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PwC Alert

Malaysian Code on Corporate Governance 2012

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An overview

On 29 March 2012, the Securities Commission (SC) released the Malaysian Code on Corporate Governance 2012 (MCCG 2012), the first major deliverable of the Corporate Governance Blueprint 2011*.

The MCCG 2012 supercedes the Malaysian Code on Corporate Governance 2007. It sets out broad principles and specific recommendations on structures and processes which companies should adopt in making good corporate governance an integral part of their business dealings and culture.

The objectives of MCCG 2012 are to:

- Achieve excellence in corporate governance through strengthening self and market discipline and promoting good compliance and corporate governance culture.
- Focuses on strengthening board structure and composition.

MCCG 2012 advocates the adoption of standards that go beyond the minimum prescribed by regulation. While it is not mandatory for companies to observe the MCCG 2012, listed companies are required to explain in their annual reports how they have complied with the recommendations. They should also explain and justify the reasons for non-observance of any of the recommendations.

* The SC's Malaysia's five-year Corporate Governance Blueprint, which was launched on 8 July 2011, provides the action plan to raise the standards of corporate governance in Malaysia by strengthening self and market discipline and promoting greater internalisation of the culture of good governance. It seeks to engender a shift in corporate governance culture from mere compliance with rules to one that more fittingly captures the essence of good corporate governance; namely a deepening of the relationship of trust between companies and stakeholders.

Definition of Corporate Governance

“The process and structure used to direct and manage the business and affairs of the company towards enhancing business prosperity and corporate accountability with the ultimate objective of realising long-term shareholder value, whilst taking into account the interests of other stakeholders.”

When does it take effect?

The MCCG 2012 takes effect on 31 December 2012. However, listed companies are encouraged to make an early transition to the principles and recommendations.

Where a company's financial year ends on 31 December 2012, disclosure will be required in relation to the financial year 1 January 2012 - 31 December 2012 and should be made in the annual report published in 2013. Where a company's financial year begins on 1 July 2012, disclosure will be required in relation to the financial year 1 July 2012 - 30 June 2013 and should be made in the annual report published in 2013.

A copy of the MCCG 2012 can be downloaded from the SC’s website (www.sc.com.my).

"In essence, the Malaysian Code on Corporate Governance 2012 and the Blueprint seek to embed a culture of good corporate governance, addressing the key components of the corporate governance ecosystem to strengthen self and market discipline. Boards and shareholders must embrace the fact that good business is not just about achieving the desired financial bottom line by being competitive. It is equally about creating shareholder value, which can only be sustained by well-informed strategic direction and engaged oversight, which stretch beyond short-term financial performance."

Tan Sri Zarinah Anwar,
Former Chairman, Securities Commission
29 March 2012

The MCCG 2012 sets out 8 broad principles followed by 26 corresponding recommendations. Among others, the principles and recommendations focus on:

- laying a strong foundation for the Board and its committees to carry out their roles effectively
- promoting timely and balanced disclosure
- safeguarding the integrity of financial reporting
- emphasising the importance of risk management and internal controls
- encouraging shareholder participation in general meetings.

