



Centre for Banking & Finance Law
Faculty of Law

NUS Centre for Banking & Finance Law Working Paper 18/03
NUS Law Working Paper 2018/032

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Petrina TAN Tjin Yi

Adjunct Research Fellow, Centre for Banking & Finance Law, Faculty of Law,
National University of Singapore

petrinatan@gmail.com

[uploaded 27 April 2018]

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**Institutional Investor Stewardship in the UK and Malaysia: Functionally Similar,
Contextually Different**
Petrina Tan Tjin Yi*

Abstract

Institutional investors are acknowledged as an influential force worldwide as a result of their large shareholdings and ownership of public equity. Arising from a focus on their investing and shareholding practices and their impact on the listed companies which they have invested in as well as on the economy and society overall, stewardship codes have been introduced in the UK and Malaysia to promote their role as stewards. The key objective of this paper is to evaluate the theoretical and practical issues relating to the relatively recent phenomenon of stewardship of institutional investors in Malaysia through functional and contextual lenses as juxtaposed against the more established practice of stewardship in the UK. It is argued that notwithstanding a similar legal framework for shareholder rights and substantial similarities with regard to the content of the UK Stewardship Code and the Malaysian Code for Institutional Investors and its status as soft law, the market structure and political economic factors which are unique to Malaysia represent a constraint on the effectiveness of the Malaysian Code for Institutional Investors in shaping the practices of institutional investors in Malaysia. As such, recommendations to address issues pertaining to the stewardship of institutional investors in the Malaysian context would need to take into account the theoretical and contextual constraints, although insights may be gained from examining structural issues in the investment industry in the UK.

Key Words: Stewardship, Institutional Investor, United Kingdom, Malaysia

Introduction

Institutional investors are acknowledged as a force to be reckoned with worldwide as a result of their large shareholdings and ownership of public equity.¹ The influence of

* Adjunct Research Fellow, NUS Centre of Banking & Finance Law
LLM (Hons) (Corporate And Financial Services Law), National University of Singapore; LLB (Hons)(With Distinction), University of Malaya, Malaysia.
Email address: petrinatan@gmail.com All errors and omissions are the Author's own. Data and statistics cited in this paper are correct as of 31 March 2018.

¹ See generally Lucian Bebchuk and others, 'The Agency Problems of Institutional Investors' [2017] 31(1) Journal of Economic Perspectives 89-112; OECD 'Principles of Corporate Governance' [2015] 29; Brian Cheffins, 'Delaware and the Transformation of Corporate Governance' [2015] 40(1) Delaware Journal of Corporate Law

institutional investors has led to an increased focus on their investing and shareholding practices and their impact on the listed companies which they have invested in as well as on the economy and society overall. An illustration of this sharpened focus on institutional investors was the introduction of the Stewardship Code in the United Kingdom in 2010. The United Kingdom Stewardship Code (UKSC) was the model for the Malaysian Code for Institutional Investors (MCII) which was launched in 2014. The MCII is the first stewardship code to be launched in Southeast Asia, and the second of its kind to be introduced in Asia after Japan.

The key objective of this paper is to evaluate the theoretical and practical issues relating to the relatively recent phenomenon of stewardship of institutional investors in Malaysia through functional and contextual lenses as juxtaposed against the more established practice of stewardship in the UK. The UK was chosen as a basis for comparison as the provisions of the MCII are closely aligned with those of the UKSC. Moreover, the contrasting background of the UK's status as a developed economy as compared to Malaysia's position as an emerging economy enables a clearer identification of common themes and issues pertaining to stewardship while drawing out context driven divergences.

It is argued that notwithstanding a similar legal framework for shareholder rights and substantial similarities with regard to the content of the UKSC and the MCII and its status as soft law in both jurisdictions, the differences with regard to the market structure and political economic factors which are unique to Malaysia represent a constraint on the effectiveness of the MCII in shaping the practices of institutional investors in Malaysia. As such, recommendations to address the issues pertaining to the stewardship of institutional investors in the Malaysian context would need to take into account both the theoretical limitations pertaining to stewardship as well as its structural and contextual limitations.

This paper will be divided into 5 sections. The first section will examine the foundations of stewardship by institutional investors. It will begin with an exposition on the legal framework of shareholder rights which forms the basis for stewardship followed by the

1-76; Samuel Graves and Sandra Waddock, 'Institutional owners and corporate social performance' [1990] 37(4) *Academy of Management Journal* 1034-1046

theoretical underpinnings of the role of institutional investors as monitors and activists which preceded the development of the concept of institutional investors as stewards. The second section provides a chronological account of the background and introduction of the UKSC and MCII. The following section of the paper will turn to a comparison of the UKSC and MCII's principles and its oversight and reporting frameworks, leading to an evaluation of the UKSC and MCII adoption and take-up since its inception. The fourth section will set out the broader factors which have an impact on stewardship in the UK and Malaysia, beyond the dominant law and economics lens through which most corporate governance and stewardship matters have been analysed. The fifth section will provide responses to the UK's most recent consultation questions in relation to stewardship as part of a way of paving the way ahead for the further development of institutional investor stewardship in concept and in practice.² Finally, this paper will conclude with a few summary remarks.

I. The Foundations of Institutional Investor Stewardship

The Legal Framework of Shareholder Rights

The ownership of shares in a corporation gives rise to rights generally established in companies' legislation and modified by the constituent documents of a corporation, where applicable. Shareholder rights are an important determinant of the structure and process of corporate governance, particularly in determining the key relationships between shareholders and other stakeholders (such as creditors) and between shareholders and the board of directors.³

² The UK Financial Reporting Council issued a Consultation Paper on a revised UK Corporate Governance Code in December 2017 which included broad questions on stewardship, in anticipation of a more detailed consultation on stewardship to be carried out in the second quarter of 2018. This section will be revised to reflect these changes in due course.

³ Ian MacNeil, 'Activism and collaboration among shareholders in UK listed companies' [2010] 5(4) Capital Markets Law Journal 419-438, 421

The classic definition of a share was laid down in the case of *Borland's Trustee v Steel Bros & Co Ltd*⁴ as 'the interest of a shareholder in the company measured by a sum of money for the purpose of liability in the first place, and of interest in the second, but also consisting of mutual covenants entered into by all the shareholders inter se in accordance with section 16 of the Companies Act, 1862'.⁵

This definition in *Borland's Trustee* illustrates the intangible nature of shares which are characterised as choses in action, whereby the ownership of shares confers rights on shareholders which are enforceable by law.⁶ The legal nature of the ownership of shares is distinct from the conventional understanding of ownership⁷ which is focused on the indefeasibility of interest and the private ownership right to a share may be subject to the right of an offeror to buy out a minority shareholder in a takeover under section 979 of the UK Companies Act 2006 or by provisions in the company's Articles of Association.⁸ Thus, share ownership gives rise to a bundle of rights and liabilities, as described in *Her Majesty's Commissioners of Inland Revenue v Laird Group PLC*,⁹ which amounts to share ownership as being in a superior position to personal or contractual rights but not yet achieving full-fledged proprietary rights.¹⁰

With reference to the statutory provisions pertaining to shareholder rights, section 541 of the UK Companies Act 2006 provides that shares or other interests of a member in a company are personal property or moveable property in Scotland. Similarly, section 70 of the Malaysian Companies Act 2016 describes shares as personal property and transferable in accordance with section 105.

⁴ [1901] 1 Ch. 279

⁵ Supra n4 at p 289

⁶ Shanthy Rachagan and others, *Principles of Company Law in Malaysia* (2nd edn, Malayan Law Journal 2002) 185

⁷ See Iris HY Chiu, *The Foundations and Anatomy of Shareholder Activism* (Hart Publishing, 2010) 107 where she cites Goode's famous treatise on Commercial Law which states that 'ownership of property is defined as an absolute interest in the residual rights in property, and such interest is indefeasible'

⁸ Supra n7 108. See *Gambotto & Anor v WCP Limited* (1995) 182 CLR 432 HCA

⁹ [2003] UKHL 54

¹⁰ Supra n7 109

In addition, the rights attached to a share which shareholders may enjoy are set out in section 71(1) of the Malaysian Companies Act 2016 which states that 'A share in a company, other than preference shares, confers on the holder-

- (a) the right to attend, participate and speak at a meeting;
 - (b) the right to vote on a show of hands on any resolution of the company;
 - (c) the right to one vote for each share on a poll on any resolution of the company;
 - (d) the right to an equal share in the distribution of the surplus assets of the company;
- or
- (e) the right to an equal share in dividends authorised by the Board.'¹¹

The rights set out in section 71(1) may be characterised as an intervention right of shareholders to challenge the view of the board of directors on particular issues.¹² As such, shareholders have the right to call for a general meeting at the company's expense under section 305 of the UK Companies Act 2006 and section 313 of the Malaysian Companies Act 2016. Shareholders may also request that the company circulate their proposed resolutions or statements as prescribed in section 314 UK Companies Act 2006 and section 323 of the Malaysian Companies Act 2016, although it is noted that the Malaysian section is confined to public companies. The UK Companies Act adds in a specific section which imposes an obligation on traded companies to answer members' questions on the business discussed at the general meeting¹³ which is not found in the Malaysian Act, although this is alluded to in the Malaysian Code on Corporate Governance 2017.¹⁴

The rights enumerated above are to be understood in light of the division of powers between management and shareholders wherein the general meeting has specific powers, but the shareholders have residual powers given specific powers but the residual powers vest with the shareholders. Although the remit of directors' powers is usually broad, there are a

¹¹ Note however that section 71(2) Companies Act 2016 provides that the rights to dividends may be negated, altered or added to by the constitution of the company or in accordance with the terms on which the share is issued.

