

MALAYSIAN CODE FOR INSTITUTIONAL INVESTORS



MINORITY SHAREHOLDER WATCHDOG GROUP
BADAN PENGAWAS PEMEGANG SAHAM MINORITI BERHAD



Suruhanjaya Sekuriti
Securities Commission
Malaysia

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FOREWORD

BY TAN SRI DATUK DR SULAIMAN MAHBOB

Chairman, Minority Shareholder Watchdog Group

The development of the Code was spearheaded by the Minority Shareholder Watchdog Group (MSWG) and started a year ago with the formation of a Steering Committee consisting of chief executive officers and key representatives from the institutional investors' fraternity in Malaysia. They are the Employees Provident Fund, Permodalan Nasional Bhd, Kumpulan Wang Persaraan (Diperbadankan), Pertubuhan Keselamatan Sosial (PERKESO), Lembaga Tabung Angkatan Tentera, Lembaga Tabung Haji, Private Pension Administrator, Malaysian Association of Asset Managers and Malaysian Takaful Association.

In addition to extensive discussions held at the Steering Committee, the Code took into account feedback and comments by international corporate governance experts and the public at large through the joint public consultation paper issued in January this year. Though the Code is voluntary, institutional investors are encouraged to be signatories to demonstrate their commitment to adopting these best practices. A good take-up and application of the Code by institutional investors encourages good governance and long-term sustainability of their investee companies which spurs further development of the capital market.

My sincere appreciation to the members of the Steering Committee, Working Group, Expert Group and Observers for their invaluable insights and contributions, Ms Rita Benoy, and the MSWG team who worked on the Code's formulation. I would also like to sincerely thank all the stakeholders who provided their views on the consultative draft and the Securities Commission Malaysia for the support extended throughout the development of the Code.



TAN SRI DATUK DR SULAIMAN MAHBOB

June 2014

MESSAGE

BY DATUK RANJIT AJIT SINGH

Chairman, Securities Commission Malaysia

I am pleased to write this message to mark the significant milestone achieved through this collaborative and collective effort led by the Minority Shareholder Watchdog Group (MSWG) together with Malaysia's largest institutional investors culminating in this Malaysian Code for Institutional Investors (Code).

The formulation of an industry-led Code is a recommendation under the *Corporate Governance Blueprint 2011* to promote leadership in governance and responsible ownership by institutional investors and is a critical building block to realising our goal in moving towards greater self and market discipline. The development of this Code is unique as institutional investors themselves were primarily involved in its formulation; signifying the culmination of the common vision and aspiration of institutional investors who share a passion and commitment to good corporate governance.

Institutional investors are significant influencers of corporate governance practices in their investee companies. Active engagement taken collectively by institutional investors will usher in an ownership culture that ensures management prioritises the best interest of the company at all times. Malaysia's vision of becoming a high-income nation with inclusiveness and sustainability will be realised when there is greater leadership to ensure the delivery of sustainable long-term value for all stakeholders.

I would like to thank members of the Steering Committee, Expert Group, Working Group and Observers for this concerted effort in developing this Code. I look forward to the strong commitment by all stakeholders in this initiative which is an important catalyst to achieving corporate governance excellence.



DATUK RANJIT AJIT SINGH

June 2014

INTRODUCTION

Background

1. In 2011, the Securities Commission Malaysia (SC) issued the *Corporate Governance Blueprint 2011* (CG Blueprint) which outlined strategic initiatives aimed at reinforcing self and market discipline. The *Malaysian Code for Institutional Investors 2014* (Code) is one of the deliverables of the Blueprint.

“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.”

-CG Blueprint 2011-

2. A Steering Committee for the Development of an Institutional Investors Code for Malaysia (Steering Committee) was formed to undertake the formulation of the Code spearheaded by the Minority Shareholder Watchdog Group (MSWG). The Steering Committee was headed by the Chairman of the MSWG while the Working Group was headed by the Chief Executive Officer of MSWG.
3. The members of the Steering Committee comprised CEOs and key representatives from the institutional investors' fraternity in Malaysia namely Employees Provident Fund (Kumpulan Wang Simpanan Pekerja), Permodalan Nasional Bhd, Kumpulan Wang Persaraan (Diperbadankan) (Retirement Fund Incorporated), Lembaga Tabung Angkatan Tentera (Armed Forces Fund Board), Lembaga Tabung Haji (Pilgrims Fund Board), Pertubuhan Keselamatan Sosial (Social Security Organisation), Malaysian Association of Asset Managers (Persatuan Pengurus Aset Malaysia), Malaysian Takaful Association (Persatuan Takaful Malaysia) and Private Pension Administrator (Pentadbir Pencen Swasta).

4. The Code is intended to give institutional investors guidance on effective exercise of stewardship responsibilities to ensure delivery of sustainable long-term value to their ultimate beneficiaries or clients.
5. The terms used in the Code are explained in the Definitions section below.

