



THE WORLD BANK

# Report on the Observance of Standards and Codes (ROSC)

Corporate Governance

38970

## Corporate Governance Country Assessment

Malaysia  
June 2005

# Overview of the Corporate Governance ROSC Program

## WHAT IS CORPORATE GOVERNANCE?

Corporate governance refers to the structures and processes for the direction and control of companies. Corporate governance concerns the relationships among the management, Board of Directors, controlling shareholders, minority shareholders and other stakeholders. Good corporate governance contributes to sustainable economic development by enhancing the performance of companies and increasing their access to outside capital.

The *OECD Principles of Corporate Governance* provide the framework for the work of the World Bank Group in this area, identifying the key practical issues: the rights and equitable treatment of shareholders and other financial stakeholders, the role of non-financial stakeholders, disclosure and transparency, and the responsibilities of the Board of Directors.

## WHY IS CORPORATE GOVERNANCE IMPORTANT?

For emerging market countries, improving corporate governance can serve a number of important public policy objectives. Good corporate governance reduces emerging market vulnerability to financial crises, reinforces property rights, reduces transaction costs and the cost of capital, and leads to capital market development. Weak corporate governance frameworks reduce investor confidence, and can discourage outside investment. Also, as pension funds continue to invest more in equity markets, good corporate governance is crucial for preserving retirement savings. Over the past several years, the importance of corporate governance has been highlighted by an increasing body of academic research.

Studies have shown that good corporate governance practices have led to significant increases in economic value added (EVA) of firms, higher productivity, and lower risk of systemic financial failures for countries.

## THE CORPORATE GOVERNANCE ROSC ASSESSMENTS

Corporate governance has been adopted as one of twelve core best-practice standards by the international financial community. The World Bank is the assessor for the application of the OECD Principles of Corporate Governance. Its assessments are part of the World Bank and International Monetary Fund (IMF) program on Reports on the Observance of Standards and Codes (ROSC).

The goal of the ROSC initiative is to identify weaknesses that may contribute to a country's economic and financial vulnerability. Each Corporate Governance ROSC assessment reviews the legal and regulatory framework, as well as practices and compliance of listed firms, and assesses the framework relative to an internationally accepted benchmark.

- Corporate governance frameworks are benchmarked against the OECD Principles of Corporate Governance.
- Country participation in the assessment process, and the publication of the final report, are voluntary.
- The assessments focus on the corporate governance of companies listed on stock exchanges. At the request of policymakers, the ROSCs can also include special policy focuses on specific sectors (for example, banks, other financial institutions, or state-owned enterprises).
- The assessments are standardized and systematic, and include policy recommendations. In response, many countries have initiated legal, regulatory and institutional corporate governance reforms.
- Assessments can be updated to measure progress over time.

By the end of June 2005, 48 assessments had been completed in 40 countries around the world.

## EXECUTIVE SUMMARY

### **Achievements/progress since previous assessment**

Important corporate governance reforms have been implemented in Malaysia since 1998, when a high-level Finance Committee on Corporate Governance, consisting of both government and industry, was formed to identify and address weaknesses highlighted by the Asian financial crisis. Key reforms have included the development of a comprehensive master plan to further develop the capital market, the demutualization of Bursa Malaysia, introduction of a Code of Corporate Governance, and changes in the composition and role of its Board of Directors. In 2004, disclosure rules and corporate whistleblower protections were strengthened. In 2005, major reforms commenced to overhaul government-linked corporations (GLCs).

### **Key Challenges**

To further improve its corporate governance practices, Malaysia faces the following challenges: the government's level of equity ownership remains large; free float remains low; and directors' accountability and protection for minority shareholders need further improvement. In addition, the role of institutional investors and shareholder activism in the corporate governance framework needs to be strengthened.

### **Next Steps**

This report identifies several key measures that focus on enforcement and implementation, including:

- Continued and consistent enforcement of disclosure and reporting requirements by the Securities Commission, with a focus on quality of information provided;
- Implementation of legislative reform to strengthen directors' independence and accountability to investors; and
- Development of a legal basis for and promotion of an active institutional investor community.

## **ACKNOWLEDGEMENTS**

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## COUNTRY ASSESSMENT: MALAYSIA

This ROSC assessment of corporate governance in Malaysia benchmarks law and practice against the OECD Principles of Corporate Governance, and focuses on listed companies.

### Market profile

#### *Capital Market Overview*

The Malaysian economy experienced record growth in 2004. Real gross domestic product (GDP) increased by 7.1 percent (RM 248 billion) in 2004 compared to 5.3 percent in 2003, and the capital market continued to expand. The Kuala Lumpur Composite Index (KLCI) ended the year at 907.43 points or 14.3 percent higher than the end-2003 level. Total market capitalization increased from RM 722.04 billion, an increase of 12.8 percent compared to the end-2003 level. Market activity remained significant, with annual turnover amounting to 108 billion units valued at RM 216.7 billion. Market liquidity declined slightly in 2004, as the average daily turnover decreased to 433 million units from 456 million units in 2003. Better market performance and broader investor interest resulted in 72 Initial Public Offerings (IPOs). Total funds raised through the capital market, however, were slightly lower at RM 6.5 billion, as compared with RM 7.8 billion in 2003.

#### *The Capital Market Master Plan sets the framework for the long-term development of the capital market*

A Capital Market Master Plan (CMP) was developed in 2001 to set the framework for the long-term development of the market and provide clarity for issuers, investors, and intermediaries. The CMP contains 152 recommendations dealing with the development of the institutional and regulatory framework for the capital market from 2001 to 2010, of which 10 recommendations focus specifically on corporate governance. These are credible recommendations that, when fully implemented, will further improve the capital market in Malaysia. As of December 2004, 62 percent of the recommendations in the CMP have been completed, with another 38 percent in progress.

#### *Legislative Framework*

The legal framework for corporate governance is based on common law. The key piece of legislation for the securities market is the Companies Act of 1965 (CA).<sup>1</sup>

#### *Institutional Framework*

*The Capital Market Master plan and the amendments to the Securities Act introduced greater clarity in the institutional framework. However, further streamlining is needed.*

One of the key weaknesses that surfaced as a result of the 1997 financial crisis was the overlapping authority and resulting ambiguous accountability of the regulatory institutions governing the securities market. This problem was intended to be addressed by the Capital Market Master Plan and the amendments made to the Securities Commission Act of 1993. The Securities Commission (SC) is now the sole regulator for fundraising activities and for the corporate bond market. However, there are still five principal authorities involved in regulating the capital market. They are the SC, Bank Negara Malaysia (BNM), Companies Commission of Malaysia (CCM), Foreign Investment Committee (FIC), and the Ministry of Trade and Industry (MITI).<sup>2</sup> There is a perception, however, that the framework still may be challenged by regulatory gaps and lack of coordination.

### Key issues

The following section highlights key observations of the principle-by-principle assessment of Malaysia's corporate governance compliance with the OECD Principles of Corporate Governance.

## Investor protection

*Shareholder rights well-defined and observed*

Basic shareholder rights are generally well-observed in Malaysia. Information is available in a timely and regular manner. Further efforts, however, will be required to facilitate shareholders' ability to exercise their right to vote, including voting by mail and a longer notice period.

*Shareholders rights are protected by the CA, the Listing Requirements, and the SCA*

Shareholders have been accorded a number of rights to protect their interests by the CA, the Listing Requirements, and the SCA. The right to vote is a member's fundamental right. Every member has an unfettered right to exercise his/her vote as attached to the shares s/he owns. Some government-linked corporations have issued a Special Share/Golden Share to the government, entitling it to exercise a veto over any tabled resolution. A review of publicly available information for the past 15 years indicates that the government (or its institutions) has not at any instance exercised this right. Whereas, on the one hand, the presence of a golden share is a source of comfort for a small investor, on the other hand, it has the potential of being used to further public policy that may not be entirely in line with short-term commercial goals. However, the very existence of these golden shares could be perceived by the market as a poison pill, depriving investors of potential returns.

*Enforcement of shareholder rights (statutory and/or equitable)*

The CA provides statutory remedies for shareholders who are aggrieved by the acts of directors or the company, or treated inequitably by the company. There are, however, significant weaknesses in the ability of investors to institute an action against directors for breach of their fiduciary duties.

## Disclosure

*Disclosure of ownership*

A substantial shareholder is a person who holds 5 percent or more of the voting shares of the company. Substantial shareholders are required under law to give notice to the company, with a copy to the Bursa, of any changes to their ownership interests. Notices are required to be given within 14 days from the date on which a person becomes a substantial shareholder, or when his/her ownership changes upward or downward.

*Related-party Transactions and large transaction disclosure and enforcement*

Related-party transactions involving the directors of listed companies are regulated by the Listing Requirements. Shareholder approval is required under the Law for Related-Party Transactions. This requirement has been further enhanced by the Listing Requirements.<sup>3</sup> Shareholder approval is required for the acquisition of an undertaking or of property of substantial value in relation to the total assets of the company; and for the disposal of a substantial portion of the company's assets. However, the mere reliance on the Listing Rules alone to regulate related-party transactions may not be sufficient.

*Key annual disclosures*

In addition to the audited financial statements, companies are required by the Listing Requirements and the CA to disclose in their annual reports:

- The names of the substantial shareholders and their direct and deemed interests, stating the number and percentage of shares in which they have an interest, as shown in the register of substantial shareholders of the publicly listed company.<sup>4</sup>
- The direct and deemed interests of each director (including number and percentage) in the publicly listed company, or in a related corporation, as stated in the register of substantial shareholders.
- The number of holders of each class of equity securities and any convertible

securities, and the voting rights attaching to each class.

*Immediate disclosure  
of material events*

Under the continuous disclosure regime, publicly listed companies are required to make immediate disclosure of all material (price sensitive) information. Such announcements are submitted to Bursa.

**Company oversight and the board**

*Composition of the  
board*

The board of each listed company is required by the Listing Requirements to have a balance of executive directors and independent directors. The Malaysia Code of Corporate Governance recommends that at least one-third of the board should consist of independent directors. The Listing Requirements stipulate that at least 2 directors or one-third of the board, whichever is higher, must be independent.

In practice, most boards have about 7 to 9 directors. One reason that most boards are of relatively small size is the shortage of suitable independent directors, as the larger the board size the higher the number of independent directors that must be appointed.

*Board independence  
The Listing  
Requirements require  
a minimum of one-  
third independent  
directors and the  
appointment of an  
Audit Committee and a  
Remuneration  
Committee to assist the  
board. However, the  
role of independent  
directors needs further  
clarification.*

The MCCG recommends the appointment of committees with clearly stated responsibilities to assist the board, including an audit committee (see below) and a remuneration committee, comprised wholly or mainly of non-executive directors. Its function is to recommend to the board the remuneration of the executive directors, drawing on outside advice if necessary. The remuneration of non-executive directors is a matter for the board as a whole. Directors must abstain from discussing their own remuneration.

According to the explanatory notes of the MCCG, the role of independent directors is to:

- contribute to the formulation of the company's strategy.
- provide complementary skills and experience to the company, derived from their diverse backgrounds.
- represent their respective significant shareholders' interests on the board.
- provide a balanced and independent view.

It is difficult to reconcile how an independent director can represent his/her respective shareholders and still provide a balanced and independent view. Even more importantly, accountability to specific shareholders contradicts the fiduciary duties of board members, as defined by the CA. This matter needs to be addressed.

*Audit committee*

According to the MCCG, boards of listed companies are required to appoint an Audit Committee. The majority of the members and the chairman of the Committee must be independent. One of the key functions of the Audit Committee is to review the quarterly results prior to approval by the board, which indirectly fixes the minimum number of times the Audit Committee must meet in a year. There is room for further improvement in the function of Audit Committees with respect to the external auditors.

*Directors' duties*

The CA imposes a number of general and specific duties on directors. One of their general duties is a fiduciary duty to act in good faith and in what they believe to be the best interests of the company as a whole. The CA codifies the directors' duties and, in some instances, sets standards that directors are expected to meet.

*Director training* All directors of publicly listed companies are required to attend a mandatory training program known as the Mandatory Accreditation Program (MAP). The curriculum covers topics on corporate governance, duties, responsibilities and liabilities of directors, risk management and the legal framework, amongst others.<sup>5</sup> In addition to MAP, the Listing Rules require companies with financial year end of December 31, 2005 onward to disclose in the annual report the training attended by directors apart from the MAP.

### **Enforcement**

*Power of SC* The Securities Commission (SC) is responsible for investor protection. It also is obliged by statute to encourage and promote the development of the securities and futures markets in Malaysia. The SC has broad authority over companies seeking to issue or offer securities to the public. The penalties for failure to submit a proposed offering to the SC for approval or for submitting false and misleading information in connection with the application are severe – a fine of RM 3 million or a term of imprisonment of 10 years. The SC also has broad enforcement powers, especially since 1997 when its powers were enhanced. The SC administers the insider trading provisions under the Securities Industry Act of 1997, and, since 1997, has been empowered to institute civil actions against insiders to recover illegal profits earned or losses avoided and to impose a civil penalty of up to RM 1 million.

*Powers of CCM* The Companies Commission of Malaysia Act of 2001 (CCMA) became effective on April 16, 2002. The Act establishes the Companies Commission of Malaysia (CCM). The functions of the Companies Commission are provided under section 17 of the CCMA 2001. The main functions of the CCM are to: administer and enforce the provisions of the CCMA 2001 and the laws specified in the First Schedule thereto; regulate matters relating to corporations, companies and businesses; promote proper conduct amongst directors, secretaries, managers and other officers of a corporation; and provide a facility whereby any corporate information received by, or filed or lodged with, the Companies Commission may be analyzed and supplied to the public.

*Powers of Bursa* Bursa conducts front-line monitoring of the compliance of publicly listed companies with their reporting requirements through monitoring their announcements, market trading activity, the media in general, public complaints, and, in the case of reporting to Bursa, through internal review of documents furnished.

Under the Listing Requirements, the sanctions Bursa may impose include the issuance of caution letters, reprimands, fines (not exceeding RM 1 million) directions for rectification, the non-acceptance of applications or submissions, the imposition of conditions for approval of submissions, suspension of trading and de-listing. Bursa may on application to the High Court seek an order requiring the removal of a director from office and that the person be barred from becoming a director of any other public company for the breach of Listing Requirements.

*Reporting Requirements* Under the CA, the profit and loss account and the balance sheet of a company must be audited before they are laid before the shareholders at its annual general meeting. The directors have to include a statement explaining the board of directors' responsibility for preparing the annual audited accounts in its annual report.

The auditor's report must include an opinion as to whether the accounts give a

true and fair view (or are presented fairly, in all material respects) of the company, in accordance with applicable approved accounting standards, and state whether the accounts comply with statutory requirements.<sup>6</sup>

The auditor is required to report on any defect or irregularity in the accounts or consolidated accounts of the company that detract from their representation of a true and fair view. If an auditor, in the course of the performance of his duties discovers that: (i) there has been a breach or non-observance of the provisions of the CA; and (ii) the circumstances are such that in his opinion the matter has not been or will not be adequately dealt with by the directors of the company, he/she is required to report the matter in writing to the Registrar. The penalty for a breach of this provision is imprisonment for two years or thirty thousand RM or both.

### Reform

#### *Capital Market Master Plan*

Initiatives to improve the legal and institutional framework for corporate governance have been based the OECD Corporate Governance Principles.

In 1998, a high-level Finance Committee on Corporate Governance, consisting of both government and industry, was formed for the purpose of identifying and dealing with those corporate governance weaknesses highlighted by the 1997 crisis. Its findings were reported in the Finance Committee Report on Corporate Governance in March 1999. Implementation of key aspects of the report, such as the introduction of the MCCG, was spearheaded by industry.

The thrust of the Malaysian corporate governance reform agenda, as articulated in the Capital Market Master Plan, focuses on the following key areas:

- Fair treatment of all shareholders and protection of shareholder rights, with particular focus on the rights of minority shareholders.
- Transparency – through the timely disclosure of adequate, clear, and comparable information concerning corporate financial performance, corporate governance, and corporate ownership.
- Accountability and independence of the board of directors.
- Strengthening regulatory enforcement.
- Promoting training and education at all levels to ensure that the framework for corporate governance is supported by the necessary resources.

Building on the report's recommendations, the CMP (released in February 2001) contributed to furthering the Malaysian corporate governance reform agenda. The CMP contains 152 recommendations dealing with the development of the institutional and regulatory framework for the capital market from 2001 to 2010, of which 10 focus specifically on corporate governance.

#### *Corporate Law Reform Committee*

The CCM established the Corporate Law Reform Committee in August 2003 to spearhead the corporate law reform program, with the objective of undertaking a comprehensive review of corporate law in Malaysia. Corporate governance reforms are a high priority of the Corporate Law Reform Committee, one of the four working groups focused solely on issues of corporate governance and shareholders' rights. The SC is the chair and the secretariat for the working group that focuses on corporate governance. Although the Corporate Law Reform Committee (CLRC) was established in 2003, it was only officially launched in June 2004. The CLRC in its deliberations consults with various stakeholders from the business community, and with regulators and lawyers.