¹² Supra n3 423

¹³ Section 319A UK Companies Act 2006

¹⁴ Principle C, Part Ii, page 47 Malaysian Code on Corporate Governance 2017

wide range of powers which are reserved to shareholders.¹⁵ Thus, it follows that the shareholders exercise their statutory rights during the general meeting but are subject to limitations such as the inability to override management decisions¹⁶ and limitations stated in the articles of association or the constitution of the company.¹⁷

Having set out the legal framework of shareholder rights, this paper will now turn to a discussion on the conceptualisation of institutional investors and their exercise of shareholder rights in the capacity of corporate monitors and activists.

Institutional Investors as Monitors and Activists

The growth of the institutional investor in the capital markets, which were widely perceived to have the resources and clout because of its ownership size and resources, brought with it exciting possibilities to play a role as a monitor and an activist.¹⁸ This was vividly illustrated in a germinal paper by Black and Coffee on the British experience of institutional investor monitoring, its limits and their implications on the American institutional investor landscape.¹⁹ The key takeaway of this paper was the observation that UK institutions were more involved in corporate governance than their US counterparts, although the UK institutions were constrained by the cost factor in managing shareholder coalitions and restricted incentives for money managers to invest in monitoring.

¹⁵ *Supra* n3 422

¹⁶ See *Automatic Self-Cleansing Filter v Cuninghame* [1906] 2 Ch 34

¹⁷ See *Re Chi Liung & Son Ltd; Tong Chong Fah v Tong Lee Hwa & Ors* [1968] 1MLJ 97. However, see *Baldev Singh V Mahima Singh & Ors* [1974] 2 MLJ 206 in which the decisions of the general meeting may prevail over those of the directors as allowed by the company's articles of association

¹⁸ See generally Bernard Black, 'Shareholder passivity reexamined' [1990] 89 Michigan Law Review 520-608, 575-591; Bernard Black, 'Agents watching Agents: The Promise of Institutional Investor Voice' [1992] 39(4) UCLA Law Review 812; Ronald Gilson and Reinier Kraakman 'Reinventing the outside director: an agenda for institutional investors' [1991] 43 Stanford Law Review 863–906; John Coffee Jr, 'Liquidity versus Control: The Institutional Investor as Corporate Monitor' [1991] 91(6) Columbia Law Review, 1278-1368

¹⁹ Bernard Black and John Coffee Jr, 'Hail Britannia?: Institutional Behavior Under Limited Regulation' [1994] 92(7) Michigan Law Review 1997-2087

Institutional investor intervention was viewed as able to address the classic agency problem established by Berle and Means²⁰, and developed further by Jensen and Meckling²¹, where the separation of ownership and control leads to the managers of the company (the agent) making decisions which are not in the best interests of the shareholders (the principal) and in conflict with the shareholders' goals i.e. where they are inconsistent with value maximisation of the company's assets²² or where they pertain to the pursuit of wealth, security and prestige at the expense of the company. A common example of the agency problem in action is where there is excessive executive compensation.²³ The conflict of interest between shareholders and managers are exacerbated by the information asymmetry between both parties, making it difficult for shareholders to verify the behaviour of the agent.²⁴

Agency conflicts can occur in both dispersed and concentrated ownership scenarios based on the typology established by Pedersen and Thomsen in which they differentiated between Type I and Type II agency conflicts.²⁵ In this regard, Type I agency conflicts arise in a dispersed ownership scenario where shareholders have little direct control over management and is more commonly associated with the USA and the UK. The lack of a dominant or single owner holding sufficient shares to exercise ownership rights results in shareholders being less able to remove poor managers and reduces the incentive for and ability of shareholders to monitor managerial activity.²⁶ Shareholders are also described as suffering from the classic free rider problem where the costs of monitoring are borne by a particular shareholder but the benefits are shared by all shareholders, resulting in their 'rational apathy'.

²⁰ Adolf Berle and Gardiner Means, *The Modern Corporation and Private Property* (Transaction Publishers, 1932)

²¹ Michael Jensen and William Meckling, 'Theory of the firm: Managerial behavior, agency costs and ownership structure' [1976] 3:4 *Journal of Financial Economics* 305-360

²² Oliver Hart, 'Corporate Governance: Some Theory and Implications' [1995] 105 *The Economic Journal* 678-689

²³ Julie Elston and Lawrence Goldberg, 'Executive compensation and agency costs in Germany' [2003] 27(7) *Journal of Banking and Finance* 1391-1410; Lawrence Goldberg and Todd Idson, 'Executive compensation and agency effects' [1995] 30(2) *The Financial Review* 313-335

²⁴ Aiysha Dey, 'Corporate governance and agency conflicts' [2008] 46(5) *Journal of Accounting Research* 1143-1191

²⁵ Torben Pedersen and Steen Thomsen, 'Ownership structure and value of the largest European firms: the importance of ownership identity' [2003] 7(1) *Journal of Management and Governance* 27-55

²⁶ Lim Boon Leong Lim and Siew Hwa Yen, 'Agency Problem and Expropriation of Minority Shareholders' [2011] 48(1) *Malaysian Journal of Economic Studies* 37-59

Under such circumstances, shareholders will typically leave the monitoring to others rather than taking it upon themselves.²⁷

By contrast, Type II agency conflicts arise in firms with concentrated ownership where there are blockholders or owners holding a single block or several large blocks of shares in the firms. Firms with concentrated ownership are more typically found in Europe and East Asian countries²⁸ which includes Malaysia.²⁹ The combination of concentrated ownership and government ownership of public listed companies as well as weak investor protection are reflective of an insider model of corporate governance which has been linked to minimised transparency and limited responsibility on the part of the companies.³⁰ Be that as it may, it has been argued that the existence of external blockholders could mitigate the agency conflict and thus promote better corporate governance as they would have greater incentive to monitor the management in view of their bearing a greater portion of the losses arising from managerial opportunism³¹ and they would be able to overcome the free rider problem³² illustrated in the preceding paragraph. Nevertheless, the optimism surrounding blockholders is tempered by the existence of conflicts of interest between controlling or blockholders and minority shareholders.³³

The conceptualisation of institutional investors as monitors and activists to address agency conflicts is an illustration of the dominance of the law and economics perspective and its contractarian view of the corporation in the study of corporate governance. Although valuable in providing a framework to identify the incentives and constraints faced by

²⁷ Armen Alchian and Harold Demsetz, 'Production, information costs and economic organization' [1972] 62(5) *American Economic Review* 777-795

²⁸ Stijn Claessens and others, 'The separation of ownership and control in East Asian corporations. *Journal of Financial Economics*' [2000] 58 (1-2) 81-112

²⁹ Kamini Singam, 'Corporate governance in Malaysia' [2003] 15(1) *Bond Law Review* 314-344; Tam On Kit and Monica Guo-Sze Tan, 'Ownership, Governance and Firm Performance in Malaysia' *Corporate Governance: An International Review* [2007] 15(2) 208-222

³⁰ Hairul Azlah Annuar, 'Changes in ownership forms and role of institutional investors in governing public companies in Malaysia' [2015] 11(4) *Journal of Accounting & Organizational Change* 455-475

³¹ Harold Demsetz and Kenneth Lehn, 'The structure of corporate ownership: causes and consequences' [1985] 93(6) *Journal of Political Economy* 1155-1177

³² Andrei Shleifer, A and Robert Vishny, 'A survey of corporate governance' [1997] 52(2) *Journal of Finance* 737-783

³³ Joseph Fanand T.J Wong, 'Do external auditors perform a corporate governance role in emerging markets? Evidence from East Asia' [2005] 43(1) *Journal of Accounting Research* 35-72

managers and owners in exercising corporate governance responsibilities, agency theory needs to be complemented by an understanding of the political and institutional context which corporations and shareholders operate in to provide a more holistic assessment of the monitoring and activism of institutional investors, a point which will be more fully fleshed out in the Malaysian context in Section IV of this paper.

