Recent Developments in Malaysia

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Malaysia's journey to better corporate governance has continued with unabated vigour in the first decade of the new millennium. Sporadic scandals both abroad and in the domestic market have ensured reform efforts have maintained continued momentum and the recent global financial crisis, whilst originating from the more developed markets, serves as a timely reminder that we must continue to intensify the efforts that are currently in development.

After the East Asian financial crisis the focus was on rectifying and strengthening the legal and regulatory plumbing whilst inculcating corporate governance into the corporate psyche of Malaysia – often through regulatory force-feeding measures. Recent efforts were focused on complementing these measures with facilitation of the market and self-discipline.

Strengthening the regulatory framework

2007 saw significant changes to the law which have further strengthened the regulatory framework.

First, the Capital Market Services Act (CMSA), which consolidates part of the Securities Commission Act (SCA), the Securities Industry Act, and the Futures Industry Act, came into force. The CMSA introduced new provisions which widened the enforcement powers of the Securities Commission (SC). Under the CMSA, the SC, through civil actions, can now obtain compensation of up to three times the pecuniary gain made or loss avoided for a range of offences including false trading, stock market manipulations and the use of manipulative and deceptive devices.

The Companies (Amendment) Act 2007 also significantly changed the corporate governance framework. For instance, the 'business judgment' rule and statutory derivative actions were introduced. Statutory derivative actions enable shareholders to institute private actions against persons who have wronged the company and the business. The business judgement rule also protects directors against errors made whilst managing the company's affairs, if they have exercised reasonable care. Furthermore, the requirement for directors to disclose interests in contracts or properties is widened to include the interests of a spouse and children.

The latest enhancements to the law are aimed at strengthening SC's enforcement powers against corporate governance lapses. New provisions of the CMSA are expected to be tabled to Parliament in the last quarter of 2009, which will empower the SC to take action against a director or officer who causes wrongful loss to a PLC or its subsidiary to the detriment of shareholders. A new offence is also created to prohibit any person from influencing, coercing or misleading any person engaged in the preparation or audit of the financial statements of a PLC.

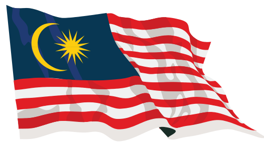
In 2000, Malaysia became the first country in the region to introduce a Code on Corporate Governance. In 2007, revisions were made which were aimed at strengthening the roles and responsibilities of the board of directors, particularly independent directors, and the audit committee to ensure they discharge their duties effectively. This revised Code sets out criteria that the nomination committee needs to consider when recommending candidates, such as the candidate's skills, expertise, experience, knowledge, integrity and professionalism. It also requires the audit committee to comprise exclusively of non-executive directors, the majority of whom are independent and all of whom are financially literate.

The Listing Requirements were also amended to raise governance standards amongst listed issuers and enhance investor confidence. Key amendments include enhancing the function and composition of audit committees and mandating the internal audit function. The Listing Requirements require the internal audit function of listed issuers to report directly to the audit committee and the remit of the audit committee is expanded to include the adequacy and competency of the internal audit function. Disclosures in the annual reports are enhanced to include information pertaining to the internal audit function.

Enforcement efforts intensified

The corporate scandals that have continued to hog the limelight in many markets over the past decade underscore the fact that the work of enhancing corporate governance is never done. Therefore, strong and effective public enforcement and ensuring directors are accountable remain at the heart of the SC's enforcement actions. The SC has adopted a strategic approach to enforcement by focusing on outcomes that protect investors and maintain market confidence. As such, recent years have seen civil and administrative powers used to ensure swift, effective resolutions. Attention is being channeled towards restitution for investors, freezing of assets and the disgorgement of ill-gotten gains.

