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KEY DEVELOPMENTS IN CORPORATE LAW REFORM IN MALAYSIA

JANINE **PASCOE**[*] AND SHANTHY **RACHAGAN**[†]

This paper outlines recent milestones in Malaysia's efforts to raise the standards of corporate governance and directors' duties. Much has been achieved concerning the regulation of listed companies. This can be attributed in large part to the overhaul of the Listing Requirements of the Bursa Malaysia Securities Bhd, which occurred in 2001 as a response to recommendations of the High Level Finance Committee. The next challenge involves the reformulation of core provisions of the *Companies Act 1965* regulating directors' duties and related party transactions. This reform task is currently in the hands of the newly constituted Corporate Law Reform Committee.

I. INTRODUCTION

Since the financial crisis of 1997/1998 much has been done to improve the corporate regulatory framework in Malaysia. Indeed Malaysia's initiatives to improve corporate governance have gained increasing international recognition.[1] The reforms are commendable given the degree of concentrated family ownership of companies which typifies certain Asian economies.[2]

Such concentrated shareholding, in the Malaysian context, is possibly a direct consequence of the traditional family held companies which have been operating for many decades. The patriarchal approach has continued to find its way into the corporate structure even where traditional family held private companies have grown and become public listed companies. The requirement for a narrow shareholding spread to achieve listing has not benefited the situation much.[3]

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[*] B.A., LL.B. (Hons) Ph.D. (Mon); Senior Lecturer, Department of Business Law & Taxation, Monash University, Australia.

[†] LL.B.(Hons), C.L.P.(Hons), LL.M., M.B.A.; Senior Lecturer, Department of Business Law & Taxation, Monash University, Malaysia.

[1] As confirmed by the OECD, Roundtable on Corporate Governance, *White Paper on Corporate Governance in Asia* (2003), online: Organisation for Economic Co-operation and Development <http://www.oecd.org.coporate>, and the findings in Kuala Lumpur Stock Exchange & Price Waterhouse Coopers, Survey, "the Joint Kuala Lumpur Stock Exchange-Price Waterhouse Coopers Survey on Corporate Governance" (25 April 2002), online: Price Waterhouse Coopers <http://www.pwc.com/Extweb/ncsurvres.nsf/docid/>, which indicated that the corporate governance gap between Malaysia and other Asia Pacific jurisdictions like Singapore, Hong Kong and Australia has narrowed. All three target groups surveyed—the Institutional groups, the Independent Non-Executive Directors and the Public Listed Companies confirmed that the corporate governance regime in Malaysia has improved.

[2] In Asia two-thirds of listed companies and substantially all private companies are family run: See *White Paper on Corporate Governance in Asia*, *ibid*.

[3] Kala Anandarajah, *Corporate Governance, A Practical Approach*, 1st ed. (Singapore: Butterworths Asia, 2001) at 219.

Such shareholder influence continues to work through informal mechanisms which are not subject to any obvious external accountability and which lack transparency to many of the parties with a vested interest in the outcome. Consequently, often there is no opportunity for unconnected shareholders to exert any influence at all in public listed companies as shareholding spread requirements meet only 10 per cent requirement. This means that 90% of the shareholding is retained by family and friends. In such an instance, the ability to influence becomes even more remote.

Further, in line with former Prime Minister Dr. Mahathir Mohammed's explicit desire for the development of the Malay (Bumiputera—prince of the land) capitalists through government patronage via policies such as the New Economic Policy ("NEP") and privatisation, a number of major conglomerates controlled by the Bumiputera with close links to the political elite emerged and developed rapidly during the 1980s.

This pattern of concentrated ownership, cross directorships and government patronage exacerbated problems associated with poor corporate governance structures, inadequate monitoring and abuse of the position of minority shareholders as a result of detrimental related party dealings.

Significant steps in overcoming these problems have occurred as a result of non-statutory reforms, particularly the implementation of the Code on Corporate Governance[4] ("Code"), and resulting changes to the Bursa Malaysia Securities Berhad[5] (formerly Kuala Lumpur Stock Exchange) Listing Requirements ("LRs").[6] There is a now well-accepted scheme of industry self-regulation which impacts upon the governance practices of listed companies in Malaysia. This paper outlines those key non-statutory milestones and indicates what further legislative measures are necessary to complement and reinforce these reforms. Statutory reforms have been slower. There is now a need for statutory reform of the core rules in the *Companies Act 1965* (Malaysia)[7] affecting directors' duties, disclosure of interests and related party transactions. This is necessary to provide the statutory backing and enforcement weapons required to reinforce the government's commitment to effective corporate governance and law reform.

II. Corporate Law Reform Committee

On 17 December 2003 the Companies Commission of Malaysia announced that it was undertaking a review of corporation's law provisions under its Corporate Law Reform Program. The objective of the Corporate Law Reform Program is to enable corporate and business activities in Malaysia to function in a cost effective, consistent, transparent and competitive business environment whilst balancing obligations, responsibilities and protection of corporate participants, in line with international

[4] The Code is available online: Securities Commission of Malaysia <http://www.sc.com.my/eng/html/resources/ inhouse/mccg.pdf>.

[5] Following the process of demutualisation, the Kuala Lumpur Stock Exchange was officially renamed the Bursa Malaysia Securities Bhd [BMSB] on 20 April 2004. It operates under a new organisational structure with its holding company now named as Bursa Malaysia Bhd.

[6] Bursa Malaysia Listing Rules, online: Bursa Malaysia <http://www.bursamalaysia.com/website/documents/LR_MBSB_Jan05.pdf >.

[7] Act 125.

standards of good corporate governance. A Corporate Law Reform Committee ("CLRC") has been established to implement the program and its powers are conferred under section 20 of the *Companies Commission of Malaysia Act 2001*.[8] The CLRC, which comprises 16 eminent legal experts and practitioners, will undertake a comprehensive and fundamental review of core company law provisions governing the creation, management and termination of companies. In addition, the review will, as far as possible, take into consideration any legal and/or regulatory changes that will need to be made in order to modernise company law. The Committee is directed to complete its project by 2006.[9]

III. The Malaysian Code on Corporate Governance

In March 1998, the Malaysian Government, in recognition of the importance of enhancing standards of corporate governance, announced the formation of a High Level Finance Committee that would look into establishing a framework for corporate governance and setting best practices for business.[10] At the same time, the Malaysian Institute of Corporate Governance was formed. While the Committee's focus was on enhancing standards for publicly listed companies, it was hoped that its recommendations for improved corporate responsibility would flow through to all companies, public and private. The Committee made recommendations intended to restore the confidence of investors and overseas markets in the Malaysian capital markets. Its recommendations for reform of the LRs have now been implemented.