It is arguable that institutional monitoring and shareholder activism are conceptually similar. Institutional monitoring may generally be defined as any form of involvement, direct or indirect, at firm level or industry-wide, by institutions in corporate governance. Shareholder activism has been defined as the range of actions which may be taken by shareholders to influence corporate management and boards without a change in control.³⁴ Such actions may be classified as 'exit' or 'voice' in accordance with the model developed by Hirschman in which they may either sell their shares (exit) or make their dissatisfaction with management known via participative, interactive or combative means (voice), as underpinned by the concept of loyalty to the organisation which it has invested in.³⁵

Alternatively, shareholder activism may be viewed as encompassing 2 distinct approaches, the first being where long-term investors engage with portfolio companies to improve long-term returns to shareholders and the second where investments are made in undervalued companies on the basis that the intervention may result in changes which lead to a rise in the share price.³⁶ The first approach is more closely associated with the traditional or mainstream institutional investors and stewardship, while the second approach is more commonly employed by hedge funds.³⁷

³⁴ Janet Marler and Christophe Faugere, 'Shareholder Activism and Middle Management Equity Incentives' [2010] 18(4) *Corporate Governance: An International Review* 314 which referred to earlier research by Lori Versteegen Ryan and Marguerite Schneider, 2002 'The antecedents of institutional investor activism' *Academy of Management Review*, [2002] 27, 554-573; Marco Becht and others, 'Returns to shareholder activism: Evidence from a clinical study of the Hermes UK Focus Fund.' [2008] 22(8) *Review of Financial Studies*, 3093-3129; and Stuart Gillan and Laura Starks, 'The Evolution of Shareholder Activism in the United States' [2007] 19(1) *Journal of Applied Corporate Finance* 55

³⁵ Albert Hirschman *Exit, voice, and loyalty: responses to decline in firms, organizations, and states* (Harvard University Press, 1970)

³⁶ *supra* n3 424

³⁷ See for example Lucian Bebchuk and others, 'The long-term effects of hedge fund activism', [2015] 115(5) and papers on hedge funds and corporate governance; Leo Strine 'Who Bleeds When the Wolves Bite? A Flesh-and-

The Emergence of Institutional Investor Stewardship

Despite the conceivable promise shown in relation to the activist and monitoring role of institutional shareholders, they did not manage to rise to the occasion in the late 1970s to the 1990s.³⁸ Cheffins illustrates this point by explaining that institutional investor involvement was constrained as a result of diversification of the investment portfolio.³⁹ Investment managers acting on behalf of institutional shareholders were concerned that intervention in the affairs of underperforming companies would be time consuming and unlikely to have a significant impact on a diversified investment portfolio.⁴⁰ There were also obstacles preventing institutional investor activism which were a result of regulation creating an onus to diversify.⁴¹

In the wake of the global financial crisis of 2007-2008, the spotlight shifted to the role of shareholders in governance to prevent the recurrence of future crises. The House of Commons Treasury stated that ‘investors have failed in one of their core tasks, namely the effective scrutiny and monitoring the decisions of boards and executive management in the banking sector.’ This observation was supported by findings that institutional investors in the UK generally refrained from qualitative shareholder engagement and that they do not have a significant impact on the market reaction to purchase and sales of shares.⁴² The OECD also noted that institutional shareholders tended to be reactive rather than proactive and seldom

Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System’ [2017] Faculty Scholarship 1727

³⁸ Brian Cheffins, ‘Corporate Governance since the Managerial Capitalism Era’ [2015] 89 Business History Review 717-744. See also Coffee n18 in which he argued that the monitoring by financial institutions could be confined only to improving their own positions rather than that of the shareholder; Yale School of Management, ‘Are Institutional Investors Part of the Problem or Part of the Solution?’ http://web.law.columbia.edu/sites/default/files/microsites/millstein-center/80235_CED_WEB.pdf Are Institutional Investors Part of the Problem or Part of the Solution? Key Descriptive and Prescriptive Questions about Shareholders’ Role in US Public Equity Markets, accessed 15 March 2018

³⁹ supra n 38 732

⁴⁰ n1 Cheffins 61-67, 76-77

⁴¹ Mark Roe, *Strong Managers, Weak Owners: The Political Roots of American Corporate Finance* (Princeton, 1994), 104-5, 138-9

⁴² Marc Goergen and others, ‘Do UK Institutional Shareholders Monitor Their Investee Firms?’ [2008] *Journal of Corporate Law Studies* (2008) p. 39

challenged boards in sufficient number to make a difference.⁴³ Moreover, the excessive focus of shareholders on short-term proceeds or short-termism and the insufficient engagement of shareholders in corporate governance⁴⁴ which were related concerns⁴⁵, were highlighted as the two major complaints against shareholders and their role in the global financial crisis.⁴⁶

Be that as it may, it is noted that these criticisms were largely levelled at mainstream institutional investors such as pension funds rather than the emerging hedge funds which specialised in targeting underperforming companies and lobbying for changes to boost shareholder returns.⁴⁷ Despite a battering from the Global Financial Crisis, activist hedge funds came back at full strength with campaigns at more than 20% of companies in the S&P 500 between 2009 and 2014.⁴⁸ While the role of hedge fund activists in the area of corporate governance is set to grow in light of the increasing willingness of mainstream institutional investors to back their proposals⁴⁹, the focus of this paper will be on the traditional institutional investors and their role in stewardship.

At the same time, policymakers also began to draw upon ideas of a commitment-focused approach to ownership and universal ownership to encourage investors to engage with the corporations and to look at the long term.⁵⁰ From an external perspective, institutional investor stewardship emerged as a result of the growth of privatisation and deregulation, greater reliance on private savings to fund the retirement of the workforce at

⁴³ Organisation for Economic Co-operation and Development 'Corporate governance and the financial crisis: Conclusions and emerging good practices to enhance implementation of the principles' [2010] <http://www.oecd.org/corporate/ca/corporategovernanceprinciples/44679170.pdf> accessed 10 March 2018

⁴⁴ Jaap Winter, 'The Financial Crisis: Does Good Corporate Governance Matter and How to Achieve it?' Duisenberg School of Finance Policy Paper, No. 14. See also Dominic Barton, 'Capitalism for the Long term' [2011] 85 Harvard Business Review 3

⁴⁵ Jaap Winter 'Shareholder Engagement and Stewardship, the Realities and Illusions of Institutional Share Ownership' <https://ssrn.com/abstract=1867564> accessed 3 March 2018

⁴⁶ Bart Bootsma, 'An Eclectic Approach to Loyalty-Promoting Instruments in Corporate Law: Revisiting Hirschman's Model of Exit, Voice and Loyalty', [2011] 6 Erasmus Law Review 111 (2013)

⁴⁷ Brian Cheffins and John Armour, 'The Past, Present, and Future of Shareholder Activism by Hedge Funds' [2012] Journal of Corporation Law 1-90

⁴⁸ Joel Seligman, 'The Transformation of Wall Street: A History of the Securities and Exchange Commission and Modern Corporate Finance' (Boston, 1982) 537; Moira Conoley, 'Moves to Halt Another Decade of Excess' (*Financial Times*, 5 Aug 1999) and 'The Barbarians Return to the Gate' (*Financial Times*, 25 April 2014)

⁴⁹ Brian Cheffins, 'The Team Production Model as a Paradigm' [2015] 38(2) University of Seattle Law Review 397

⁵⁰ Terry McNulty and Donald Nordberg, 'Ownership, Activism and Engagement: Institutional Investors as Active Owners' [2016] 24(3) Corporate Governance: An International Review 348

large as well as the strengthening of shareholder rights and an increased scrutiny of the actions of institutional investors as shareowners.⁵¹

As will be discussed in greater detail in Section III below, stewardship is closely associated with engagement and dialogue between shareholders of companies and directors, but in practical terms, stewardship transcends engagement. It was described by Adam Smith as ‘anxious vigilance’ performed by a good owner, related to becoming sufficiently knowledgeable about the operations of a company to exercise its ownership rights.⁵² The combination of engagement and information analysis is a determinant of voting decisions, the means by which shareholders are able to hold company boards to account.⁵³

II. A Chronological Account of the Development of the UKSC and MCII

From Industry Statement to Code

The UKSC began its life as an industry sponsored standard-setting norm which differed from statutory governance provisions and company articles of association in terms of their flexibility and arrangements for monitoring and compliance.⁵⁴ There was no formal legal status ascribed to these norms which remained a matter between shareholders and the company as well as the scope to permit non-compliance in appropriate cases.⁵⁵

As early as 1991, the Institutional Shareholders Committee (ISC) published a statement on ‘The Responsibilities of Institutional Shareholders in the UK’ which functioned as a form of collective standard setting by institutional investors and a way of overcoming the

⁵¹ Peter Butler and Simon Wong, Recent trends in institutional investor responsibilities and stewardship, Pensions [2011] 81

⁵² Charles Cronin and John Mellor, ‘An Investigation into Stewardship: Engagement between Investors and Public Companies, Impediments, and Their Resolution’ (Foundation for Governance Research and Education, June 2011)

http://www.cfainstitute.org/learning/products/publications/contributed/corpfinance/Documents/investigation_into_stewardship.pdf accessed 4 March 2018

⁵³ supra n52

⁵⁴ MacNeil n3 423

⁵⁵ MacNeil n3 424

collective action problem to monitor and discipline companies.⁵⁶ In the following year, the Cadbury Report lauded the ISC statement as part of efforts to develop a constructive relationship between companies and their owners.⁵⁷ The Cadbury Report highlighted the need for institutional shareholders to maintain regular, systematic contact with senior management, make positive use of their voting rights and to take a positive interest in the composition of the board of directors of the companies invested in and hoped that market-based regulation would be able to realise these proposals.

