URGENT NEED TO REVIEW LEGISLATION WHEN BOARDS ARE WEAK

By DATO' YUSLI MOHAMED YUSOFF
President, Malaysian Institute of Corporate Governance
7 January 2020

To refresh memories, SRCI is a unit of 1Malaysia Development Bhd (1MDB). In 2011 and 2012, SRCI borrowed RM4bil from the Retirement Fund Inc (KWAP) – RM2bil in each tranche. Security was a government guarantee.

Last month, I read a report on the SRC International (SRCI) trial and was struck by an exchange between the accused and the prosecutor. Of course, I can't comment on the accusations, but this particular exchange involved something I can discuss – good governance.

The accused argued he was not involved in operational matters in SRCI, only in policy and big decision-making. He would become involved in operating matters, however, if he was informed of "something undesirable against the principle of good governance".

To refresh memories, SRCI is a unit of 1Malaysia Development Bhd (1MDB). In 2011 and 2012, SRCI borrowed RM4bil from the Retirement Fund Inc (KWAP) – RM2bil in each tranche. Security was a government guarantee.

The accused, and former SRCI "adviser emeritus", said he was not aware of some US$600mil (RM1.8bil) of SRCI funds held in a bank in Hong Kong. He did not know of further substantial amounts held in a bank in Switzerland that were frozen by local regulators.

These operating matters were not on the accused's radar. However, he asserted that the Minister of Finance Inc (MoF Inc) had instructed the SRCI board to locate the entire RM4bil and arrange for the money to be returned to Malaysia.

It was clear to me there were four bodies where governance should be examined: SRCI, 1MDB, KWAP and MoF Inc. In a nutshell these are the salient facts:

At SRCI, these operating matters were not covered by the policy and big decision remit of the "adviser emeritus", despite their financial magnitude.

At 1MDB, these debts were part of a highly-leveraged business model, which should have been a matter for the board's concern. The chairman of the 1MDB advisory panel had compulsory approval power for all major investments and funding exercises enshrined in 1MDB's constitution.

Under the KWAP Act, the board has the duty to administer and manage the fund, but investment decision-making for the fund rests with the investment panel.

The Minister of Finance appoints members of both the board and the investment panel at KWAP.

The investment panel must report its activities to the board, but the board can only give directions to the panel on general policy matters, subject to the Minister's approval.

This is confusing and herein lies the rub.

How can the board fulfil its legal duty to administer and manage the fund without exercising oversight of the fundamental function of investment decision-making?

The lack of clarity is easily interpreted as meaning the panel needs only to inform the board on investments but does not need to seek its approval. This is not transparent and leaves investment decisions open to Ministerial influence, without accountability.

There are no authority limits imposed on the panel. This can be interpreted to mean the panel has unlimited authority.

Unfortunately, due to the vagueness of the relevant sections of the KWAP Act, the board is exposed to criticism for matters beyond its control but, it could be argued, for which it may be legally responsible. This is not ideal.

Good governance is built around the theory that power and accountability rests with the board. The board may delegate some power to an investment panel, but the panel appointments should be approved by the board. Investments authorised by the panel within delegated limits should be reported to the board. Investment recommendations above delegated limits should made to the board for its final approval.

The board may delegate but it cannot abdicate its over-riding fiduciary duty to the fund's beneficiaries.

Regrettably, it is the role of the Minister of Finance and MoF Inc that complicates matters. If the Minister can appoint both the board and the investment panel, the Minister can influence investment decisions. This cuts around fiduciary duty.

It seems the same person wears many hats: as “adviser emeritus” at SRCI – the borrower; as chairman of the advisory panel at 1MDB – the borrower’s parent; as a possible influencer of investment decisions at KWAP – the lender; and as the body corporate giving the security at MoF Inc – the guarantor.

Conflict of interest has no part in good governance and an Act of Parliament which enables such conflict, however unintended, must be reviewed.

Whether or not any actual conflict occurred is not the issue. That it was possible undermines all the principles of good governance.

The issues around the KWAP loans to SRCI challenge public trust in an economically and socially important institution. Governance processes in all such institutions should provide accountability and transparency. This is essential if public trust is to be restored.

The KWAP Act may have been thought fit for purpose at the time it was drafted; it is questionable that it continues to be so. This may apply to similar legislation, and a thorough review of all such legislation is warranted.

Board appointments in public bodies should ideally be subject to the approval of a public oversight body – a Parliamentary committee, perhaps. The board should be the source of authority in the organisation, reporting and accountable to the public oversight body in a transparent and public manner.

For the principles of good governance to have weight, those charged with governance must themselves be principled. It is governance in action that counts.

Dato’ Yusli Mohd Yusoff is president of the Malaysian Institute of Corporate Governance. The views expressed here are the writer’s own.

https://www.thestar.com.my/business/business-news/2020/01/07/urgent-need-to-review-legislation-when-boards-are-weak