The Code on Corporate Governance, which implemented the Finance Committee's recommendations, was issued in March 2001. The role of the Code is to guide boards of listed companies by clarifying their responsibilities and providing prescriptions for strengthening the control exercised by boards over their companies.[11] In developing the Code, the Finance Committee agreed on the need to adopt international standards of best practice. The Malaysian Code is modeled on the recommendations of the UK Hampel Committee and is based on a hybrid approach to corporate governance. The Code outlines a definition of corporate governance and sets out four forms of recommendations and the compliance responsibilities in respect of these recommendations.

The Finance Committee adopted the following definition for the purpose of the establishment of the Code on Corporate Governance:

> Corporate governance is 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 realizing long-term shareholder value, whilst taking into account the interests of other stakeholders.[12]

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[8] Act 614.

[9] Malaysia, Companies Commission, "Strategic Framework for the Corporate Law Reform Program of the Companies Commission of Malaysia", online: Companies Commission of Malaysia <http://www.ssm.gov.my/SSM_CLRC_Framework_FINAL.pdf>.

[10] Government of Malaysia, Finance Committee, "Report on Corporate Governance" (February 1999), online: Securities Commission < http://www.sc.com.my/eng/html/cg/Oview.html#FCR>.

[11] Bursa Malaysia Listing Requirements, c. 15.

[12] *Supra* note 10 at 10.

The Finance Committee's Report Part 1 "Principles", sets out broad principles of good corporate governance for Malaysia.[13] Part 2 "Best Practices in Corporate Governance", sets out best practices for companies.[14] It identifies a set of guidelines or practices intended to assist companies in designing their approach to corporate governance. These two elements are now incorporated into the Code on Corporate Governance.

IV. Implementation of Reforms

A. *Revamp of Listing Requirements*

The recommendations of the Malaysian Code on Corporate Governance were incorporated into Chapter 15 of the LRs, which were reissued in January 2001. The revamped rules have an added focus on transparency, independence of the board and the rights of minority shareholders. Key changes are outlined below. Some of the initiatives are quite far-reaching. For example, initiatives such as compulsory director training programs and restrictions on the number of directorships in listed companies. Since the reissuing there have been a number of further amendments to the LRs.

Superimposed on all of the specific changes, is the overriding obligation under the LRs for disclosure of corporate governance practices by all listed companies. Compliance with the Code of Corporate Governance is voluntary, but Paragraph 15.26(a) of the LRs requires listed companies to provide in their annual reports a mandatory narrative statement on the extent of compliance with the principles set out in Part I of the Code. Companies must also explain any circumstances justifying departure from the best practices outlined in Part 2 of the Code and the alternative to the best practice principles, if any, the company has adopted: Paragraph 15.26(b). Practice Note 9/2001 on Disclosure was issued in January 2001 to assist listed companies in complying with Paragraphs 15.26(a) and (b).

1. *Board structure and composition*

The Code on Corporate Governance states that best practice in corporate governance requires independent, non-executive directors to comprise at least one-third of the membership of the board of listed companies. This requirement is now set out in Paragraph 15.02 of the LRs, which requires a listed issuer to ensure that at least two directors or one-third of the board (whichever is the higher) are independent directors. These directors should be persons of calibre, credibility and have the necessary skills and experience to bring an independent judgment to bear on the issues of company strategy, performance and resources, including key appointments to the company. The Code also states that there should be a clear separation of the roles of board chairman and chief executive officer, with the necessity for a public explanation where the two roles are combined.

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[13] *Ibid.* at 67.

[14] *Ibid.* at 69.

Amendments to the LRs effective from 1 January 2003[15] provide a revised definition of the term "independent director".[16] The new definition contained in Paragraph 1.01 of the LRs comprises a general test of independence and seven specific exclusions.[17] Under the general test, an independent director is "independent of management and free from any business or other relationship which could interfere with the exercise of independent judgment or the ability to act in the best interests of the company."

Thus, independent directors are not involved in the day to day running of the company. They do not have a contract of service with the company and their integrity is to be maintained by avoiding conflicting relationships which could interfere with the exercise of independent judgment or the ability to act in the best interests of the company. The ultimate responsibility of the board for the company's welfare and good governance is reinforced by the requirement in LR 15.27 of a board statement acknowledging responsibility for the annual audited accounts and systems of internal control.

Directors claiming independent status must provide signed certification to that effect to the exchange. Any person who fails the general test or falls within any of the exclusions will be disqualified from being an independent director. Moreover, Practice Note 13/2002 makes it clear that the over-riding test is one of substance rather than form by specifying that the mere fact that a director does not fail within a specific exemption does not mean that person has satisfied the test of independence. The general test must still be satisfied.

Substantive implementation of the new "independence" rule will undoubtedly continue to prove challenging for regulators given the social and cultural context of related party dealings in Malaysia. Unfortunately, despite these regulatory changes, in many cases the appointment of independent directors remains one of form over substance. The Malaysian regulators are only too aware of the need for cultural change to accompany regulatory reforms. The Securities Commission holds the view that there is a demonstrated need for companies to provide particular induction programs for independent directors to provide adequate information about their strategic and fiduciary roles and responsibilities.[18] The OECD *White Paper on Corporate Governance in Asia*[19] cautioned against complacency on the issue of director

[15] Bursa Malaysia, Practice Note No. 13/2002, issued in relation to paras. 1.01, 9.27, 15.07 and 15.10 of the LRs; and pursuant to para. 2.08 of the LRs. See online: Bursa Malaysia <http://http://www.klse.com.my/website/listing/pn.htm>.

[16] Practice Note 13/2002, Bursa Malaysia, was issued by the BMSB to clarify the LRs pertaining to independent directors, restriction on directorships and composition of audit committees.

[17] The specific exclusions cover persons who, in relation to a corporation or its related entities, are:

- relatives, major shareholders or executive directors of the company;
- professional advisers, nominees of directors, officers within the last two years and certain parties contracting with the company.

[18] Datin Zarinah Anwar, Deputy Chief Executive, Malaysian Securities Commission, "Board of Directors: Performance beyond Compliance", Opening Address at the Conference on Corporate Governance—Adding Vision to Oversight, PWTC, Kuala Lumpur, 1 August 2003.

[19] See *White Paper on Corporate Governance in Asia*,*supra* note 1.