Despite the Cadbury Report's sanguineness about a positive market response to these proposals, in the report titled 'Institutional Investment in the United Kingdom: A Review' published in 2001 which was led by Lord Myners, it was noted that fund managers remained 'unnecessarily reluctant to take an activist stance in relation to corporate underperformance, even where this would be in their clients' financial interests'.⁵⁸ Lord Myners later commented that they behaved more akin to absentee landlords rather than long term shareholders committed to the growth and development of the company which they invested in.⁵⁹

Pursuant to the recommendations from the Myners Report, the Institutional Shareholders Committee (ISC) embedded shareholders' activism into fund-management mandates and published a statement titled 'The Responsibilities of Institutional Shareholders and Agents: Statement of Principles' in 2002.⁶⁰ The statement was reviewed and reissued in 2004 and 2007 and published as a Code i.e. the 'Code on the Responsibilities of Institutional Investors' in November 2009.⁶¹

⁵⁶ supra n54

⁵⁷ Adrian Cadbury, 'The Financial Aspects of Corporate Governance' [1992] <https://www.icaew.com/-/media/corporate/files/library/subjects/corporate-governance/financial-aspects-of-corporate-governance.ashx?la=en> accessed 8 March 2018

⁵⁸ Paul Myners, 'Institutional Investment in the United Kingdom: A Review' [2001] <http://webarchive.nationalarchives.gov.uk/+http://www.hm-treasury.gov.uk/media/1/6/31.pdf> accessed 14 March 2018

⁵⁹ 'Myners lashes out at landlord shareholders' (*Financial Times*, 21 April 2009) <https://www.ft.com/content/c0217c20-2eaf-11de-b7d3-00144feabdc0> accessed 14 March 2018

⁶⁰ supra n54

⁶¹ Investment Management Association 'Asset Management in the UK 2010-2011: The IMA Annual Survey' [2011] <https://www.theinvestmentassociation.org/assets/files/research/20110705-IMA2010-2011AMS.pdfstat> accessed on 12 March 2018 stating that institutional investors accounted for 68% of funds invested in UK equities

In 2009, the Walker Report which reviewed corporate governance in UK banks and other financial industry entities recommended that the Financial Reporting Council mandate be broadened to cover the development and adherence to best practices in the stewardship of UK-listed companies. Sir David Walker who spearheaded this review also highlighted that the board and director shortcomings discussed in the report would have been tackled more effectively had there been more vigorous scrutiny and persistence by major investors acting as owners.⁶²

Among the key recommendations in the Walker Report were the decision to separate the then Combined Code into a separate Corporate Governance Code and the UKSC⁶³ and to make the FRC the sponsor of the UKSC to give more material weight to the Code.⁶⁴ It also recommended that the ISC Code should be ratified by the FRC to become the UKSC which would give 'materially greater weight to the Stewardship Code' and place the UKSC on par with the Combined Code as a statement of best practice and observance on a similar 'comply or explain' basis.⁶⁵

Following a six-month consultation period, the UKSC was published in a form which was substantially similar to the earlier ISC Code. The UKSC was revised in September 2012 pursuant to a public consultation from April to July 2012.⁶⁶ In January 2015, the FRC announced that it would commence a project to study how to promote a culture of stewardship and its benefits and how the FRC can increase its scrutiny of adherence to the UKSC to improve the quality of practice and reporting. Subsequently, the FRC launched a public consultation in December 2017 to seek views on a wide range of issues pertaining to stewardship. The author's thoughts and responses to these questions are set out in Section V below.

⁶² David Walker, 'A review of corporate governance in UK banks and other financial industry entities' [2009] http://webarchive.nationalarchives.gov.uk/+http://www.hm-treasury.gov.uk/d/walker_review_261109.pdf accessed on 14 March 2018

⁶³ *supra* n62

⁶⁴ *supra* n62

⁶⁵ *supra* n62

⁶⁶ Financial Reporting Council 'Consultation Document: Revisions to the UK Stewardship Code' [2012] <https://www.frc.org.uk/consultation-list/2012/consultation-document-revisions-to-the-uk-steward> accessed 15 March 2018

The Malaysian Vision of Stewardship

Early steps toward the MCII were taken via the issuance of the ‘Guide of Best Practices for Institutional Investors’ by the Institutional Investor Committee and Minority Shareholder Watchdog Group⁶⁷ (MSWG) jointly which adopted the recommendations in the Capital Market Masterplan in line with the Corporate Governance Code and the Green Book – Enhancing Board Effectiveness. The Employees Provident Fund (EPF), the primary retirement fund in Malaysia, took the lead in introducing the Corporate Governance Principles and Voting Guidelines in 2010, which focused on the size and composition of the board, separation of power between chairman and CEO, re-election of directors, related party transactions and dividend policy.

In addition, the positive relationship between corporate governance and institutional investors was established in an empirical study published in 2008, which also found evidence that corporate governance influenced pressure-insensitive investors, although the relationship became less positive after the 2001 reforms, which implied that the monitoring role of both corporate governance and institutional investors could arise simultaneously and endogenously.⁶⁸ The findings of this study suggested that the reform was successful in catalysing the role of institutional investors and MCCG.⁶⁹

As preparatory groundwork for the MCII, the Securities Commission of Malaysia (SC) in its Corporate Governance Blueprint (CG Blueprint) referenced the existence of various international codes, guidelines and principles pertaining to the role of institutional investors, in particular the International Corporate Governance Network (ICGN) Statement of Principles on Institutional Shareholder Responsibilities and the UKSC.⁷⁰

⁶⁷ The MSWG is an independent research organisation on corporate governance matters. It provides a platform and a collective voice to both retail and institutional minority shareholders, and it advises on voting at general meetings of public listed companies. See <https://www.mswg.org.my/who-we-are>

⁶⁸ Effiezal Aswadi Abdul Wahab, ‘Corporate Governance and Institutional Investors: Evidence from Malaysia’ [2008] 4(2) Asian Academy of Management Journal of Accounting and Finance 67

⁶⁹ *supra* n67

⁷⁰ Securities Commission Malaysia, Corporate Governance Blueprint 2011, https://www.sc.com.my/wp-content/uploads/eng/html/cg/cg2011/pdf/cg_blueprint2011.pdf accessed 14 March 2018

The CG Blueprint also set out a case for change in the prevailing practices of institutional investors, focusing on the effective exercise of ownership rights which were to be manifested via the expected best practices under the new code for institutional investors⁷¹. The document also mooted the creation of a network of institutional investors to represent the common interest of all institutional investors and be a platform to shape and influence a wider sphere of corporate governance culture.⁷² Here, the CG Blueprint referred to the UK and Australian experience, and highlighted the Institutional Investor Committee in the UK as an example of an institutional investor representative group.⁷³ In summary, the CG Blueprint proposed 2 recommendations i.e. that institutional investors drive the formulation of a new code and publish their commitment to the new code for institutional investors and create an industry driven umbrella body for institutional investors.⁷⁴

The next leg of the journey was taken up by the MSWG which oversaw the formation of a Steering Committee comprising chief executive officers and key representatives of Malaysian institutional investors and the publication of a consultation paper jointly with the SC. After incorporating the comments from the public, the MCII was launched in 2014, one of the deliverables of the CG Blueprint. This code was intended to give institutional investors guidance on effective exercise of stewardship responsibilities to ensure delivery of sustainable long-term value to their ultimate beneficiaries or clients.

III. Stewardship in the UK and Malaysia

UKSC v MCII: Principles, Approach, Oversight

The term 'stewardship' is given a brief description in the UKSC, with an allusion to its aim to 'promote the long-term success of companies in such a way that the ultimate providers of capital also prosper' and a statement that effective stewardship benefits companies,

⁷¹ *ibid*

⁷² *ibid*

⁷³ *ibid*

⁷⁴ *ibid*

investors and the economy as a whole. By contrast, the MCII's definition section contains a definition of 'stewardship' as follows:

Stewardship is investor stewardship from the perspective of a **long-term institutional investor** in particular **asset owners** such as pension funds. It includes the **responsible management and oversight of assets for the benefit of the institutional investors' ultimate beneficiaries or clients**. The discharge of effective stewardship responsibilities would include development of a set of principles/policies, application of the principles/policies, oversight of agents, communications of expectations and reporting to their clients or beneficiaries. These activities also include **monitoring and engagement** with the investee companies on matters relating to strategy, performance, risk management, voting, corporate governance or sustainability issues. (emphasis added)

The definition of stewardship in the MCII is more detailed compared to the UKSC with a list of principles which constitute a discharge of effective stewardship responsibilities. While the UKSC refers to the objective of stewardship as promoting the long-term success of companies, the MCII uses the phrase 'long-term institutional investor' and focuses on 'asset owners such as pension funds'. The emphasis on 'asset owner' in the MCII seems odd given that institutional investors are defined to include both asset owners and asset managers, both of which play distinct roles along the investment chain, and this choice of phrasing seems unnecessarily reductionist.

