



# Statement of Compliance with The Malaysian Code for Institutional Investors

For Year 2017



## Background

This policy describes the approach taken by the Employees Provident Fund (EPF) to stewardship and how its policies comply with the requirement set forth by the Malaysian Code for Institutional Investors 2014 (Code). The purpose of the Code is to enhance the communication between institutional investors like EPF and its investee companies that are publicly listed to help improve long term returns to shareholders and further promote good corporate governance among the listed companies.

## What is the Malaysian Code for Institutional Investors?

The Code was launched on 27 June 2014, based on one of the recommendations from the Corporate Governance Blueprint 2011 (CG Blueprint) to formulate an industry-driven code that is expected to strengthen the accountability of institutional investors to their own members and investors. In addition, institutional investors being a major player in the global financial markets have significant influence over their investee companies due to the substantial stake that they hold. This clout can provide the institutional investors with the ability to encourage good governance and influence appropriate behaviours by their investee companies to ensure delivery of sustainable long term value to their shareholders.

The formulation of the Code was done through the Steering Committee and the Working Group comprising senior executives from large institutional investors in Malaysia including EPF, Kumpulan Wang Persaraan (KWAP), Lembaga Tabung Angkatan Tentera (LTAT), Lembaga Tabung Haji (LTH), Pertubuhan Keselamatan Sosial (Perkeso), Malaysia Association of Asset Managers (MAAM), Persatuan Takaful Malaysia, Pentadbir Pencen Swasta and Badan Pengawas Pemegang Saham Minoriti Berhad (MSWG).

The Code aims to set out the broad principles of effective stewardship by institutional investors such as their disclosures of stewardship policies, monitoring of and engagement with investee companies, and managing conflict of interests. EPF became a signatory to the Code on 24 January 2017, as part of the agenda to further promote good corporate governance in Malaysia. As of 31 December 2017, 17 organisations have become signatories to the Code.

Following the launch of the Code, the Institutional Investors Council (IIC) was established on 3 July 2015 and registered with the Registry of Societies Malaysia (ROS) on 29 December 2017 to represent the common interests of institutional investors in Malaysia.

## Disclosing Policies on their Stewardship

01

*Institutional investors should disclose the policies on their stewardship responsibilities.*

Since its inception in 1951, EPF invested its funds into a portfolio of diversified asset class comprising government bonds and securities, both private and public equities, money market instruments and real estate. The EPF has a long standing commitment to a solid governance structure as well as disciplined investment procedures and approval processes. The activities and operations of EPF are governed under the EPF Act 1991 whereby investments are made according to Section 26 of the Act.

The Act also provides for the establishment of an Investment Panel who is responsible in making investment decisions. The Investment Panel comprises of representatives from the Ministry of Finance, Bank Negara Malaysia and three others with financial and investment expertise. The Investment Panel formulates investment policies, guidelines and criteria on all investment matters and closely monitors EPF investment activities. The Investment Panel is responsible to ensure prudent management of EPF investment on behalf of its members.

At the management level, before any investment is made, senior members of the investment departments will conduct professional and independent vetting of the investment proposals, and resolve all investment matters through the Management Investment Committee (MIC). The committee, which meets on a weekly basis, is also responsible for the day to day operations of investment activities.

All investment transactions are handled by the Investment Division according to the asset allocation which has been vetted and approved by the MIC, the Investment Panel and Ministry of Finance. A portion of the fund is outsourced to the external fund managers who have been selected based on a number of criteria which includes the quality of investment philosophy and processes, experience of the organization and the team, consistency of financial performance as well as the organization and board structure.

With the introduction of Simpanan Syariah on 8 August 2016, the EPF's current governance structure has been enhanced to incorporate the key components of Shariah governance framework. A dedicated team has been setup to monitor the Shariah compliance of investments and other operational matters. All activities related to Simpanan Syariah are reported in monthly meetings to the Shariah Advisory Committee (SAC) which consists of prominent Shariah scholars. The SAC is accountable for all decisions, views and opinions related to Shariah investment and operation matters.

The EPF Principles of Corporate Governance is set on four main pillars of good stewardship:

- ★ **Effective Board:** Effective and independent Board with highly competent and diverse members to exercise objective judgment
- ★ **Manage Conflicts:** Reduce conflicts of interest between various stakeholders and related parties
- ★ **Efficiency:** Efficient and productive use of resources in the best interests of shareholders
- ★ **Transparency:** Transparency through timely and complete disclosure of important information for effective shareholder decision.