## Recommendations

### *Reform of Companies Act provisions on related-party transactions*

Reliance on the Listing Requirements alone to regulate related-party transactions may not be sufficient.<sup>7</sup> The provisions concerning related-party transactions in the CA only require that the transactions be disclosed and approved by the shareholders, but the interested parties are not required to abstain from voting. The Listing Requirements are stricter than the CA in this regard. Therefore, the CA should be amended to require interested parties to abstain from voting on a related-party transaction.

With the recent amendments to the Securities Industry Act of 1983 (SIA), penalties for insider trading have been increased to three times the insider's gain. The new civil penalties also allow investors to seek full compensation for loss from the offenders. In view of the substantial harm to minority shareholders that can be caused by related-party transactions, penalties for the breach of legal provisions with respect to such transactions should be reviewed and substantially increased, so they are comparable to those for insider trading violations. There is also a need to improve the quality of enforcement actions taken for breach of the provisions on related-party transactions.

### *Facilitating the shareholder's ability to exercise his right to vote*

It is important to make it easier for shareholders to vote by mail, including mail-in proxy voting. This should be supplemented with provisions mandating longer notice periods and sufficient disclosure of information so as to give shareholders a better opportunity to decide how to vote.

### *Effectiveness of the Annual General Meeting and shareholder communications*

Another area of reform is to improve the quality and effectiveness of the annual general meeting (AGM), which would help motivate institutional shareholders to attend and participate. At present, attendance at AGMs in Malaysia is not high, and is dominated by retail investors. While the Malaysia Code on Best Practices represents a positive effort to improve the quality of AGMs, similar to that of the Institute of Chartered Secretaries in the United Kingdom, through focusing on the conduct of AGMs and the rights of shareholders in relation to them, there may be scope for statutory intervention in this area. Section 151 of the CA sets out the rights of shareholders wishing to submit proposals to the AGM.

### *Strengthening the effectiveness of independent directors*

There has been a discernible trend in Malaysia toward increasing the range of matters where decision making authority is allocated to the shareholders at the AGM. In addition, there appears to be increasing reliance on independent directors to strengthen the internal monitoring/oversight mechanisms when broad powers of management are conferred on directors. There are several areas that could be considered to increase the effectiveness of independent directors:

Consideration could be given to amending the law to provide for cumulative voting for company directors. Cumulative voting would help minority shareholders to place their representatives on the board.

Section 131 of the Companies Act of 1965 could be strengthened to require that an interested director abstain from voting with respect to transactions in which he has an interest. This would enhance the effectiveness of the independent directors.

Efforts need to be made to strengthen the MCCG's ability to require directors to represent the company as a whole, consistent with their fiduciary duty under the CA.

### *External auditors and*

The framework under which external auditors operate in Malaysia can be further improved. For instance, auditors work closely with management and have no

*audit committees*

direct line of communication with the shareholders (or the Audit Committees) to whom they report.

The framework could be improved through strengthening the relationship of the external auditors with the audit committees, including duties of Audit Committees consistent with international best practices. In addition, there should be full disclosure of fees paid to audit firms for non-audit work. This would require changes to the CA to include disclosure of fees paid in respect of non-audit work.<sup>8</sup>

*Strengthening the enforcement capability of statutory regulators*

Another critical area for improvement lies in strengthening the effectiveness of enforcement action by the regulators. There has been considerable criticism of the speed and effectiveness of enforcement efforts by regulators. Critical areas for improvement include:

- Strengthening the independence of regulators: Regulators need to be independent—both in fact and appearance—to ensure that their regulatory and enforcement activities are fair and objective, have credibility with the public, and are free from undue political pressure.
- Rationalization of the regulatory framework: Fragmentation obstructs enforcement in two important ways. First, by creating ambiguity about responsibilities, it can reduce the pro-activeness of regulators in addressing potential violations, while relying unduly on effective coordination among regulators. Second, it creates public confusion, thereby magnifying the perception that regulators are not enforcing the law.
- Modernizing the range of regulatory enforcement powers, including the introduction of a general power to permit the regulator to institute a civil action on behalf of an investor to recover damages suffered as a result of transgressions.<sup>9</sup>
- Focusing experience and skills on enforcement: In the context of corporate governance, emphasis has to be on regulation and enforcement. Authorities should continue to undertake measures that would improve the incentive system for corporate governance, complemented by measures aimed at enhancing monitoring and enforcement.

*Strengthening the private enforcement capacity of investors*

There are significant weaknesses in the ability of investors to institute an action against directors for breach of their fiduciary duties. The existing common law provisions on derivative actions present practical and substantive difficulties for minority shareholders. There is also considerable uncertainty as to whether ratification by some shareholders of a director's breach of duty would result in denying other shareholders the right to bring a derivative action to protect a company. In addition, Malaysian courts have been strict when it comes to the ability of shareholders to bring a derivative action on behalf of the company. More often than not, an action is rejected, as the director's breach has been ratified by majority shareholders and therefore deemed to be in the best interest of the company. Efforts should be expanded to make it easier to file derivative actions. Additionally, there is no provision related to class-action lawsuits. It is recommended that steps be taken to make it possible for shareholders and investors to file class-action suits against directors and managers for breaches of duty and violations of the law. Such measures would increase private enforcement in the long run, and reduce the need for public or regulatory intervention.

*Statement of compliance*

It is proposed that all listed companies should disclose in their reports how they have applied the principles set out in Part 1 of the MCCG; and include a statement of compliance with respect to the best practices set out in Part 2, which would identify and explain any areas of non-compliance.

*Disclosure of corporate governance and voting policies by institutional investors*

The current initiative by the institutional investors to prepare a set of guidelines with regard to exercise of ownership rights in their portfolio companies is welcome and a step in a right direction. The guidelines should recommend that institutional investors disclose, on a voluntary basis, at least initially, their ownership policy with regard to exercise of their ownership rights and procedures that they put in place to ensure that the policy is implemented effectively. Such disclosure could take place via a website. This least costly and voluntary approach would allow differentiation of institutional investors from each other by the market. In addition, the guidelines should recommend that institutional investors disclose, on an ex-post basis, their voting records. Such practice should contribute to development of shareholder activism in Malaysia.

*Reform of GLCs*

The government is currently implementing a series of reform to improve performance of government-linked corporations (GLCs). In this context, it is recommended that measures be considered to strengthen independence and the process for nomination of directors, as well as the protection of minority shareholders in the case of listed companies. In addition, the government should review the organization of ownership function of the state in order to ensure that the policy/regulatory functions are clearly separate from the ownership function, in line with international good practice.

*Keeping the Code up-to-date*

The revised Listing Requirements, which took effect in June 2001, aim to raise the standard of conduct of directors and company officers of publicly listed companies, and to promote the development of effective internal governance and compliance. The amendments to the Listing Requirements brought into effect the MCCG, which addressed those issues that appeared to require the most immediate attention. In addition, Bursa has issued 12 Practice Notes to promote better understanding, and to facilitate consistent application of the new Listing Requirements by industry participants. The corporate governance environment is evolving, however, and the Code and supplemental materials need to be kept up-to-date with evolving best practices.

## Summary of Observance of OECD Corporate Governance Principles

<b>PRINCIPLE</b>				
<b>I. ENSURING THE BASIS FOR AN EFFECTIVE CORPORATE GOVERNANCE FRAMEWORK</b>				
		Malaysia	Thailand*	Korea**
IA	Overall corporate governance framework	75	75	n.a.
IB	Legal framework enforceable and transparent	75	75	n.a.
IC	Clear division of regulatory responsibilities	75	75	n.a.
ID	Regulatory authorities have sufficient authority, integrity and resources	75	75	n.a.
<b>II. THE RIGHTS OF SHAREHOLDERS AND KEY OWNERSHIP FUNCTIONS</b>				
IIA	Basic shareholder rights	75	75	75
IIB	Rights to participate in fundamental decisions	50	50	100
IIC	Shareholders AGM rights	75	75	75
IID	Disproportionate control disclosure	75	75	75
IIE	Control arrangements should be allowed to function	75	50	75
IIF	The exercise of ownership rights by all shareholders, including institutional investors, should be facilitated	50	75	50
IIG	Shareholders should be allowed to consult with each other	75	75	n.a.
<b>III. EQUITABLE TREATMENT OF SHAREHOLDERS</b>				
IIIA	All shareholders should be treated equally	50	50	75
IIIB	Prohibit insider trading	75	75	50
IIIC	Board/managers disclose interests	75	75	50
<b>IV. ROLE OF STAKEHOLDERS IN CORPORATE GOVERNANCE</b>				
IVA	Legal rights of stakeholders are to be respected	75	75	50
IVB	Stakeholder redress	75	75	100
IVC	Performance-enhancing mechanisms	75	75	75
IVD	Stakeholder disclosure	75	75	100
IVE	Whistleblower protection	75	50	n.a.
IVF	Creditor rights law and enforcement	75	50	n.a.
<b>V. DISCLOSURE AND TRANSPARENCY</b>				
VA	Disclosure standards	75	75	75
VB	Accounting standards	100	50	50
VC	Independent audit annually	75	75	75
VD	External auditors should be accountable to the shareholders	75	75	n.a.
VE	Fair and timely dissemination	75	75	75
VF	Research conflicts of interests	75	75	n.a.
<b>VI. RESPONSIBILITIES OF THE BOARD</b>				
VIA	Act with due diligence, care	50	50	75
VIB	Treat all shareholders fairly	75	75	50
VIC	High ethical standards	50	50	50
VID	The board should fulfill certain key functions	75	50	75
VIE	The board should be able to exercise objective judgment	75	50	50
VIF	Access to information	75	75	50

Notes: The numerical ratings correspond to: 100=Observed; 75=Largely Observed; 50=Partially Observed; 25=Materially Not Observed; 0=Not Observed.

\*Thailand CG ROSC was completed in 2005 and was published in Sept. 2005.

\*\*Korea CG ROSC was completed in 2003 and was published in Sept. 2003.

## Principle - By - Principle Review of Corporate Governance

This section assesses Malaysia compliance with each of the OECD Principles of Corporate Governance. Policy recommendations may be offered if a Principle is less than fully observed. **Observed** means that all essential criteria are met without significant deficiencies. **Largely observed** means only minor shortcomings are observed, which do not raise questions about the authorities' ability and intent to achieve full observance in the short term. **Partially observed** means that while the legal and regulatory framework complies with the Principle, practices and enforcement diverge. **Materially not observed** means that, despite progress, shortcomings are sufficient to raise doubts about the authorities' ability to achieve observance. **Not observed** means no substantive progress toward observance has been achieved.

### SECTION I: ENSURING THE BASIS FOR AN EFFECTIVE CORPORATE GOVERNANCE FRAMEWORK

The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.

**Principle IA: The corporate governance framework should be developed with a view to its impact on overall economic performance, market integrity and the incentives it creates for market participants and the promotion of transparent and efficient markets.**

**Assessment: Largely Observed**

**Capital Markets.** The Malaysian economy experienced its most rapid growth in 2004. Real gross domestic product (GDP) increased by 7.1 percent (RM 248 billion) in 2004 compared with 5.3 percent in 2003. In 2004, the Malaysian capital market continued to expand. The Kuala Lumpur Composite Index (KLCI) ended the year at 907.43 points or 14.3 percent higher than the end-2003 level. Total market capitalization increased from RM 722.04 billion, an increase of 12.8 percent compared to the end-2003 level. Market activity remained significant, with the annual turnover amounted to 108 billion units valued at RM 216.7 billion. Market liquidity declined slightly in 2004, as the average daily turnover decreased to 433 million units from 456 million units in 2003. Better market performance and broader investor interest resulted in 72 Initial Public Offerings (IPOs). Total funds raised through the capital market, however, were slightly lower at RM 6.5 billion, compared with RM 7.8 billion in 2003.<sup>10</sup>

**Ownership framework.** Companies are usually majority controlled by a small group of related parties and managed by owner-managers. An analysis of the ten largest companies by market capitalization showed that the five largest shareholders in these companies owned 60.4 percent of the outstanding shares and more than half of the voting shares. Some 67.2 percent of shares were in family hands, 37.4 percent had only one dominant shareholder, and 13.4 percent were state controlled. The post of CEO, chairman of the board, or vice chairman belonged to a member or nominee of the controlling family.

**Free float.** The average free float is approximately 30 percent of paid-up capital, compared to 40 percent in Singapore and 50 percent in Hong Kong. The government has taken several policy measures to increase the free float of Malaysian listed companies, including the gradual relaxation of the exchange control measures introduced in 1998, the liberalization of equity policy applicable to new investments from 1998 to 2003, and the corporate restructuring of government-linked companies.<sup>11</sup> In addition, Phase 2 of the Capital Market Master Plan includes a series of measures to attract foreign participation in the domestic market, and the divestiture of government-owned shares.

**GLCs.** As of the December 2004, there were about 40 GLCs, with a combined market value of approximately RM 232 billion, accounting for 32 percent of the market capitalization of Bursa Malaysia. A GLC is defined as a company for which the government has the ability to appoint board members and senior management, and actively makes major decisions (e.g., contract awards, strategy, restructuring and financing, acquisitions and divestments). There are three types of GLCs. In the first type, the Government of Malaysia exercises controls directly through Khazanah, the National Pension Fund, and the Bank Negara Malaysia. The second type are companies controlled indirectly by other federal government-linked agencies, through the Permodalan Nasional Berhad, the Employees Provident Fund, and Tabong Haji. The third type consists of companies where control is exercised through state agencies.

GLCs are undergoing a series of reforms to promote a culture of high performance and to transform them into more efficient and globally competitive corporate vehicles. The policy initiatives include the use of key performance indicators (KPIs), performance-linked compensation (PLC) and competitive contracts for the senior management of all GLCs. This policy signals greater emphasis on commercially driven strategies within the private sector, as well as on the government's gradual withdrawal from active micro-management of its private sector entities. In line with these initiatives, the government released 13 guidelines to assist GLCs in their effort to implement KPIs and PLC. Initiatives to strengthen the process for nomination of directors and their independence, the protection of minority shareholders in listed GLCs, and more fundamentally the organization of ownership function within the state, would complement the ongoing reform process.

**Institutional investors.** Domestic institutional investors in the Malaysian capital market consist largely of GLCs, government-linked investment companies, mutual funds, pension funds and investment companies. The most important institutional investors include Khazanah,<sup>12</sup> Ministry of Finance Incorporated, the National Pension Fund, Permodalan Nasional Berhad, the Employees Provident Fund, Lembaga Tabong Haji, RHB Nominees (Tempatan) Sdn Bhd, Petroliam

Nasional Berhad, Amanah Raya Nominees (Tempatan) Sdn Bhd and Malaysian Venture Capital Management Berhad.

**Promotion of efficient and transparent markets.** To increase transparency, the Malaysian regulatory framework mandates disclosure and dissemination to potential and existing investors of timely, accurate, and material information on corporate performance, affairs, and events. Such disclosures are mandated at the IPO of the securities and thereafter on a periodic or continuous basis, depending on the information disseminated.

**Principle IB. The legal and regulatory requirements that affect corporate governance practices in a jurisdiction should be consistent with the rule of law, transparent and enforceable.**

**Assessment: Largely Observed**

**Corporate legal framework.** The legal framework for corporate governance is based on common law. The legal framework governing companies is defined by the Companies Act of 1965; the Securities Industry Act of 1983, as amended; the Banking and Financial Act of 1989; the Securities Industry (Central Depositories) Act of 1991; the Securities Commission Act of 1993; the Futures Industry Act of 1993; and the Financial Reporting Act of 1997.

**Company types.** There are three types of companies governed by the CA: (i) companies limited by shares, where the personal liability of members is limited to the par value of their shares; (ii) companies limited by guarantee, where the members guarantee to meet liability up to a nominated amount if the company is wound up and (iii) unlimited companies, where there is no limit to the members' liability. The most common company structure in Malaysia is a company limited by shares. Such limited companies may be either public (Berhad, or Bhd.) or private (Sendirian Berhad or Sdn Bhd).

**Listing rules.** In addition to providing the conditions to be eligible for listing, and requirements and standards to be maintained for continued listing, the Listing Requirements specifically address key corporate governance issues, including issues such as substantial and related-party transactions, board composition, the role and function of Audit Committees, directors' rights and training, as well as disclosures in relation to the state of internal controls and compliance with the MCCG.

**Securities Law framework.** The Securities Law framework consists of the Securities Industry Act of 1983 as amended, the Securities Industry (Central Depositories) Act of 1991, the Securities Commission Act of 1993, the Futures Industry Act of 1993, and the Financial Reporting Act of 1997.