The principles pertaining to disclosure of stewardship responsibilities, management of conflicts of interest in relation to stewardship, monitoring and engagement with investee companies are present in the UKSC and MCII. With regard to the principle of managing conflict of interest, both the UKSC and MCII appear to tacitly accept the presence of conflict of interest situations rather than mandating that potential conflict of interest situations be disclosed and methods of dealing with the conflict of interest explained, points which would be of greater

utility and significance to clients and beneficiaries and which would strengthen the impact of the USKC and MCII.

However, the UKSC principles relating to the escalation of stewardship activities, the willingness to act collectively with other investors where appropriate and reporting periodically on stewardship activities has not been incorporated into the MCII. It is worth noting that the principle on collective action was previously Principle 7 of the draft version of the MCII issued for consultation, but was deleted and moved to the preamble of the finalised MCII as a result of feedback received. Among the concerns raised were that collective action with other investors could be deemed to be acting in concert to manipulate the market, the difficulty of establishing clear policies on collective engagement and competition law concerns.

Moreover, where the UKSC requires institutional investors to have a clear policy on voting and disclosure of their voting activities, MCII Principle 6 only requires institutional investors to publish a voting policy. Nevertheless, the guidance provided in paragraph 6.5 of the MCII states that institutional investors are encouraged to disclose a summary of their voting activities as it gives the beneficiaries great clarity on how the votes are cast and is also a way of demonstrating that conflicts of interest are being properly managed.

It is worth noting that the MCII Principle 5 requires institutional investors to incorporate corporate governance and sustainability considerations into the investment decision-making process while the UKSC does not contain a corresponding principle. The public feedback to the MCII stated that emphasis should be given on the importance of integrating ESG (Environment, Social and Governance) factors in the stewardship activities.⁷⁵ As such, the inclusion of this principle brings the MCII in alignment with the 2011 United Nations Principles for Responsible Investment in which investors are asked to incorporate environmental, social and governance issues in its investment analysis and decision-making processes.⁷⁶

⁷⁵ Minority Shareholders Watchdog Group Malaysia and Securities Commission Malaysia, The Malaysian Code for Institutional Investors 2014- Public Response Paper, (June 2014, 1/2014) https://www.sc.com.my/wp-content/uploads/eng/html/consultation/140626_PublicResponse_1.pdf accessed 15 March 2018

⁷⁶ United Nations, Principles for Responsible Investment 2011, <https://www.unpri.org/pri/what-are-the-principles-for-responsible-investment> accessed 15 March 2018

The UKSC and MCII are characterised as ‘soft law’, in contrast with a statutory regulatory regime with penalties for non-compliance.⁷⁷ As such, the MCII expressly states that it is a voluntary code.⁷⁸ Although the UKSC is mainly voluntary, the UK Financial Conduct Authority (FCA) Conduct of Business Rule 2.2.3 requires any firm authorised to managed funds, which is not a venture capital firm, and which manages investments for professional clients that are not natural persons, to disclose “the nature of its commitment” to the UKSC or “where it does not commit to the UKSC, its alternative investment strategy”, thus rendering it mandatory for this category of asset managers. A breach of Rule 2.2.3 may result in public censure or a financial penalty as imposed by the FCA under section 205 or 206 of the UK Financial Services and Markets Act 2000.

In line with the approach taken in the UK Corporate Governance Code, The UKSC mandates a ‘comply or explain’ approach whereby a signatory is required to explain why it has not complied with elements of the UKSC which has not been applied or where it has failed to disclose specific information requested in the guidance to the principles.⁷⁹ Although the MCII provides that institutional investors should explain how they have applied the principles in the MCII, taking into account the guidance provided under each principle, set out in the form of best practice recommendations, the MCII does not require signatories to explain reasons for non-observance of a principle, unlike the UK position. It is submitted that the omission to require explanations weakens the quality of the disclosures, a point which is borne out later in this paper.

The take up of the UKSC is currently monitored by the FRC, an independent regulator which has oversight of auditors, accountants and actuaries and looks into the Corporate Governance Code and UKSC to promote transparency and integrity in business.⁸⁰ The FRC’s

⁷⁷ See Iris Chiu, ‘Institutional Shareholders as Stewards: Toward a New Conception of Corporate Governance’ [2012] 6 Brooklyn Journal of Corporate, Financial & Commercial Law 837 in which she describes the soft law on corporate governance in the UK as developing in order to boost institutional shareholder monitoring as a form of private order beneath the corporate structure.

⁷⁸ Minority Shareholder Watchdog Group, ‘The Malaysian Code for Institutional Investors 2014’ <https://mswg.org.my/sites/default/files/IIC/MICC.pdf> accessed 15 March 2018

⁷⁹ Financial Reporting Council, ‘The UK Stewardship Code’ [https://www.frc.org.uk/getattachment/d67933f9-ca38-4233-b603-3d24b2f62c5f/UK-Stewardship-Code-\(September-2012\).pdf](https://www.frc.org.uk/getattachment/d67933f9-ca38-4233-b603-3d24b2f62c5f/UK-Stewardship-Code-(September-2012).pdf) accessed 28 February 2018

⁸⁰ Financial Reporting Council, ‘About the FRC’ <https://www.frc.org.uk/about-the-frc> accessed 28 February 2018

position as an independent regulatory body stands in contrast to the industry-driven character of the Institutional Investor Council (IIC) which oversees the effective adoption of the MCII among others and was formally established under the Societies Act 1966 on 29 December 2017. The IIC comprises representatives from statutory bodies, GLICs, the MSWG, government linked fund managers and a private fund manager. It replaces the MSWG which was previously tasked with overseeing the implementation of the MCII. In many ways, the IIC is similar to the UK ISC, suggesting that any changes to the MCII to harden its principles to regulatory obligations would be more difficult than if undertaken within the UK framework.

Stewardship Practice in the UK

As of 2016, there were almost 300 signatories to the UKSC.⁸¹ This represents a fairly sizeable figure which appears to be a significant marker of the support for the UKSC. Nonetheless, beyond paying attention to the number of signatories, the key indicators of the success of the UKSC rests on its potential to improve long-term returns to shareholders and to discharge fiduciary obligations to its ultimate investors.⁸² Hence, the quality of the engagement, translation of the UKSC principles into compliance and the quality of the disclosures made in compliance statements are important criteria in determining whether the quantity of signatories merely amounts to winning a numbers game without significant practical backing.⁸³

With regard to the ‘comply or explain’ approach governing stewardship statements, academic research has pointed to its limitations. MacNeil highlights three major issues: firstly, the fact that institutional investors are left to determine their own policy using the UKSC principles as a guide which militates against the credibility of the ‘comply or explain’ approach against self-selected standards; secondly, the limited nature of the legal obligation of the

⁸¹ Financial Reporting Council, ‘Proposed Revisions to the UK Corporate Governance Code’ <https://www.frc.org.uk/getattachment/f7366d6f-aa57-4134-a409-1362d220445b/;aspx> accessed 15 March 2018

⁸² n3 429

⁸³ Arad Reisberg, ‘The UK Stewardship Code: On the Road to Nowhere?’ *Journal of Corporate Law Studies* [2015] 15(2) 217-253

UKSC where it only applies to fund managers under the Financial Services and Markets Act 2000 remit which undermines its status as an industry-wide standard; and thirdly, a structural issue in which the nature and duration of fund management mandates do not lend themselves easily to disciplinary action by underlying investors who cannot 'exit' fund management contracts in the same way they may choose to sell their shares in companies subject to the UK Corporate Governance Code.⁸⁴ Further, as the UKSC provisions are not incorporated into the Listing Rules, non-compliance will not attract any penalties or censure.⁸⁵ Indeed, the admission by the FRC that many statements on the UKSC give little insight into investors' actual practices⁸⁶ simply confirms that these concerns are valid and that the gap between theory and practice needs closing.