Definitions

Agents in the investment chain are those involved in the investment process and include the following:

- **Asset owners** are collective investment vehicles which collect funds on behalf of their beneficiaries or clients and manage them internally or externally such as pension funds, private retirement scheme providers, insurance companies, takaful operators and investment trusts.
- **Asset managers** are agents that are responsible to manage the funds on behalf of the asset owners through an investment mandate.
- **Service providers**, such as—
 - (i) custodians are agents responsible for the maintenance and safekeeping of the records both in electronic or paper form of the asset owners' and asset managers' assets, including sub-custodians; and
 - (ii) proxy advisers, investment consultants and trustees are agents that undertake functions mandated by asset owners and asset managers to support their activities.

Institutional investors are asset owners and asset managers with equity holdings in corporations listed on Bursa Malaysia.

Investee companies are corporations listed on Bursa Malaysia.

Stewardship is investor stewardship from the perspective of a long-term institutional investor in particular asset owners such as pension funds.

It includes the responsible management and oversight of assets for the benefit of the institutional investors' ultimate beneficiaries or clients. The discharge of effective stewardship responsibilities would include development of a set of principles/policies, application of the principles/policies, oversight of agents, communications of expectations and reporting to their clients or beneficiaries. These activities also include monitoring and engagement with the investee companies on matters relating to strategy, performance, risk management, voting, corporate governance or sustainability issues.

Role of Institutional Investors

1. Institutional investors are major players in the global economy who can exert significant influence over their investee companies due to the substantial stake they hold. This clout provides them with an opportunity and ability to encourage good governance and appropriate behaviour by their investee companies to ensure delivery of sustainable long-term value for their beneficiaries or clients.
2. The activities of institutional investors include managing and allocating funds, designing investment policies and strategies, awarding investment mandates and monitoring investment activities.
3. 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.
4. Institutional investors should be led by capable board and management with the appropriate capacity and experience to effectively discharge their stewardship duties.
5. Institutional investors should consider acting collectively with other investors where appropriate in areas aimed at promoting good corporate governance. When working with other parties, institutional investors should be cognisant of market regulations, in particular, rules relating to acting in concert and market manipulation.

6. Institutional investors are also encouraged to engage in the development of relevant policies and best practices. This engagement facilitates the inclusion of institutional investors as an important stakeholder group in the design of policies, and may be an efficient and effective way to influence or raise awareness on issues affecting beneficiary or client interest such as matters relating to investee companies or the investment chain.

The Malaysian Code for Institutional Investors

1. The Code is a voluntary code which sets out the broad principles of effective stewardship by institutional investors, followed by guidance to help institutional investors understand and implement the principles.
2. The asset owners' commitment to the Code may be directly applied to their investee companies or indirectly through the mandates given to asset managers. In such instances the asset owners should clearly communicate their stewardship policies to their asset managers. In addition, these institutional investors may also choose to outsource to external service providers some of their stewardship activities. However, they cannot delegate their stewardship responsibility, hence, should ensure that those activities are carried out in a manner consistent with their own approach to stewardship.
3. While corporate governance matters should be the issue of main consideration in the investment decision-making process, the issue of sustainability must equally be considered. In addition to economic considerations, the Code advocates institutional investors to ensure that they invest in a responsible manner by having regard to corporate governance and sustainability of the company. Such an approach is expected to be in the interest of the ultimate beneficiaries in the longer term as part of the delivery of enhanced risk-adjusted returns on investment.
4. Compliance to the Code does not constitute an invitation to manage the affairs of a company or preclude a decision to sell a holding, where this is considered in the best interest of beneficiaries or clients.

Application and Reporting

1. The Code advocates the adoption of standards that go beyond the minimum prescribed by regulations.
2. Institutional investors are encouraged to be signatories of the Code and should explain how they have applied the principles in this Code, taking into account guidance provided under each principle. The guidance is set out in the form of best practice recommendations. Institutional investors are allowed to determine the best approach to adopting the principles, as there is no 'one-size-fits-all' approach to stewardship.
3. Institutional investors are expected to encourage their service providers to apply the principles of the Code where relevant and to conduct their investment activities in line with the institutional investors' own approach to stewardship. Accordingly, service providers are also encouraged to be signatories of the Code.
4. Signatories of the Code are expected to report annually on their application of the principles of the Code in their website, annual report or in other accessible forms. Signatories are encouraged to review their policy statements annually, and update them where necessary to reflect changes in actual practice. It should include contact details of an individual who can be contacted for further information.
5. It is also recognised that not all parts of the Code are relevant to all signatories. For example, smaller institutions may judge that some of the principles and guidance are disproportionate in their case. In these circumstances, the signatory can explain why their business model precludes adherence to certain principles of the Code.
6. Institutional investors with several types of funds or products need to make only one statement, but are encouraged to explain which of their funds and products are covered by the approach described in their statement.
7. Institutional investors are encouraged to be early adopters of the principles and guidance set out in the Code. Signatories should report their extent of observance to the Code starting from the year 2016.