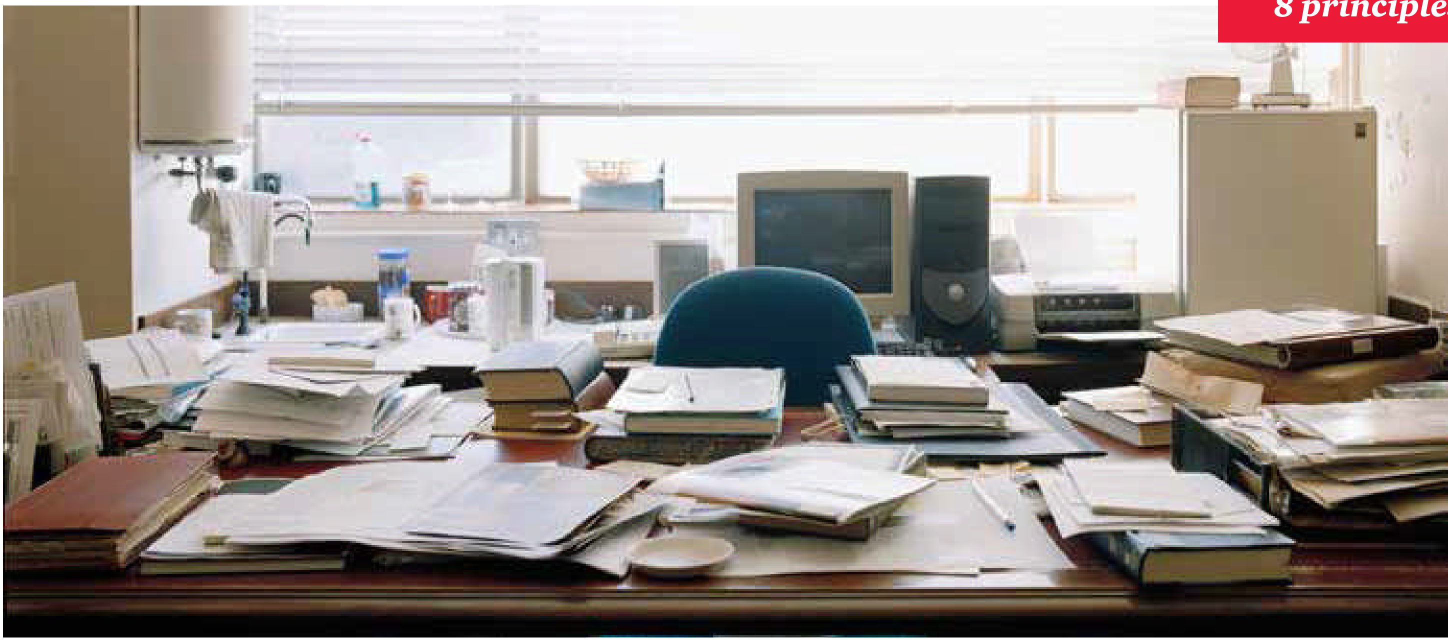
Principles	Recommendations	Key commentaries
1 Establish clear roles and responsibilities *Text in italics refer to new recommendations that were not included in MCCG 2007.*	1.1 The Board should establish clear functions reserved for the Board and those delegated to management. 1.2 The Board should establish clear roles and responsibilities in discharging its fiduciary and leadership functions. ***1.3 The Board should formalise ethical standards through a code of conduct and ensure its compliance.*** ***1.4 The Board should ensure that the Company's strategies promote sustainability.*** 1.5 The Board should have procedures to allow its members access to information and advice. 1.6 The Board should ensure it is supported by a suitably qualified and competent Company secretary. ***1.7 The Board should formalise, periodically review and make public its Board charter.***	• The Board should assume, amongst others, the following responsibilities: - Reviewing and adopting a strategic plan for the Company - Overseeing the conduct of the Company's business - Identifying principal risks and ensuring the implementation of appropriate internal controls and mitigation measures - Succession planning - Overseeing the development and implementation of a shareholder communications policy for the Company - Reviewing the adequacy and the integrity of the management information and internal controls system of the Company. • In formalising the Company's strategies on promoting sustainability, attention should be given to environmental, social and governance (ESG) aspects of business. • Management should supply accurate and complete information to the Board in a timely manner to enable the Board to discharge its duties effectively. • In establishing the Board charter, the Board should amongst others set out the key values, principles and ethos of the Company; division of responsibilities and powers between the Board and management; the different committees established; and the processes and procedures for convening Board meetings. The charter should be made public.