As such, to improve the quality of reporting against the UKSC and to encourage greater transparency in the market and maintain the credibility of the UKSC, the FRC introduced a tiering system based on the quality of the descriptions of signatories' approach to stewardship and their explanations in accordance with the 'comply or explain' basis of the UKSC in November 2016. Tier 1, which is at the apex, refers to signatories which provide a good quality and transparent description of their approach to stewardship and explanations of an alternative approach where necessary while Tier 2 describes signatories which meet many of the reporting expectations but report less transparently on their approach to stewardship or do not provide explanations where they depart from provisions of the UKSC. Tier 3 signatories were those which required significant reporting improvements to ensure a more transparent approach and had not engaged with the process of improving their statements which continue to be generic and provided no, or poor, explanations where they depart from provisions of the UKSC. The FRC later removed the Tier 3 categorisation in August

⁸⁴ n3 436. See also Marc Moore, 'Whispering Sweet Nothings: The Limitations of Informal Conformance in UK Corporate Governance' [2009] 9(1) *Journal of Corporate Law Studies* 95-138 for an exposition on the limits of the 'comply or explain' approach in the context of the UK Corporate Governance Code.

⁸⁵ Lorraine Talbot, 'Polanyi's Embeddedness and Shareholder Stewardship: A Contextual Analysis of Current Anglo-American Perspectives on Corporate Governance' [2011] 62 *North Ireland Legal Quarterly* 2011, 462

⁸⁶ Financial Reporting Council, 'FRC encourages better comply or explain disclosure and improved investor transparency' [19 December 2013]. <https://www.frc.org.uk/news/december-2013/frc-encourages-better-comply-or-explain-disclosure> accessed 17 March 2018

2017 after noting improvements in 50% of the 80 identified Tier 3 signatories while the other half removed themselves from the list of signatories.

The Malaysian Stewardship Journey to date

The IIC issued its report titled 'Investor Stewardship and Future Key Priorities'⁸⁷ (IIC Report) in 2016, its first significant publication since the launch of the MCII in 2014. As an introduction, IIC Report showed that as at 31 December 2015, the featured institutional investors in the IIC Report i.e. the EPF, Permodalan Nasional Berhad, Kumpulan Wang Persaraan (Diperbadankan), Lembaga Tabung Haji, Khazanah Nasional Berhad, Social Security Organisation and Aberdeen Asset Management Sdn Bhd, collectively managed a fund size of approximately RM1,321 billion, and the size of domestic equities was approximately RM524 billion. The total fund size in domestic equities of the above institutions amounted to approximately RM524 billion as at 31 December 2015. This represented 31% of total Bursa Malaysia's market capitalisation of RM1.69 trillion as at end December 2015, reflecting the magnitude of these institutions in the Malaysian capital market.

The findings of the IIC Report were intended to provide an indication of the extent of the stewardship and engagement activities undertaken by institutional investors as well as their observations on corporate governance practices of their investee companies, based on a survey of 7 member organisations of the IIC i.e. the EPF, Permodalan Nasional Berhad, Kumpulan Wang Persaraan (Diperbadankan), Lembaga Tabung Haji, Khazanah Nasional Berhad, Social Security Organisation and Aberdeen Asset Management Sdn Bhd. The IIC evaluated the stewardship, engagement and resources for stewardship⁸⁸ as well as the key areas which showed progress and areas for improvement identified by the member institutional investors.⁸⁹

⁸⁷ Institutional Investor Council Malaysia, 'Investor Stewardship and Future Key Priorities 2016', <https://www.mswg.org.my/investor-stewardship-future-key-priorities-2016> accessed 3 March 2018

⁸⁸ n87, 18-25

⁸⁹ n87, 26-33

Further to the IIC Report, as at April 2018, are now 17 signatories to the MCII. They are as follows:

1. Hermes Fund Managers
2. Hermes Equity Ownership Services
3. Aberdeen Asset Management Sdn Bhd
4. Legal & General Investment Management
5. BNP Paribas Investment Partners Malaysia Sdn Bhd
6. BNP Paribas Investment Partners Najmah Malaysia Sdn Bhd
7. Kumpulan Wang Persaraan (Diperbadankan)
8. ValueCAP Sdn Bhd
9. Khazanah Nasional Berhad
10. Employees Provident Fund
11. Aiiman Asset Management Sdn Bhd
12. Affin Hwang Asset Management Berhad
13. Nomura Asset Management Malaysia Sdn Bhd
14. Nomura Islamic Asset Management Sdn Bhd
15. Pertubuhan Keselamatan Sosial (PERKESO)
16. Kenanga Investors Berhad
17. Kenanga Islamic Investors Berhad

Based on the above, the signatories to the MCII may be classified into 3 different categories. The first category comprises foreign fund managers and the Malaysia-based representatives of foreign investment management groups of companies i.e. Hermes Fund Managers, Hermes Equity Ownership Services, Aberdeen Asset Management Sdn Bhd, Legal & General Investment Management, BNP Paribas Investment Partners Malaysia Sdn Bhd, Nomura Asset Management Malaysia Sdn Bhd, Nomura Islamic Asset Management Sdn Bhd. They comprise 35.2% of the total number of signatories.

The second category are local fund managers, namely Aiiman Asset Management Sdn Bhd, Affin Hwang Asset Management Berhad, Kenanga Investors Berhad and Kenanga Islamic Investors Berhad. They form 23.5% of the total number of signatories.

Finally, and most crucially, the third and largest category of signatories to the MCII comprise Government Linked Investment Companies (GLIC), local statutory body and a government linked fund manager i.e. Kumpulan Wang Persaraan (Diperbadankan), ValueCAP Sdn Bhd, Khazanah Nasional Berhad, Employees Provident Fund and Pertubuhan Keselamatan Sosial (PERKESO). These entities comprise 41.3% of the total number of signatories. The GLICs in this list refer to Kumpulan Wang Persaraan (Diperbadankan), Khazanah Nasional Berhad and Employees Provident Fund, in accordance with the classification by the Ministry of Finance.⁹⁰ It is curious that despite being respondents to the IIC Report survey as well as having representation on the IIC⁹¹, Permodalan Nasional Berhad and Lembaga Tabung Haji are not signatories to the MCII, which raises questions as to the effect and credibility of the UKSC as a signal for the promotion and exercise of stewardship principles.

Some initial observations may be made based on the data set out earlier. The first is the international reach of stewardship principles whereby the Malaysia-based representatives of foreign investment management groups of companies which are signatories to the UKSC (Hermes, Aberdeen, Legal & General Investment) and the Japanese Stewardship Code (Nomura) are also signatories to the MCII. Indeed, in the Legal & General Investment Management stewardship statement, there is an express reference to the MCII and the UKSC as well as the Japan Stewardship Code in the same section of the statement.⁹² Such references are also a nod towards the possible co-ordination and convergence of stewardship practice internationally.

⁹⁰ Ministry of Finance Malaysia, Government Investment Companies Division (GIC) Frequently Asked Questions, 'What are Government-Linked Investment Companies (GLIC)?' <http://www.treasury.gov.my/index.php/en/contactus/faqs/gic.html> accessed 18 March 2018

⁹¹ Institutional Investor Council Malaysia, 'Council Malaysia Members; <http://www.mswg.org.my/institutional-investors-council-malaysia> accessed 18 March 2018

⁹² Legal & General Investment Management, 'Malaysian Code for Institutional Investors', <http://www.lgim.com/files/document-library/capabilities/malaysian-stewardship-code.pdf> accessed 18 March 2018

The second is the lacklustre take up rate among local fund management institutions. While there are 77 fund managers currently licensed by the SC⁹³, the fact that only 3 fund management institutions are signatories to the MCII gives rise to an issue as to why there has not been greater support from other fund managers locally and what may be done to increase buy-in from this segment of the investment management community. While it is arguable that stewardship as envisioned in the MCII may not be practicable for all models of fund management, the small number of signatories among this sector does give one pause.

A brief survey of the stewardship statements which have been prepared by the signatories to date reveals divergences in how information on stewardship is explained and presented. While the local representatives of foreign fund management institutions tend to provide more detailed explanations, owing perhaps to the influence of their parent companies which are signatories to the UKSC, local signatories tend to provide scant details and brief explanations, with the notable exceptions of EPF and ValueCap which have detailed stewardship statements easily accessible to the public.

Apart from a list of signatories to the MCII, there is a category of supporters to the MCII although there is no reference to the role of 'supporters' in the MCII. A perusal of the form to sign up as a supporter shows that it refers to 'service provider/professional/other support bodies'.⁹⁴ Thus far, there are 8 supporters, namely the SC, Goodway Integrated Industries Berhad, TA Ann Holdings Berhad, Malaysian Resources Corporation Berhad, the Securities Industry Development Corporation, the Malaysian Institute of Corporate Governance, the International Corporate Governance Network (ICGN) and PricewaterhouseCoopers Malaysia. Among the reasons to become a supporter, as listed on the form, are 'Client interest', 'Beneficiary interest', 'Reputational benefits', 'Commitment to responsible investment cause', and 'Able to contribute to the development of capital market'.

⁹³ Securities Commission Malaysia, Data & Statistics, <https://www.sc.com.my/data-statistics/> accessed 20 March 2018

⁹⁴ Minority Shareholder Watchdog Group Malaysia, 'SUPPORT FORM - SERVICE PROVIDER / PROFESSIONAL / OTHER SUPPORT BODIES' <http://www.mswg.org.my/support-form-service-provider-professional-other-support-bodies> accessed 20 March 2018

There is currently no official statement with regard to supporters of the MCII and the nature and significance of being a supporter is unclear. It is proposed that in the next revision of the MCII, the IIC consider setting out clearly and comprehensively the role expected to be played by supporters of the MCII.

