June 27, 2016

Securities Commission Malaysia
3, Persiaran Bukit Kiara
Bukit Kiara
50490 Kuala Lumpur

By email: Azryta@seccom.com.my; NadiaZ@seccom.com.my

Attention: Azryta Abdul Aziz; Nadia Zainuddin

Dear Ms. Aziz,

ACGA Response to the Public Consultation on the "Proposed Draft of the Malaysian Code on Corporate Governance 2016"

We welcome the opportunity to respond to the Draft.

The Asian Corporate Governance Association (ACGA) is a not-for-profit association chartered under the laws of Hong Kong. The association is dedicated to assisting companies and markets across Asia in their effort to improve corporate governance practices. In our educational outreach, we are guided by a practical long-term approach. ACGA's operations are supported by a membership base of institutional investors, such as public pension funds and fund managers, as well as listed Asian companies, law and accounting firms, and universities. ACGA now has more than 100 corporate members, two thirds of which are institutional investors with around US$24 trillion in assets under management globally. They are also significant investors in the Malaysian market.

We support the objective of the proposed revision to the Malaysian Code on Corporate Governance 2016, that is to enhance corporate governance standards and outcomes at Malaysian listed companies, and would like to make some general comments on the structure and content of the Code before addressing specific sections.

Code structure and content

We note that the new code is structured according to four broad "Principles" covering board leadership and effectiveness, the integrity of financial and corporate reporting, managing risk to preserve and create value, and strengthening relations with shareholders. Under each Principle is a "Practice" (or set of practices) that explain the actions and processes that companies are expected to adopt. Each Practice then has an "Intended Outcome" that provides the rationale or objective for the Practice.

The Practices are further grouped into "Core" and "Core+"—the former being applicable to all companies and the latter more aspirational practices that companies can choose to adopt.

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We also note that the new code proposes a change from "Comply or Explain" to "Apply or explain an alternative". The intention is to make companies think harder about the practices they "apply" and encourage them to do so in a positive manner—as opposed to merely "complying" mechanistically with a set of best practices. Where a company applies a Core practice, it should explain how it is doing so to achieve the Intended Outcome. Where it does not, it is expected to provide a clear explanation of how its alternative practice will achieve the intended outcome.

Our general comments are as follows:

- The description of the four **Principles** is reasonably detailed in some areas, such as Principle A on board leadership, but may be misleading in others. For example, the narrow reference to "accounting literacy" in audit committees under Principle B on financial and corporate reporting could be read as implying that audit committees do not need members with a wider range of financial, process-oriented and risk-related skills in addition to accounting expertise. Similarly, we feel the description under Principle D on strengthening relations with shareholders is excessively brief and generic.

- We recommend more detailed guidance be given in some of the **Core Practices**, such as the role of company secretaries, investor relations and communication with shareholders.

- Certain terms that may be new or legalistic to many readers, such as "skills matrix", "fiduciary duty" and "integrated reporting", should be defined in sufficient detail so that they are well understood.

- The Code could make clearer when an explanation is required. We recommend that it state that explanations are required for each Intended Outcome, whether the Core Practice is followed or not. Further, that a simple statement from a company that it applies a Practice is not sufficient.

- We believe the wording and ordering of the **Intended Outcomes** could be more effective. Many are written in quite general language or merely repeat wording already contained in related Practices. Indeed, the Outcomes often read more like general principles or recommendations, with the specificity coming first under Practices. Whereas the previous version of the code (2012) began logically with general statements followed by specific commentaries, this new version often inverts this order. We suggest the Intended Outcome is placed first.

- Some of the "**Core+**" practices are not especially aspirational, even for smaller listed companies. For example, disclosing the relationship between executive pay and performance should be a basic requirement for all listed companies. Smaller

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companies are likely to have simpler pay structures, hence the disclosure challenge is commensurately reduced.

Practices

Our specific comments on different Practices are as follows:

Practice 1.1 - Board responsibilities

While the elements are clearly stated, the Intended Outcome is less clear. Specifically, it contains the word "fiduciary", which we believe is not generally well understood.