Monitoring and Review

1. The boards of signatories will be responsible for their own organisations' monitoring on how they have applied the principles of the Code. In the initial stages, MSWG will undertake the monitoring of the take-up and application of the Code.
2. Subsequently, an umbrella body for institutional investors is envisaged to be formed as a platform to discuss stewardship matters, including undertaking the oversight role of monitoring the take-up and application of the Code. It is envisaged that the governing structure of the umbrella body would comprise representatives from the institutional investors' industry, professionals as well as other important stakeholders.
3. The Code will be reviewed from time to time to assess its implementation and reflect changes in the capital market and corporate governance landscape.

PRINCIPLES OF THE CODE

The Code provides guidance on effective exercise of stewardship responsibilities towards the delivery of sustainable long-term value to the institutional investors' ultimate beneficiaries or clients. There are six key principles:

1. Institutional investors should disclose the policies on their stewardship responsibilities.
2. Institutional investors should monitor their investee companies.
3. Institutional investors should engage with investee companies as appropriate.
4. Institutional investors should adopt a robust policy on managing conflicts of interest which should be publicly disclosed.
5. Institutional investors should incorporate corporate governance and sustainability considerations into the investment decision-making process.
6. Institutional investors should publish a voting policy.

PRINCIPLE 1

Disclosing Policies on their Stewardship

Institutional investors should disclose the policies on their stewardship responsibilities.

Guidance

- 1.1 The stewardship policies should reflect the institutional investors' stewardship activities along the investment chain, and how they will discharge their responsibilities arising from those activities.
- 1.2 The policies should be accessible to investee companies, beneficiaries and clients in plain and understandable language.
- 1.3 In the event where the stewardship activities are outsourced, institutional investors should explain in the stewardship policies what steps have been taken to ensure that the investment activities are carried out in line with their own approach to stewardship.
- 1.4 Asset owners should disclose general guidelines on the selection of asset managers and other service providers.

PRINCIPLE 2

Monitoring Investee Companies

Institutional investors should monitor their investee companies.

Guidance

- 2.1 Institutional investors should actively monitor their investee companies as it is an essential part of their stewardship role.
- 2.2 The monitoring process should be conducted in an active manner which include but not limited to monitoring the investee companies for the following:
 - Performance and its value drivers;
 - Key risk areas;
 - Leadership, including board and management;
 - Adherence to the form and spirit of the *Malaysian Code on Corporate Governance 2012* (CG Code);
 - Quality of company reporting and quality of management discussion and analysis; and
 - Signs of problems at an early stage, which may result in a significant loss in investment value.
- 2.3 The monitoring activities should also include attending general meetings where practicable as well as exercising voting rights.
- 2.4 Institutional investors should carefully consider explanations given by their investee companies, or lack thereof, for any departure from the CG Code. The investee company's board should be informed in writing where appropriate, if the institutional investor does not agree with the investee company's explanation or position taken on how the investee company applies the CG Code together with its reasons.

PRINCIPLE 3

Engaging Investee Companies

Institutional investors should engage with investee companies as appropriate.

Engagement is purposeful dialogue with investee companies with the aim of preserving or enhancing value on behalf of beneficiaries or clients. It is typically an extension of monitoring activities and it arises when institutional investors have a close and full understanding of the specific circumstances of the investee company in matters of performance, governance or risk management.

It entails dialogue on matters such as strategy, long-term performance, risk, capital structure, and corporate governance, including culture and remuneration as well as on issues that are the immediate subject of votes at general meetings.

When engaging with investee companies, institutional investors must respect market-abuse rules and do not seek trading advantage through possession of price-sensitive information.

Guidance

- 3.1 Institutional investors should develop a clear engagement strategy and engagement process or practices to enable a more meaningful and effective dialogue between investee companies and the institutional investors.
- 3.2 Institutional investors should report a summary of their engagement activities or engagement highlights at least on an annual basis in the annual report or company website. Records of engagement activities with the investee companies should be kept in a proper manner.
- 3.3 Institutional investors should engage with the investee companies when there are concerns on the financial and operational performance, governance or risk management of their investee companies, with initial discussions carried out on a confidential basis. Institutional investors should have a clear approach for dealing with situations where the normal avenues of dialogues and communications with boards and management are failing and it becomes necessary to intervene to arrest issues at an early stage.

3.4 In engaging with the investee companies, institutional investors could make their concerns known, for example, by:

- expressing concerns in writing to the board of directors; or
- meeting with the chairman or other board members, including senior independent directors; or
- engaging jointly with other institutions on particular issues; or
- submitting resolutions and expressing concerns at the general meeting; or
- requisitioning a general meeting, which may seek to remove poorly performing directors.

