



ICGN

International Corporate Governance Network

Steering Committee
for the Development of an Institutional
Investors Code for Malaysia

By Email: mcii@mswg.org.my

27 February 2014

Dear Sirs,

Re: Response to joint public consultation paper on the Malaysian Code for Institutional Investors 2014, NO. 1/2014

The International Corporate Governance Network (ICGN) is an investor-led organisation of governance professionals with members including institutional investors responsible for assets under management in excess of US\$18 trillion. Our mission is to inspire and promote effective standards of corporate governance to advance efficient markets and economies world-wide. As such we welcome the opportunity to comment on the joint public consultation paper on the Malaysian Code for Institutional Investors 2014 (“the Malaysian Code”). For more information about ICGN please visit www.icgn.org.

General comment

The ICGN has adopted corporate governance principles and guidelines that relate to a number of the questions raised in the Malaysian Code. Responsible investment requires high standards of transparency, probity and care on the part of institutions, and we applaud the efforts of the Steering Committee in drafting a code which will help provide guidance in adhering to the proposed principles. We are also pleased to note the reference to the ICGN Statement of Principles of Institutional Investor Responsibilities (“ICGN Statement”) produced by our members in 2013. In this regard we would also draw your attention to the ICGN Model Mandate which sets out our contractual terms between asset owners and managers, and which also may be useful to users of the Malaysian Code.

More generally, the Malaysian Code might also benefit from inclusion of attention to risk management at the company in guidance 2.2 or in the guidance under principle V. Company actions can have ramifications that affect other portfolio companies and/or create systemic risk exposures, as well as influence investor risk exposure at the company level. The ICGN Model Mandate provides useful context in this regard as follows:

"Following the financial crisis, there is also an increasing focus on the risk to asset owners of investment approaches which generate systemic risk and the opportunities from those generating systemic benefits. Asset owners are exposed to financial markets generally and so are unlikely to benefit over the long run from investment strategies which produce returns by generating systemic risks that jeopardise the efficient functioning of a particular market or markets more generally."

In the ICGN Statement, a distinction is made between principles of internal governance and external responsibilities. This distinction is defined in order to clarify both the external stewardship responsibilities of investors and also the importance of robust internal governance arrangements of investors themselves. In this regard, we would encourage inclusion of internal governance principles in the Malaysian Code.

We welcome the reference to institutional investors' fiduciary duty in the Malaysian Code. This means that the culture, activities and role of all institutional investors should focus on delivering value to the benefit of beneficiaries or clients over the appropriate time-horizon. This is consistent with the ICGN Statement which says:

"[Institutional investors] should play an active role as responsible investors, promoting corporate governance and other best practices at investee companies by engaging with them on pertinent financial and other relevant matters. This should help foster sustainable long-term performance by these companies to the benefit of all investors. In this way, investment institutions will be fulfilling their core role as a fiduciary, mandated to invest in the interests of their ultimate clients or beneficiaries. They are likely best to be able to deliver effectively for their clients or beneficiaries over appropriate time horizons where their internal governance is established in a way giving them the skills, capacity and structures to focus appropriately on client or beneficiary interests. In considering what time horizons are appropriate, institutional investors will need to consider the best interests of their clients and beneficiaries, and any issues of intergenerational fairness between them as well as where the ultimate risk-bearing lies within the institutional investor."

Regarding both the principles I and VI, we would like to stress the importance of transparency and accountability. Institutional investors should be transparent and open with their beneficiaries or clients so as to be fully accountable for the effective delivery of their duties. As mentioned in Guidance 1.3 and 6.6. institutional investors may have decided to outsource some of their duties and/or activities. Nevertheless, they are still accountable for those duties and/or activities and therefore should have policies in place on how to initiate, act and disclose the appropriate level of outsourcing details.

Specific comments

(a) Are the principles of the Code sufficient to strengthen the accountability of institutional investors as envisaged in the CG Blueprint 2011? Are there other areas that should be included in the Code?

The Steering Committee may also consider addressing the themes on 'Independent Oversight', 'Remuneration Structures' and 'Capacity and Effective Management'. Some issues that are aligned with these themes were addressed in sidelines by the Guidance. It is ICGN's opinion that these themes actually deserve more attention. For example, a commitment to independent oversight has been identified as a way for institutional investors to fulfill their responsibility to

their members. As institutional investors engage public companies on executive pay and compensation, independent directorships and oversight of senior leadership, it is useful for institutional investors to model best practices as well.

(b) Are the definitions provided clear and appropriate?

The definitions appear to be clear and appropriate. ICGN has one additional comment for the definition section of the Malaysian Code. Agents working on behalf of the collective investment vehicles, whether they are fund managers, custodians or other service providers, need to be effectively held to account for their delivery of appropriate services, not least those relevant to the areas covered in the principles for external responsibilities. This issue should be addressed in the definition section because it relates to all agents that are potentially involved in the investment chain.

(c) Is the guidance provided under the respective principles adequate?

In general, the Guidance is adequate however we would suggest that reference be included to the importance of portfolio turnover and how it relates to alignment with client expectations and with consideration of the systemic effects of excessive short-termism. In this regard we would draw your attention to the following observations in the ICGN Model Mandate:

"Turnover of holdings is a significant indicator of whether fund manager processes are fully aligned with the identified strategy and interests of clients. Significant deviations from turnover expectations can be an indicator of a lack of conviction in investment decisions and momentum-following behavior, neither of which may be in clients' long-term interests, especially as increases in turnover increase the frictional costs faced by client portfolios and can influence systemic risks. Conversely, unexpectedly low turnover might signal inattention to risk management or a drift towards a more passive investment approach."

(d) The Code encourages its signatories to report annually on their application of the principles of the Code, and where there is non-observance of a principle, signatories are expected to provide meaningful explanation for the departure. Do you agree with this approach?

Members of the ICGN are strong supporters of the concepts of flexible application of standards, commonly referred to as 'comply or explain'. In this regard, any set of principles of governance whether for investors or companies, should be applied with flexibility and understanding of the specific circumstances of individual companies and their markets.

Conclusion

We again applaud the Steering Committee in taking forward this initiative and being an early adopter of the concept of a Stewardship Code which we strongly support. Both investors and companies have a mutual interest in promoting the long-term success of the company and therefore both parties benefit from codes which clarify their respective roles and responsibilities.

We are grateful for the opportunity to comment on the joint public consultation paper on the Malaysian Code for institutional investors 2014. Should you wish to discuss any of the points that we have raised, please feel free to contact Kerrie Waring, ICGN's Managing Director, by email at kerrie.waring@icgn.org or by telephone on +44 (0) 207 612 7079.

Yours faithfully,

Michelle Edkins
Chairman, ICGN Board

Cc: ICGN Board Members
ICGN Shareholder Responsibilities Committee

To view the ICGN 'Statement of Principles for Institutional Investor Responsibilities' and 'Model Mandate Initiative' please go to: <https://www.icgn.org/best-practice>

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