MINORITY SHAREHOLDER WATCHDOG GROUP
BADAN PENGAWAS PEMEGANG SAHAM MINORITI BERHAD
(Incorporated in Malaysia – Company No. 524989-M)
The Star – StarBiz Week, 22 February, 2014 **(C)**

The big guys get guidance on governance

Ten things to know about new code for institutional investors

Optimistically Cautious by ERROL OH

THE public consultation on the Malaysian Code for Institutional Investors (II Code) ends this Friday . It would be a shame if few people actually went through the consultation paper, let alone took the trouble to submit feedback.

The Code is a potential game changer. If wholeheartedly embraced and dutifully implemented, it will elevate corporate governance in Malaysia, in the same way that the Malaysian Code on Corporate Governance (CG Code) has done since its introduction in 2000.

In addition, the II Code is expected to have a positive impact on how such investors are run.

The II Code is a product of the Securities Commission's (SC) *Corporate Governance Blueprint 2011* (CG Blueprint), which devotes a chapter to the role of institutional investors.

The CG Blueprint calls on these large investors to take the lead in improving governance because their significant stakes in companies and their deeper expertise and resources allow them to do things that individual investors can't.

The SC points out that institutional investors can 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.

As such, the CG Blueprint recommends the creation of the II Code and that the institutional investors publish their commitment to it.

"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," says the SC.

"It is also important for institutional investors to include governance analysis in their investment appraisal to help identify better governed-companies."

The Minority Shareholder Watchdog Group (MSWG) spearheaded the development of the II Code. The others involved include the leading government-linked investment companies (namely, the Employees Provident Fund, Permodalan Nasional Bhd, Retirement Fund (Inc), Armed Forces Fund Board, Lembaga Tabung Haji and Social Security Organisation), Private Pension Administrator, Malaysian Association of Asset Managers and Malaysian Takaful Association.

The SC and MSWG released the consultation paper on Jan 15. It's available on the MSWG website (www.mswg.org.my). Here are 10 key points about the II Code:

1. The basics

Forming the backbone of the Code are eight broad principles of effective stewardship by institutional investors. The document also offers guidance to help these investors understand and implement the principles. The effective date for reporting on the application of the Code is Jan 1 next year.

2. It's the whole chain

The Code isn't just for the institutional investors; it's also meant to apply to their service providers in the investment chain. In this context, institutional investors are defined as asset owners (such as pension funds, private retirement scheme providers, insurance companies and investment trusts) and asset managers with equity holdings in Malaysian listed companies. The service providers include custodians, proxy advisors, investment consultants and actuaries.

3. Focus on the focus lists

Under Principle 2 ("Institutional investors should monitor their investee companies."), institutional investors are urged to target underperforming companies by coming up with so-called focus lists, which comprise underperforming companies with good potential. The Code explains that by targeting such companies and analysing their corporate governance practices, the investors can push for improvements that can unlock hidden value.

4. Escalating the engagement

Principle 3 encourages engagement, which the Code describes as "purposeful dialogue with investee companies with the aim of preserving or enhancing value on behalf of beneficiaries or clients". Part of this is to engage when there are concerns about the investee companies' financial and operational performance, governance or risk management. The Code sets out various forms of engagement for the investors to make their concerns known. These begin with discussions on a confidential basis but can escalate to airing the issues through public platforms if the companies refuse to make improvements. The worst-case scenario, as envisioned by the Code, is to seek legal remedies or arbitration.

5. When interests clash

Conflicts of interest involving institutional investors are seldom openly discussed in Malaysia. But that doesn't mean they are rare. It's good then that the Code advocates the adoption of a robust policy on managing conflicts of interest, which should be made public. Says the Code: "Institutional investors should seek to avoid conflicts of interest situations. Nevertheless, as conflicts of interest may inevitably arise from time to time, they need to understand, minimise and manage such conflicts in a transparent manner."

6. The lasting effects of ESG

ESG refers to environmental, social and governance. With Principle 5, the Code extends beyond corporate governance matters. It argues that institutional investors are expected to deliver sustainable returns in the long-term interest of their beneficiaries or clients. As such, these investors should take into account both corporate governance and sustainability considerations in their investment decision-making process. These include ESG factors.

7. No secret votes

The Code expects institutional investors to publish their voting policies. "The exercise of voting rights is a key indicator that an institutional investor is effectively implementing its engagement policy," it says. "Publishing a voting policy will give both beneficiaries and investee companies a better understanding of the criteria used to reach those decisions."

8. Band of investors

The CG Blueprint recommends that institutional investors work together to set up an umbrella body so that there is a collective voice and a platform to address governance issues, address impediments and seek solutions. The II Code says the umbrella body is expected to be a platform to discuss stewardship matters and will later take over from the MSWG in monitoring the take-up and application of the Code.

9. Committing to the Code

Each of the eight principles starts with "Institutional investors should...". The mildness of the language is because compliance with the Code is voluntary. It explains: "Institutional investors are encouraged to be signatories of the Code. Institutional investors should explain how they have complied with the principles in this Code, taking into account guidance provided under each principle. Institutional investors are allowed to determine the best approach to adopting the principles, as there is no 'one size fits all' approach to stewardship."

Is there any good reasons for an institutional investor to refuse to sign up? And if there are holdouts, hopefully they will eventually be pressured into doing the right thing.

10. Look inwards as well

The principles of the Code talk about effective stewardship, but this can't be solely about the way the investee companies are governed. What about the institutional investors themselves?

The preamble in the Code has this to say: "Institutional investors should be committed to effective corporate governance in running their own businesses and put in place policies and practices which embody good corporate governance principles and best practices as part of discharging their duties and responsibilities to advance the interest of their beneficiaries or clients.

"Institutional investors should be led by capable board and management with the appropriate capacity and experience to effectively discharge their stewardship duties."

Executive editor Errol Oh is looking forward to the institutional investors wielding their power with more structure, responsibility and transparency.