PRINCIPLE 4

Managing Conflicts of Interest

Institutional investors should adopt a robust policy on managing conflicts of interest which should be publicly disclosed.

Institutional investors should seek to avoid conflict-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.

Guidance

- 4.1 Institutional investors should put in place, maintain and publicly disclose a policy for identifying and managing conflicts of interest with the aim of taking all reasonable steps to advance the interests of their beneficiaries or clients.
- 4.2 Institutional investors should communicate to their service providers on the need to disclose all known potential conflicts of interest and to explain how they are managed.
- 4.3 Institutional investors should have robust policies to deal with inside information and to avoid market manipulation in their dealings. Broader ethical considerations such as policies on prevention of corruption, including anti-bribery and anti-money laundering and establishment of “Chinese wall” should also be incorporated.
- 4.4 In instances where an institutional investor becomes involved in the board or management to support a process of longer term change in the investee companies, it should indicate in its stewardship policies the mechanism by which this could be done including managing any conflict of interest.

PRINCIPLE 5

Incorporating Sustainability Considerations

Institutional investors should incorporate corporate governance and sustainability considerations into the investment decision-making process.

Institutional investors are expected to deliver sustainable returns in the long-term interest of their beneficiaries or clients.

Guidance

- 5.1 Institutional investors should incorporate corporate governance and sustainability considerations, including environmental, social and governance (ESG) factors in their investment decision-making process.
- 5.2 Institutional investors should assess the quality of disclosures made by investee companies on the application of the CG Code. This includes disclosure of–
- Diversity targets and policies, including gender, age and ethnicity;
 - Board remuneration and nomination policies and procedures;
 - Board quality;
 - Financial reporting; and
 - Risk management and internal controls.
- 5.3 Institutional investors should develop a policy on how it incorporates sustainability consideration, including ESG, into its investment analysis and activities. The matters to be dealt with in the policy should include, but not necessarily be limited to, an assessment of–
- the quality of the company's sustainability report dealing with the company's strategy and operations. If sustainability disclosure has not been published, an enquiry could be made on the reasons for this; and

- disclosure and adherence to responsible investment codes, if any.

5.4 Examples of ESG factors that the institutional investors evaluate may include the following–

- Corporate governance and business ethics;
- Employee benefits and corporate culture;
- Products, customers and supply chain; and
- Environmental and social impact.

PRINCIPLE 6

Publishing Voting Policy

Institutional investors should publish a voting policy.

Voting is an element of engagement and institutional investors are expected to make use of their voting rights. The exercise of voting rights is a key indicator that an institutional investor effectively implements its engagement policy.

Guidance

- 6.1 Institutional investors should exercise their voting rights with due care and diligence.
- 6.2 Institutional investors should disclose their overall voting policy with respect to their investments and the procedures that they have in place.
- 6.3 Institutional investors should seek to reach a clear decision either in favour or against each resolution. The reasons for voting against or abstaining in relation to any vote at a general meeting should be communicated to the investee company, preferably in writing. Where the decision deviates from the normal policy institutional investors should be prepared to give the reasons to their beneficiaries or clients.
- 6.4 Institutional investors should seek to vote on shares held and may set a policy on the threshold for active voting¹. Where an institutional investor chooses not to vote in specific circumstances, or in particular markets or where holdings are below a certain threshold, this should be clearly disclosed to beneficiaries or clients.
- 6.5 Institutional investors are encouraged to disclose a summary of their voting activities as it 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.

¹ Active voting means the exercise of active voting beyond a certain ownership threshold which is determined by the institutional investor's own internal policy guidelines.

- 6.6 Institutional investors are encouraged to disclose the use, if any, of proxy voting or other voting advisory services. They should describe the scope of such services, identify the providers and disclose the extent to which they follow, rely upon or use recommendations made by such services.
- 6.7 Institutional investors should work with other relevant parties where possible, to remove barriers to voting so long as it does not contravene any applicable law or regulation in the relevant jurisdictions. Votes cast by intermediaries should be exercised only in accordance with the wishes of the beneficial owner or its authorised agent.
- 6.8 Institutional investors should disclose their approach to securities lending and situations where they will recall lent securities so as to be able to exercise vote.

REFERENCES

Code for Responsible Investing in South Africa 2011

Corporate Governance Blueprint 2011

ICGN Statement of Principles for Institutional Investor Responsibilities 2013

Institute of Chartered Secretaries and Administrators, "Enhancing stewardship dialogue"

Organisation for Economic Co-operation and Development (OECD), 2004, "*Principles of Corporate Governance*"

Malaysian Code on Corporate Governance 2012

The UK Stewardship Code 2012

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