8 principles

Principles	Recommendations	Key commentaries
2 Strengthen composition	2.1 The Board should establish a Nominating Committee which should comprise exclusively of non-executive Directors, a majority of whom must be independent. 2.2 The Nominating Committee should develop, maintain and review the criteria to be used in the recruitment process and annual assessment of Directors. 2.3 The Board should establish formal and transparent remuneration policies and procedures to attract and retain Directors.	• The chair of the Nominating Committee should be a Senior Independent Director identified by the Board. • The Board should establish a policy formalising its approach to boardroom diversity and explicitly disclose in the annual report its gender diversity policies and targets and the measures taken to meet those targets.
3 Reinforce independence	***3.1 The Board should undertake an assessment of its independent Directors annually.*** ***3.2 The tenure of an independent Director should not exceed a cumulative term of nine years. Upon completion of the nine years, an independent Director may continue to serve on the Board subject to the Director's re-designation as a non-independent Director.*** ***3.3 The Board must justify and seek shareholders' approval in the event it retains as an independent Director, a person who has served in that capacity for more than nine years.*** 3.4 The positions of Chairman and CEO should be held by different individuals, and the Chairman must be a non-executive member of the Board. ***3.5 The Board must comprise a majority of independent Directors where the Chairman of the Board is not an independent Director.***	• These requirements place more work on the Nominating Committee. • The Nominating Committee should develop the criteria to assess independence. In assessing independence, the Board should focus beyond the independent Director's background, economic and family relationships and consider whether the independent Director can continue to bring independent and objective judgement to Board deliberations. • The Board should disclose that it has conducted such assessments in the annual report and in any notice convening a general meeting for the appointment and re-appointment of independent Directors.

Text in italics refer to new recommendations that were not included in MCCG 2007.

