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Pengarah
Jabatan Dasar Kewangan Pruden
Bank Negara Malaysia
Jalan Dato' Onn
50480 Kuala Lumpur

By email: pfpconsult@bnm.gov.my

Attention: Ms. Stephanie Tan, Mr. Jinho Clement, and Mr. Lee Zhi Wei

Dear Ms. Tan,

ACGA's Response to the Concept Paper – Corporate Governance

We welcome the opportunity to respond to the Concept Paper.

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 Malaysian market.

We are broadly supportive of Bank Negara Malaysia's (BNM's) Concept paper and the goal of improving the corporate governance performance of Malaysia's financial institutions. The Concept Paper outlines sound guidance principles, coherent standards, and a pragmatic implementation and transparency plan that are relevant to the needs of the Malaysian financial sector.

ACGA supports BNM's focus on improved standards for financial institution boards. Given the importance of providing the right incentives for greater board engagement and responsibility, we agree with the focus on director time commitments, independence, conflicts of interest, and skill levels.

Correctly calibrating the underlying standards to ensure that they are practical and do not create unrealistic expectations, resulting in broad-based non-compliance, is also important however. With this in mind, we had the following comments:

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Director Suitability—Affiliates, Outside Commitments, and Effectiveness
In Section 10.3, it is stated that the board "must maintain a policy on the maximum number of external professional commitments" that a director may have. While we believe that this is an important concern, we are not confident that this is a fruitful area for board self-regulation. Indeed, in light of the fact that the Bursa Malaysia Listing Rules cap board participation at five board roles, we believe that BNM should consider setting an explicit limit rather than leaving this to the discretion of the board. In light of the systemic significance of financial institutions and the complexity of many of Malaysia's financial groups, we believe that a case could be made that a limit of three board seats might be worth considering depending on the policy adopted toward participation on affiliate boards.

ACGA shares BNM's concern about the impact of small-circle board governance that can result from overlapping board structures for financial groups, leading to poor oversight of operational dependencies. In the absence of information on board structures and risk exposures for Malaysia's financial sector on this issue, however, it is challenging for us to form a clear picture of how group and affiliate boards in Malaysia currently map to needed governance practices. Guidance point 11.11 and standard 11.12 place an understandable emphasis on the need for limits to board overlaps with affiliates and cap director participation at less than half of board members. We support the transitional arrangements in principle, but would also support relief on a case-by-case basis if a board is making good progress toward the standard but must address director capacity issues short-term.

The board effectiveness norms highlighted in standards 10.2 through 10.5 concerning time commitments, political exposure, and links to auditors are all common sense requirements closely aligned with the conflicts of interest policies laid out in standard 14.1. Nevertheless, the approach taken in standard 10.8 toward board self-policing on matters of compliance with these norms could prove aspirational rather than practical. These are issues that may be better pursued through annual filing of director disclosures, which can then be examined by an independent third party such as BNM to ensure the norms are becoming embedded in the market.

Director Independence
Standard 11.3 uses a five-year cooling off policy to promote independence of board chairs who have previously served as chief executives. Although we understand the logic of this approach, we believe that the insider-versus-independent mindset is best established by prohibiting insiders from serving in board roles reserved for independent directors.

Similarly, we do not support standard 11.7 that sets a two-year cooling off period for other executives prior to becoming an independent director. If companies are in

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need of qualified executives who can fill such roles, it would be preferable to develop a truly independent and experienced talent pool that can meet the governance needs of organisations without an insider bias. Banks and companies could contribute to the development of such a pool by creating a stronger demand for independent directors, refreshing their boards more regularly, casting the net more widely when looking for new directors, and ensuring proper training of both new directors and existing directors.

Standard 11.9 proposes a nine-year policy limit on director tenure. While this is sensible benchmark, rather than requiring "exceptional circumstances" for an exception, we would advocate exceptions only in the event that a declaration is made concerning the reasons for retaining the director. In such instances, we would also recommend a separate vote on the director's appointment.

Conflicts of Interest

The standard proposed in 15.2 concerning the role of company secretaries establishes an important market norm by ensuring that a financial institution company secretary should play an integral role in supporting the company's board governance and should not, therefore, be an outside contractor operating as a freelance service provider to numerous corporate clients.

We also endorse the concept established in standard 17.4 that financial institution CEOs should be focused on the institution that employs them rather than on outside roles.

Director Skills

In section 11, standards are established to govern the composition of the board. We strongly support these norms and would recommend that one additional norm be embedded, possibly in standard 11.2, to ensure that all independent and other non-executive directors are capable of discharging their oversight responsibilities related to financial reporting. This is a crucial issue, as it is often the case in Asia that financial and accounting oversight responsibilities are limited in practice to the non-executive directors who serve on the audit committee. While these directors, of necessity, should have a high level of financial and accounting skill, other non-executive directors should also be able to discharge their oversight obligations related to financial reporting. If there is doubt about the capacity of such directors on this issue, we believe that there is a positive role for BNM to play in raising standards or partnering with others to ensure that training is available to support otherwise capable directors.

Holding Company Board Overlaps

The standard established in section 11.12 to limit the number of directors who also hold directorships in affiliates appears to strike a sensible balance in terms of ensuring continuity, while also protecting the integrity of company-level governance relative to unique stakeholders. We are concerned, however, that the principles may

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not be fully expressed in application without the benefit of examples to clarify BNM's intent. This could be particularly true in the case of clause (d), which makes specific reference to highly material situations where there are affiliates with strong operational dependencies. It would also be helpful if the principles established in this section could be harmonised or compared to best practices relating to the treatment of related-party transactions where overlapping board structures might be used to undermine normal board oversight standards.

Transparency

The section 22 on transparency provisions establishes the right principles and has the potential to fill important gaps for external stakeholders by clarifying the relationship between the apex entity and subsidiaries and affiliates. Based on a recent review of several Malaysian financial institution websites with extensive affiliate networks, it is clear that there is a lack of coherence in current disclosure related to critical governance structures for regulated financial groups. Of items specified in Appendix 4, we are particularly pleased to see the reference to qualitative disclosures covering current and future risks and how these issues relate to compensation. We would stress, however, that institutions may benefit from examples of relevant disclosure to ensure that companies do not rely on jargon or boilerplate statements concerning "the key risks" that are taken into account for purposes of compensation.

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

Yours truly,

Jamie Allen
Secretary General

**Melissa Brown, Specialist Consultant, ACGA contributed to this submission.*