**Codes.** There are several mandatory and voluntary codes of good practices, such as Malaysia Code on Corporate Governance (MCCG). The MCCG provides a set of principles and best practices for companies on corporate governance. While the Code is voluntary, the Listing Requirements require the boards of publicly listed companies to disclose the extent to which the MCCG has been complied with, and the reasons for any non-compliance. Other codes include Codes on Takeovers and Mergers, Guidelines on Internal Control Disclosures by the Board, and Guidelines on the Specimen Financial Statements for Licensed Financial Institutions.<sup>13</sup>

**Principle IC. The division of responsibilities among different authorities in a jurisdiction should be clearly articulated and ensure that the public interest is served.**

**Assessment: Largely Observed**

**Securities Commission.** The SC is the enforcer of securities laws and the regulator of the Bursa Malaysia Securities Berhad. Its jurisdiction over public companies stems from the SCA. All public companies seeking to issue or offer securities are to submit their proposal to the SC for approval. The penalties for failure to submit the proposals for approval or for submitting false and misleading information in connection with the application is severe – a fine of RM 3 million or a term of imprisonment of 10 years. The SC also administers the insider trading provisions under the Securities Industry Act of 1983. Amendments to the provisions in early 1997 allow the Commission to institute a civil action against the insider to recover the profit or loss avoided by the insider and to impose a civil penalty of up to RM 1 million. The powers of enforcement and investigation of the Commission have been enhanced by the introduction in early 1997 of new sections 99A, 99B, 99C and 99D in the Securities Industry Act of 1987.<sup>14</sup>

Underpinning all these functions is the SC's ultimate responsibility of protecting the investor. Apart from discharging its regulatory functions, the SC is also obliged by statute to encourage and promote the development of the securities and futures markets in Malaysia.<sup>15</sup>

**Companies Commission of Malaysia.** The Companies Commission of Malaysia Act of 2001 (CCMA 2001) came into force on April 16, 2002. The Act establishes the Companies Commission of Malaysia (CCM).<sup>16</sup>

**Bursa Malaysia Securities Berhad (the Stock Exchange).** is the front-line enforcer of its Listing Requirements. Section 11 of the Securities Industry Act of 1983 alters the contract between the Exchange and a listed entity by empowering the Bursa to enforce its rules, not merely against the listed entity, but also against the individual directors of the listed entity, and any person for whom the Listing Requirements are intended.<sup>17</sup> It has recently been demutualized and is now listed on the Kuala Lumpur Stock Exchange.

In general, Bursa<sup>18</sup> conducts front-line monitoring of the compliance of publicly listed companies with their reporting requirements, through monitoring their announcements, market trading activity, the media in general, public complaints, and, in the case of reporting to Bursa, through internal review of furnished documents.

Under the Listing Requirements, the types of sanctions Bursa Malaysia Securities Berhad may impose include the issuance of caution letters, reprimands, fines (not exceeding RM 1 million), directions for rectification, the non-acceptance of applications or submissions, the imposition of conditions for the approval of submissions, suspension of trading, and de-listing. Bursa Malaysia Securities Berhad may, on application to the High Court, seek an order requiring the removal of a director from office and barring him from becoming a director of any other public company for the breach of Listing Requirements.

**Bank Negara Malaysia.** BNM is not independent from the government. It works closely with other key agencies in the government, particularly the Ministry of Finance.

**Bursa Malaysia Depository Sdn Bhd.** Bursa Malaysia Depository Sdn Bhd (formerly known as Malaysian Central Depository Sdn Bhd) was set up on 14 April 1990 to establish and operate the central processing of securities transactions, for both listed and unlisted securities. All securities are deposited with and held in custody by, or registered in the name of, the company or its nominee company for the depositors. Dealings in those securities are carried out by means of entries in securities accounts without the physical delivery of scrip, which facilitates the settlement of securities transactions. Bursa Malaysia Depository is Malaysia's sole Central Depository System (CDS). The Malaysian Delivery Versus Payment (DVP) environment is consistent with most jurisdictions. DVP is final and irrevocable on T+3 and is guaranteed by law.

**Courts.** The Companies Act provides statutory remedies for shareholders who are aggrieved by the act of or inequitably treated by the company, or discriminated against. The shareholders may apply to the court for remedial actions under Section 181 of the CA, or apply to the court to wind up the company under Section 218 of the CA. Section 181 tends to be used more frequently, as it has a wider range of remedies. The high-level Finance Committee, in its report, recommended that there should be statutory provisions to assist shareholders to obtain access to company records for the purpose of gathering sufficient evidence for a court action, subject to the court being satisfied that the shareholder is acting in good faith and the inspection is made for proper purposes.

At present, the CA does not provide for any derivative actions or class actions that could be taken by the aggrieved minority shareholders. However, the high-level Finance Committee has recommended that statutory provisions for both derivative actions and class actions be considered. Under the amended SCA, the SC can bring a derivative action on behalf of the aggrieved party under Section 155. Enforcement in Malaysia seems to be working largely through cooperation and information sharing among regulatory authorities.

**Principle ID. Supervisory, regulatory and enforcement authorities should have the authority, integrity and resources to fulfill their duties in a professional and objective manner. Moreover, their rulings should be timely, transparent and fully explained.**

**Assessment: Largely Observed**

**Authority, integrity, and resources of front line regulators.** The SC is the main regulator of the securities and capital market. Its work is supported by a team of professional staff and its leadership in shaping various corporate governance initiatives leading to enhanced disclosures, and enhanced penalties for violations of securities.

The entities that fall under the jurisdiction of the SC can be categorized as front-line regulators and market intermediaries. Entities under the category of front-line regulators are Bursa Malaysia Securities Berhad (this includes the securities and derivatives exchanges), Bursa Malaysia Securities Clearing (this includes Bursa Malaysia Securities Clearing and Bursa Malaysia Derivatives Clearing), and Bursa Malaysia Depository. Entities that fall under the category of market intermediaries are dealers, dealers' representatives, fund managers (securities and derivatives) and fund managers' representatives, investment advisers, and investment representatives.

Under the SCA, the SC may institute civil proceedings for prohibited conduct such as false trading and market rigging, stock market manipulation, false or misleading statements, fraudulently inducing persons to deal in securities, use of manipulative and deceptive devices, dissemination of information about illegal transactions, and insider trading.<sup>19</sup> Under the SIA, the amount recovered for breach of the insider trading provisions will be applied to reimburse the Commission for its costs and compensate the person who suffered losses or damages by reason of, or by relying on, the conduct of another person who has breached the insider trading provisions. The SC may also recover on behalf of a person who suffers loss or damage by reason of, or by relying on, the conduct of another person who has contravened any provisions of the Act.<sup>20</sup> The SC may also recover on behalf of a person who suffers loss or damage by reason of, or by relying on, the conduct of another person who has contravened any provisions of the Act.<sup>21</sup>

SC is a corporate body established by statute.<sup>22</sup> Currently there are nine members of the SC board. The board is well balanced between the private sector and government officials, and capture does not seem to be an issue.<sup>23</sup> Under the Securities Laws, the SC is accountable to both the Minister of Finance and parliament, and has to submit its annual report and audited accounts to the Minister and table the latter to both houses of Parliament.<sup>24</sup> SC is independently funded through levies and fees charged in the capital market to ensure its independence. The SC is also required to be transparent in its procedures, practices, and use of powers and resources.

While the SC reports to the Minister of Finance, it does not require its consent to exercise any of its administrative, supervisory, and investigatory or enforcement powers, save in specific cases where the consent of or consultation with the Minister is required by law (for example, as to the grant or renewal of a license). In those instances, the Minister makes the decision, usually in consultation or upon the recommendation of the SC. In each of these instances, the process is clearly

set out in the Law. Nevertheless, the close ties between the SC and the Ministry of Finance raise the questions of whether the SC is truly a fully independent regulatory body, consistent with international good practice.

The laws are continuously reviewed and, where necessary, amended to ensure the SC has adequate powers to effectively implement and enforce the Law and its regulations. For example, in 2000 the SCA was amended to bring the prospectus regime relating to the issue and offer of securities under the authority of the SC. The SC became the single regulatory authority for all fundraising activities, in particular for the registration of prospectus and requirements for trustees, trust deeds, and borrowers' and guarantors' obligations for debentures of corporations other than unlisted recreational clubs. In 2003, amendments to the SC's civil enforcement remedies and ability to take administrative actions were further enhanced.

Findings can be appealed administratively and through the court system. The Laws require that a person affected by the SC's proposed administrative action have an opportunity to be heard. The processes within the Laws and the guidelines issued by the SC circumscribe the SC's exercise of its discretion. The SC has the power to review any of its own decisions under the SCA upon the application of a person aggrieved by the decision.<sup>25</sup> Additionally, there is the ability to appeal to the Minister with respect to certain actions, e.g., where the SC refuses to grant, renew, revoke, or suspend a license<sup>26</sup> of the SIA, or where the SC prohibits trading in particular securities.<sup>27</sup> Under the securities legislation, the SC has to seek a court order to exercise its enforcement powers. Additionally, all administrative decisions of the SC are subject to judicial review.

## SECTION II: THE RIGHTS OF SHAREHOLDERS AND KEY OWNERSHIP FUNCTIONS

**The corporate governance framework should protect and facilitate the exercise of shareholders' rights.**

**Principle IIA: The corporate governance framework should protect shareholders' rights. Basic shareholder rights include the right to:**

**Assessment: Largely Observed**

(1) Secure methods of ownership registration	The Malaysian Central Depository operates a system that enables securities transactions to be effected electronically without the need for physical delivery of shares. Under the Companies Act of 1965, any name that appears on the record of depositors maintained by the central depository, under Section 34 of the Securities Industry Central Depositories Act of 1991, is deemed to be a member of the company. A depositor will not be regarded as a member of a company entitled to attend, speak, or vote at the general meeting unless his name appears on the record of depositors not less than three market days before the general meeting. <sup>28</sup> Any rectification of the register of depositors must be made to the Court, and the Court's discretion to rectify is limited to the circumstances set out in the Companies Act. <sup>29</sup>
(2) Convey or transfer shares	Shares are freely transferable, as provided by the Articles of Association, and are also capable of being inherited or transmitted by operation of law. Section 98 of the Companies Act provides that shares are subject to the law relating to ownership and dealing in property. <sup>30</sup> The Listing Requirements stipulate that the Articles of Association of a listed company must not contain any restriction on the transfer of fully paid securities. <sup>31</sup>
(3) Obtain relevant and material company information on a timely and regular basis	The Companies Act of 1965 makes provision for members to have access to various records and registers that the company must maintain to enable the members to be fully informed of what is happening in the company. <sup>32</sup> All shareholders have a right to receive a copy of the audited annual reports and circulars issued by the company. The contents of the annual reports include the audited financial statements of the company and statutory disclosures, as required by the CA under Section 169, and the Ninth Schedule and the Listing Requirements. The statutory disclosures include both financial and non-financial information, as well as directors' declarations and statements. Under the new Listing Requirements issued in 2001, the directors need to give additional statements on the state of internal controls in the company, and the extent of compliance with the MCCG. In addition, beginning in 1999, publicly listed companies have been required to make quarterly announcements of their financial results and financial position. These announcements are made available to the investing public and must be made by the end of the second month after the end of the quarter.
(4) Participate and vote in general shareholder meetings	The right to vote is recognized in Malaysia as a proprietary right, and every member has an unfettered right to exercise his/her votes as attached to the shares. <sup>33</sup> Some companies have issued shares with special voting rights, called Special Shares or Golden Shares. These shares entitle the holder to exercise a veto over any tabled resolution. These shares have been used by the government as a discipline measure against the management of a company with which it was displeased. In addition, under the Guidelines on the Acquisition of Interests, Mergers and Takeovers by Local and Foreign Interests, foreign investment in companies whose activities involve national interests such as water

	<p>and energy supply, broadcasting, defense, and security, is limited to 30 percent.</p> <p>Voting procedures. The general rule is that two members personally present will constitute a quorum. Voting in Malaysia may be by show of hands or written ballot.<sup>34</sup> Each member is entitled to one vote on a show of hands, unless the articles of a company provide otherwise. Voting by mail is not permitted. A member may appoint a proxy to vote on his/her behalf. The statutory provisions contained in the Companies Act are aimed at curbing undue restrictions against voting by proxy that may be inserted into Articles of Association. A proxy has the right to speak at a meeting, in the absence of a contrary provision in the Articles. Otherwise a proxy may only vote by ballot. The proxy may demand a ballot. Companies with Articles of Association generally require proxy forms to be deposited with the company some time before the meeting, to facilitate checking and validation of the forms. But any provision requiring forms to be deposited more than 48 hours before the meeting is void.<sup>35</sup> In practice, these procedures largely work. However, there have been instances when they have not been followed.</p>
(5) Elect and remove board members	Shareholders are entitled to vote on the election of directors. Directors are elected normally by the passing of an ordinary resolution at a general shareholders meeting. Directors can be removed from office by the shareholders under Section 128 of the Companies Act, requiring a resolution with only a simple majority but with 28 days notice. The one-share-one-vote rule is observed strictly in Malaysia. Voting caps are prohibited, and cumulative voting is not permitted.
(6) Share in profits of the corporation	How and when dividends are to be declared is a matter specified in the Articles of Association. Typically, directors recommend the amount of dividends and a general shareholder meeting declares the dividends, subject to the maximum recommended by the directors. There is no mandatory minimum dividend. Dividends may not be paid unless there are profits available for that purpose. <sup>36</sup>
<b>Principle IIB. Shareholders should have the right to participate in, and to be sufficiently informed on, decisions concerning fundamental corporate changes such as:</b>	
<b>Assessment: Partially Observed</b>	
(1) Amendments to statutes, or articles of incorporation or similar governing company documents	Shareholders have the right to vote on major transactions, including amendments to a company's Articles of Association, authorization of additional shares, and other extraordinary transactions. An extraordinary general meeting must be called and the quorum is as specified in the company's Articles. The nature of a special resolution is described by section 152(1) CA and generally must satisfy three conditions: i) it has been passed by a majority of not less than 75 percent of such members as being entitled to do so vote in person or, where proxies are allowed, by proxy; ii) it has been passed at a general meeting; and iii) not less than 21 days' notice specifying the intention to propose the resolution as a special resolution has been duly given.
(2) Authorization of additional shares	<p>Issuing share capital. An increase in the share capital of the company may be done by simply issuing more shares. Where a company proposes to increase its share capital, it may be passed by an ordinary resolution, i.e. not less than 50 percent of such members who are entitled to vote do so in person or, where proxies are allowed, by proxy. Reduction of share capital requires a special resolution.</p> <p>Preemptive rights. Preemptive rights are available in private limited companies but not public listed companies. The CA imposes restriction on the alteration of capital without shareholders' mandate. Any new issue or offer of shares must first be issued or offered to existing shareholders in proportion to their entitlements. In addition, the CA imposes a restriction on reduction of capital. It is only by way of court confirmation and a super majority resolution that a company may reduce its share capital.</p>
(3) Extraordinary transactions, including sales of major corporate assets	Sale of major corporate assets. Transactions involving transferring or selling of whole or part of the business or property of the company require special resolutions. In the case of a public listed company, a general mandate may be sought from its shareholders on a yearly basis pursuant to paragraph 10.09 of the Bursa Listing Requirements for such transactions. However, in a case where no general mandate is obtained from its shareholders, specific shareholders' approval must be obtained for such transactions that reach the threshold which requires shareholders' approval.

**Principle IIC: Shareholders should have the opportunity to participate effectively and vote in general shareholder meetings and should be informed of the rules, including voting procedures, that govern general shareholder meetings:**

**Assessment: Largely Observed**

Rules governing shareholder meetings include the following.

**(1) Sufficient and timely information on date, location, agenda, and issues to be decided at the annual general meeting.**

**Meeting deadline.** Once in every calendar year, and not more than 15 months after the holding of the last preceding annual general meeting.

**Meeting notice.** All shareholders are entitled to receive notices of the company's AGMs, as provided in the company's Articles of Association. The notice period for AGMs has been extended from 14 days to 21 days to allow for a longer circulation period to ensure that all shareholders receive the notice. However, this may not be sufficient for foreign shareholders or shareholders residing outside of the jurisdiction.

**Information available.** The CA accords the shareholders the right to inspect certain statutory records and registers of the company, such as the register of members, register of directors, register of substantial shareholders, register of charges, and others. The shareholders have also the right to inspect the minutes of AGMs. The accounts of the company must be presented before the members at the AGM.

**Quorum rules.** The Articles specify the number of members needed for a quorum. The general rule is that two member will constitute a quorum. The shareholders have the right to demand a general meeting under the CA if they hold 10 percent or more of the paid-up capital of the company. The Companies Act also provides that shareholders can propose resolutions to be put forth for consideration at the general meeting if they own 5 percent of the voting rights or the request is made by at least 100 shareholders, each owning not less than RM 500 fully paid-up shares in the company.