8 principles

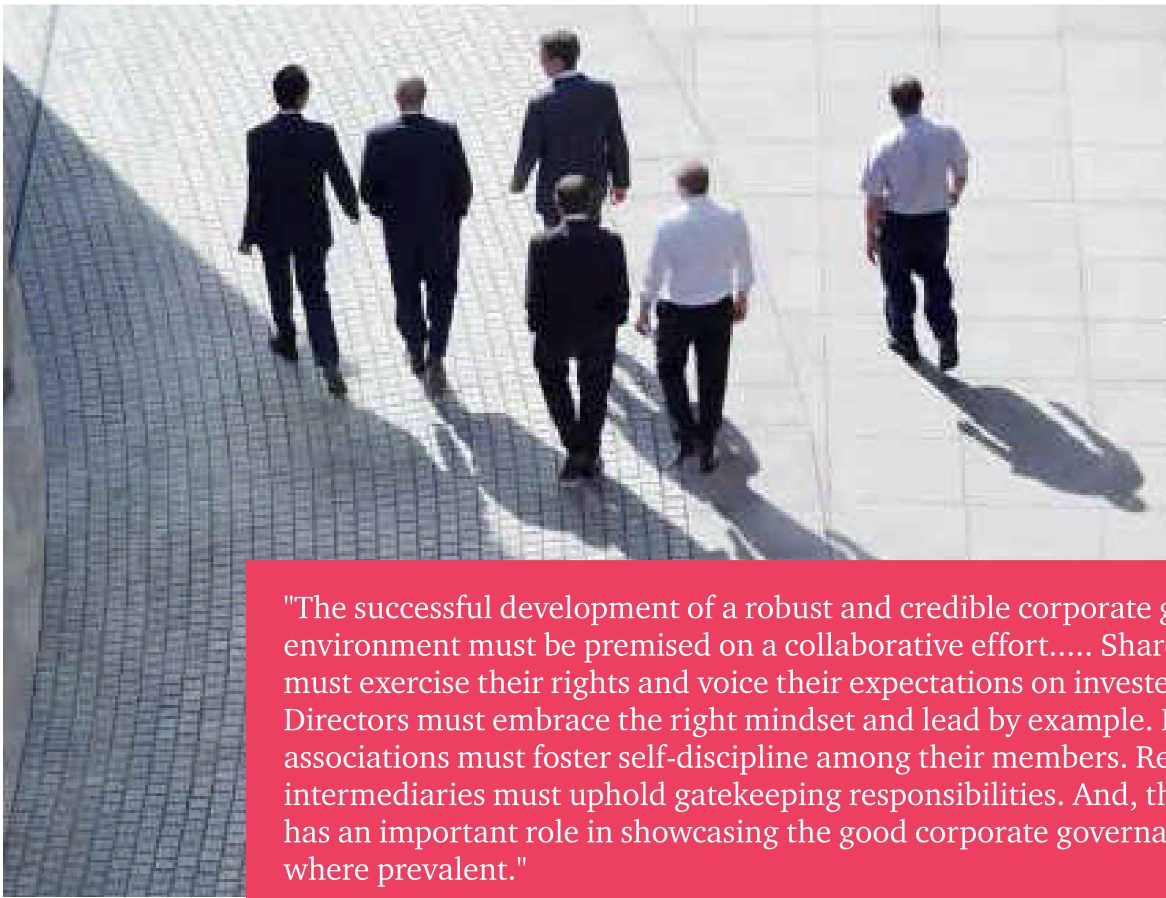


Principles	Recommendations	Key commentaries
4 Foster commitment	*4.1 The Board should set out expectations on time commitment for its members and protocols for accepting new directorships.* *4.2 The Board should ensure its members have access to appropriate continuing education programmes.*	• Directors should devote sufficient time to carry out their responsibilities, and the Board should obtain this commitment from its members at the time of appointment. • Directors should notify the Chairman about the estimated time that will be spent on the new directorship appointment before accepting any new directorship.
5 Uphold integrity in financial reporting	5.1 The Audit Committee should ensure financial statements comply with applicable financial reporting standards. 5.2 The Audit Committee should have policies and procedures to assess the suitability and independence of external auditors.	• The Audit Committee should establish policies governing the circumstances under which contracts for the provision of non-audit services can be entered into and what periodic internal assessment of external auditors needs to be undertaken. • The Audit Committee should obtain written assurance from the external auditors confirming that they are, and have been, independent throughout the conduct of the audit engagement in accordance with the terms of all relevant professional and regulatory requirements.

Text in italics refer to new recommendations that were not included in MCCG 2007.

8 principles

Principles	Recommendations	Key commentaries
6 Recognise and manage risks	6.1 The Board should establish a sound framework to manage risks. 6.2 The Board should establish an internal audit function which reports directly to the Audit Committee.	• The Board should be committed to articulating, implementing and reviewing the Company's internal controls system. Periodic testing of the effectiveness and efficiency of the internal controls procedures and processes must be conducted to ensure that the system is viable and robust.
7 Ensure timely and high quality disclosure	***7.1 The Board should ensure the Company has appropriate corporate disclosure policies and procedures.*** ***7.2 The Board should encourage the Company to leverage on information technology for effective dissemination of information.***	• The Board should be guided by best practices and compliance with Bursa Malaysia's disclosure requirements in formulating these policies and procedures. • Companies should consider wider usage of information technology in communicating with stakeholders including establishing a dedicated section for corporate governance on their website, which would include information such as the Board charter, rights of shareholders and the annual report.
8 Strengthen relationship between Company and shareholders *Text in italics refer to new recommendations that were not included in MCCG 2007.*	8.1 The Board should take reasonable steps to encourage shareholder participation at general meetings. ***8.2 The Board should encourage poll voting.*** 8.3 The Board should promote effective communication and proactive engagements with shareholders.	• The Board should direct the Company to disclose all relevant information to shareholders to enable them to exercise their rights. • The Chairman should inform shareholders of their right to demand a poll vote at the commencement of the general meeting.



"The successful development of a robust and credible corporate governance environment must be premised on a collaborative effort..... Shareholders must exercise their rights and voice their expectations on investee companies. Directors must embrace the right mindset and lead by example. Industry associations must foster self-discipline among their members. Reputational intermediaries must uphold gatekeeping responsibilities. And, the media also has an important role in showcasing the good corporate governance practices where prevalent."