**02**

## Monitoring Investee Companies

*Institutional investors should monitor their investee companies.*

The EPF's team of investment managers and research analysts rigorously monitor its investee companies. The monitoring process largely comprises meeting management of the investee companies, analysing company annual reports and announcements, investment screening and studying external research. The EPF investment team conduct frequent meetings with the investee companies and ask questions on the company's strategy, financial performance and other relevant issues such as ESG and current developments. Any areas of concern are monitored and raised at dialogue meetings and voting resolutions are analysed before decisions are made. If EPF believes that a decision or proposal by the company's management will negatively affect the company's long-term value, EPF will escalate the issues with written queries, meetings, dialogues or engagement between its investment officers and the company's management. EPF would monitor the company's response to ensure that steps are being taken to address the issues raised in order to protect and enhance shareholders value.

As part of regular top level engagement program with the investee companies, the EPF CEO led a team of senior investment heads to visit 37 companies under the CEO Visit Program in 2017. In addition, the EPF Investment team of analysts have completed a total of 740 meetings with over 100 Malaysian companies under coverage in 2017.

## Engaging Investee Companies

**03**

*Institutional investors should engage with investee companies as appropriate.*

The EPF believes that alignment of interest between long-term shareholders and companies will fulfil its fiduciary duty to achieve sustainable risk-adjusted returns over the long term. The EPF undertakes engagement with companies on issues that may impact the companies' long term value. Engagement may relate to the company's financial performances, long term strategic plans and ESG issues. Engagement is normally undertaken when it is believed that it would lead to an improvement or prevent deterioration in the company's performance.

Our approach to engagement activities are based on two prongs:

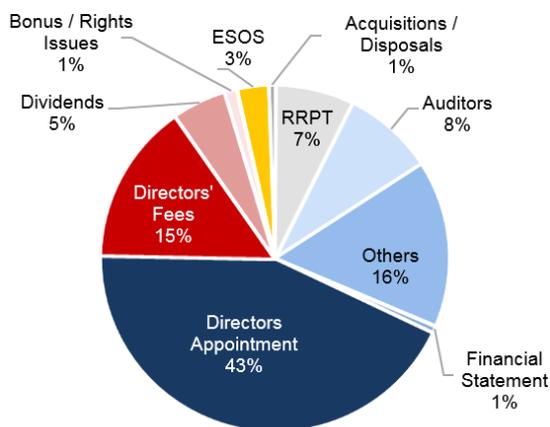
- ★ The engagement with the board and management of the investee companies on issues of ESG and long term strategy with the objective of maximizing long term shareholders. This is carried out through a scheduled annual engagement by the EPF's top management.
- ★ The engagement with the management of the investee companies by EPF team of analysts on business model and financial performances with the objective of ongoing monitoring of the investee companies.

On a few occasions, further engagement is escalated over time according to the nature and severity of concerns and the responsiveness of the companies to the issues. EPF also engages the companies by attending the shareholders meetings. In addition, alignment of interests can be accomplished through meetings and discussions.

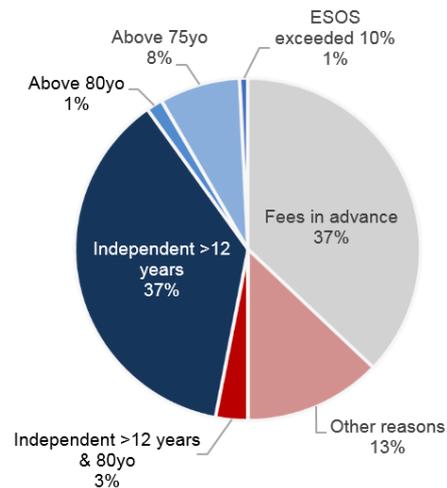
In 2017, EPF attended and voted at 136 shareholders' meetings on 1,061 resolutions. The Equity Research Department analysed all the resolutions based on the EPF Corporate Governance Principles and Voting Guidelines. The guideline is based on the best governance practices for PLCs and to align to EPF Principles of Corporate Governance.

Charts below show the number of resolutions EPF voted in 2017 and the reasons why EPF decided to vote against or abstain.

### Voting by Resolution Types



### Reasons for Against or Abstain



In addition to attending regular analysts and shareholders meetings, EPF has also involved in specific engagements with a total of 13 companies in 2017 on the following issues:

### Issues on remuneration of directors and employees

Issues on remuneration to directors has been one of the most common issues that EPF is facing every year. EPF reiterates its view that the compensation to the directors should be based on performance of the company and EPF is against any excessive and advance remunerations to the directors.