"independence". The Paper stated that:

> While the theory on independent non-executive approval may hold some appeal, real-life experience in Asia reveals shortcomings not unlike those in other regions. High ownership concentration among Asian listed companies means that controlling shareholders usually select the entire board of directors. In these and similar cases, non-executive directors can fail to demonstrate in practice the independent judgment required to make their consent an effective safeguard against abuse. In other cases, non-executive directors assume their duties with an independent mindset but cease to maintain it over time as their sympathies, or their interests become too closely aligned with insiders. Finally, passive or unknowledgable directors can fail to scrutinise transactions closely enough to apply informed, independent judgment, even if their level of activity may be sufficient to shield them from liability from negligence.[20]

The *White Paper* recommended that Asian countries should continue to refine the noms and practices of "independent" directors. Zarinah Anwar, Deputy Chief Executive, Malaysian Securities Commission, also notes that:

> Unfortunately, the appointment of independent directors remains one of form over substance. The persistent cases of minority shareholder exploitation demonstrate the failure of independent directors in giving effect to the role and responsibility intended to be discharged by them, either by condoning the wrong of the executive directors or by being unaware of such wrong in the first place.[21]

2. *Strengthened rules on related party transactions*

The 2001 amendments to the LRs[22] strengthened the provisions on related party transactions which are now tighter than the rules under the *Companies Act 1965.* The changes have widened the range of related party transactions. The definition under Paragraph 10.2 of the LRs covers the acquisition and disposal of assets, the provision and receipt of services and the provision of financial assistance. However, it now also extends to the establishment of joint ventures and any business transaction or arrangement entered into by a listed issuer or its subsidiaries. Further, the changes have enhanced the disclosure requirements. Whether the listed company must comply with disclosure requirements depends on whether the values of the transaction exceed certain financial ratios prescribed by the LRs.[23] In particular, a listed company has special disclosure obligations concerning substantial related party transactions where the prescribed percentage ratios exceed five per cent.[24] These transactions require full disclosure to and approval of disinterested shareholders. In

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[20] *Ibid.* at 27.

[21] *Supra* note 18.

[22] Bursa Malaysia, Practice Note No. 12/2001, issued in relation to paras. 10.08 and 10.09 of the LRs and pursuant to paras. 2.06, 2.08 and 2.19 of the LRs.; See online: Bursa Malaysia <http://www.bursamalaysia.com/website/listing/pn.htm>.

[23] LRs, *supra* note 6, para.10.02(h). Practice Note 14/2003 Related Party Transactions provides particular guidance on the exemptions from the related party provisions of the LRs.

[24] Para. 10.08 of the LRs, *ibid*., considers substantial transactions by reference to a "percentage ratio" exceeding five per cent on a number of variables including profits, equity, market capitalisation and assets.

other words, a director who is interested in a substantial related party transaction must abstain from board deliberation and voting on the relevant resolution. Significantly, this prohibition also extends to connected persons[25] or substantial shareholders with any interest, direct or indirect, in the transaction. Prior to approval, the company must appoint an independent adviser to advise shareholders whether the transaction is fair and reasonable from their point of view and whether or not the transaction is to the detriment of the minority shareholders.

3. *Recognition and enhancement of role of Board committees*

The Code on Corporate Governance recognises that the function of the board in listed companies is a strategic one; to oversee the company's business, identify risks, make strategic decisions and develop policy to properly guide and direct the company. As a necessary corollary to the recognition of the board's general strategic role, the Code recognises that delegation of specific tasks by the board to committees is desirable. Such committees include those dealing with matters such as nomination to the board, directors' remuneration and the integrity of the external audit process to ensure its independence.

Corporate governance good practice also provides for the functions of internal control and accountability to be delegated to board committees controlled by a majority of non-executive or independent directors.[26] The most important of these is the audit committee. Audit committees have been mandatory in Malaysian listed companies since 1993.[27] They are appointed by the board to act as an independent committee with the task of monitoring the company's financial position. The formation of such committees is regarded as a necessary part of corporate governance best practice and the Finance Committee made recommendations to improve the independence of audit committees. It stated that the audit committee should deal independently with the company's external auditors and review areas of financial risk and systems of internal control which have been put into place. The committee should also, where it deems necessary, investigate any transactions which involve possible conflicts of interest, abuse by controlling shareholders or questions about management integrity. Its findings should be referred to the board.[28]

Paragraphs 15.10 and 15.11 of the LRs, implemented in 2001, deal with the composition of audit committees appointed by listed companies. The LRs preserve the independence of audit committees by requiring that a majority, including the chairperson, must be independent and that no alternate directors may be appointed to the committee. Paragraph 15.18 of the LRs enhances their independence by investing them with the ability to directly communicate with the external auditors

[25] It is interesting to note that the definition of "person connected" under the LRs is substantially wider that the corresponding definition in s. 122A of the *Companies Act 1965*, which contains no reference to substantial shareholders.

[26] Bursa Malaysia, Practice Note 13/2002, 2002, "Requirements Relating to Directors and Signatory to Statutory Declaration Accompanying Annual Audited Accounts" issued to clarify the meaning of "independent director", applies specifically to the audit committee requirements under para. 15.10 of the LRs. Practice Note 13 provides additional clarification on the professional qualifications and work experience qualifications of members of the audit committee and expands the pool of suitable professionals who can sit on audit committees.

[27] LRs, part. C, c. 15.

[28] Code on Corporate Governance, part three.

and obtain independent professional or other advice. There is also the provision for the independent members of the committee to convene meetings with the external auditors in the absence of the executive members of the committee.

The Code on Corporate Governance envisaged that the selection of non-executive directors should occur through a formal and transparent process under an independent nomination committee. It further recommended the appointment of remuneration committees, also comprising a majority of independent directors to deal with the remuneration and compensation of directors and senior management.[29] The issue of director and executive remuneration is still a contentious issue in Malaysia as elsewhere.[30] While the existence of a remuneration committee may go some way to establishing that there is an independent element in the remuneration approval process, clearly too few public boards have established such committees.[31] So far as remuneration is concerned, it should be noted that the LRs provide disclosure and voting requirements for listed companies. In accordance with LR 9.25, listed issuers must provided aggregated details of directors' remuneration packages[32] and the number of directors who fall within each RM50,000 band in the annual report. Under LR 7.27, directors are prohibited from voting on pecuniary matters in which they have a direct or indirect interest. So regardless of whether remuneration matters are considered by a committee or the board collectively, directors may not vote on recommendations concerning their own remuneration. There is a need to align the remuneration disclosure and voting requirements of all companies with those of listed companies.[33] This will require amendments to the *Companies Act 1965*, which presently contains no provisions directly regulating these matters. Disclosure of remuneration policy should be a fundamental plank of good corporate governance. Recent corporate collapses in the US and Australia have highlighted the dangers of incorporating share and option schemes in executive remuneration packages.

4. *Empowerment of independent directors*

Under Paragraph 15.04 of the LRs, directors must be supplied, at the company's cost, with all of the resources which are necessary and reasonable for the proper

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[29] Code on Corporate Governance, part two; LRs, para.15.02.

[30] See Aiman Nariman Sulaiman, "Executive Remuneration and Compensation in Malaysia—A Step at a Time" [2002] C.L.J. 1.

[31] The number of companies, which had established remuneration committees comprising a majority of independent directors, was only about 20 per cent. The results of the 2002 Joint KLSE-PriceWaterhouseCoopers Joint Survey on Corporate Governance, *supra* note 1, indicating that only about 20 per cent of respondent companies had established remuneration and nomination committees, demonstrates that there is room for improvement in implementing this aspect of corporate governance as set out in the Code.