Datuk Ranjit Ajit Singh, Chairman, Securities Commission
"***Raising the Bar: the Malaysian Code on Corporate Governance***" ***seminar***
8 June 2012

What's new in MCCG 2012?	Key questions that the Board should be thinking about
Roles and responsibilities of the Board The Board is required to formalise ethical standards through a code of conduct and ensure that Company strategies promote sustainability. It is also expected to formalise a Board charter.	• Is timely information provided to the Board of sufficient depth and quality to facilitate a robust Board discussion on the risks and benefits of a particular proposal? • Has the Board spent enough time on areas of particular concern to stakeholders, including strategy and succession planning? • How satisfied are you with the Company's CEO, CFO and key officers' succession planning? • How satisfied are you with the frequency and depth of the Board's re-evaluation of the continued viability of the Company's strategy? • Do you know the organisation's ethical values? How effective is the organisation's code of conduct in encapsulating such values? • Do you know the operational, reputational and commercial risks and opportunities faced by the Company regarding sustainability? How does the Company benchmark with its peers? • Has your CEO developed a sustainability strategy that is aligned to the Company's corporate ambitions? Has your CFO robustly and transparently reported the company's sustainability activity?
Composition of the Board The Board should establish a Nominating Committee, chaired by a Senior Independent Director, who is responsible in overseeing the selection and assessment of Directors. The Nominating Committee is charged with developing a set of criteria including policies formalising its approach to diversity of the Board.	• Does the composition of the Board comprise independent-minded individuals who ask relevant and challenging questions in Boardroom discussions? • Is the Nominating Committee effective in establishing a Board with a balance of needed skills and diversity of views? • What are the impediments affecting the Board's ability to add Directors with certain skill sets/attributes (e.g. international, technology, financial, legal, accounting, marketing expertise)? • What are the resources (both internal and external) available to the Nominating Committee to assist them in performing their duties more effectively? Examples would be the use of an industry-led independent Directors registries or a recruitment specialist. Ultimately, what the Nominating Committee is trying to strive for is a Board mix that is effective, balanced and diverse, as well as comprising members capable of and willing to offer contrarian views, who possess attributes that contribute to the right Board dynamics and has the right chemistry for robust Boardroom discussions.

What's new in MCCG 2012?	Key questions that the Board should be thinking about
Independence of independent Directors The tenure of independent Directors is capped to a cumulative period of nine years unless approved by the shareholders. Upon completion of the nine years, such Directors can be re-designated as non-independent Directors. In addition, the positions of Chairman and CEO should be held by different individuals. If the Chairman is not an independent Director, the Board should comprise a majority of independent Directors.	• Has the Board formulated a policy on the terms of service of independent Directors? • Has the Board considered whether there is a potential conflict of interest when the roles of Chairman and CEO are combined? • Has the Board considered whether there is an appropriate balance of power between the CEO and the independent Board members?
Remuneration of Directors The Board should establish formal and transparent remuneration policies and procedures to attract and retain Directors. A Remuneration Committee can perform this function.	• How did your Board conduct the annual Board evaluation process this year? • How satisfied are you with the Board's annual evaluation process? Is this conducted through self-assessment or by more objective measurements? • Is the Directors' remuneration made at the appropriate level to attract the right calibre and required expertise to the Board? • Are the benefits sufficiently defined and appropriate for the role and responsibility of the Directors, and is there a difference between executive and non-executive Directors?
Risk management framework and internal controls system The Board is required to establish a sound framework to determine the Company's level of risk tolerance and actively identify, assess and monitor key business risks.	• Has the Board considered how risk integrates with the Company's overall strategy as part of its responsibility for overseeing risk? • With many organisations increasingly expanding overseas, does the Board know enough and understand the risks of operating in foreign countries (e.g. regulatory, political and cultural risks)? • How does the Board oversee major risks, such as risks relating to tax, regulatory, legal and information technology matters? • How comfortable is the Board with the level of monitoring on the strategic risks identified?
Integrity of financial reporting The Audit Committee should ensure financial statements comply with applicable financial reporting standards.	• How confident are you with the reliability of the organisation's financial reporting processes? What was the level of audit adjustments or issues in the past? • What is the degree of manual work employed in preparing management and financial reporting? • How reliant is management on the auditors for technical support and accounts preparation? Is the Board being kept up-to-date by management on key developments in financial reporting? • Are financial numbers reliable, accurate and timely? How long does it take for management to close the financial reporting books? • Does the organisation have sufficient IFRS knowledge and resources (both internal and external) to facilitate accurate financial reporting and strategic decision-making? • What is the succession plan for the CFO and key members of the Finance team?

