Corporate governance code gets a sweet 16 makeover

Corporate governance: The Securities Commission building in Kuala Lumpur. On April 18, the SC released a draft of the 2016 version of the MCCG and invited the public to comment on it. The consultation ends on June 8.

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When listed companies don't comply with good practices, they must explain what else they can do

THE Malaysian Code on Corporate Governance (MCCG) turned 16 recently. After revisions in 2007 and 2012, the Code today is vastly different from the one first issued in March 2000.

That's a good thing because it ought to be a living, breathing document that sets the pace for improvements in corporate governance practices and standards, and not a hidebound set of rules that's forever a step or two behind corporate Malaysia's evolution.

And now, it's time to change again. On April 18, the Securities Commission released a draft of the 2016 version of the MCCG and invited the public to comment on it. The consultation ends on June 8.

There's no doubt that the MCCG is an authoritative source on the best ways for directors and management to steer a company. For example, the Public Accounts Committee referred to the Code, among other things, when reviewing 1Malaysia Development Bhd's governance structure and practices.

In the introduction to the proposed new Code, the SC says, "The MCCG is a key document in Malaysia's corporate governance framework and has contributed significantly in improving the corporate governance standards of Malaysian listed companies.

“Over the years, companies have demonstrated a better appreciation of good governance and key stakeholders. Among others, institutional shareholders have increasingly taken on more definitive and prominent role in the domestic corporate governance sphere.

While significant strides have been made, it is important for us to keep our ongoing commitment to meet new demands and challenges.”

The MCCG 2016, according to the regulator, adopts an approach unlike those of the previous editions so as to “encourage progression and provide greater utility for companies and their stakeholders”.

The MCCG 2000 and MCCG 2007 both used the approach of prescribing the best practices in corporate governance that listed companies should try to embrace.

This was paired with the requirement that the companies disclosed in their annual reports the extent of their compliance with these prescriptions.

Where they hadn’t followed the prescriptions, the companies must provide explanations. This is called the ‘comply or explain’ basis.

With the release of the MCCG 2012, it appears that the SC has loosened up a bit on what the companies should or shouldn’t do about their corporate governance practices.

The listed companies are still obliged to provide narratives in their annual reports on how they have complied with the Code’s recommendations, but there’s more flexibility.

“As there is no ‘one size fits all’ approach to corporate governance, companies are allowed to determine the best approach to adopting the principles,” says the SC. “Where there is non-observance of a recommendation, companies should explain the reasons.”

The MCCG 2016 is significantly novel because it splits corporate governance practices into two categories — Core and Core+.

The Core+ category is for exemplary practices that companies should aspire to achieve. Examples include having a policy of rotating external audit firms, adopting integrated reporting based on a globally recognised framework, using technology (such as electronic voting and real-time broadcasting) in general meetings, and engaging a professional and independent party to facilitate board evaluation at least once every three years.

The proposed Code says that while its seven Core+ practices are voluntary, companies are “strongly encouraged” to adopt them and disclose in the annual report how these practices are being undertaken or implemented.

There are 32 Core corporate governance practices. Many of them are familiar, such as the separation of the board chairman and CEO roles; annual assessments on the independence and objectivity of independent directors; reserving the chair of the audit committee for an independent director who’s not the board chairman and for a person with accounting expertise or relevant work experience; and having a dedicated investor relations function.

But what’s new about the Core practices is that the companies will be expected to disclose their adherence to these practices on an ‘apply or explain an alternative’ basis. The SC says this “encourages greater thought process in undertaking the practices and in making disclosures”.

The problem with the ‘comply or explain’ approach is that companies tend to end up being mechanical in their corporate governance practices.

They focus more on ticking the compliance boxes than on honouring the spirit and intention behind the practices.

The regulator's response to that is to now pair each Core practice with an Intended Outcome.

For example, it is good corporate governance practice that when a board chairman is not an independent director, the board should have a majority of independent directors. In this case, the Intended Outcome is balance of power and authority on the board.

The 'apply or explain an alternative' basis means that the companies must provide "clear and meaningful explanation" on how they have adopted the Core practices in MCCG 2016, and achieve the Intended Outcome of each practice.

"'Apply' requires greater thought process and consideration in implementing or undertaking the practices, including in disclosing information on these practices," says the SC.

"Companies that do not adopt the identified Core practices in the MCCG 2016 must provide clear explanation for the non-adoption of the practice(s) and an alternative that is able to fulfil the Intended Outcome. The explanation must be reasonably detailed and informative so that the market understands how the alternative meets the Intended Outcome."

This is a way to hopefully discourage our listed companies from churning out boilerplate statements and hollow assurances. The text in annual reports are just words, but they can be damaging if they don't match actual deeds.

Executive editor Errol Oh wishes that the Malaysian Code on Corporate Governance gets a coming of age party now that it's 16.