**(2) Opportunity to ask the board questions at the general meeting.**

**Forcing items on the agenda.** The notice of the meeting must contain the agenda for the meeting. New items cannot be placed on the agenda at the meeting itself. Notice of the meeting and its agenda can only be amended prior to the meeting and an amended notice has to be given.

**Questions.** There is no formal provision in the CA for shareholder questions during the AGM. The handling of shareholder questions is solely a matter of discretion of the board of directors. Under common law, the shareholders are obliged to confine their questions to matters in the resolution. However, in practice there is an open forum for the shareholders to ask a wide range of questions under the agenda item adopting the reports and accounts. Typically, shareholder questions during the AGM are few in number, and there is not much communication to the shareholders about the company's business plans or strategies.

**Ability to vote both in person and in absentia.** Shareholders are entitled to appoint a proxy or proxies to attend on their behalf, subject to the depositing of the proxy instrument with the Company Secretary, normally within 48 hours before the meeting. Restrictions on the eligibility of becoming a proxy vary from company to company. Generally there are no stringent constraints on the eligibility of proxies. A shareholder is entitled to attend and vote at the general meetings if his/her name has been entered into the register of members not less than three market days before the general meeting.<sup>37</sup>

In practice, however, there are cases where the AGM has not work as expected. For example, in one recent case, minority voting through proxies and corporate representatives were refused entry to the AGM on technical grounds under the CA.<sup>38</sup> In practice, AGM works generally well unless the company has an intention to be non-transparent.<sup>39</sup>

**Principle IID: Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.**

**Assessment: Largely Observed**

**Classes of shares.** The CA distinguishes two types of shares – equity shares (i.e., voting shares) and preference shares (which can be voting or non-voting).

**Ownership disclosures by shareholders.** Substantial shareholders (holding 5 percent or more of the aggregate of the nominal amount of all the voting shares in the company) are required under law to give notice to the company, with a copy to the exchange of any changes to their interests. The 5 percent rule applies to the beneficial owners as well as to persons "acting in concert."

**Ownership disclosures by companies.** Similar notification is also required to other relevant regulatory agencies pursuant to the law (i.e., SC, CCM, and BNM). The Companies Act also accords the shareholders the right to inspect certain statutory records and registers of the company, such as the register of members, register of directors, register of substantial shareholders, and register of charges.

**Public access to register of members and register of substantial shareholders.** Companies are under a legal obligation to maintain both a register of members and a register of substantial shareholders. The registers are open to inspection by

any member without charge, and by any other person for a prescribed fee. The register of members is principally derived from the record of depositors, provided by the central depository as a service to companies for a fee. In addition, companies can require any member of the company within a reasonable time to disclose whether (s)he holds any voting shares in the company as beneficial owner or as a trustee; and if so, to indicate so far as possible the names and other particulars of the persons so that their identities and nature of their interest may be known.

**Disclosure of shareholder agreements.** Under the Listing Requirements, shareholder agreements have to be disclosed via an announcement to Bursa.

Pyramid structures are no longer present in Malaysia after the 1997 financial crisis, in the light of the disclosure and stringent related-party requirements that have been put in place.

**Principle IIE: Markets for corporate control should be allowed to function in an efficient and transparent manner.**

**Assessment: Largely Observed**

<p>(1) Transparent and fair rules and procedures governing acquisition of corporate control</p>	<p><b>Code on Takeovers and Mergers.</b> The Malaysian Code on Takeovers and Mergers is administered by the Securities Commission. Compliance with the provisions of the Code is mandatory under the law. In administering the Code, the SC is required to ensure the fair and equal treatment of all shareholders, in particular minority shareholders, in relation to takeover offers, mergers, or compulsory acquisitions.<sup>40</sup></p> <p><b>Tender rules/mandatory bid rules.</b> Under the SCA and in accordance with the provisions of the Takeover Code, an acquirer who obtains 33 percent of the voting rights in a company must make a mandatory general offer for the remaining shares.<sup>41</sup> The Takeover Code makes the SC the sole authority to grant waivers from such requirements.</p> <p><b>Delisting/going private provisions.</b> Listing Requirements provide protection of shareholders against companies whose financial performance is unsatisfactory. The recent Bursa Malaysia improvements to the framework for Practice Notes through amendments to the Listing Requirements and Practice Notes is aimed to further improve and strengthen the quality of companies and expedite the time taken by listed companies with unsatisfactory financial condition and the level of operations to regularize their condition.<sup>42</sup> Under the new framework, listed companies with unsatisfactory financial conditions and level of operations (other than cash companies) will have 8 months to submit their regularization plans to relevant authorities for approval. In case of failure, their securities will automatically be suspended within the prescribed time period and de-listing procedures will be taken against such companies.<sup>43</sup> The new framework applies to listed companies that trigger the prescribed criteria after January 3, 2005. For other existing companies, however, the requirement under the previous framework will continue to apply.<sup>44</sup> Voluntary delisting is regulated by the SCA.<sup>45</sup></p> <p><b>Squeeze out provisions.</b> Presently the CA provides that in the case of a general offer to buy the remaining shares not already owned by the controlling shareholder, and 90 percent of the shareholders accept the offer, the remaining 10 percent of the shareholders must sell their shares to the controlling shareholder under the same terms and conditions as the general offer.</p> <p><b>Abuse of buyback/treasury shares.</b> If authorized by its Articles of associations, and if certain procedures are followed, a listed company on an exchange can buy-back its own shares from the stock market.<sup>46</sup> A listed company shall not purchase its own shares unless it is solvent at the date of the purchase, the purchase is made through the stock exchange on which the shares are quoted, and the purchase is made in good faith and in the interest of the company.</p>
<p>(2) Anti-take-over devices</p>	<p>Under the Takeover Code, there is no prohibition against affecting a hostile takeover bid. In Malaysia, hostile takeover bids are not usual. However, the Securities Commission, in response to the abuse of back-door listings, has introduced, in Chapter 18 of Policies and Guidelines on Issue/Offer of Securities, the requirement for prior permission to be sought before a back-door listing can be affected. This is to minimize abuse of the minority. There is also a case for recognizing the fiduciary duty of the controllers to the minority in situations where there is a change of control.</p>

**Principle IIF: The exercise of ownership rights by all shareholders, including institutional investors, should be facilitated.**

**Assessment: Partially Observed**

(1) Disclosure of corporate governance and voting policies by institutional investors	At present, institutional investors are not required to disclose their corporate governance and voting policies with regard to their portfolio companies, nor the procedures in place to implement such policies. In addition, institutional investors do not disclose their voting records to the market. Major institutional investors in Malaysia are currently in the process of formulating a set of best practices for institutional investors. The Minority Shareholder Watchdog Group (MSWG) is acting as the secretariat for this initiative.
(2) Disclosure of management of material conflicts of interest by institutional investors	SC's Guidelines on Unit Trust Funds and the Prospectus Guidelines require unit trust management companies to disclosure material conflicts of interest, in particular the nature of the conflict of interest and its subsequent treatment.

**Principle IIG: Shareholders, including institutional shareholders, should be allowed to consult with each other on issues concerning their basic shareholder rights as defined in the Principles, subject to exceptions to prevent abuse.**

**Assessment: Largely Observed**

**Rules on shareholder cooperation in board nomination/election.** There are no rules specified in the law. While there are no rules preventing such discussion among shareholders, cooperation and communications among shareholders are encouraged. Institutional organizations such as the Malaysian Association of Asset Managers and Federation of Malaysian Unit Trust Managers are providing discussion forums and facilitate cooperation among group of invertors.

**Rules on communication among minority shareholders.** The law does not regulate the issue. However, in 2001, the MSWG was set up. Minority shareholders can appoint MSWG to attend general meetings on their behalf.

**Proxy solicitation or other formalities required.** Not applicable.

**Rules on communication among institutional investors.** The issue is not regulated.

### SECTION III: THE EQUITABLE TREATMENT OF SHAREHOLDERS

**The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.**

**Principle IIIA: All shareholders of the same series of a class should be treated equally.**

**Assessment: Partially Observed**

(1) Equality, fairness, and disclosure of rights within and between share classes	<p>Availability of share class information. The rights attached to each class of shares are described in the CA and available from CCM, the Central Depository, and the company.</p> <p>Equal rights within classes. The equal rights of shareholders of different classes of shares are entrenched in the CA. Of course, the rights within a class of shares are also equitable. This fact, coupled with high standards of transparency of ownership/substantial shareholding, results in a high degree of transparency with regard to shareholder rights.</p> <p>Approval of change by the negatively impacted classes of change. Where the capital of the company is divided into different classes of shares and there is a provision in the memorandum or Articles authorizing the alteration only upon the consent of some specified proportion of shareholders of that class, an alteration of the Articles to affect class rights may be restrained under Section 65 of the Companies Act of 1965.</p>
(2) Minority protection from controlling shareholder abuse; minority redress	<p>Malaysian law provides various avenues for minority shareholders' voices to be heard. Under the CA, shareholders have the right to call for an AGM, or can apply for a court order under Section 181 of the CA where they believe they have been oppressed, prejudiced, or unfairly discriminated against or their interests disregarded. The underlying element is one of unfairness to the shareholder concerned. Section 181 orders can be sought in situations where the shareholder alleges there has been appropriation of business, property, or corporate opportunity at the expense of the company or its minority shareholders, unjustifiable failure to pay dividends, or the director's neglect of the duty of care, skill, and diligence.<sup>47</sup> More than a thousand cases have been brought so far, and half of them have been successful.</p> <p><b>Shareholder's right to request a meeting.</b> The CA provides that a meeting may be demanded by members holding not less than 10 percent of the company's voting rights. If</p>

	<p>the directors do not convene a meeting within 21 days after receipt of the demand, the members may convene the meeting themselves.<sup>48</sup> Crucially, any reasonable expenses incurred by the members in calling the meeting are to be paid by the company, which may reimburse itself out of any sums due to the defaulting directors by way of fees or other remuneration. Members also have an independent power to convene an extraordinary general meeting under the CA, which provides that two or more members holding not less than 10 percent of the company's issued share capital may call a meeting of the company.</p> <p><b>Ability to inspect books.</b> Under the CA, the registers are open to inspection by any member without charge, and by any other person for a prescribed fee. There are a number of registers which are required to be made available under the Companies Act.<sup>49</sup> There is no need for special audit or inspection, as the books are always available for inspection.</p> <p><b>Withdrawal rights?</b> N/A</p> <p><b>Ability to challenge shareholder resolutions.</b> Shareholders may, under Section 20 of the CA, challenge a shareholder's resolutions as either beyond the powers of the meeting or as ultra vires the purposes of the company.</p> <p><b>Power to postpone an AGM.</b> Under the CA, the director must convene a meeting as soon as possible within two months after the receipt of the requisition by the company. There is no power of postponement.</p> <p><b>Court redress.</b> There are a few forms of action that are capable of being brought by a shareholder: (i) personal action; and (ii) derivative action. In a personal action, a shareholder takes action to enforce his personal rights as a shareholder against the company as the defendant. In practice, common law derivative action is constrained by the common law principal of locus standi and by cost. Personal actions are also constrained by cost. Judges in Malaysia do not have a standard guideline for applying the principal. However, there are occasional successful actions.<sup>50</sup></p> <p>In a derivative action, a minority shareholder seeks to enforce the company's rights against the majority shareholder. A court judgment would be given in favor of the company, which is made a party to the proceedings. In practice it is very difficult to cause the company to commence an action against a defaulting director, especially where he controls the board. So it is not uncommon to find that a company commences an action only after there has been a change in management or where the defaulting director has left the company.</p> <p><b>Regulatory redress.</b> Section 155 of the Securities Commission Act now provides that the SC may recover loss or damage by reason of the conduct of another person who has contravened any provisions or regulations made under this Act, whether or not that other person has been charged with an offense with respect to the contravention, or whether or not a contravention has been proved in a prosecution. This new provision enables the SC to bring a derivative action against malfeasant officers and third parties who have caused loss and damages to the company. This regulatory redress has not yet been used.</p>
(3) Custodian voting by instruction from beneficial owners	Custodian voting is regulated by the CA. A member may appoint a proxy to vote on his/her behalf. Section 149 of the CA provides for a statutory right for the appointment of proxies.
(4) Obstacles to cross border voting should be eliminated.	The AGM notice period of 14 days (21 days extended notice) is too short to collect voting instructions from beneficiaries.
(5) Equitable treatment of all shareholders at GMs	Preference shareholders may attend AGMs but cannot vote. Ordinary shareholders of companies have full voting rights on all matters involving the company.
<b>Principle IIIB: Insider trading and abusive self-dealing should be prohibited.</b>	
<b>Assessment: Largely Observed</b>	
<p><b>Basic insider trading rules.</b> Insider trading is regulated by the SIA. The purpose of the SIA is to prevent people who possess price-sensitive information about securities from trading in those securities, or recommending to others that they do so, before that information is published or otherwise reflected in market prices.</p> <p>The SIA, inter alia, prohibits insider trading and defines which information is considered price sensitive and the elements of insider trading. In addition, the Act imposes duties of secrecy, civil and criminal liabilities, and provides for compensation to victims affected by losses.</p> <p>Pursuant to Securities Industry Act of 1983, a person is an "insider" if that person:</p> <ul style="list-style-type: none"> <li>➤ possesses information that is not generally available which, on becoming generally available, a reasonable person</li> </ul>	

would expect to have a material effect on the price or the value of securities; and

- knows or ought reasonably to know that the information is not generally available.

Principal officers, employees, company secretaries, and substantial securities holders who hold inside information are presumed to hold that information by reason of their position, unless they can prove to the contrary.

**Insider trading disclosure.** In addition to the provisions of the SIA, the Listing Requirements also provide that a listed public company must adopt rules governing dealings by directors in its listed securities, in terms that are no less than those stipulated in the Guidelines.<sup>51</sup>

**Criminal/civil/administrative penalties.** A person engaging in insider trading activities is liable to a seller or a buyer of the securities for any loss incurred, and to the company issuing the shares, for the amount of any gain made or loss avoided, and to a penalty.

Further, the CA contains specific provisions for officers in listed entities not to abuse their official position by dealing in securities, and not to improperly use of information that relates to unpublished price-sensitive information. However, there have been only a few cases of successful prosecution.

**Principle IIIC: Members of the board and key executives should be required to disclose to the board whether they, directly, indirectly or on behalf of third parties, have a material interest in any transaction or matter directly affecting the corporation.**

**Assessment: Largely Observed**

**Related-party transactions approval/rules for approval of board/AGM.** A related party is a director, major shareholder, or person connected with such director or major shareholder. A major shareholder includes any person who has or had, within the preceding 12 months of the date on which the terms of the transaction were agreed upon, and defined as a person who has an interest or interests in one or more voting shares in a company and the nominal amount of those shares, or the aggregate of the nominal amounts of those shares, not less than 5 percent of the aggregate of the nominal amounts of all voting shares in the company.

Related-party transactions by directors of listed companies are regulated by the Listing Requirements. Approval from shareholders is required for related-party transactions. For related-party transactions exceeding 5 percent of the given percentage ratios in the Guidelines, the company must issue a circular to the shareholders providing full details of the transaction, and appoint an independent advisor to advise the shareholders on the transaction.

If the transaction exceeds 25 percent of the given percentage ratio of material threshold, the company must appoint a main advisor to ensure that the transaction is carried out on fair and reasonable terms, not detrimental to the minority shareholders, and confirm to Bursa and the SC when the transaction has been completed that they have discharged their responsibility with due care. Such approvals from the shareholders must be obtained prior to the transactions taking place. Interested parties to the transaction and persons connected to it must abstain from voting on the resolution to approve the transaction.

#### **Directors' dealings with the company**

**Conflicts of interest.** Directors who are directly or indirectly involved in any transaction with their company must ensure that the company is obtaining fair value and ensure that they disclose the nature and extent of their interest to the other directors.

**Nature of interest.** Interests can be categorized as direct or indirect. Both direct and indirect interests must be disclosed. A director has a direct interest when the director is:

- a party to a transaction;
- a parent, child, adopted child or stepchild, or spouse of a party to the transaction;
- a director, officer, or trustee of a party to the transaction. An indirect interest arises in a number of situations. For example, an indirect interest arises if a director has a material financial interest in another party to a transaction, or in a party that will obtain a material financial benefit from the transaction.

**Disclosure.** The primary obligation of interested directors is to enter the nature and extent of the interest, including monetary value, in the interests register (see below). If the nature of conflict is directly between the director and the company, the director is also required to disclose the interest to the board. If the transaction is between the director and the company, and the transaction is entered into but falls within the provisions of the CA, the director should seek the approval of the shareholders at a general meeting.<sup>52</sup> The information must be set down in the audited accounts and annual report, a copy of which must be sent to every shareholder who has not waived the right to receive the report at the annual general meeting.