Practice 1.2 and 1.3 – Board and management roles

More elaboration on the division of responsibilities between the board and management would be welcome in 1.2, while the specific elements in the footnote to 1.3 could be better incorporated in the text of the Practice itself.

Practice 1.6 – Company secretary

The wording here is general and adds little to the Outcome. A clearer statement on the range of clerical and other tasks carried by the company secretary would be useful. For example, the extent to which the company secretary advises the board on corporate governance issues, acts as a trusted advisor to the chairman, facilitates communication within the board between meetings, and so on.

Practice 2.1 – Nominating committee and board skills

The text refers to a "board skills matrix", which as noted above is a term not widely understood. A definition outlining the main elements of such a matrix would be useful for companies. The Code could also provide further steps here on the role and responsibilities of the nominating committee, such as identifying the skills required to ensure board composition is fit for purpose, that there is a sufficient degree of independence, and board committees have the requisite skills.

Practice 2.2 – Diversity

While we agree gender balance on a board is important, there are other important elements to diversity beyond this one component. Diversity can extend to a range of skills, including business experience, industry knowledge, professional and technical qualifications, leadership capabilities, and to such factors as ethnicity.

Practice 3.2 – Majority independence

Independent directors are a vital protection for the company and its shareholders, including minorities. When acting effectively, they provide necessary oversight on the management team and controlling shareholder, as well as independent guidance and support. This is particularly important where there is a concentration of powers in one individual.

To achieve this goal, such directors must be independent in substance, not just form. Hence, the criteria for independence is important. In our view, the definition provided by Bursa

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Malaysia in its Listing Requirements (Chapter 1, Part 1.01) is weak in areas, particularly regarding former executives who are permitted to become independent directors after a cooling-off period of only two years. We believe it is highly unlikely that such people would be sufficiently independent of mind and free of personal ties to the company or its leadership to act as genuinely independent directors, no matter how capable they may be. Without a revision to the listing rules in this area, the spirit of the Code is unlikely to be realised.

Under the heading of board independence, we believe it would also be useful to clarify how companies with large shareholders, especially government-linked entities, can balance the interest of all shareholders. For example, there may be times when a government-linked company is required to implement a corporate action that appears to be driven by public policy interests. The Code should require that in such instances boards pay particular attention to the action to ensure it is not to the detriment of minority shareholders, and follow up with relevant disclosure as to the rationale for the action.

Practice 3.3 – Director tenure

While we support the proposal for a separate annual vote on an independent director who has served for nine years, it is doubtful whether allowing all shareholders to vote—majority/controlling and minority—is in accordance with the spirit of the Code. Indeed, the Code seems to imply that only unaffiliated shareholders should be permitted to vote, since what is required is an independent assessment of the director's performance and independence. How can this be achieved if the controlling shareholder votes as well and the result is a foregone conclusion?

The "two vote" model adopted in the UK for the election of independent directors at companies with controlling shareholders could be usefully adapted to voting on independent directors in Malaysia with a tenure of nine years or more. This system provides first for a vote by all shareholders and second for a vote by independent shareholders only. An independent director must be approved by majorities in both votes, otherwise a further vote is required at a later date.

Whatever voting model is applied, companies should be required to explain substantively why an independent director with a tenure of more than nine years still meets the criteria for independence of mind and judgement.

Practice 4.3 – Nomination of directors

The Code proposes that a Core+ Practice could include the right of shareholders to nominate candidates as directors. Our view is that the nomination of directors is a fundamental right of shareholders and should be a Core Practice.

Practices 5.1 to 5.3 – Remuneration

We believe that the alignment of incentives between management and shareholders is a critical protection for shareholders. Further, as shareholders appoint directors, it is

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appropriate to understand how that alignment is achieved through remuneration policies and practices. The purpose of providing disclosure on remuneration is to enable shareholders and other stakeholders to come to a view on fairness. Consequently, disclosing the relationship between pay and performance should be considered a Core Practice, not Core+.

