listing Requirements	*Bursa Malaysia Listing Requirements*
MASB	Malaysian Accounting Standards Board
MIA	Malaysian Institute of Accountants
MSWG	Minority Shareholder Watchdog Group
NEM	New Economic Model
OECD	Organisation for Economic Co-operation and Development
RPT	Related-party transaction
SC	Securities Commission Malaysia

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