IV. Broader Factors Affecting Stewardship

Further to the discussion above, there are also structural issues in the investment management industry which limit effective stewardship. One of these issues is that of short-termism in investment, which was the focal point of the Kay Review on long-term decision making in the UK equity markets.⁹⁵ It was found that the principal causes of such short-termism were the decline of trust and the misalignment of incentives throughout the equity investment chain. Further, the Kay Review found that public equity markets currently encouraged exit (the sale of shares) over voice (the exchange of views with the company) as a means of engagement, replacing the concerned investor with the anonymous trader.

Additionally, short-term relative metrics which are the norm in the investment management industry are also inimical to developing a long-term view of stewardship. Where performance objectives and financial incentives are short-term, the investment horizons will inevitably follow as well. This could result in damage suffered by investee companies as evidenced by a study conducted by Stanford University in 2014 which showed that: nearly two-thirds of companies (65%) agree or strongly agree that a company whose shareholder base is dominated by short-term investors cannot focus on strategic decisions because of a focus on short-term results and just over half (51%) believe that short-term investors lead a company to focus on cost cutting while the majority of companies (57%) agree or strongly agree that a company whose shareholder base is dominated by short-term investors will have

⁹⁵ John Kay, 'Independent review on investment in UK equity markets and its impact on the long-term performance and governance of UK quoted companies: Final Report' https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/253454/bis-12-917-kay-review-of-equity-markets-final-report.pdf accessed 3 March 2018.

reduced market value and/or reduced long-term growth.⁹⁶ Indeed, empirical research has indicated that investor horizons matter for engagement : long-term investors intervene more intensively than short-term investors, and engagements are primarily triggered by concerns about a firm’s corporate governance or strategy rather than about short-term issues.⁹⁷

Some proposals which have been mooted to address this issue include asset owners making sure that the performance metrics and financial incentives applied to asset managers are consistent with good stewardship, e.g. evaluating fund managers using a 5-7 year time horizon, focusing annual reviews on the manager’s investment process and determining whether the portfolio assets – in terms of number of holdings, degree of concentration, types of assets, turnover level, valuation ratios are in line with the stated philosophy.⁹⁸ Other suggestions pertaining to fee arrangements include introducing performance fees and spreading fee payments over multiple years – in ensuring that the fund manager’s incentive structure does not promote too much risk-taking, the investment management agreement should specify the level of risks that the asset owner is prepared to assume.⁹⁹ Nonetheless, the difficulty of measuring a company’s long-term performance must not be underestimated and the easy availability of short-term indicators such as quarterly report and share prices which may not be indicative of the actual underlying value of the company are also a factor to consider in addressing this issue of short-termism.

Be that as it may, the proposals above must be seen in light of the varying types of investment strategies, some of which may be short-term in nature and which may thus legitimise non-adoption of the principles in the UKSC or the MCII. However, it is beyond the scope of this paper to discuss the normative question of whether short-term investment

⁹⁶ Graduate School of Stanford Business, ‘2014 Study on How Investment Horizon and Expectations of Shareholder Base Impact Corporate Decision-Making’ <https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/cgri-survey-2014-investment-horizon.pdf> accessed 20 March 2018

⁹⁷ Joseph McCahery and others, ‘Behind the Scenes: The Corporate Governance Preferences of Institutional Investors’, [2016] 71(6) 2929

⁹⁸ Marathon Club, ‘Guidance Note for Long-Term Investing’ <https://www.unpri.org/Uploads/f/s/r/GuidanceNoteforLong-TermInvestingSpring2007.pdf> accessed 22 March 2018

⁹⁹ supra n51, 85

strategies are consistent with long-term investment objectives and the fiduciary duties which asset owners and asset managers owe to their beneficiaries or clients.

Political Realities in the Malaysian Sphere

It is argued that context is critical, particularly with regard to emerging economies such as Malaysia which possess a different institutional context, politics, history and ownership structure from that of developed economies.¹⁰⁰ In this light, it is worthwhile examining the distinct features of the Malaysian political and economic milieu to understand their impact on the stewardship of institutional investors.

The shareholding structure of many Malaysian listed companies is concentrated, rather than the dispersed shareholding commonly found in the USA and the UK.¹⁰¹ Another unique characteristic which differentiates Malaysia is the extensive political influence on firms, as reflected in the large number of politically connected firms and its impact on the corporate governance system.¹⁰² There are also high levels of family or state concentrated shareholdings.¹⁰³ This development may be traced to the Malaysian government's efforts to implement its privatisation program, government linked companies (GLCs) were introduced in the 1980s which the Malaysian government invested in, giving them ownership and control as evidenced by government influence in the appointment of members of the board of

¹⁰⁰ Nor Zalina Mohamad Yusof, 'Context Matters: A Critique of Agency Theory in Corporate Governance Research in Emerging Countries' *International Journal of Economics and Financial Issues*, [2016] 6(S7) 154-158

¹⁰¹ Shanthy Rachagan, 'Controlling Shareholders and Corporate Governance in Malaysia: Would the Self-Enforcing Model Protect Minority Shareholders' [2007] 3 *Corporate Governance Law Review* 1, 20; Thillainathan, 'Corporate Governance and Restructuring in Malaysia – A Review of Markets, Mechanisms, Agents and the Legal Infrastructure' (1999) paper prepared for the World Bank/OECF Survey of Corporate Governance arrangements

¹⁰² Laurent Germain, Nadine and others, 'Corporate governance reform in Malaysia: Board size, independence and monitoring' [2014] 75 *Journal of Economics and Business* 126-162; Effiezal Aswadi Abdul Wahab and others, 'The impact of the Malaysian Code on Corporate Governance: Compliance, Institutional Investors and Stock Performance' [2007] 3(2) *Journal of Contemporary Accounting & Economics* at <https://ssrn.com/abstract=1058421>; Mara Faccio and others, 'Political connections and corporate bailouts' [2006] 61(6) *Journal of Finance* 2597-2635

¹⁰³ Amir Ranjbar and others, 'Corporate Ownership Patterns in Malaysian Listed Companies' [2008] Terengganu International Business and Economics Conference, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1898642 accessed 15 March 2018; Kuek Chee Ying, 'Shareholder activism through exit and voice mechanisms in Malaysia: A comparison with the Australian experience' [2014] 26(3) *Bond Law Review* 91

directors and senior managers and decision making.¹⁰⁴ Given these circumstances, GLCs are thus affected differently by regulatory changes.¹⁰⁵

As a corollary to the above, a majority of the most influential and powerful Malaysian institutional investors are GLICs which in turn have ownership of leading public-listed GLCs.¹⁰⁶ Both the GLICs and GLCs are professionally managed and are well among the top performers in the Malaysian capital market.¹⁰⁷ Empirical research conducted in 2007 showed that politically connected firms were found to have weaker corporate governance in place than politically independent firms, which was however mitigated by institutional ownership which in this instance referred to the 2 pension funds, EPF and LTAT, an investment fund, PNB, a pilgrim funds, LTH and an insurance company, SOCSO.¹⁰⁸ However, a different study indicated that institutional investors in Malaysia do play a monitoring role to reduce agency costs by demanding higher quality audit for politically connected firms.¹⁰⁹

Be that as it may, subsequent and more recent research has shown that the GLICS and the GLCs under its control are ultimately under the control of the Minister of Finance Incorporated, a corporate body established under the Minister of Finance (Incorporation) Act 1957 which is authorised to enter into contracts, acquisitions, purchases, possessions, holdings and maintains tangible and intangible assets.¹¹⁰ The formation of such an entity is not problematic in of itself as state driven investments may be beneficial economically and socially.

Nevertheless, given that the nature of the Malaysian state as semi-authoritarian or quasi-democratic i.e. where the independence of oversight institutions to ensure checks and

¹⁰⁴ *ibid*

¹⁰⁵ *ibid*

¹⁰⁶ See generally Edmund Terence Gomez and others, 'Minister of Finance Incorporated: Ownership and Control of Corporate Malaysia' (Strategic Information and Research Development Centre, 2017)

¹⁰⁷ n105

¹⁰⁸ n101 Effiezal 127. However, see Rashidah Abdul Rahman and Mohammad Rizal Salim, 'Corporate Governance in Malaysia: Theory, Law and Context' (Sweet & Maxwell Asia, 2010) at 66 which, argues that states may be negatively correlated with the company's financial performance i.e. companies controlled by the state may be low performers although agreeing that companies controlled by the state are perceived to be more sensitive to political concerns.