[32] Sulaiman, *supra* note 30, notes some inadequacies in the listing requirements concerning remuneration disclosure. These include, for example, the absence of disclosure of individual directors' remuneration and the failure to disclose specific components such as the exercise price of share options or other securities provided as part of directors' remuneration.

[33] On the issue of self-interest, Sulaiman, *ibid.* at 2, notes that: "Since there is no provision in the Companies Act 1965 that prohibits an interested director from voting, the process is tainted with self interest. Board remuneration is subject to the statutory duty of disclosure under s. 131(1). However, since all the directors are interested, the disclosure made is not sufficient as the board itself is incapacitated from deciding a matter in which all the directors are interested."

performance of their duties. Aside from this general stipulation, the company must also bear the cost of necessary independent professional advice.

This is in accordance with the 2003 OECD *White Paper on Corporate Governance in Asia* which recommends that directors should enjoy direct access to company employees and to outside professionals advising the company in accordance with procedures established by the board or its committees.[34] This is of course, subject to the rule that directors should not rely on professional or other advice until they have evaluated it in the light of their own experience and judgment.

5. *Requirement for statement of internal controls*

Since the financial crisis there has been increasing awareness of the paramount importance of a sound system of internal controls. The Code on Corporate Governance recommends that companies should establish an internal audit function to undertake monitoring of key controls and procedures. In 2000, a Taskforce on Internal Controls was established by the BMSB to issue guidelines to listed issuers to report on the state of their internal controls.[35] The Taskforce's Issued Guidelines,[36] require listed companies to set out a formal structure for managing the internal audit function. The roles and responsibilities of those persons involved should be clearly defined, with an emphasis on the objectivity and independence of the internal audit activity. Subsequently, in 2001, Paragraph 15.27(b). of the reissued LRs mandated the board to make a statement in its annual report on the state of internal controls of the listed company as a group. This is further reinforced by Paragraph 15.24, which requires the Internal Control Statement to be reviewed by external auditors who will report to the board of directors. The BMSB's Practice Note 9/2001 on Disclosure[37] provides guidance to assist companies in complying with Paragraph 15.27(b). Its purpose is to ensure that statements of compliance with corporate governance practices are uncompromised and contain adequate, accurate and meaningful information.

The requirement for disclosure of the state of internal controls is an important initiative in the area of transparency. In the past, the area of internal risk control was one where the level of directors' duty of care, skill and diligence has been called into question.[38] The requirement for an annual statement should help regularly focus directors on potential problems in internal risk control and the need to adopt appropriate standards of care and diligence.

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[34] See *White Paper on Corporate Governance in Asia*, *supra* note 1 at 55, para. 308.

[35] Followed by the separate Taskforce on Internal Audit Function, under the auspices of the Institute of Internal Auditors, Malaysia. The Institute released the Guidelines on Internal Audit function in August 2002.

[36] Malaysia, Taskforce on Internal Controls, *Statement on Internal Control: Guidance for Directors of Public Listed Companies*, modelled on the UK Turnball Report. See online: Bursa Malaysia <http://www.bursamalaysia.com/website/documents/intcontguid.pdf>.

[37] Bursa Malaysia, Practice Note No. 9/2001, "Disclosure in relation to the Malaysian Code on Corporate Governance and the State of Internal control", issued in relation to paras. 15.26 and 15.27 of the LRs; and pursuant to para. 2.08 of the LRs; See online: Bursa Malaysia <http://www.bursamalaysia.com/website/listing/pn.htm>.

[38] For example, internal misfeasance was undetected by the boards of some of Australia's largest companies including HIH Insurance, National Australia Bank and the communications giant Onetel Ltd. Similar situations occurred in other jurisdiction including the infamous Enron case in the United States and Parmalat in Italy.

As noted above, the audit committee has a crucial role in overseeing the internal audit function. Those persons directly responsible for carrying out the internal audit function should report directly to the audit committee.

6. *Restrictions on number of directorships*

While cross directorships are permissible at common law, LR 15.6 now restricts the number of directorships any one director can hold to no more than 10 directorships in public listed companies and not more than 15 in non-listed public companies.[39] Each directorship in the same group is treated separately for the purpose of the restriction. This requirement came into effect in March 1999. Directorships in non-listed companies include subsidiaries of listed companies. Directorships in non-profit and sporting entities are not included. Each director is required to file a statutory declaration confirming compliance with the requirement.

7. *Directors' education programs*

The requirement for compulsory continuous education and training for listed company directors is now mandated by LR 15.09. It is one of the significant factors recognised in the 2002 Joint KLSE-PWC Survey on Corporate Governance as having contributed to Malaysia's raised corporate governance standing in the Asian region since the financial crisis. There are two components to the focus on establishing a culture of enhanced training and educator for directors, introduced by Bursa Malaysia Securities Bhd, through its training arm Bursa Malaysia Training Sdn Bhd. First, newly appointed directors are required to undergo an initial Mandatory Accreditation Program. This is a foundation program, which commenced in April 2001, aimed at providing directors with a general overview of the regulatory framework of the capital market and the role and duties of directors. Secondly, directors are required to undergo ongoing training. For the years 2003-2004, directors were required to participate on an annual basis in the Continuing Education Program ("CEP") so long as they remain listed board directors. The program, which commenced in July 2003, ensured that directors were continuously updated on developments in companies and securities markets, risk management, ethics, corporate governance, accounting standards, corporate offences and in particular the duties and responsibilities of directors. A CEP Accreditation Committee was set up comprising representatives from industry to accredit suitable programs and allocate point to those programs. Directors must keep supporting documents evidencing their attendance/completion of accredited actives under the CEP program for a minimum of 3 years. Directors who failed to comply with the CEP breached the LRs. From 1 January 2005 onwards, directors' ongoing training was de-regulated. The CEP program was replaced by a system whereby directors must attend such training as may be determined by their respective boards of directors.[40]

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[39] Bursa Malaysia, Practice Note 13/2004 prescribes a new method of computing and aggregating directorships in, for example, certain non-profit organizations and non-listed issuers. This has clarified the method of computation of directorships so as to facilitate compliance with the LRs. See online: Bursa Malaysia <http://www.bursamalaysia.com/website/listing/pn200213.htm>.

[40] Bursa Malaysia Securities Bhd, Media Release, "Board of Listed Companies to be Responsible for the Continuing Education of Directors" (29 September 2004). The LRs were amended to require a statement

The importance of these key initiatives in training and education in enhancing the knowledge and skills of directors cannot be underestimated. As at September 2004, 6,329 directors had attended the MAP, while 3, 535 directors have attended the CEP.[41] The programs have had a flow-on effect to all companies. The Corporate Directors Training Program was introduced by the Companies Commission of Malaysia in 2001 and involves a one and a half day training scheme for all directors of companies, listed or otherwise.