Meanwhile, the Code is silent on the need for a remuneration/compensation committee. We recommend that as a Core+ Practice, companies be advised to establish one, led by independent directors. It should clarify the criteria used to link pay to performance, and disclose company policies on employee share-ownership plans.

Section 7 – Audit committee

This section is extremely brief and outlines only three basic practices regarding audit committees. We recommend that it be reviewed and expanded.

While we support the suggestion that all members of the audit committee be able to read and understand financial statements, we recommend that this be extended to all members of the board. If not, how will they properly assess financial reports and transactions, or be able to ask sensible questions of management, the audit committee and the auditor? We believe that this point should become another Practice area.

Practice 8.2 – Auditor cooling-off period

As per our comment above regarding cooling-off periods for former executives, we believe it unlikely that retired or former partners of a company's external audit firm would be—or would be perceived to be—suitable candidates for the role of independent director. However, given that such people have valuable knowledge and expertise to share, we recommend the Code specify that they may be appointed as non-independent, non-executive directors.

Practice 9.1 – Corporate reporting

The Practice briefly states that companies should be guided by "best practices" in formulating and reviewing policies to ensure the robustness of corporate reporting. We believe this is not clear. It would be helpful either to refer to a set of such practices or list some within this section.

One important area of emphasis is the prompt disclosure of price-sensitive events and transactions, such as those that impact 5-25% of a firm's revenues, net assets or profits. Companies that do not disclose such material information often suffer more volatility in their market valuation.

Other key areas where disclosure could improve include (but are not limited to):

- Related-party transactions
- Biographical details on directors
- Board committee reports

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Practice 9.2

While the Code recommends "integrated reporting" as a Core+ Practice, we are concerned that many companies may not understand what such reporting entails. There are a wide variety of approaches to "integrated reporting" in Asia, some of which bear only limited resemblance to the IIRC's Integrated Reporting Framework. It may be more appropriate to guide companies to the range of sustainability and ESG reporting guidelines available, including the "Sustainability Reporting Guide" from Bursa Malaysia. Indeed, a clearer link between the Code and the Sustainability Reporting Guide would be welcome.

Practice 12.1 – General meetings

The only practice mentioned here relates to the timeliness of information. However, many other factors are equally important in running a transparent and fair general meeting, including information of sufficient quality for shareholders to make decisions, unbundling of individual meeting resolutions, and ensuring that all votes are properly counted and the results disclosed, among other things. While these elements are typically covered in the Listing Requirements, we believe it is appropriate to highlight their importance in the Code.

Practice 13.1 – Communication with shareholders

We believe this section needs to be expanded beyond a focus just on investor relations (IR). In many cases, IR serves as a gatekeeper, preventing investor access to management. More guidance should be provided on how companies could more effectively communicate and engage with shareholders, including but not limited to: fair and equitable information sharing with all shareholders, large and small; the use of IT and websites to communicate more widely and efficiently; the importance of allowing the investor relations unit to pass messages from shareholders to senior management and the board; and a more proactive approach to making directors and senior management available to shareholders for discussion of substantive issues.

There can be different levels of interaction between shareholders and a company depending on the nature of a query. If a shareholder wishes to discuss strategic issues, they should be able to communicate directly with the chairman or board directors. If they have questions regarding the structure of the board, typically they would communicate with the corporate secretary. If they have questions regarding the operations of the business, these are typically handled through investors relations.

Looking ahead, we expect that over time the relationship between boards and shareholders will change significantly in Asia, as it has done in other developed markets around the world. Companies that adapt earlier to this new and more open approach to engagement will be recognized and rewarded by their shareholder and stakeholders.

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We hope these comments are useful and we would be pleased to discuss any aspect of this letter in further detail.

Yours truly,

P.P.

Jamie Allen
Secretary Allen

**Benjamin McCarron, Specialist Consultant, ACGA contributed to this submission.*

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