¹⁰⁹ Effiezal Aswadi Abdul Wahab and others 'Institutional investors, political connection and audit quality in Malaysia' [2009] 22(2) Accounting Research Journal 167-195

¹¹⁰ section 3 Minister of Finance (Incorporation) Act 1957 (Act 375)

balances have been compromised and the government's professed intention to implement selective patronage-based affirmative action as well as the Prime Minister holding the post of Finance Minister simultaneously, GLICs and GLCs face a significant risk of corporate abuse leading to major politically-linked scandals.¹¹¹ A vivid illustration of such a scandal was seen in 2015 when assets of a prominent unlisted GLC which was in financial distress were acquired by GLICs, and investigations into this intricate scandal are still underway.

In summary, despite some being signatories to the MCII, broader concerns arise as to the issues surrounding these powerful GLICs and capacity to realise the goals of stewardship to ensure the long-term value of shareholdings. It is submitted that these contextual factors represent a sizeable constraint on the effectiveness of the MCII at a macro-level, putting Malaysia at a disadvantage with regard to advancing stewardship as well as the broader goal of improving corporate governance overall.¹¹² Indeed, as Gomez et al. highlight, taking into account the political economy context in which GLICs and GLCs operate, institutional reforms to devolve power are imperative as their performance is not simply an outcome of their business decisions but their relationship with the state.¹¹³

V. The Path Ahead for Institutional Investors and Stewardship

A broad range of questions which were raised in the December 2017 FRC Consultation Exercise on Stewardship in the Proposed Revisions to the UK Corporate Governance Code prior to a more detailed consultation set to take place later this year. Some of the key focus areas underscoring the consultation questions were a clearer and more inclusive role of investors in promoting stewardship and the expanding of stewardship to incorporate wider stakeholders, ESG factors and broader social impact and the need for separate guidance for different categories of the investment chain and the role of asset managers in disclosing a

¹¹¹ n105 230

¹¹² See Shanthi Rachagan and Aiman Nariman Mohd Sulaiman, 'Controlling Shareholders: Issues and Challenges for Shareholders' Empowerment in Directors' Remuneration in Corporate Malaysia, [2014] 9(1) Asian Journal of Comparative Law 267-294 for an interesting study on how these issues play out in the context of empowering shareholders to check excessive remuneration of directors.

¹¹³ n105 231

fund's approach to stewardship, a re-evaluation of the current 'comply or explain' format. The wide scope of the questions points to a clear and urgent need to determine the path ahead for the role of institutional investors and the stewardship codes.

Based on these questions, it would appear that the FRC has begun to take into consideration the possibility that previous versions of the UKSC had been overly focused on the monitoring role of shareholders, resulting in an unnecessary relegation of the importance of other stakeholders.¹¹⁴ It had been argued that shareholder activism and the management response are motivated exclusively by financial incentives, resulting in there no longer being a substantive concept of shareholder democracy independent of market demands.¹¹⁵ Moreover, this repeated concentration on shareholders had also been described as unimaginative and path-dependent.¹¹⁶ Hence, to the extent that there were problems with the incentives of institutional investors to spend on stewardship, stewardship codes putting forward aspirations, principles or guidelines are likely to have less of an impact than if investment managers had appropriate incentives.¹¹⁷ Attention should therefore be paid to the structure of institutional investing and share ownership to address the issues which have arisen since the introduction of the UKSC.

The need for structural reform of the investment industry has been highlighted in both the Kay Review and other academic research.¹¹⁸ In this regard, the share ownership chain has become longer and more complicated as a result of more intermediation, making it a far cry from the original theoretical model. Consequently, the ultimate holders or capital providers i.e. the beneficiaries or clients are even more distant from the company's activities, thus lessening the sense of accountability between the ultimate investor and the investee company. This accountability is founded on an understanding of the shareholder as an active

¹¹⁴ n77 387, 431

¹¹⁵ Dalia Tsuk Mitchell, 'Shareholders as Proxies: The Contours of Shareholder Democracy' [2006] 63(4) Washington and Lee Law Review 1576

¹¹⁶ Christopher Bruner, 'Power and Purpose in the "Anglo-American" Corporation' [2010] 50 Virginia Journal of International Law 329.

¹¹⁷ n1. See also Iris HY Chiu, 'Reviving Shareholder Stewardship: Critically Examining the Impact of Corporate Transparency Reforms in the UK' [2014] 38(3) 984 - 1023

¹¹⁸ Simon Wong 'Why Stewardship is proving Elusive for Institutional Investors' [2010] Butterworths Journal of International Banking and Financial Law 406-411

member of the corporation¹¹⁹ entailing ideas of participation, identity, responsibility and obligation¹²⁰ rather than a passive observer. In other words, the shareholder is now part of a collective enterprise¹²¹. It follows that the shareholder now has both a formal role (e.g. voting) and an informal role (e.g. private negotiations with the corporation prior to the shareholders' meeting)¹²² which are encapsulated within the UKSC principles.

Increased intermediation is also an issue in the context of the fund management industry, which typically relies on relative financial performance, indices or other benchmarks measured over short periods and bases its fee structure on the size of assets under management. This incentivises fund managers to attract more assets under management than to improve the performance of the assets already under management. In other words, it is easier to pay more to attract more assets by carrying out more marketing and by paying distribution fees than to make the efforts that improve the performance of shares in the portfolio.¹²³ Therefore, apart from the short-term measurement canvassed earlier, the question of the fee structure of asset managers needs to be reviewed as well.

On another point, the FRC's question on the inclusion of a wider range of stakeholders and the consideration of ESG factors raises the question as to whether the FRC intends for the UKSC to more clearly incorporate socially responsible investing into stewardship, as has already been incorporated into the MCI and is a keystone in the United Nations Principles for Responsible Investment. This is in effect a conflation of what is beneficial for society with what is beneficial for institutional investors. Although this suggests a departure from the idea

¹¹⁹ Bootsma n46 124. He refers to the idea of membership relation as found in Dutch corporate law. See e.g. Van der Heidjen/Van der Grinten, *Handboek voor de Naamloze en de Besloten Vennootschap* (1992) No. 131 at 148-149 and Van Schifgaarde/Winter, *Van de NV en de BV* (2006) No.1 at 2

¹²⁰ Stephen Bottomley, 'The Constitutional Corporation: Rethinking Corporate Governance (Ashgate Publishing, Ltd., 2007) 12 which states that 'the corporate world is too complex and too variable for any single theory or discipline to be able to supply all of the answers to all of the problems of corporate governance. There are aspects of corporate life for which economic theories are well-suited, but equally, there are other aspects for which we need a different framework, another option of the conceptual menu. Economics can share the analytical stage with other approaches.'

¹²¹ Ibid

¹²² n118

¹²³ Stephen Davis and others, 'The New Capitalists' (Harvard Business School Press, 2006) 68

of stewardship as promoting long-term risk adjusted returns, a modern conception of value which transcends measurement in purely financial terms.

Another issue which requires further exploration is what clients or beneficiaries can do to help promote stewardship practices. This would mean a relook at the current paradigm in which the balance of power is seen to be tilted towards asset owners and asset managers rather than beneficiaries or clients and correspondingly, reform is concentrated on the more powerful. Be that as it may, the beneficiary's voice should also carry weight and the concept of 'beneficiary engagement' should be examined in greater depth. In this regard, retrospective transparency and accountability to beneficiaries about decisions taken by asset managers and asset owners and the reasons may prove helpful in creating a greater sense of accountability.¹²⁴

Conclusion

In summary, the UKSC and the MCII are functionally similar yet contextually different. The presence of common structural factors arising from the investment industry and its impact on institutional investor stewardship indicates that there may be convergence in seeking solutions. Nevertheless, the identification and articulation of the unique contextual constraints in Malaysia, juxtaposed against its absence in the UK context, is the first step in addressing them, although in view of the entrenched nature of these issues and their linkage with the incumbent political scenario at play, it would not be realistic to expect short-term changes.

It is critical to ensure that apart from the incentivising the take up of stewardship codes which are fundamentally voluntary, there is structural support which encourages the development of a long-term, sustainable approach to investments. Apart from a focus on the overarching structures governing asset owners and asset managers which has been studied previously, structural support also includes addressing the role of the individual beneficiary

¹²⁴ Christine Berry and Charles Scanlan, 'The voice of the beneficiary' in Cambridge Handbook of Institutional Investment and Fiduciary Duty (Cambridge University Press 2014) 337-352

or client to drive demand for better stewardship. In a world that is driven by numbers and financials, the push towards stewardship must not only emanate from the regulator and industry but also from beneficiaries or clients. In tandem with the growing democratisation and empowerment of individual shareholders, perhaps the time has come for a deeper examination into the exercise of individual shareholder rights as a form of check and balance, together with that of institutional investor actions.

The idea that the conduct of the institutional investor should be the focal point in realising the long-term value of company investments is incomplete as structures, systems and contextual factors have a real and substantial impact on the creation of value for beneficiaries and clients of institutional investors and society at large. A systemic and structural approach is important in ensuring that changes are real and long-lasting and meaningful.