Bodies involved in the various training program and modules include amongst others the Malaysian Institute of Corporate Governance, the Malaysian Institute of Chartered Accountants, the Malaysian Institute of Chartered Secretaries and the Securities Commission.

V. Enforcement

Strengthening the statutory enforcement capability of regulators is essential to give backing to corporate law reforms and promote a culture conducive to effective corporate governance. This includes providing the financial commitment necessary for effective enforcement and modernising the range of enforcement powers of regulators to allow for the commencement of civil as well as criminal actions. Although much is still to be achieved, the enforcement powers of the Malaysian Securities Commission and other regulators, including Bursa Malaysia, have been significantly enhanced since the late 1990s. For example, enhancement of the Commission's powers in insider trading cases was one of the first effective enforcement initiatives following the financial crisis.[42] Recent amendments to the *Securities Industry Act* 1983[43] ("*SIA*") have also substantially strengthened the ability of the Securities Commission to take action and impose sanctions against directors or others who contravene the LRs.

Further, the Securities Commission continued to step up its efforts in 2004 to ensure strong and proactive surveillance and enforcement by establishing the tripartite High-Level Enforcement Committee on Corporate Governance involving the Companies Commission of Malaysia, the Malaysian Police and the Commission. Reporting directly to the Prime Minister, the functions of the Committee includes:

- promoting and enabling mutual sharing of information between the three parties to facilitate investigations by any of the authorities concerned;
- developing an appreciation of illegitimate corporate transactions through case presentations, with a view to refer such cases to the appropriate authority for investigation;
- deliberating on cases involving multi-jurisdictional breaches, and advising on material developments and/or the outcome of those cases; and

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by the board that briefly describes the type of training that directors have attended for the year to be provided in the annual report. See LR 9.25.

[41] Media Release, *ibid*.

[42] Speech by YBhg Dato Dr. Munir Abdul Majid, Chairman, Securities Commission of Malaysia, on Amendment to the Securities Laws (16 June 1998), online: Securities Commission of Malaysia <http://sc.com.my/eng/html/resources/fr_stats.html>.

[43] Act 280.

- enhancing investigative and enforcement skills and industry knowledge of the three parties through co-ordinated training programmes.

The Securities Commission has released information indicating the effectiveness of its new enforcement powers.[44]

A. *Insider Trading*

The range of civil powers given to the Securities Commission and to investors has been greatly enhanced by the amendments to the *SIA* which commenced operation 1 April 1998. A civil action may be brought, regardless of whether criminal charges proceedings have commenced and of course will be subject to the civil standard of proof. Either the Securities Commission or an investor may institute a civil action. An investor who is successful in a personal action against the offender may, under new section 90A of the *SIA*, seek full compensation for any loss suffered. Importantly, a wide range of powers has been bestowed on the Securities Commission which may recover triple the amount of gain or loss avoided by the offender,[45] seek civil penalties of up to RM500, 000 and apply directly to the court for a range of orders under section 100 of the *SIA*. These orders include rescission of share contracts, injunctions and management disqualification orders. The Commission is also given the power under section 99A of the *SIA* to go behind nominee accounts, as a necessary part of its investigative powers in insider trading cases. The objective of these new civil powers is to pave the way for more effective enforcement of the law and to complement the traditional criminal sanctions.[46] Criminal penalties have also dramatically increased, and insiders are now liable for fines of *not less* than RM1 million and imprisonment of up to ten years.

B. *Disqualification Provisions*

Amendments to the *Securities Industry Act 1983*, which came into effect in January 2004, have considerably broadened the powers of the Securities Commission to apply to the High Court to disqualify and remove errant directors from office. Under section 100(1)(kk) of the *SIA*, the Securities Commission can apply to the High Court to remove and bar a director from office or from becoming a director of any public or public listed company for such time as the court thinks fit. The application may be made where a person has committed, or is likely to commit, an offence in relation to dealing in securities or has contravened the listing requirements of the stock

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[44] Since 1999, the number of prosecutions initiated by the Securities Commission increased by over 150% compared to the total number over the preceding six years (1993-1998), including the first insider trading conviction. In addition, statistics indicate that since the enhanced enforcement powers accorded to the Bursa Malaysia Securities Berhad under the revamped LRs in 2001, 437 infringement cases were investigated with action taken in 289 cases for established breaches of the LRs. Sanctions against defaulting companies included public reprimands and private reprimands, cautions and fines. See "Malaysia's corporate governance standards widely acclaimed", online: Securities Commission of Malaysia <http://www.sc.com.my>.

[45] To be distributed to investors as compensation for their losses: *SIA*, s. 90A(6).

[46] Securities Commission Malaysia, Press Release, "Securities Commission Powers Enhanced" (1 April 1998).

exchange. This enables the Securities Commission to take pre-emptive action even before a crime is committed. Further, the Securities Commission may apply to the court under section 99C (3) to remove directors from office in the event of successful civil recovery against the director, as well as in cases where the officer has been convicted of an offence under securities laws. These powers are in addition to the existing disqualification provisions in sections 130 (1) and 130A of the *Companies Act*.

C. *Sanctions for Breach of Listing Requirements*

Developments have also occurred in the enforcement of the LRs, by the exchange, the Securities Commission and by private enforcement actions. Amendments to the *SIA* in 1998 expanded the category of persons under an obligation to comply with the listing requirements.[47] These persons now include directors and officers of member companies, advisers of member companies and any person to whom the listing requirements are directed. Previously action could only be taken against listed companies.

The BMSB's powers to deal with breaches of the LRs were enhanced with their reissuance in 2001. Paragraph 16 of the LRs sets out the exchange's wide enforcement powers. So far as a listed issuer is concerned, the BMSB's powers include cautions, public and private reprimands, orders for rectification of the breach, suspension, de-listing and the imposition of fines up to RM1 million. Directors or officers of the listed issuer or other natural persons to whom the LRs are directed are also subject to cautions reprimands and fines of up to RM1 million. The BMSB's powers are very broad indeed. They can impose "any other action which the exchange deems fit".[48]

Moreover, under the recent amendments to the *SIA*, dealing with the disqualification of directors and errant officers, the BMSB, as well as the Securities Commission, may apply to the courts for an order to remove a director and bar him or her from office if found in breach of the LRs.[49]

More recently, pursuant to the demutualisation of the Kuala Lumpur Stock Exchange (now Bursa Malaysia), the *SIA* was amended in January 2004 to grant the Securities Commission an additional range of sanctions that it can impose for, *inter alia*, breach of the exchange LRs. The range of sanctions includes pecuniary penalties not exceeding RM1 million, reprimands, and directions for compliance and directions to remedy or mitigate the effect of the breach.