Failure of a director to disclose his/her interest to the board does not affect the validity of the transaction. The transaction would have to be challenged by the company. If the company does not challenge the transaction, a shareholder may apply to the court to bring a derivative action in the name of the company to challenge the transaction. In addition, a shareholder may bring a personal action against a director for breaching his/her duty to disclose the relevant interest.

**Abstention by interested directors.** Interested directors of all companies cannot participate fully in decision making or

voting, and should be excluded as part of the quorum. Once approved, they can carry out fully the implementation of transactions in which they are interested, unless the Articles provide otherwise.

**Use of company information.** A director must not disclose, use, or act on information which (s)he has obtained through his/her position with the company, where the information would not otherwise be available to the directors. Exceptions to this statutory obligation include using the information for the purposes of the company or as may be required by law.

Unless prohibited by the board, a director can give information to a person whose interests that director represents on the board (this applies also to nominee directors). A director may also provide information to a person who directs or instructs that director, unless prohibited by the board. Before a director can make such disclosure, the director must inform the board of the name of the person to whom the information is to be disclosed.

In all other situations, before directors are allowed to disclose any information they have obtained in connection with the company, they must advise the board in writing of the proposed disclosure; and obtain the authority of the board to disclose the information. No disclosure can be made if it is likely to prejudice the company.

**Share dealings by directors.** The Directors of listed companies are not allowed to deal with their shares during a closed period, and are required to announce such dealings to the Bursa if their wish to deal during a closed period. [See also Section IIIB above on insider trading.]

#### SECTION IV: THE ROLE OF STAKEHOLDERS IN CORPORATE GOVERNANCE

**The corporate governance framework should recognize the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.**

**Principle IVA: The rights of stakeholders that are established by law or through mutual agreements are to be respected.**

**Assessment: Largely Observed**

**List of relevant codes for stakeholders.** The rights of other stakeholders are established under various statutes in the country such as the Labor Law, Contracts Law, and Insolvency Law. Increasingly corporations have realized the importance of stakeholders in contributing to the building of competitive and profitable companies and in increasing the wealth of the principal stakeholder – the shareholder. The interests of stakeholders are entrenched in the corporate governance framework in Malaysia, and in line with the OECD Principles of Corporate Governance provision, proposals have been made to permit more active participation by the other stakeholders, particularly the creditor banks and employees, in enhancing corporate governance. However, in the Malaysian context, these proposals will face an uphill battle in securing corporate buy-in.

**Principle IVB: Where stakeholder interests are protected by law, stakeholders should have the opportunity to obtain effective redress for violation of their rights.**

**Assessment: Largely Observed**

**Redress mechanism available to stakeholders.** Employees and creditors can seek redress in court. Employees' rights have been safeguarded under the various Labor Laws, such as the Employment Act 1955. The rights to outstanding wages and salaries in the event of the company winding up is protected under the CA, whereby payment of the outstanding wages and salaries ranks second in priority, even above the secured creditors.<sup>53</sup> Creditors' rights are protected under the Debt Collection Law and the Bankruptcy law.

**Principle IVC. Performance-enhancing mechanisms for employee participation should be permitted to develop.**

**Assessment: Largely Observed**

**Employee participation mechanism.** The law does not prohibit performance-enhancing mechanisms for employee participation. Share option schemes or other profit-sharing mechanism are permitted by law. A performance-enhancing mechanism in the form of Employee Stock Option Scheme (ESOS) is relatively common. Bursa Malaysia regulates the ESOS size, recipients, and eligibility under the scheme. For example, not more than half of the proposed issue can be given to management. From year 2006, the benefit derived by employees from the right to acquire shares in a company, as in the case of ESOS, will be taxed in the same year the right is exercised, assigned, released, acquired, and treated as income in the same year.<sup>54</sup>

**Principle IVD: Where stakeholders participate in the corporate governance process, they should have access to relevant, sufficient and reliable information on a timely and regular basis.**

**Assessment: Largely Observed**

**Annual report discloses economic and financial prospects.** Economic and financial prospects are discussed in the annual report. The Listings Requirements provide that material information should be disclosed in the annual report,

including information that:

- concerns the publicly listed company's property, business, financial condition, or prospects;
- relates to dealings with employees, suppliers, customers, and others;
- relates to any event affecting the present or potential dilution of the rights or interests of the publicly listed company's securities; or
- relates to any event materially affecting the size of the public holding of its securities.

**The annual report discloses significant facts about employees.** Beyond the requirement to disclose the total number of employees in the prospectus, the quarterly report, and the annual report, there is no requirement to disclose material issues regarding employees.

**Information is sufficient and reliable.** The required information is sufficient and reliable, as the securities market regulator will monitor the compliance of listed companies with reporting requirements; and there is a requirement that companies have their annual (consolidated) financial statements externally audited.

**Information is timely and regular.** There is a requirement in securities regulations or listing rules for companies to continuously disclose all material information. All publicly listed companies are required to publish and file the annual report to the shareholders and the exchange within a period not exceeding 6 months from the close of its financial year.

**Principle IVE: Stakeholders, including individual employees and their representative bodies, should be able to freely communicate their concerns about illegal or unethical practices to the board and their rights should not be compromised for doing this.**

**Assessment: Largely Observed**

**Whistleblower rules.** The SC has in place legislation to protect whistleblowers, effective January 2004. Malaysia is the first Asian country to implement such provisions. The provisions were aimed at protecting directors, management, and auditors of publicly listed companies, who report breaches of securities laws or listing rules and any matter that had material and adverse financial impact on publicly listed companies (the whistle-blowing provisions to report such breaches or financial matters were mandatory for auditors).

The CA is currently being reviewed by the CLRC. Among the provisions under the proposed bill is the introduction of enhanced provisions for protection of corporate whistleblowers.

**Principle IVF: The corporate governance framework should be complemented by an effective, efficient insolvency framework and by effective enforcement of creditor rights.**

**Assessment: Largely Observed**

**Schemes of arrangement and reconstruction under the Companies Act of 1965.** Certain provisions of the CA deal with rehabilitation and restructuring of companies as ongoing concerns.<sup>55</sup> Under the CA, the High Court can permit a compromise or arrangement between a company and its creditors, subject to a majority in number representing three-fourths in value of the creditors or class of creditors agreeing to a reorganization/compromise plan. The Court can also issue summary orders temporarily restraining creditors from proceeding against the company.<sup>56</sup>

**Asset management company, or Danaharta.** Danaharta was established in 1998 to acquire non-performing loans from banks, and assets from distressed companies, to minimize the problem of a credit crunch, as well as to facilitate an orderly payment/write-down of debts. It has the same claims as the original creditors and relies on a number of asset disposal methods (including private placements, public auctions, and public tender offers) to recover its claims.

The legal process to be followed by Danaharta aims to compensate for the absence of a well-defined scheme of judicial management of corporate restructuring under the Companies Act.<sup>57</sup> The goal is to expedite and shorten the legal procedures and to bring to bear professional expertise on design and implementation of reorganization plans. The operations of Danaharta are covered under a special act that confers on it broad powers to acquire and manage assets.<sup>58</sup>

**Restructuring of small borrowers.** For corporate borrowers with total outstanding debt of less than RM 50 million, the Loan Monitoring Unit at BNM provides assistance in enabling these borrowers to continue to receive financial support while restructuring their operations. These borrowers could also use the Danaharta route. In Asia, the more serious problem arises not from large shareholdings but from the more widespread practice of pyramiding and cross-holdings. This causes a major divergence between the control and cash flow rights of insiders. Therefore, the incentive is for insiders to maximize their private benefits of control and not necessarily shareholder value. There is thus a higher probability that minority shareholders run the risk of being expropriated or their assets squandered.<sup>59</sup>

## SECTION V: DISCLOSURE AND TRANSPARENCY

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.

**Principle VA: Disclosure should include, but not be limited to, material information on:**

**Assessment: Largely observed**

(1) Financial and operating results of the company	<p>Under the CA, a company's financial statements must be approved by the annual general meeting of shareholders, and audited by an external auditor prior to such approval. If a listed company has a subsidiary, it is required to file consolidated financial statements that must be audited as well. The listing rules require that the following be made available to shareholders, Bursa Malaysia, and the SC: the annual audited accounts, auditors' reports, directors' report, directors' statement in relation to preparation of annual audited accounts, declaration of correctness of accounts, board statement on compliance, board statement on internal controls, and chairman's statement. Annual reports and the annual audited accounts are required to be distributed directly to the shareholders prior to the annual general shareholder meeting and are also submitted to the Bursa Malaysia.</p> <p>The Bursa Malaysia Listing Information Network (Bursa Malaysia Link) is the network that connects listed companies, merchant banks, and external company secretaries to the Bursa Malaysia. This link provides an infrastructure for announcements to be submitted electronically. There is no charge for public access to the data. Efforts are underway to enable filing of other documents such as circulars, prospectuses, and annual reports through the link in the future.</p>
(2) Company objectives	<p>Under the CA, the principal activities of the company in the course of the financial year and any significant change in the nature of those activities during the period should be described in the annual report. Under the listing rules, the annual report includes a directors' report which contains: (a) a brief description of the industry trend and developments; (b) a discussion and analysis of the group's performance and the material factors underlying its results and financial position, with particular trend and significant events during the year under review; and (c) prospects for the company.</p>
(3) Major share ownership and voting rights	<p>Substantial shareholders (holding 5 percent or more of the aggregate of the nominal amount of the entire voting shares in the company) are required under the Securities Law to give notice to the company as well to the Bursa and other regulatory agencies (SC, CCM, and BNM) of any changes to their interest. Companies are required to disclose in the annual reports the names of the substantial shareholders and their direct and deemed interest, as shown in the register of substantial shareholders of the publicly listed company. Amendments to the Securities Law in 1998 require disclosure of beneficial shareholders through nominees accounts. Companies are required to maintain both a register of members and a register of substantial shareholders. The registers are open for inspection by any member without charge, and by anyone for a prescribed fee.</p>
(4) Remuneration policy for board and key executives, and information about directors	<p>The aggregate remuneration of the board members with details on director's fees, salaries, bonuses, commission, compensation for loss of office, and benefits in kind must be disclosed in annual reports. The particulars of each director, including name, qualification, and whether the director is an executive or non-executive, must be disclosed in the annual report. The annual report also includes disclosure of any conflict of interest that the directors have with the company.</p>
(5) Related party transactions	<p>The listing rules require immediate disclosure of related-party transactions. A related-party is defined as a director, a substantial shareholder, or a person connected with a director or a substantial shareholder. Where the transaction equals or exceeds 5 percent of the requisite threshold, a circular to shareholders must be issued. Annual report disclosure must include particulars of material contracts of the company and its subsidiaries involving directors' and substantial shareholders' interest and providing the particulars of each contract. Related party disclosures are also required in accordance with the Malaysian accounting standard on related party disclosures, which is consistent with IAS 24.</p>
(6) Foreseeable risk factors	<p>There is a requirement for companies to disclose in their annual reports their policies on risk management and material risk factors. The annual report should include a discussion of internal controls. Under the listing rules, the audit committee and the external auditor are required to evaluate the system of internal controls.</p>

(7) Issues regarding employees and other stakeholders	The material issues regarding employees and stakeholders are not required to be disclosed in the annual report. However, where such issues are considered to have risk management implications, these must be disclosed under disclosures relating to internal control in the annual report.
(8) Governance structures and policies	Listed companies are required to disclose the governance structures and policies in the annual report.

**Principle VB: Information should be prepared and disclosed in accordance with high quality standards of accounting and financial and non-financial disclosure.**

**Assessment: Observed**

**Compliance with International Financial Reporting Standards.** Malaysia has been adopting, starting from the late 70s, accounting standards that are consistent with those issued by the International Accounting Standards Committee (IASC) and now the International Accounting Standards Board (IASB). The approved accounting standards are mandatory for all 700,000 listed and non-listed companies in Malaysia and enforced strictly by the Securities Commission, the Central Banks and the Companies Commission. Where standards are not dealt with by the IASB, or where particular features of the Malaysian environment warrant a domestic standard, the Malaysian Accounting Standards Board (MASB) will issue its own standards.<sup>60</sup> By the end of 2003, Malaysia had adopted all of the 34 International Accounting Standards except for five which were being reviewed for adoption.<sup>61</sup> There have been no major differences between IASs and MASB Standards. Minor differences, if any, are to ensure consistency with local laws. Malaysia has adopted a policy of convergence, where all standards issued by the MASB are word-for-word IFRS, for implementation beginning of 2006. The standards, known as Financial Reporting Standards, are fully IFRS compliant, including the related party disclosure standard and the Financial Instruments standard.

In respect of public listed companies, the law stipulates that the responsibility to comply with accounting standards rests with the listed corporation, its directors and chief executive. The Companies Act further requires the auditors to state in the audit report whether the financial statements have been prepared in accordance with MASB approved accounting standards. The MASB is an independent body and has the Financial Reporting Foundation as its oversight body.

**Review/enforcement of compliance.** The SC conducts surveillance through the monitoring of listed companies announcements, market trading activities, the media in general, and in the case of reporting to the SC, through internal review of documents furnished. In the case of compliance with approved accounting standards, the SC examines on a post-vetting basis, annual audited accounts and interim reports of publicly listed companies. The KLSE conducts the front-line monitoring of compliance with periodic and continuous reporting obligations. In practice, all reports and financial statements are prepared in accordance with the legally backed Malaysian approved accounting standards, which are closely monitored by the Securities Commission, the Central Banks, the Companies Commission, and the KLSE. Departures are penalized subject to the respective Acts of the regulatory agencies.

**Principle VC: An annual audit should be conducted by an independent, competent and qualified, auditor in order to provide an external and objective assurance to the board and shareholders that the financial statements fairly represent the financial position and performance of the company in all material respects.**

**Assessment: Largely Observed**

**International Standards on Auditing.** The Council of the Malaysian Institute of Accountants (MIA) has determined to adopt the International Standards on Auditing (ISA) as the basis for approved standards on auditing and related services in Malaysia.<sup>62</sup> Therefore, the Malaysian Approved Standards are fully consistent with the ISA issued by the International Auditing and Assurance Standards Board of IFAC. In the event that an ISA contains guidance which is significantly different from Malaysian law or practice, the explanatory foreword to an approved ISA provides guidance on such differences. The Malaysian Code of Professional Ethics is substantially based on the Code of Ethics issued by IFAC in June 2005.<sup>63</sup>

**Compliance with Approved Standards on Auditing.** The Council of the Malaysian Institute of Accountants expects members who assume responsibilities as independent auditors to observe Approved Standards on Auditing in the conduct of their audits under all reporting frameworks, as determined by legislation, regulation, and promulgations of the Malaysian Institute of Accountants, and where appropriate, to follow mutually agreed upon terms of reporting. The onus is on members to use their best endeavors to ensure that such standards are also observed by those persons who assist them in their work. In practice, compliance with the Approved Standards on Auditing is strictly enforced by MIA. The penalty for non-compliance could go far as revocation of the license by the Ministry of Finance.<sup>64</sup>

**Audit enforcement.** The Listing Requirements requires a listed issuer to appoint a suitable accounting firm to act as its external auditors. The factors to be considered for the appointment are, among others, adequacy of the experience and resources of the firm and the persons assigned to the audit.<sup>65</sup> The Investigation Committee and Disciplinary Committee of the Malaysian Institute of Accountants may inquire into apparent failures by members and those persons under their supervision to observe approved Standards on Auditing and Generally Accepted Auditing Principles. Any failure to observe approved Standards on Auditing could be regarded as conduct discreditable to the profession of an accountant and might lead to disciplinary action being taken against the member or members concerned.

**Auditors' qualifications.** External auditors should comply with the Code of Ethics for Professional Accountants issued by IFAC and adopted by MIA with modifications to meet national requirements of the Malaysian Institute of Accountants.<sup>66</sup> Ethical principles require auditors to be independent, competent, and qualified to provide objective assurance to the board and shareholders that the financial statements fairly represent the performance of the company.

**Principle VD: External auditors should be accountable to the shareholders and owe a duty to the company to exercise due professional care in the conduct of the audit.**

**Assessment: Largely Observed**

**Auditor accountability.** The Companies Act of 1965 requires every auditor of a company to report to the shareholders on the accounts required to be laid before the company in general meeting and on the company's accounting and other records relating to those accounts and, if it is a holding company for which consolidated accounts are prepared, also report to the members on the consolidated accounts.<sup>67</sup>

The appointment of external auditors by the AGM is a pro forma approval of the board selection, and the shareholders almost always approve the board's recommendation. The International Standards on Auditing, as adopted by MIA, state that the external auditors' report should be appropriately addressed to the shareholders, in accordance with statutory and professional requirements, and independently assure the board on the discharge of their responsibilities, as required by the Code and in accordance with professional guidance. The powers and duties of auditors in Malaysia are provided for under the Companies Act of 1965 and Securities Industry Act (SIA) of 1983. In addition to the exiting provision in the SIA, the amendment to the Act in 2004 include the whistle blowing provision, which impose a mandatory duty on auditor to report breaches of securities laws and the rules of exchange (Bursa Malaysia) to the relevant authorities.