Criminal prosecution continues in cases of serious corporate fraud and securities law breaches. In 2008, the SC made 20 criminal charges against five directors of PLCs for falsely reporting inflated revenues. One company was directed to remove its Chief Operating Officer for breaching the Takeovers Code. Another director was forced to disgorge profits made to a charitable organization for failure to undertake a mandatory general offer and fines totaling RM600,000 were imposed on two directors. Already in 2009, two



directors have been charged with securities fraud and criminal breach of trust while another three were charged with authorising the submission of misleading statements to the stock exchange. An external auditor of a PLC was also charged with helping the company submit false information to the stock exchange.

Other efforts to fortify the governance ecosystem

Industry efforts to maintain the governance ecosystem that complement regulatory efforts continue. As such, the sharing of responsibility among regulators, gatekeepers (like auditors and advisers), corporations who understand the need to create value for all shareholders, boards who place the interest of the company above their own and investors who understand that they protect their interests best by being vigilant and knowledgeable, is vital.

The lack of an effective audit oversight framework that is independent and comprehensive, in terms of the eligibility of auditors, monitoring compliance, and disciplining errant auditors has raised public concerns about the reliability of audited financial statements. As such an Audit Oversight Board (AOB) is being established through amendments to the SCA which will provide independent oversight over auditors and ensure they comply with prescribed standards when auditing financial statements of PLCs and public interest entities.

In early 2009, the Malaysian Institute of Accountants launched two standard-setting boards. The Audit Assurance Board and the Ethical Standards Board will promote adherence to high quality professional and ethical standards. Along with other industry-driven associations, such as the Malaysian Investor Relations Association, the Malaysian Alliance of Corporate Directors and the Institute of Corporate Responsibility Malaysia they will contribute to raising the level of corporate governance and corporate responsibility amongst PLCs.

To promote retail and institutional shareholder activism, the Minority Shareholder Watchdog Group (MSWG) envisions itself as the premier capital market institution enhancing shareholder activism and protecting minority interest. The MSWG has been actively attending AGMs and voicing concerns of minority shareholders. It has also launched the Malaysian Corporate Governance Index 2009, which aims at ranking plcs on best governance practices. Furthermore, it has embarked on an initiative to create a pool of independent directors for PLCs to source candidates with diverse skill sets from, to be nominated as directors.

Directors are encouraged to attend continuous education programmes in addition to the Mandatory Accreditation Programme they must attend under the Listing Requirements and information relating to this must be disclosed in the annual report. Finally, numerous corporate governance and corporate responsibility awards such as the Malaysian Environmental and Social Reporting Awards by the Association of Chartered Certified Accountants and the Corporate Governance Awards by MSWG are given out each year to exemplary PLCs, setting high standards for others to aspire to.

Challenges

Notwithstanding a robust corporate governance framework in place, there are still obstacles to be overcome, such as:

- some companies persist with the habit of mere box-ticking, focusing on the letter over the purpose, demonstrating a lack of application by the board;
- shareholder activism remains at a nascent stage, and much more can be done by shareholders to ensure that their rights are protected;
- although there is a requirement to report on directors' continuing education activities, many directors still have a lackadaisical attitude towards continuing professional development; and
- many companies have not grasped the true meaning of 'corporate responsibility'. While training and education have alleviated some concerns, there remains the need for more comprehensive reporting, as required by the Listing Requirements.

In response, the stock exchange has just launched the Corporate Governance Guide, a comprehensive and practical tool for directors and management personnel. It is designed to help them better understand their roles and responsibilities, as well as guiding them in fulfilling their obligations.

Additionally, the inaugural 'Corporate Governance Week' in June 2009 provided an opportunity for capital market participants to share insights and develop how governance can be enhanced in light of the current global financial challenges.

The changing capital market landscape offers investors and issuers greater choices as they are now able to explore opportunities in other markets more easily. The presence of foreign investors, issuers and intermediaries in the Malaysian capital market means that PLCs will be closely watched by fund managers, analysts, rating agencies and financial journalists from across the globe. As the Malaysian capital market becomes increasingly interlinked with the global market, it must conform to standards expected in the global marketplace.