Rising to the occasion
Our point of view

The MCCG 2012, being the first major deliverable of the SC's Corporate Governance Blueprint, has certainly placed a spotlight on the quality of directors on Malaysian PLC boards. Also being emphasised is the role of the Nomination Committee – charged with the responsibility of selecting, evaluating and nominating candidates for Board and Committee memberships.

The Nomination Committee has a challenging task indeed. Not only is it responsible for selecting the right directors with high standards of professionalism, integrity, expertise and experience, but also those who can add value to the Board as a whole. For this to happen, the Committee has to ensure diversity from the industry, technical, business and gender aspects. This helps to provide for robust discussions, varied points of views and avoiding the groupthink syndrome. In addition, the Nomination Committee needs to help the Board select independent directors - who are indeed independent – based on a determined set of criteria (which will likely be another responsibility of the Nomination Committee).

However, the road ahead for the Nomination Committee is not without bumps. Based on feedback from Boards we have had the opportunity to work with, among the challenges the Nomination Committee faces on Board membership selection include:

- Talent shortage in the country
- Relatively low Director remuneration
- Pressure from shareholders to consider certain individuals as candidates.

The Board needs to realise that the Nomination Committee has a tough task on their hands. However, before the Committee can even begin its job, the Nomination Committee itself needs to comprise the right members. In addition to providing guidance on Nomination Committee membership, the MCCG 2012 now advocates the appointment of the Senior Independent Director as the Chairman of the Nomination Committee. This move should provide additional independence and objectivity to the Director appointment process.

A study done in the United States (Catalyst 2011 report) shows that companies with 3 or 4 female Directors on their Boards for at least 4 years financially outperformed companies with minimal female Board representation. Although this correlation between more women Directors and better financial performance does not prove causation, it may support the notion that having broader perspectives on the Board can be valuable.

Next, the Nomination Committee should be equipped with the necessary tools and means to perform its duties. An example of these tools can be in the form of the Board effectiveness evaluation (BEE), which, if performed well, can provide the Nomination Committee and the Board with valuable information on its current state of performance, strengths and areas for improvement.

Information from the BEE process can:

- Be used to build a Board composition grid to analyse Directors' needed skills, experience and attributes, both in light of current operations and in anticipation of future challenges. The Nomination Committee can focus on building the Board succession pipeline and consider various ways to source for appropriate candidates.
- Help to identify current and potential gaps in Board composition, as well as required enhancements in Board practices.
- Highlight Directors' training and development needs.

Nomination Committees can use the following methods and sources to find suitable Board candidates:

- **Agencies and headhunters**
- **Candidates nominated by fellow Board members, management and shareholders – which meet the required criteria**
- **Suitably qualified internal or external management personnel**
- **Candidates from Director registries which employ robust screening processes.**

The annual Board effectiveness assessment (including Director assessments) is one of the recommendations in the MCCG 2012 for continuous Board improvement. Performed regularly, with proactive follow through, this iterative process will help the Nomination Committee and Board to focus on required improvements and strengthen the Board's performance and dynamics over time.

In a 2010 PwC survey, 65% of Directors surveyed said they had made changes to their Board policies and practices as a result of Board evaluations.

In summary

Without a doubt, the Nomination Committee's responsibilities have increased significantly with the introduction of MCCG 2012. While some of these recommendations may seem tedious, it is a necessary evil.

The Nomination Committee is a Board committee that should perhaps share equal recognition as the Audit Committee, which is typically regarded as the committee that 'works the hardest'. While the Audit Committee's main role is to ensure the integrity of financial reporting, the Nomination Committee's task is to ensure the presence of quality Board members, able to provide an organisation with proper stewardship.

It is time for Boards to recognise this critical role.

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