**Effective oversight of the audit function.** The audit committee, comprising a majority of independent non-executive directors, oversees the audit function. The Bursa and the SC conduct surveillance/reviews of the audited financial statements, and any transgressions result in sanctions against the publicly listed company and/or directors, whereas the respective auditors are referred to the Malaysian Institute of Accountants for disciplinary action.

**Auditor insurance.** Shareholders and/or stakeholders can sue the external auditors. There is a mandatory requirement for each auditor in Malaysia to obtain professional indemnity insurance for a minimum coverage of RM 100,000.00 (US\$26,316) per year. This requirement is monitored at the stage of issuance of the yearly practicing certificate.

**Principle VE: Channels for disseminating information should provide for equal, timely and cost-efficient access to relevant information by users.**

**Assessment: Largely Observed**

In general, access to corporate information by the public is available through several channels, including annual reports and annual audited accounts, quarterly financial reports, and notices and circulars. The move toward electronic reporting and the use of the internet as a channel for dissemination has greatly enhanced the accessibility of corporate information. Listed companies have also been encouraged to establish investor relations units. The dissemination of information as stated above is currently in practice. In fact, most of the listed companies have established websites as a means to disseminate corporate information electronically, and some have also established a corporate relations department for greater transparency and to facilitate shareholder/investor involvement.

**Material events.** Publicly listed companies are required to make immediate disclosure of all material (price sensitive) information. Such announcements are submitted to the Bursa and the SC.

**Published information.** Annual reports and the annual audited accounts are required to be distributed directly to shareholders no less than 14 days before the AGM and are also submitted to the Bursa Malaysia. Quarterly financial reports are to be released not later than 2 months after the end of each quarter of the listed issuer's financial year. The move toward electronic reporting and the use of the internet as a channel for dissemination has greatly enhanced the accessibility of such information. There are also other documents filed and lodged with the CCM, which are accessible for a small fee.

**Principle VF: The corporate governance framework should be complemented by an effective approach that addresses and promotes the provision of analysis or advice by analysts, brokers, rating agencies and others, that is relevant to decisions by investors, free from material conflicts of interest that might compromise the integrity of their analysis or advice.**

**Assessment: Largely Observed**

**Disclosure of conflicts of interests by analysts, brokers, rating agencies, etc.** The SC and Bursa Securities regulate conflicts of interest by advisers/experts through the provisions of law as well as through administrative guidelines and the Business Rules of the exchange respectively. The SIA regulates conduct of securities business and requires certain persons (dealers, fund managers, investment advisers or representative) to disclose their interest in securities when making a recommendation with respect to such securities.<sup>68</sup> Rating agencies are required to be independent, objective, and free from undue intervention or influence from shareholders. Rating agencies are required to maintain written policies and procedures to maintain their independence and disclose all material conflicts of interest in their rating reports.

In addition, the SC's Policies and Guidelines on Issues and Offer of Securities (Issues Guidelines) provide that a principal adviser with relation to a corporate proposal must take reasonable steps to ascertain whether a conflict of interest exists. Where such conflict exists or is likely to exist, all possible steps must be taken to avoid or resolve such conflicts. Full disclosure must be made and of the nature of the conflict including any equity or financial relationship with the company being advised and the steps taken to address these conflicts. The same principles are also applicable to other advisers/experts including analysts.

The SC's Guidelines on Firewalls prescribe measures to contain risks and to manage issues of conflicts of interests between a broker company and its affected related companies. Under the Guidelines on Firewalls, a broker company must maintain its own independent and separate board and management from its affected related companies, it must have sufficient independent directors, must have specific policies relating to authority limits for the granting of facilities to its client and must report to the SC and Bursa Securities any increase in its risk position brought about by its affected related companies.

The SC is empowered under the SCA of 1993 to take actions against a person for failing to make appropriate disclosure under the respective guidelines.

## SECTION VI: THE RESPONSIBILITIES OF THE BOARD

**The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.**

**Principle VIA: Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders.**

**Assessment: Partially Observed**

The CA, Malaysia Code, and the Listing Requirements provide guidance and set out the obligations of directors to act bona fide in the best interest of the company and the shareholders, and also to ensure that directors have full access to information to enable them to make fully informed decision.

**Basic description of board.** Malaysian companies have single-tier boards. The MCCG and the Listing Requirements require the boards of publicly listed companies to have a balance of executive directors and independent directors. The Chairman of the Board and Chief Executive Officer (CEO) are usually different people. Amongst the principal responsibilities of the board is to review and approve a strategic plan and to oversee the business operations, while also directly monitoring and evaluating the management's performance and ensuring the integrity of accounting and financial reporting systems. The discharge of the board's responsibilities inherently requires directors to exercise good judgment and discretion.

**Size requirements and typical size.** There is no requirement for a specific number of directors on a board. In practice, most are comprised of 7 to 9 directors.

**Nomination and election.** The MCCG recommends that the board of every company should appoint a committee, comprising non-executive directors, a majority of whom are independent, charged with the responsibility of proposing new nominees for the board and with assessing performance of the directors on an ongoing basis. The selection of directors should be based on objective evaluation. All directors appointed are subject to retirement and re-election at least once in three years under the Listing Requirements.

**Eligibility requirements.** Directors do not have to be shareholders. Behavioral norms, training, and experience are significant factors in guiding director behavior.

**Certification by directors.** In addition to the general duties that are imposed on directors by statute and that apply at all times, as outlined above, the Companies Act of 1965 imposes specific duties on directors. One is the requirement to complete formal certification. What is contained in the certification depends on the nature of the resolution. For example, where a company makes a distribution, directors voting in favor of the proposal must certify that they are of the opinion that the company will, immediately after the distribution, satisfy the solvency test. The individual directors voting in favor of the resolution are each required to complete a certificate in certain cases.<sup>69</sup>

Through the CLRC, greater attention is being paid in efforts to enhance the enforcement of breaches of director's fiduciary duties. There have also been successful civil cases where directors have been found to have breached their duties to act honestly.<sup>70</sup>

**Principle VIB: Where board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly.**

**Assessment: Largely Observed**

**Directors' duty.** The Companies Act of 1965 imposes a number of general and specific duties on directors. One of the general duties is a fiduciary duty to act in good faith and in what the directors believe to be the best interests of the company. The Act codifies previous common law in the area of directors' duties and, in some instances, increases the standard that directors are required to meet. When exercising judgment in making decisions, directors must, in general, act in the interests of the company and not in their own interests or in the interests of a particular shareholder.<sup>71</sup> A general duty

of care is imposed on directors under the Companies Act of 1965. The level of care required of directors has increased, particularly for listed corporations.<sup>72</sup>

Directors are judged by objective criteria and not by their own subjective standards. Directors of large companies have to meet a much higher standard than directors of a family business. A higher standard may be expected of executive directors than of non-executive directors. The fundamental concept underlying the duty of care is that of diligence. Directors must be alert and active. Directors are under an obligation to make inquiries and to understand their business. In large companies, diligence may require directors to ensure that appropriate reporting and control structures and systems are put in place and monitored.

Under the Companies Act of 1965, directors have a duty to ensure that neither the directors nor the company act in a manner that contravenes the Companies Act of 1965 or the company's constituent documents. This requirement means that directors must be aware of their statutory obligations and the restrictions imposed upon them and their company by the company's Articles of Association. The penalty for a breach of this duty is the same as the penalty for a breach of the duty of good faith.

**Insurance for directors.** A company may insure a director for liability for any act or omission in his/her capacity as a director. Although insurance cannot be effected for any criminal liability or compliance matters, a company can insure a director to cover costs incurred in successfully defending any criminal proceedings. Such costs include legal costs and court charges.

In addition to insurance, a company may agree to indemnify directors with respect to liability for any act or omission as director, except for criminal liability or liability for a breach of the duty of good faith, and for costs incurred in defending or settling a claim. The company may also indemnify directors for the costs incurred in defending legal proceedings in which judgment is given in the director's favor, or in which the director is acquitted, or which is discontinued. This includes actions brought by the company. Particulars of any indemnity or insurance must be disclosed in the annual report.

**Business judgment rule.** The fundamental purpose of a business judgment rule is to protect the authority of directors in exercise of their duties, not to insulate directors from liability. A director who makes a business judgment must meet the requirements of the duty under section 132 of the CA and their equivalent duties under the common law if: (a) a director makes the judgment in good faith for a proper purpose; (b) a director does not have a material personal interest in the subject matter of the judgment; (c) a director is informed about the subject of the business judgment to the extent the director or officer reasonably believes to be appropriate under the circumstances; and (d) a director reasonably believes that the judgment is in the best interest of the company. The proposed section 132(1F) to the CA provides clarification on the duties of directors to exercise care, skill and diligence.

**Principle VIC: The board should apply high ethical standards. It should take into account the interests of stakeholders.**

**Assessment: Partially Observed**

There are voluntary code of ethics such as Rukuniage Malaysia (Malaysian Code of Business Ethics) and the Directors' Code of Ethics. Some Malaysian GLCs have a code of ethics in place on a voluntary basis; e.g., Maybank (Malaysia's largest bank). Staff members are usually briefed by the legal/compliance/company secretariat department. Directors of GLCs are also regularly exposed to issues such as business ethics as part of the Mandatory Accreditation Program (MAP) and also the continuous education program. Businesses ethics are being further promoted by the recently issued National Integrity Plan. The Plan focuses on business ethics and good corporate governance as one of its five major pillars.

**Principle VID: The board should fulfill certain key functions, including:**

**Assessment: Largely Observed**

(1) Board oversight of general corporate strategy and major decisions

The MCCG stresses the dual role of the board; i.e., leadership and control, and the need to be effective in both. The board is responsible for the overall corporate governance of the company or group of companies, including its strategic direction, establishing goals for management, and monitoring the achievement of those goals. The role and function of the board, as well as the differing roles of executive directors and non-executive directors, should be clearly documented in a board charter.

In practice, the board has a formal schedule of matters reserved to itself for decision, which includes the overall group strategy and direction, acquisition and divestment policy, approval of major capital expenditure projects, and significant financial matters. The schedule ensures that the governance of the group is in its hands.

(2) Monitoring effectiveness of company governance practices

MCCG requires all committees to have written terms of reference and operating procedures, and the board receives reports of their proceedings and deliberations. These board committees function as a monitoring mechanism in order to assess the effectiveness of company governance practices in various aspects.

The chairs of the various committees will report to the board the outcome of the committee

	<p>meetings, and such reports are incorporated in the minutes of the full board meeting. These committees were formed in order to enhance business and operational efficiency as well as efficacy. The board retains full responsibility for the direction and control of the company and the group.</p> <p>The Audit Committee, Investment Committee, and Executive Committee play a pivotal role in channeling pertinent operational and assurance-related issues to the board. The committees partly function as a filter to ensure that only pertinent matters are tabled at the board level.</p> <p>In practice, almost all Malaysian companies have established an Audit Committee to independently monitor its financial reporting and compliance with laws and regulations. However, the establishment of the other board committees is left to the prerogative of individual companies, as the level of monitoring differs from one company to another. The more common board committees found in most of the listed companies are audit, remuneration, nomination and the executive.</p>
(3) Selecting / compensating / monitoring / replacing key executives	<p>The Code recommends that the board of every company should appoint a committee of directors charged with the responsibilities of proposing new nominees for the board and assessing performance of the directors on an on-going basis. Under the CA, directors' remuneration is subject to shareholders approval.</p>
(4) Aligning executive and board pay with long term company and shareholder interests	<p>The MCCG advocates that companies have a remuneration committee (RC) comprising wholly or mainly non-executive directors who are independent of management and free from any business or other relationships. Levels of remuneration are to be sufficient to attract and retain the directors needed to run the company successfully. The component parts of remuneration should be structured so as to link rewards to corporate and individual performance, in the case of executive directors. In the case of non-executive directors, the level of remuneration should reflect the experience and level of responsibilities undertaken by the particular non-executive concerned. Normally the remuneration committee spearheads the industry search to benchmark the level of remuneration paid to directors in different industries, to ensure fair play in the market among board members.</p> <p>The establishment of an RC is not mandatory, but it is encouraged. Current practice is for large corporations to establish an RC when are faced with a sizeable Boards. However, it is also a normal practice for certain companies to combine the functions of the remuneration and nomination committees in order to assess both the effectiveness of directors and the remuneration packages of executives. Non-executive remuneration is determined by the board as a whole.</p>
(5) Transparent board nomination / election process	<p>The first appointments of directors are provided for in the memorandum and Articles of Association of the company. In the event that they are not, then the shareholders in a general meeting or unanimously, by way of a circulating resolution, must pass a resolution to appoint the first directors.</p> <p>In practice, in accordance with the Articles of Association, all directors shall retire from office at the company's annual general meeting, and if eligible and willing to act, be reappointed. The MCCG further requires companies to establish a nominating committee with responsibility for proposing new nominees for the board, and for assessing directors on an ongoing basis. The re-election of directors should be at regular intervals and at least every three years.</p>
(6) Oversight of insider conflicts of interest, including misuse of company assets and abuse in RPTs	<p>Directors who are directly or indirectly involved in any related-party transaction with their company must ensure that the company is obtaining fair value, and that they disclose the nature and extent of their interest to the other directors.</p> <p>The primary obligation of interested directors is to enter the nature and extent of the interest, including monetary value, in the interests register. If the nature of conflict is directly between the director and the company, the director is also required to disclose the nature of the interest to the board and have the statement recorded by the company secretary. If the transaction is between the director and the company, and is entered into but falls within the ambit of relevant sections of the CA, the directors should seek the sanction of the shareholders at the general meeting.<sup>73</sup></p> <p>Disclosure can be by way of general disclosure of an ongoing relationship or disclosure of a particular matter. The information must be set down in the audited accounts and annual report, a copy of which must be sent to every shareholder who has not waived the right to receive the report at the annual general meeting. Failure of a director to disclose his/her</p>

	<p>interest to the board does not affect the validity of the transaction. The transaction would have to be challenged by the company. This is strictly followed in practice.</p> <p>Under the SIA, directors or any one possessing price-sensitive information are regarded as insiders and as such, are subject to the Act. The Listing Requirements also impose a number of important restrictions on a director's ability to buy or sell shares if (s)he has information that is not publicly available but would likely materially affect the price of the shares if it were.<sup>74</sup></p>
(7) Oversight of accounting and financial reporting systems, including independent audit and control systems	<p>The Chief Executive Officer (CEO) and Chief Financial Officer (CFO) are required to certify their company's financial statements. Under the CA, every balance sheet and profit and loss account of a company laid before the company at a general meeting (including any consolidated balance sheet and consolidated profit and loss account of a holding company) shall be accompanied by a statutory declaration by the person primarily responsible for the financial management of the company.<sup>75</sup></p>
(8) Overseeing disclosure and communications processes	<p>Publicly listed companies must ensure that the director or person primarily responsible for the financial management of the company, as the case may be, who signs the statutory declaration pursuant to the CA ("the signatory") satisfies certain requirements.<sup>76</sup></p> <p>The efforts of Bursa Malaysia have created greater awareness of the significance of continuous training and skills enhancement for directors, thus promoting a culture of continuous learning and training.</p> <p>Given the varying training needs of directors, from year 2005 onwards, the boards of directors of listed companies will take on the responsibility of evaluating and determining the specific and continuous training needs for their directors on a regular basis. Directors who had yet to complete their Continuous Education Program (CEP) prior to 2005 were required to complete it by December 2005. All listed companies must disclose in their annual reports whether their directors have attended training.</p> <p>In practice, disclosures are currently made in the annual report about whether directors have attended training, but the responsibility for the effectiveness of the training rests entirely with individual company boards.</p>