D. *Actions against "PN 4 Companies" under the LRs*

Enforcement actions against companies whose financial performance is unsatisfactory are now providing an additional measure of protection for creditors, investors and shareholders. Under Paragraph 8.14 of the LRs, the financial condition of a listed company on a consolidated basis, must, in the opinion of the BMSB, warrant continued trading and listing. Under Practice Note 4/2001, the BMSB instituted

[47] *SIA*, s. 11; *Securities Industries (Amendment) Act* 2003.
[48] LRs, s. 16.17(b) (viii) and (c)(viii).
[49] LRs, s. 100(1) (b).

measures to regulate companies whose financial performance does not reach minimum standards. Those companies are generally given 12 months to regularise their financial condition, and are required to make periodic disclosure to the market of the status of their plans to improve and regularise their financial position. As at October 2003, the BMSB had commenced de-listing procedures against 23 PN 4 companies.

VI. Whistle Blowing

In January 2004, amendments to the *SIA* came into effect which introduced unique provisions in Malaysia providing protection for "whistleblowers".[50] Sections 99E and 99F of the *SIA* implemented recommendations contained in the Finance Committee Report. Whistle blowing is a term used to describe the disclosure of information by someone who reasonably believes such information is evidence of contravention of any laws or indicates mismanagement, corruption or abuse of authority. The provisions have two major components, which include:

- A mandatory duty for auditors to report breaches of securities laws and listing requirements to the authorities. This reinforces existing requirements in the *Companies Act 1965* imposing a similar duty on auditors to report breaches of company law to the regulatory authorities; and
- Protection against retaliation for persons who report breaches to the authorities. Protected persons included chief executive officers, company secretaries, internal auditors and chief financial officers.

Those persons are protected against removal from office/employment, discrimination, demotion and suspension.

VII. Corporate Governance Scorecard for Listed Companies

Malaysia's efforts to introduce a rigorous system of corporate governance for listed companies have received positive recognition in a number of independent surveys of Asian companies undertaken since the financial crisis of the late 1990s. Further, the result of a recent survey[51] on Corporate Governance demonstrates that positive corporate governance scores are strongly associated with firm performance.

The CLSA Emerging Market Report,[52] The PWC-KLSE Corporate Governance Survey[53] and the *OECD White Paper on Corporate Governance*[54] in Asia all

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50 *Securities Industries (Amendment) Act 2004*.

51 Asian Development Bank Institute, Sang Woo Nam & II Chong Nam, Survey, "Corporate Governance in Asia" (August 2004), online: Asian Corporate Governance Association <http://www.acga-asia.org/>.

52 Credit Lyonnaiss Securities Asia (CLSA) Emerging Markets and the Asian Corporate Governance Association (ACGA) 4th Annual Corporate Governance Report, "Fakin' It: Board Games in Asia" (5 May 2003), online: Asian Corporate Governance Association <http:// www.acga-asia.org>.

53 The 2002 Survey, *supra* note 1, revealed that the corporate governance gap between Malaysia and other Asia Pacific jurisdictions like Singapore and Hong Kong has narrowed. All three target groups participating in the survey—the institutional groups, the independent non-executive directors and the public listed companies confirm that the corporate governance regime in Malaysia has improved. Institutional groups confirmed that they would pay at least a 10 per cent premium to companies with excellent corporate governance practices.

54 *The White Paper*, supra note 1, acknowledged the high standards of disclosure rules in Malaysia, with regard to corporate governance practices, directors' remuneration and non-audit fees paid to independent auditors.

indicate significant improvement on a number of corporate governance measures and increased domestic and international confidence in the Malaysian corporate sector as a result.

Nevertheless, the surveys still indicate some areas for concern and senior regulators have acknowledged these. Recently, in referring to all companies and not just Public-Listed Companies, the CEO of the Companies Commission of Malaysia stated that:

> The level of compliance and the number of prosecuted cases have not reached a satisfactory level yet. Far too many directors fail to hold annual general meetings, to keep proper accounting records, to table profit and loss accounts at the AGM and to lodge annual returns…Corporate abuses, conflict of interests, transactions which fall within a prohibited category, making and giving of false information are the types of common offences committed by company officers…The high incidence of non-compliance clearly show that these companies do not apply principles of good corporate governance.[55]

The CLSA Report[56] acknowledged that "as more and more companies and economies get feedback on their low scores, there has been a greater effort for them to present the right face and browbeat analysts into giving them higher scores". The report also noted that much of the changes are in form and the substance behind these changes is impossible to determine.

The problem of form over substance is not peculiar to Asian economies. In Australia, which has a strong history of corporate regulation and widespread acknowledgement of the importance of sound principles of corporate governance, a recent survey of the Top 200 hundred companies has indicated that there are general concerns about costs of compliance, doubts about whether governance guidelines enhance performance and 20 per cent of companies chose to comply with recommendations, rather than explain a departure from any of the recommendations, even though they believed their original practice was preferable.[57]

There is still much to be done, particularly in the areas of enforcement and statutory reform. Moreover, it must be recognised that emphasis on corporate governance is a relatively new phenomena and research examining the links between the adoption of specified practices and company performance is still is its infancy. The jury is still out on the question of the correlation between corporate governance scorecards and company performance. A recent US research study[58] questions the value

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[55] Tuan Abdul Alim Abdullah, CEO, Companies Commission of Malaysia, "Shareholders Protection and Corporate Governance: A Regulator's Perspective" (Presentation for MAICSA National Conference of Directors and Company Secretaries, Kuala Lumpur, 13 July 2004).

[56] *Supra* note 52.

[57] Chartered Secretaries Australia (CSA), Survey, "Reporting Against the ASX Corporate Governance Council Guidelines" (December 2004), online: Chartered Secretaries Australia <http://www.csaust.com/pdf/ASX_guidelines_survey_FINAL.pdf>.

[58] See David Larcker, Irem Tuna & Scott Richardson, "Does Corporate Governance Really Matter?" Wharton Business School, University of Pennsylvania (9 June 2004), online: Wharton Business School, University of Pennsylvania <http://knowledge.wharton.upenn.edu/papers/1281.pdf>, in which they question the value of much corporate governance research and the work of some corporate governance consultancy firms. Wharton accounting professors say a check-box approach to corporate governance doesn't work. Companies and their situation are too diverse. "The recipe book is big, and there's a different recipe for each company," Richardson notes. Even worse, the professors say, are consultants

of much recent corporate governance research, questioning whether positive corporate governance scorecards correlate with enhanced corporate performance and managerial standards of conduct. While this scepticism may be valid in the context of western economies, the research conducted into corporate governance practices in Asian economies since the financial crisis of 1997/98[59] conducted under the auspices of such bodies as the OECD, the Asian Corporate Governance Association and the (former) Kuala Lumpur Stock Exchange in conjunction with leading accounting firm PriceWaterhouse Coopers cannot be easily dismissed. Whether improvement in Malaysian companies' corporate governance scorecards is mere window dressing is a moot point. Certainly the measures taken in recent times can be seen as a response to the need to reassure foreign investors that fundamental problems arising from weak governance structures, corporate cronyism and ineffective corporate regulation are being seriously addressed. The measures taken to date, whether regarded as window dressing or not, can send signals to corporate stakeholders and foreign investors and may have a flow-on effect to the wider corporate community.