To ensure the effectiveness of its policy, EPF has continuously engaged with the investee companies on the recurrent issues to ensure the adherence to the good governance practice. This includes the engagement on the issues on excessive remuneration package for chairman and executive directors of some listed companies. While some of the issues are still yet to be resolved, EPF has put the company under close watch to ensure the payment to directors commensurate with the performance of the company.

In conjunction with the amended Companies Act that requires shareholders' approval for directors' remuneration, a listed company has engaged with EPF to gauge the stance on advance payments to directors. Upon further discussion, the company did adhere to EPF's recommendation, resulting in EPF voting for the proposed resolutions.

While EPF believes that the management and employees should be rewarded for their contribution to company performance, EPF believes any employee share scheme should not exceed 10% of paid-up capital to avoid significant dilution to other stakeholders. When a listed plastic manufacturing company proposed to issue ESOS beyond the threshold, EPF has engaged with the company to raise our concerns on the issue. After discussions, the management has agreed to reduce the issuance limit to be in line with our policy.

### **Issues on corporate exercises**

When a listed media company proposed to dispose its prized foreign asset which is another listed subsidiary, EPF raised concerns on loss of a significant earnings contributor to the group. EPF reached out to the company to understand the impact and the strategic direction of the company in the aftermath of such divestment. With the view that the valuation is fair and the decent gains on investment made post the offer, EPF has decided to vote for the resolutions at the EGM.

Similarly when an industrials conglomerate proposed to pare down its stake in a loss-making automotive subsidiaries to a foreign auto manufacturer, EPF deliberated on the transactions to understand the impact and direction of the company post-divestment. With the view that the valuation and the value proposition is fair to the company and its shareholders, EPF voted to support the divestment.

EPF also deliberated and engaged with a listed parent company which undertook a general offer exercise on its listed subsidiary. While headline valuations may appear to be undervalued, EPF is comforted by the range of options available for minority shareholders to remain invested in the property group. Nevertheless, the parent company agreed to amend the terms to ensure better options for EPF and other minority shareholders.

2017 was another challenging year for the oil and gas industry. Following the change in the controlling shareholder of one of a listed company in the industry, EPF has engaged with the new management to understand its business strategy. The company has suffered from poor financial performance prior to the change in controlling shareholder. The engagement is to gain assurance on the prospects of the company under the new shareholder and to ensure that the interest of minority shareholders are aligned with the priorities of the new major shareholder.

Other engagements related to the energy industry includes the proposal of rights issue to reduce debts, which would result in significant dilution to earnings per share. EPF has engaged with the company to understand the impact and direction of the company post issuance of rights. As the rights issue is a necessity for the company to continue to be a going concern, EPF has decided to vote for the resolutions as proposed in the EGM.

### **Issues on significantly weaker than expected performance**

When a petrochemical company posted significantly weaker results immediately after its listing exercise, EPF engaged with the company as well as the investment banks to understand the reasons for the weaker results soon after the public offering. EPF has also written to the Securities Commission to request for an investigation be conducted as to whether proper due diligence has been adhered to during the listing process.

## Issues on compliance with human rights by oil palm plantation companies

Despite being members of the Roundtable of Sustainable Palm Oil (RSPO), plantation companies continue to receive complaints from NGOs on violations of social and human rights of its estate workers. EPF acted immediately following a report on human rights violations by a Malaysian palm oil company in Indonesia. It was reported that the company has entered into long term leases with the Indonesia government to covert culturally sacred sites for oil palm plantations. The complaints revealed that the local communities were not consulted on the land conversion and demand for the return of this culturally sacred land to them. EPF has engaged with the company for detailed explanation and efforts taken by the company to address this issue.



## Managing Conflicts Of Interest

*Institutional investors should have a robust policy on managing conflicts of interest which should be publicly disclosed.*

The EPF is committed to adhere to the highest standard of corporate governance throughout the organization as a fundamental part of discharging its fiduciary duty to protect and enhance members' savings. EPF has put in place various policies to address potential conflicts of interest in relation to stewardship. This serves to maintain the integrity of decision-makers in EPF when dealing with and managing its investments.

In respect of conflicts of interest within the fund, members of the EPF Board, Investment Panel and sub-committees are required to make declarations of interest prior to meetings and abstain from taking part in the discussion and decision making. For example, if it concerns a related-party transaction in which a member of EPF Investment Panel is also sitting in the public-listed Board, the person will be excused from attending such discussions.