**Principle VI E: The board should be able to exercise objective independent judgment on corporate affairs.**

**Assessment: Largely Observed**

(1) Director independence	<p><b>Director independence in law.</b> The Code recommends that at least one third of the board consist of independent directors. The Listing Requirements stipulate that at least two directors, or one third of the board, whichever is higher, must be independent directors.</p>
(2) Clear and transparent rules on board committees	<p><b>Audit committees.</b> The establishment of an Audit Committee is a requirement under the Listing Requirements. This committee should comprise at least three members, a majority of whom are independent, with written terms of reference that deal with its authority and duties. At least one member of the committee must be financially trained or a qualified accountant. The function, duties, responsibilities, and rights of the Audit Committee are clearly stipulated in the Listing Requirements. One of its functions is to review the quarterly results prior to approval by the board, which indirectly determines the minimum number of times the Audit Committee must meet in a year. The Audit Committee report must be disclosed in the annual report of the listed issuer that details the committee's composition, the terms of reference, number of meetings held during the financial year, attendance of members, summary of activities for the year, and the effective discharge of the internal audit function.</p> <p><b>Other committees.</b> The MCCG recommends the appointment of board committees with clearly stated responsibilities to assist the board, such as the Remuneration, Nominations and Executive Committees. The number of board committees will be a function of the size of the company and the board. It is the practice for Malaysian boards to delegate important powers to an Executive Committee with regard to important corporate plans and actions on an ongoing basis. However the ultimate decision is then be made by the full board.</p>
(3) Board commitment to responsibilities	<p><b>Board meeting requirements.</b> The Listing Requirements indirectly fix the minimum number of times the board must meet in a year, which is a minimum of four times a year.</p> <p><b>Public availability of board attendance.</b> The MCCG and the listing rules require disclosure in the annual report of the number of board meetings held in a year and the details of attendance of each individual director. Under the Listing Requirements, paragraph 7.29, a director is automatically disqualified as a director if (s)he is absent from</p>

	<p>more than 50 percent of the total board meetings held in a year. In practice, these rules are enforced.</p> <p><b>Number of directorships.</b> Under paragraph 15.06 of the Listing Requirements, directors cannot hold directorships in more than 25 companies, comprising 10 listed companies and 15 unlisted companies.<sup>77</sup> This is to ensure that directors are able to devote sufficient attention and time to the companies under their charge, and are able to discharge their fiduciary duties effectively. This requirement is a first in the region.</p>
<p><b>Principle VIF: In order to fulfill their responsibilities, board members should have access to accurate, relevant and timely information.</b></p>	
<p><b>Assessment: Largely Observed</b></p>	
<p>The MCG Principle AIII on supply of information, as required by the KLSE listing rules, specifies that the board should be supplied in a timely fashion with information in a form and of a quality appropriate to enable it to discharge its duties. The Code recommends that directors should have access to all information within the company in furtherance of their duties. In addition, directors should have access to independent professional advice if required, and have access to the advice and services of the company secretary.</p>	

<sup>1</sup> The main pieces of legislation for the securities market are as follows:

- Companies Act of 1965 (CA)
- Securities Industry Act of 1983 (SIA)
- Banking and Financial Institution Act of 1989 (BAFIA)
- Securities Industry (Central Depositories) Act of 1991 (SICDA)
- Securities Commission Act of 1993 (SCA)
- Futures Industry Act of 1993 (FIA)
- Financial Reporting Act of 1997 (FRA)
- Bursa Malaysia Securities Berhad Listing Requirements
- Mandatory and voluntary codes of practices.

The codes consist of Code on Corporate Governance (MCCG); Malaysian Code on Takeovers and Mergers (MCTM); Guidance on Internal Control Disclosures by the Board; and Bank Negara Malaysia (BNM) Guidelines on the Specimen Financial Statements for Licensed Financial Institutions.

2

Regulatory Authority	Main Regulatory Authorities and Functions
SC	<ul style="list-style-type: none"> <li>▪ To regulate all matters in relation to securities and futures market.</li> <li>▪ To ensure enforcement of securities and futures laws.</li> <li>▪ To license, regulate, and supervise the conduct of market institutions and licensed intermediaries.</li> <li>▪ To encourage and promote the development of the capital market.</li> </ul>
BNM	<ul style="list-style-type: none"> <li>▪ Regulation and supervision of the financial institutions that are exempt dealers under the SIA.</li> <li>▪ Approval of issue of securities by financial institutions licensed under the BAFIA, and control of the shareholding in licensed financial institutions.</li> </ul>
CCM	<ul style="list-style-type: none"> <li>• Substantial shareholding reporting requirements.</li> <li>▪ Enforcement of offenses under the CA which relate to the securities industry.</li> </ul>
FIC	<ul style="list-style-type: none"> <li>▪ Provides recommendations to the SC on national policy aspects of an acquisition for the purpose of exemptions from the provisions of the MCTM.</li> <li>▪ Administration of FIC guidelines mainly pertaining to the regulation of merger and acquisition activities.</li> </ul>
MITI	<ul style="list-style-type: none"> <li>▪ Regulatory approval for the issuance of securities by companies regulated by MITI, such as manufacturing companies.</li> </ul>

<sup>3</sup> Related-party transactions are now subject to a host of control mechanisms under the Listing Requirements. Under paragraph 10.08 of the Listing Requirements, all related-party transactions greater than 5 percent net tangible asset require shareholder approval at an Extraordinary General Meeting. In addition, immediate announcement of the transaction has to be made to Bursa Malaysia and the Securities Commission.

The following are examples of situations where related-party transactions may lead to disclosures by a reporting enterprise in the period which they affect:

- purchase or sales of goods (finished or unfinished)
- purchase or sales of property and other assets
- rendering or receiving of services
- agency arrangements

<sup>4</sup> Under Section 6A(4) of the Companies Act of 1965, a person is deemed to have an interest in shares where a body corporate has an interest in shares and:

- the body corporate is, or its directors are accustomed, or is under an obligation, whether formal or informal, to act in accordance with the directions, instructions, or wishes of that person in relation to that share;
- that person has a controlling interest in the body corporate;
- that person, or associates of that person, or that person and associates of that person, are entitled to exercise or control the exercise of not less than 15 percent of the votes attached to the voting shares in that body corporate.
- 

<sup>5</sup> The directors of listed companies are no longer required to take the mandatory Continuous Education Program. The training undertaken by directors apart from MAP will have to be disclosed in the annual report starting from those companies with FY of December 31, 2005.

<sup>6</sup> The approved auditing standards in Malaysia, which are based on the International Standards on Auditing (IASs), have suggested wording to express a qualified opinion, depending on whether the matters under consideration affect or do not affect the Auditor's opinion and whether there is any limitation on the scope of the audit or any disagreement with management. See AI 700 on Auditor's Report on Financial Statements.

<sup>7</sup>For example, the range of penalties available under the Listing Requirements, while elaborate, cannot compare with those of the statutory regulator. Section 11 of the SIA provides that, in addition to any other action that it may take under its rules, Bursa can take the following

actions: direct the person in default to comply with the rules; impose a penalty, the amount of which must be commensurate with the gravity of the breach, provided that it cannot exceed one million ringgit; and, lastly, reprimand the person in default. Under the Listing Requirements, Bursa also may suspend or de-list a company. In that case, however, minority shareholders are indirectly penalized as well.

Additionally, there have also been doubts expressed as to the extent to which the Listing Requirements may restrict a shareholder from voting his/her shares with respect to a transaction in which (s)he is directly interested. Some question whether Bursa rules can deny a shareholder a fundamental property right. Bursa does not have the enforcement infrastructure available to a statutory regulator, which would include, for example, the statutory right to compel the production of information, and the right of search and seizure, which would make enforcement more effective.

<sup>8</sup> Subparagraph 1(q) of the 9<sup>th</sup> Schedule of the CA.

<sup>9</sup> Sections 90 and 90A of the Securities Industry Act of 1983 now provide for the recovery of losses caused by insider trading, by way of civil actions instituted by either the Securities Commission or the investor. Contrast the general power given to the Australian Securities Commission under the Australian Securities Commission Act of 1989, which allows the Commission to take action in a person's name for recovery of property of the person.

<sup>10</sup>

Country name	Market Cap % GDP 2004	Market Cap (current US\$ billions) 2004	Stocks traded, turnover ratio ( %), 2004
Indonesia (04)	32	61	28
Korea	50	510	N/A
Singapore	148	160	40
Hong Kong	450	714	50
Malaysia (04)	161	190	32

Source: National websites and other sources (2003).

<sup>11</sup> Major efforts are underway to overhaul GLCs. Currently 30 GLCs are slated for restructuring, including Telekom Malaysia Bhd, Tenaga Nasional Bhd, Malasia Airport Holdings Bhd, and Malays Airline System. The current effort has focused on two large companies: Tenaga Nasional Bhd and Telecom Malaysia Bhd.

<sup>12</sup> Khazanah holds in excess of 34% of the 3 largest listed companies in terms of market capitalization.

<sup>13</sup> The other codes include:

i) Code on Takeovers and Mergers – The SC administers the MCTM. It defines the standards of disclosure and corporate behavior in relation to substantial acquisitions of shares, mergers, and acquisitions. Compliance with the provisions of the MCTM is mandatory under the Securities Law. In administering the MCTM, the SC is required to ensure the fair and equal treatment of all shareholders, in particular minority shareholders, in relation to takeover offers, mergers, and mandatory tender offers.

ii) Guidance on Internal Control Disclosures by the Board – Guidance in relation to internal control disclosures is provided in the publication "Statement on Internal Control: Guidance for Directors of Publicly Listed Companies," issued by a Taskforce on Internal Control, with the support and endorsement of Bursa. The document provides guidance to directors of publicly listed companies in making disclosures in their company's annual report on the state of internal controls in accordance with the Listing Requirements. The Institute of Internal Auditors Malaysia (IIAM) is the secretariat and custodian of the guidance issued by the Taskforce.

iii) BNM has issued the Guidelines on the Specimen Financial Statements for Licensed Financial Institutions, primarily with the objective of ensuring that financial institutions comply with the provisions in the CA and accounting standards, and in the disclosure of all material facts, to help users evaluate the financial position and performance of a financial institution. These have undergone revision to take into account new developments. They include greater public disclosure to foster market discipline, greater focus on the role of the board of directors in the preparation of financial statements, assessment of the banking institution's operations in the past and for the coming years, as well as corporate governance matters such as responsibility of the board and committees, and risk management practices.

<sup>14</sup> The SC's many regulatory functions include:

- supervising exchanges, clearing houses and central depositories;
- registering authority for prospectuses of corporations other than unlisted recreational clubs;
- approving authority for corporate bond issues;
- regulating all matters relating to securities and futures contracts;
- regulating the takeover and merger of companies
- regulating all matters relating to unit trust schemes;
- licensing and supervising all licensed persons;
- encouraging self-regulation; and

- ensuring proper conduct of market institutions and licensed persons.

<sup>15</sup> Total criminal prosecutions initiated from 1993 to 2004:119. Prosecution on corporate governance offences from 1993 to 2004: 29 cases.

#### Enforcement actions taken from 1995 to 2004

	1996	1997	1998	1999	2000	2001	2002	2003	2004	Total
No. of Cases	4	5	4	16	7	9	12	1	4	68
No. of Accused charged	5	8	4	23	15	14	22	11	8	110

#### Statistics of cases involving administrative actions

	1996	1997	1998	1999	2000	2001	2002	2003	2004	Total
No. of compound cases	2	0	0	14	19	15	13	7	6	76
No of warning letters issued	1	5	1	3	4	2	16	7	5	44

#### Type of prosecution cases

Type of Prosecution Cases	1996	1997	1998	1999	2000	2001	2002	2003	2004	Total
Corporate Governance	2	0	0	6	4	5	6	3	3	29
Fraud	0	0	1	1	2	0	0	0	0	4
Futures Industry Act	0	1	0	0	1	1	3	3	1	10
Short Selling & Licensing-Related Offenses	2	3	3	8	2	3	3	1	0	27

<sup>16</sup> The functions of the CCM are to:

- ensure that the provisions of the CCMA 2001 and the laws specified in the First Schedule thereto are administered, enforced, given effect to, carried out and complied with;
- act as agent of the Government and to provide services in administering, collecting, and enforcing payment of prescribed fees or any other charges under the laws specified in the First Schedule thereto;
- regulate matters relating to corporations, companies and businesses in relation to the laws specified in the First Schedule thereto;
- encourage and promote proper conduct among directors, secretaries, managers, and other officers of a corporation, and self-regulation by corporations, companies, businesses, industry groups, and professional bodies in the corporate sector in order to ensure that all corporate and business activities are conducted in accordance with established norms of good corporate governance;
- enhance and promote the supply of corporate information under any laws specified in the First Schedule thereto, and to create and develop a facility whereby any corporate information received by, or filed or lodged with, the Companies Commission may be analyzed and supplied to the public;
- carry out research and commission studies on any matter relating to corporate and business activities;
- advise the Minister generally on matters relating to corporations, companies and businesses in relation to the laws specified in the First Schedule thereto.

<sup>17</sup> Section 11(2)(e) of the Securities Industry Act of 1983.

<sup>18</sup> The Bursa can impose a range of actions and penalties for breach. These include one or more of the following actions –

- directing the person in default to comply with or give effect to the rules;
- imposing a penalty which shall be commensurate with the gravity of the offense, but not exceeding one million RM;
- reprimanding the person in default.

Section 11 also empowers the SC to enforce the Listing Requirements of the Exchange directly. Each director of a listed company is required to sign an undertaking with the Bursa Malaysia Securities Berhad. This undertaking prevents directors from claiming lack of privity

as a defense to the Bursa's efforts to enforce the Listing Requirements.

<sup>19</sup> Section 90 of the SCA.

<sup>20</sup> Section 155 of the SCA.

<sup>21</sup> Section 155 of the SCA.

<sup>22</sup> Section 3 of the SCA.

<sup>23</sup> Currently 5 of the 9 commissioners, including the Chairman and Deputy Chief Executive, are from the private sector.

<sup>24</sup> Sections 19 and 29 of the SCA.

<sup>25</sup> Section 146 of the SCA.

<sup>26</sup> Section 28 of the SCA.

<sup>27</sup> Section 11A(3) of the SIA.

<sup>28</sup> Section 107B(3) of the Companies Act of 1965.

<sup>29</sup> Subsection 107D (2) of the Companies Act of 1965.

<sup>30</sup> Note, however, that Section 103(1) provides that notwithstanding anything in the Articles, a company may not register a transfer of shares, debentures, or interest unless a proper instrument of transfer has been delivered to the company. There is therefore no automatic transfer, e.g., by way of death of shareholder.

<sup>31</sup> The law permits free transferability of shares with some exceptions. If the sale and transfer of shares involved that of a corporation that requires the approval of a minister, then there could well be inhibitions as to free transferability or even sale by private treaty. In private companies, the problem arises as to the directors being vested with a right to refuse to register a share.

<sup>32</sup> These include:

- the register of members;
- the register of directors, secretaries, managers, and auditors;
- the register of directors' shareholdings;
- the register of substantial shareholdings;
- the register of debenture holders;
- the register of charges;
- the register of holders of participatory interests;
- a copy of the last audited profit and loss accounts, the auditor's report, and the directors' report on the accounts.

The shareholders have also the right to inspect the minutes of AGMs.

<sup>33</sup> Section 148(1) of the Companies Act of 1965 provides that every member shall have the right to vote on any resolution notwithstanding anything to the contrary in the company's memorandum or Articles of Association. The member's right may be suspended when the member has not paid any calls or other sums payable by him with respect to his shares or if the shares in question are preference shares.

<sup>34</sup> At any general meeting, Article 41 Table A stipulates that a resolution put to vote shall be decided by show of hands. However, ballots can be demanded by the chairman or at least three members present, or by proxy/members holding not less than 10 percent of the total voting rights. Listing Requirements give proxies the right to vote on a show of hands. Section 147(1)(a) CA and Article 47, Table A (Fourth Schedule) stipulate that if the Articles do not make any provisions, the quorum is two members personally present. Members include persons as proxies. The right to demand a ballot is an integral right of a member. The chairman is not permitted to refuse a demand for a poll, nor can (s)he exercise power in a manner that protects the control of management power by the incumbent directors. The manner and procedure as to the ballot taken is set out in the Articles, in the absence of which it will be prescribed by the chairman. It is the practice for publicly listed companies to appoint an independent firm of chartered secretaries or accountants to conduct ballots, thus ensuring their independence.

<sup>35</sup> Section 146(1)(c) of the Companies Act of 1965. If the Article does not have such a prescription, then a proxy may be lodged at the meeting itself.

<sup>36</sup> Section 365 of the CA.

<sup>37</sup> Section 107B of the CA and Para 7.18 of the Listing Requirements.

<sup>38</sup> Amin Shah re-election Scandale.

<sup>39</sup> For example, in the case of Fountain View's AGM, directors refused to answer any questions.

<sup>40</sup> The SC is statutorily obliged to ensure that (i) shareholders, directors, and the market are aware of the identity of the buyer and have reasonable time and sufficient information to assess the offer; (ii) shareholders have equal opportunity to partake in the offer, including the control premium, and are treated fairly and equitably; and (iii) directors of the offeree and acquirer act in good faith.

<sup>41</sup> Subsection 33B of the SCA.

<sup>42</sup> PN 16 and 17 of the Listing Requirements, which took effect from January 3, 2005.

<sup>43</sup> Practice Note 17 (PN17).

<sup>44</sup> PN4 and PN10 companies.

<sup>45</sup> Section 34A(2) of the SCA.

<sup>46</sup> Section 67 and 67A of the CA.