VIII. Need for Statutory Reform

To date, there have been many proposed changes to the companies and securities legislation which are yet to be implemented. It is appropriate that the CLRC adopt a meticulous and measured response to law reform, given that the Finance Committee's recommended changes to the *Companies Act 1965* cover core areas of company law which require an analysis of models and approaches adopted in other jurisdictions. Nevertheless, two of the areas can be identified as ripe for reform. These are:

- The *Companies Act 1965* provisions on related party transactions and
- The *Companies Act 1965* provisions on directors' duties

A. *Directors' Duties*

The Finance Committee identified a number of weaknesses in the present statutory formulation of the duties of directors presently provided by section 132 of the

and ratings services that use formulas—which they typically refuse to reveal—to boil down a company's corporate governance to a single number or grade. "Lots of people are coming up with governance scorecards," Larcker explains. "They're coming up with best practices and selling this stuff. As far as we can tell, there's no evidence that those scorecards map into better corporate performance or better behaviour by managers." The authors examine the relation between a broad set of corporate governance factors and various measures of managerial behaviour and organizational performance. Using a sample of 2,126 US firms, they distil 38 structural measures of corporate governance (e.g., board characteristics, stock ownership, anti-takeover variables etc.) to 13 governance factors using principal components analysis. For a wide set of dependent variables (e.g., abnormal accruals, excessive CEO compensation, debt ratings, analyst recommendations, and over-investment), they find that the 13 governance factors on average explain only 1% to 5.5% of the cross-sectional variation using standard OLS multiple regression technique sand 1.4% to 9.1% of the variation using exploratory recursive partitioning techniques. Overall, the results suggest, according to the authors, that the typical structural indicators of corporate governance used in academic research and institutional rating services have very limited ability to explain managerial behaviour and organizational performance.

[59] See *supra* note 1.

Companies Act 1965. Section 132 requires that:

- A director shall at all times act honestly and use reasonable diligence in the discharge of the office (section 132(1)); and
- An officer or agent of the company or officer of the Stock Exchange shall not make improper use of any information acquired by virtue of his or her position to gain a direct or indirect advantage for himself or herself or another.

A breach of section 132 involves criminal liability. Given the considerable hurdles in satisfying the criminal burden of proof, consideration should be given to the implementation of a civil penalty regime, for example such as that in Part 9.4B of the Australian *Corporations Act 2001*(Cth). In Australia, criminal sanctions are applied only in cases genuinely criminal in nature where dishonesty is an element of the contravention.

The High Level Finance Committee, recommended reform of the directors' duties provisions in the *Companies Act 1965* in order to enhance the duties of directors and others involved in the management of companies. Upon reviewing the legal framework, the Committee made recommendations for reform, including the following:

- that there should be statutory codification of the duties of care, skill and diligence of directors. Section 132(1) of the *Companies Act* presently sets out the duty of directors to use 'reasonable diligence' in the exercise of their office;
- that the statutory duty to act honestly in section 132(1) be reformulated to require a director to act bona fide in the best interests of the company;
- that there should be statutory clarification of the fact that a nominee director's primary obligation is to act in the best interests of the company and that the duty to his or her principal is always subject to the duty to act in the best interests of the company;
- that the common law fiduciary duty to avoid conflicts of interest should be codified; and
- that the section 132 duties should be extended to include senior management or principal executive officers of companies, as well as directors.

These particular recommendations mirror directors' duty reforms in various other jurisdictions.[60] For example, the replacement of the "honesty" test in section 132(1) with the "bona fide" test will overcome difficulties in interpretation and application of the provision, particularly as a breach of section 132 involves both civil and criminal sanctions. A breach of a criminal provision typically involves some element of fraud or dishonestly. However, there is case law holding that the duty to act honestly can be breached even where there is no deception or fraud on the part of the director.[61] The replacement of the duty to act "honestly" with the requirement that directors act "bona fide in the best interests of the company" was recommended by the Finance

[60] Such as the reforms which were progressively introduced in Australia in the 1990s under the CLERP program.

[61] This is because in practice the courts have applied an objective test in determining "honesty": *Charterbridge Corp v Lloyds Bank Ltd* [1970] Ch 62 at 74;*Intraco Ltd v Multi Pak Singapore Pte Ltd* [1995] 313 at 325.

Committee to avoid the confusion concerning the meaning of "honesty" in the context of directors' duties. The reformulation will also reinforce the principle that the duty of a director is to advance the best interests of his or her company and not the interests of any sectional or particular group.

Moreover, the recommendation that the common law fiduciary duty to avoid conflicts of interest should be codified has the advantage of requiring that a clear set of rules be inserted into the *Companies Act 1965*. While the fiduciary rules have evolved in some detail in the case law over many years, the Finance Committee considered it inappropriate for the matter to be left purely to case law. Case law principles have frequently developed in the context of the legal frameworks of different jurisdictions and the rules obviously operate by reference to the particular facts of the case in question. The course of law reform in Malaysia requires a more settled set of rules than that provided by case law.

There is no doubt that the present statutory directive for directors to use "reasonable diligence" is well overdue for reformulation. The ambit of the common law is clearly wider than the requirement of "reasonable diligence" presently required under section 132(1). In line with modern developments in other jurisdictions, the Finance Committee appropriately recommended that section 132(1) be amended to include the duties of skill and care. The Committee noted that the separate duties of skill, care and diligence were conceptually distinct and that recent judicial interpretation of these duties had resulted in increasingly higher standards being imposed on both executive and non-executive directors. While recommending codification of directors' duties of care and skill, the Committee expressly stated that it was not necessary for the *Companies Act 1965* to expressly clarify that the standard of care imposed is with reference to the particular circumstances of the director, noting that this was already well settled law in Malaysia.[62] Although reforms introduced in other jurisdictions, such as Australia, specify that the standard of care imposed is with reference to the particular circumstances of the director and articulate the circumstances which should be taken into account in determining the duty of directors, the Committee rejected this approach for Malaysia, where there was a need to encourage higher standards of care in both executive and non-executive directors. Clearly the duty needs careful reformulation to incorporate an objective standard of care and skill that takes into account the circumstances of the corporation, similar to section 180(1) of the Australian *Companies Act 2001* (Cth).

Given its recommendations for extensive codification of directors' fiduciary duties and duties of care, skill and diligence, the Finance Committee thought it necessary for a statutory business judgment rule to be introduced into the *Companies Act 1965*. Such a rule, commonly referred to as a "safe harbour", may operate to discharge an officer of the duty of care and diligence concerning a business judgment in the following circumstances:

- the judgment was exercised in good faith and for a proper purpose;
- the officer does not have a personal interest in the subject matter of the business judgment;
- the officer is informed about the subject of the business judgment; and

[62] *Supra* note 10 at 131.