In addition, the following policies were also implemented to address possible conflict of interest within EPF:-

- ★ Restrictions on Listed Equity Transactions on investment officers
- ★ Chinese Wall Policy
- ★ No Gift Policy
- ★ Declaration of Interest/Relationship with Panel Brokers for Equities
- ★ Integrity Code
- ★ Staff Declaration of Asset Ownership
- ★ Nominee Directors Declaration

## Incorporating Sustainability Consideration

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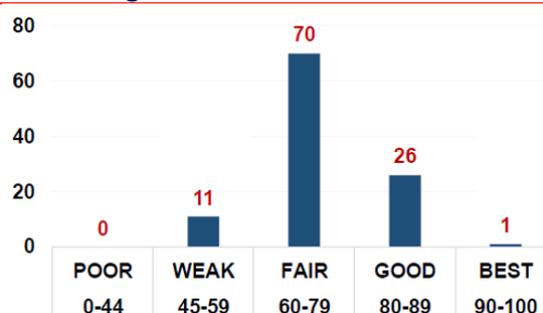
*Institutional investors should incorporate corporate governance and sustainability considerations into the investment decision-making process.*

Sustainability in investment is defined as the ability to continue doing business in a responsible manner, taking into account the impact on environment and social context while ensuring long term performance and existence. Traditionally EPF has been active in monitoring the governance aspect of our investee companies ever since the first establishment of the Malaysian Code of Corporate Governance in 2012. Over time, these considerations have evolved to include the environment and social aspects of corporate behaviours. EPF continues to believe that strong governance practices, along with deeper concerns for the environment and social risks are important drivers of investment value. In addition to the financial and governance aspect of a company that EPF has focussed on in the past, we have begun to integrate ESG aspects into our investment monitoring process that relates to how a company achieve its long-term financial goals and at the same time generate positive impact on the environment and social. The preliminary analysis is also done at the screening stage, mainly to filter out certain investments from an ethical perspective (tobacco, gambling, liquor, etc.). With the commencement of Shariah-based option, the process of integrating ESG factors into our investment processes and decisions will be more intensified. EPF has also developed its own internal rating tool to monitor and evaluate company performance in the aspect of ESG. With improved disclosure standards on ESG by the investee companies under Sustainable Reporting and/or Integrated Reporting initiatives by Bursa Malaysia, we are set for a long term journey to elevate the level of awareness on ESG standards in Malaysia.

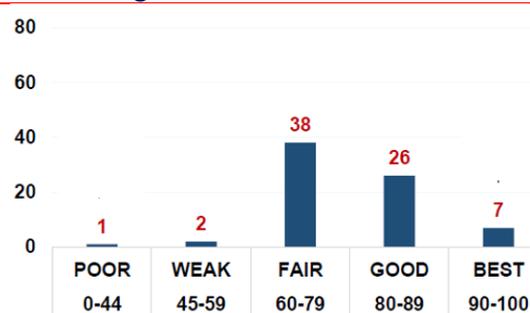
EPF has developed its own internal rating tool to assess the quality of ESG aspects by its investee companies under surveillance which is based on questions from how the company adhere to the CG code, disclosure standards and how the company integrate ESG, all the way to the conduct of general meetings. This tool is able to generate a quantifiable rating which can be considered when evaluating the companies in addition to the traditional quantitative analysis done on their financials.

Few enhancements were made during the year to take into account the growing need for good governance practices among investee companies. In 2017, the EPF surveillance universe has been expanded to 108 companies from 74 companies in 2016 while the criteria in our ESG rating tool has been revised with higher weight on ESG and analyst's assessment. Based on the data that we have gathered, ESG distribution remained left-skewed, suggesting that most of the companies under coverage have already adopted good governance practices. The top ESG scorers for the year are Telekom Malaysia, Public Bank, KLCCP and MBSB while the bottom five were led by YTL Corp, YTL Power, Oriental Holdings, UOA REIT and APM Automotive.

ESG Rating in 2017



ESG Rating in 2016





## Publishing Voting Policy

*Institutional investors should publish a voting policy.*

EPF values the voting rights attached to its equity holdings in Malaysian listed companies and will always exercise those rights to ensure that its economic interest is protected. The latest EPF Corporate Governance Principles and Voting Guidelines is published in our website.

Essentially, EPF will generally vote in favour of resolutions which are in line with the Malaysia Corporate Governance Code and are in the best interest of all shareholders. EPF may also decide to vote against or abstain on resolutions which do not meet these guidelines and are deemed to have conflicts of interest, poor transparency or what EPF believes to be detrimental to the long term value to shareholders.

Similarly, we have directed our external asset managers to vote in accordance with the latest policy in EPF Corporate Governance Principles and Voting Guidelines.

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