<sup>47</sup> In addition, under Section 218 of the CA, shareholders can seek a court order to wind up the company if, for example, the company is insolvent; the directors have acted in their own interests instead of the interests of the members; the directors have acted unfairly or unjustly to other members of the company, or in the company; and if the court is convinced that it is just and equitable for the company to be dissolved.

<sup>48</sup> Section 144(3) of the Companies Act of 1965.

<sup>49</sup> Register of substantial shareholders.  
 Register of debenture holders.  
 Register of holders of interest other than shares or debentures.  
 Register of charges.  
 Register of director shareholding.  
 Register of directors, secretary, and manager.  
 Minutes of General Meetings.  
 Register and index of members.  
 Accounts.  
 Books to be kept by liquidator.  
 Branch register of foreign company and index.  
 Computer records.

<sup>50</sup> For example, *Parallel Media V Asia PGA*.

<sup>51</sup> The Guidelines apply to the following types of dealings:

- Dealings in the securities of a listed public company by a director of the company and its subsidiaries.
- Dealings by a director in the securities of other listed public companies when, by virtue of his/her position as a director in his/her own listed public company, (s)he is in possession of unpublished price-sensitive information in relation to these other securities.
- Dealings as in (1) or (2) above by any person connected with a director as defined under the CA.

<sup>52</sup> Sections 132C and 132E of the CA.

<sup>53</sup> Section 292 of the CA.

<sup>54</sup> With the proposed change, the tax treatment in Malaysia would be on par with those in other countries.

<sup>55</sup> Sections 176 through 181 of the CA.

<sup>56</sup> The option embodied in sections 176 to 181 is to permit the preservation of the company as an ongoing concern while enabling creditors to recover monies under compromise and reorganization arrangements that have legal sanction from the courts. However, according to experts, there are no well-defined judicial management procedures for managing schemes of compromise and reconstruction. Companies' winding-up proceedings are governed under sections 254 to 318 of the CA.

Unlike other jurisdictions on which Malaysian Company Law is based, such as the UK, Australia, and Singapore, in Malaysia there are no specific provisions or guidelines, the process is cumbersome, and the courts have limited experience in supervising reorganization plans. Some experts have made a case for Malaysia to adopt the regulations in place in similar jurisdictions, and to strengthen the capacity within the court system to manage corporate restructuring on an ongoing basis. During the course of 1998, some companies misused the provisions of Section 176 to seek from the courts temporary relief from creditors for periods of up to nine months on a unilateral basis, without the company being required to initiate a process of dialogue with its creditors and without the creditors being given a chance to present their case to the court before the relief is granted. As there is a high risk that the company could use Section 176 to preempt creditors and strip the company of assets, the Government has now amended the section requiring that a company need the consent of creditors representing at least 50 percent of its debts before it can apply for court protection, and requiring that it submit a list of its assets and liabilities with the application.

The courts have been granting temporary relief from creditors not only to the debtor companies but also to their guarantors. This has been so even where the guarantees have been issued by banks, and even where the bank guarantees require payment on demand. This has disadvantaged the bondholders as many had invested in certain bond issues on the strength of the bank guarantees. This can seriously undermine the credibility of bond markets and undermine its development.

Following the 1998 recession, a Corporate Debt Restructuring Committee (CDRC) was established under the aegis and with the secretarial support of Bank Negara Malaysia (BNM), to provide a framework to enable creditors and debtors to arrive at schemes of compromise and reorganization on a voluntary basis without resorting to legal processes. The aim of this scheme, based on the "London Approach," is to tackle the complex cases of indebtedness with outstanding debt of at least RM 50 million and with more than three creditors. The key features of the CDRC framework have been worked out and are now in use. But guidelines which are viewed as credible, transparent, and consistent have to be developed or must emerge to encourage the use of the voluntary process. To assist in this process, and in the absence of a long tradition of cooperation among participants, the CDRC has to first concentrate on those cases which will help it to develop and set these guidelines and which can then be used even for the more complex or controversial cases. All efforts must be taken to ensure that there is full disclosure and sharing of information with all creditors.

There are also several specific issues that warrant further deliberations by BNM and the CDRC. To motivate creditors and debtors to use this voluntary process, its legal basis has to be established. For instance, the CDRC process provides for a "standstill" period of 60 days, during which a moratorium is imposed on recall of loans and enforcement of security interests. The question is, can the CDRC impose this in a legally binding manner? Other key issues are: what majority rule would be used to reach an agreement over the restructuring plan, and who would be eligible to vote? On the whole, the CDRC has discharged its duties satisfactorily .

<sup>57</sup> Danaharta can appoint Special Administrators (SA) that would have a legal mandate to manage and oversee all operations of the distressed enterprise. On the appointment of the SA, a moratorium for a period of 12 months (which can be extended if necessary) will take effect over winding-up petitions, enforcement of judgments, proceedings against guarantors, repossession of assets, and applications under Section 176 of the Companies Act.

<sup>58</sup> The special administration of corporate borrowers provides a much-needed option for maximizing value through the use of skilled specialists to turn around distressed enterprises. Without this option, lenders will increasingly look to liquidation, and holders of securities will rush to enforce their security. This in turn will bring down weakened enterprises and erase value.

<sup>59</sup> The managers or controlling shareholders in a company are in a position to expropriate minority shareholders:

- by selling to a connected party the output or an asset of the company at below-market price;
- by buying from a connected party an input or an asset at above-market price, and
- by acquiring an interest in a company connected with a related-party at above market price.

A sample of the more reputable or larger of the listed companies (comprising 13 percent of the total in number and over 50 percent in market capitalization) showed that the incidence of concentrated shareholding (even as measured by the shareholding of the largest shareholder) is very pronounced in the Malaysian market. The incidence of dispersed shareholding is uncommon. The incidence of interlocking ownership and cross-guarantees among firms in the same conglomerate is low compared to the situation in Japan or Korea. However, concentrated shareholding through a pyramid structure is more widespread. The number of layers between the controlling shareholder and the most distant subsidiary is three; nonetheless, it still makes for a significant divergence between control and cash flow rights of the controlling shareholder.

A large investor may be rich enough that he prefers to maximize his/her private benefits of control (including investments in unrelated activities, whether for diversification or for the purpose of empire building), rather than maximize his wealth. Unless he owns the entire firm, the large investor will not internalize the cost of these control benefits to the other investors. This will then be reflected in the failures of large investors to force their managers or companies to maximize profits and pay out the profits in the form of dividends.

An examination of the foreign-controlled companies, especially those which have a clear majority shareholder, shows that these companies have been paying out a high proportion of their profits in the form of dividends (and not reinvesting the profits in diversified or empire-building activities). Such high dividend payout ratios may have been facilitated by the more healthy relationship between the control rights of the majority shareholder with its cash flow rights.

In the case of locally controlled companies, the control rights are usually well in excess of the cash flow rights of the controlling shareholder, usually because of the pyramid structure of companies in the same group. This could explain their much lower dividend payout ratios and their greater propensity to reinvest their profits even in unrelated activities, at least in part to maximize the insider's private benefits of control.

To prevent the abuse of minority shareholders by the controlling shareholders and other insiders, there are legal and regulatory provisions requiring the approval of shareholders on substantial and connected party transactions. However, there are still weaknesses which must be addressed to reduce ownership concentration and increase the reliance of companies on external finance. Therefore, a critical area for reform would be to strengthen the related-party provisions in the Companies Act of 1965.

<sup>60</sup> The Malaysian Accounting Standards Board (MASB) was established in March 1997 under the Financial Reporting Act as the sole authority to set accounting standards for Malaysia. MASB became operational in July 1997. MASB reviews the International Accounting Standards and accords the status of approved accounting standards for the purposes of the Financial Reporting Act 1997. MASB maintains the discretion to determine the date of implementation because of its desire to go through a thorough due process.

<sup>61</sup> By the end of 2003, Malaysia had adopted 29 of the 34 IAS standards. Only five of the remaining IASs had not been adopted in Malaysia. These are standards on intangible assets, financial instruments, investment properties and agriculture. The fifth standard on accounting for financial institutions was being withdrawn by the IASB, for which BNM has drawn up its own standard format of financial reports.

<sup>62</sup> The Council of the MIA has determined that Approved Standards on Auditing for members comprise:

- International Standards on Auditing (ISA), and approved by the MIA; and
- Malaysian Standards on Auditing (MSA), and issued by the MIA.

In addition to these promulgated standards, all statements issued by the Council relating to recommended practices, including guidelines on auditing are to be regarded as opinions on best current practice and thus form part of Generally Accepted Auditing Practices (GAAP).

<sup>63</sup> The By-Laws (on Professional Conduct and Ethics) of the Malaysian Institute of Accountants comprise of two main parts:

Part I relates to the By-Laws on Professional Ethics which is substantially based on the Code of Ethics Issued by IFAC in June 2005 and as amended by IFAC from time to time, as well as additional requirements applicable to the Malaysian regulatory and professional environment. The By-Laws on Professional Ethics establishes the ethical requirements and standards applicable to all members of the Institute as professional accountants.

Part II of these By-Laws relates to the By-Laws on Professional Conduct and Practice which contain prescriptive obligations applicable to members or member firms of the Institute in respect of their professional conduct or practice of their firms.

<sup>64</sup> The power to revoke the audit license of an auditor is with the Ministry of Finance.

<sup>65</sup> Chapter 15.22 of Listing Requirements.

<sup>66</sup> All MIA members should comply with the provisions in the By Laws (on Professional Conduct and Ethics) of the Malaysian Institute of Accountants.

<sup>67</sup> Section 174(1) of the Companies Act 1967.

<sup>68</sup> Section 39(1) Part VI of the SIA.

<sup>69</sup> The individual directors voting in favor of the resolution are each required to complete a certificate whenever a board resolves to:

- issue shares or convertible securities;
- make a distribution;
- provide financial assistance for the purchase of company shares or shares in the holding company;
- buy back company shares;
- remunerate or confer any other benefit on directors; or
- merge with another company.

<sup>70</sup> These cases include Board of Trustee of Sabah Foundation and Ors. vs. Datuk Syed Kechik (1999) and Sinmah Timber Shb Bhd vs. David Low See Keat. Industries

<sup>71</sup> The subjective test. – The requirement that a director acts in good faith is subjective. A court examining a director's actions would be concerned with whether the director had reasonable grounds to believe that his/her actions were in the best interests of the company, not with whether they actually were. However, where the director's professed belief is patently unreasonable, a court may find that the belief was not genuinely held. Directors who breach their duty of care will be liable to the company for any loss the company incurs, and shareholders may, in limited circumstances, bring an action against directors.

Another general duty imposed on directors by the Companies Act of 1965 is the duty to exercise their powers for a proper purpose. This duty requires that any power conferred on directors must be exercised only for the purpose for which it is conferred. To date, the issue of whether directors have used their powers for a proper purpose has arisen mainly in relation to the issue of new shares, either to defend takeovers or to consolidate control in one shareholder. Other examples of activities that may constitute the use of a power for an improper purpose are: (i) extraordinary "golden parachutes" issued by companies to senior executives; and (ii) employee share purchase schemes that are established for securing management control or for share price maintenance rather than for advancing employees' welfare. Under the CA, two complementary general duties imposed on directors are intended to fetter directors' use of company money. The Act also provides that no director shall permit a company: to carry on business in a manner likely to create a substantial risk of serious loss to the company's creditors; or to incur an obligation, unless the director believes on reasonable grounds that the company will be able to perform the obligation when required to do so. The penalty for a breach of a general duty is discussed under "Duty of Good Faith." of the Companies Act of 1965.

<sup>72</sup> A director is now required to exercise the care, diligence, and skills by taking into account the nature of the company; the nature of the decision; and the position of the director and the nature of the responsibilities undertaken.

<sup>73</sup> Sections 132C and 132E the Company Act.

<sup>74</sup> Directors of listed companies are not allowed to deal with their shares in closed period, and are required to announce such dealings to the Bursa if they wish to deal in a closed period.

<sup>75</sup> Section 169 (16) of the CA.

<sup>76</sup> The signatory is a member of the Malaysian Institute of Accountants; or if the signatory is not a member of the Malaysian Institute of Accountants, the signatory must have at least 3 years' working experience; and

- must have passed the requisite examinations specified in the Accountants Act of 1967; or
- must be a member of one of the associations of accountants specified in the Accountants Act of 1967.

The signatory also fulfils such other requirements as prescribed by the exchange.

<sup>77</sup> This is in contrast with NYSE requirements, which currently permit only three directorships in their listed companies by an individual director.

# Malaysia Terms/Acronyms

<b>AGM:</b> Annual General Meeting	<b>MITI:</b> Ministry of Trade and Industry
<b>Bursa:</b> Bursa Malaysia Securities Berhad	<b>MSWG:</b> Minority Shareholder Watchdog Group
<b>BNM:</b> Bank Negara Malaysia	<b>PDS:</b> Private Debt Securities
<b>BAFIA:</b> Banking and Financial Institutions Act of 1989	<b>PLC:</b> Performance-Linked Compensation
<b>CA:</b> Companies Act of 1965	<b>Pre-emptive rights:</b> Pre-emptive rights give existing shareholders a chance to purchase shares of a new issue before it is offered to others. These rights protect shareholders from dilution of value and control when new shares are issued.
<b>CCM:</b> Companies Commission of Malaysia	<b>Proportional representation:</b> Proportional representation gives shareholders with a certain fixed percentage of shares the right to appoint a board member.
<b>CDS:</b> Central Depository System	<b>Related-party transactions:</b> The OECD Principles of Corporate Governance hold that it is important for the market to know whether a company is being operated with due regard to the interests of all its investors. It is therefore vital for the company to fully disclose material related to party transactions to the market, including whether they have occurred at arms-length and on normal market terms. Related parties can include entities that control or are under common control with the company, and significant shareholders, such as relatives and key managers.
<b>CLRC:</b> Corporate Law Reform Committee	<b>SC:</b> Securities Commission
<b>CMP:</b> Capital Market Master Plan	<b>SCA:</b> Securities Commission Act of 1993
<b>CDRC:</b> Corporate Debt Restructuring Committee	<b>SIA:</b> Securities Industry Act of 1983
<b>Cumulative voting:</b> Cumulative voting allows minority shareholders to cast all their votes for one candidate. Suppose that a publicly traded company has two shareholders, one holding 80 percent of the votes and another with 20 percent. Five directors need to be elected. Without a cumulative voting rule, each shareholder must vote separately for each director. The majority shareholder will get all five seats, as s/he will always outvote the minority shareholder by 80:20. Cumulative voting would allow the minority shareholder to cast all his/her votes (five times 20 percent) for one board member, thereby allowing his/her chosen candidate to win that seat.	<b>SICDA:</b> Securities Industry (Central Depositories) Act of 1991
<b>DVP:</b> Delivery Versus Payment	<b>Shareholder agreement:</b> An agreement between shareholders on the administration of the company. Shareholder agreements typically cover rights of first refusal and other restrictions on share transfers, approval of related-party transactions, and director nominations.
<b>FIA:</b> Futures Industry Act of 1993	<b>Squeeze-out right:</b> The squeeze-out right (sometimes called a freeze-out) is the right of a majority shareholder in a company to compel the minority shareholders to sell their shares to him/her. The sell-out right is the mirror image of the squeeze-out right: a minority shareholder may compel the majority shareholder to purchase his shares.
<b>FIC:</b> Foreign Investment Committee	<b>VC:</b> Venture Capital
<b>FRA:</b> Financial Reporting Act of 1997	
<b>GDP:</b> Gross Domestic Product	
<b>GLC:</b> Government-Linked Corporation	
<b>IFAC:</b> International Federation of Accountants	
<b>IFRS:</b> International Financial Reporting Standards	
<b>IOSCO:</b> International Organization of Securities Commissions	
<b>IPO:</b> Initial Public Offering	
<b>KLCI:</b> Kuala Lumpur Composite Index	
<b>KPI:</b> Key Performance Indicator	
<b>Listing Requirements:</b> Bursa Malaysia Securities Berhad Listing Requirements	
<b>MASB:</b> Malaysian Accounting Standards Board	
<b>MCCG:</b> Malaysian Code on Corporate Governance	
<b>MCTM:</b> Malaysian Code on Takeovers and Mergers	
<b>MESDAQ:</b> MESDAQ Market	
<b>MIA:</b> Malaysian Institute of Accountants	

This report is one in a series of corporate governance country assessments carried out under the Reports on the Observance of Standards and Codes (ROSC) program. The corporate governance ROSC assessments examine the legal and regulatory framework, enforcement activities, and private sector business practices and compliance, and benchmark the practices and compliance of listed firms against the OECD Principles of Corporate Governance.

The assessments:

- use a consistent methodology for assessing national corporate governance practices
- provide a benchmark by which countries can evaluate themselves and gauge progress in corporate governance reforms
- strengthen the ownership of reform in the assessed countries by promoting productive interaction among issuers, investors, regulators and public decision makers
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