- rationally believes that the business judgment is in the best interests of the company.

B. *Related Party Provisions*

The company's legislation of most common law jurisdictions contains specific related party prohibitions which reinforce general provisions against conflicts of interests. The specific and general prohibitions act in addition to the common law fiduciary principles set out in established cases.[63] The provisions in Malaysia's *Companies Act 1965* governing specific conflict of interest situations are:

- Section 133 and 133A prohibiting loans and guarantees provided to directors and connected persons;[64]
- Section 132C requiring shareholder approval for the disposal or acquisition of a company's main undertaking or assets;
- Section 132D requiring shareholder approval for the issue of shares by directors;
- Section 132E requiring shareholder approval for the acquisition and disposal of substantial non-cash assets;
- Section 132G prohibiting the acquisition of shares or assets in a company in which a director, substantial shareholder or related party has a direct or indirect interest.

It is beyond the scope of this paper to outline these related party provisions and their relevant exceptions in detail.[65] Suffice to say that a number of substantial weaknesses and loopholes in the provisions have been identified. The Committee made a number of important recommendations to tighten specific related party provisions.

The High Level Finance Committee recommended amendments to section 133 to close off some apparent loopholes. As presently formulated, section 133 only prohibits loans and guarantees to directors and related parties. Other financial benefits, gifts, quasi loans and generous extension of credit facilities are not covered. The Committee therefore recommended that the scope of section 133 be widened to include other types of financial benefits provided to directors and others that would have the potential to adversely affect the company.

The Finance Committee also expressed concerns about the provision in section 132E(2) which allows for ratification of a substantial property transactions, observing that in practice shareholders may be unwilling to vote against a transaction that has already been entered into. The Committee recommended that the provision should be removed. In addition, section 132E should be reformulated to adopt a simplified method of defining a substantial property transaction. In accordance with the criteria adopted in the LRs, the prohibition should extend to situations

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[63] See, for example, *Regal (Hastings) v. Gulliver* [1942] 1 All ER 378 and *Cook v. Deeks* [1916] 1 AC 554.
[64] Section 122A, *Companies Act 1965*.
[65] For a detailed analysis of the provisions see J. Pascoe, "Regulation and Disclosure of Financial Benefits to Directors and Related Parties: a Comparative Analysis of the Malaysian and Australian Experience" (1999) 3 S.J.I.C.L.108.

where the size of the transaction is 25 per cent or more of the value of the company's assets.

The Finance Committee made several recommendations for the reform of section 132G. The Committee noted that the absolute prohibition with respect to section 132G transactions should be reviewed, given that the provision may have the effect of capturing legitimate transactions. Section 132G should also be amended to require errant vendors and directors to indemnify the company for expenses incurred in acquiring the shares or assets and any further expenses in recovering the consideration. In addition, any amendment to section 132G should also clear up the ambiguity with respect to phrase "first held the shares in that other company".

It is clear that the newly formulated related party provisions in the LRs are, in many ways, much tighter and more clearly defined than the present *Companies Act 1965* provisions on related party transactions. For example, LR 10.08 governing acquisition and disposal of significant assets establishes a clear five per cent threshold test, unlike the convoluted threshold requirements for substantial transactions set out in section 132E of the *Companies Act 1965*. Clear definition in the *Companies Act 1965* of tests concerning company assets, consideration for transactions, profits and capital should be a high priority. Moreover, the LRs extend to transactions between a company and substantial shareholder. With the exception of section 132G, this is not the case with the *Companies Act 1965* related party provisions. Overall, these are a disparate group of provisions which are poorly drafted, have complicated and differing exceptions and as noted above, contain wide loopholes. It may well be appropriate for the CLRC to consider their complete overhaul and replacement by generic provisions with consistent and streamlined tests and restrictions on voting by interested parties. No doubt the CLRC will consider the Australian model set out in Chapter 2E of the *Corporations Act 2001* (Cth). The net should be cast wider to catch substantial shareholders. Although the changes to the LRs are commendable, statutory reform is still essential. As Koh points out[66] reliance on just the LRs is not satisfactory for the following reasons:

- There are a wider range of penalties open to the statutory regulator compared with those of the exchange.
- The ability of the exchange to de-list or suspend a defaulting company may not always be an appropriate action and may end up compounding losses to shareholders and outsiders.
- The exchange does not have the enforcement capability of the statutory regulator, which for example can require information and examine parties and has the right of search and seizure.

Unlike the strengthened related party obligations under the LRs, the related party provisions under the *Companies Act 1965* only require disclosure to shareholders, but do not expressly prohibit an interested director from voting at a board meeting that is considering a contract with the directors unless there is provision to that effect in their articles. As the CEO of the Companies Commission of Malaysia noted recently in the context of the concentrated ownership model typical of most East Asian Companies:

[66] R Thillainaithan, Phillip Koh & Shanti Kandiah, Report submitted to the World Bank, "Corporate Governance in Malaysia—An Assessment" (1999), online: Organisation for Economic Co-operation and Development <http:// www.oecd.org/dataoecd>.

If disclosure of interest is made compulsory but is not accompanied by prohibition of the interested person from voting, this will render the disclosure mechanism virtually worthless.[67]

The Finance Committee considered it was inappropriate for directors to vote in circumstances where they are directly or indirectly interested in a contract with the company. The Committee recommended that the *Companies Act 1965* be amended to prohibit directors and persons connected with a director from voting as a shareholder on matters in which they have a direct or indirect interest. The prohibition was seen as necessary to deter directors from influencing a company's decision to enter a transaction which may be to its detriment. The Committee also recommended that the prohibition be extended to cover substantial shareholders.

This paper has concentrated on reforms concerning corporate regulation and directors' duties. It should be noted that there have also been significant developments and recommendations in the area of shareholders' rights. In terms of shareholder activism, a Minority Shareholders Watchdog Committee was formed in 2000. Additionally, Malaysia's corporate regulator support initiatives such as the introduction of a broad injunctive power and a statutory derivative action which have broadened minority shareholder remedies in other jurisdictions such as Australia.[68]

IX. Conclusion

Malaysia seems dedicated towards raising the standards of its corporate governance and directors' duties. Much has been achieved concerning the regulation of listed companies and the formulation of principles designed to ensure sound corporate governance systems and practices. The corporate governance system which has emerged in Malaysia is a result of the interplay of historical, cultural economic and political factors. To entrench a culture of sound corporate governance in Malaysia requires more than changes to laws and regulations. It requires also a change of mindset which values ethics, honesty, transparency accountability and fairness. This may take some time, but Malaysia is on the right path.

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[67] *Supra* note 55.

[68] *Ibid.*