MALAYSIA: THE UNGPs AND ESG INVESTMENT POLICIES IN GOVERNMENT-LINKED INVESTMENT COMPANIES

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As the world's most authoritative, normative framework guiding responsible business conduct, the UN Guiding Principles on Business and Human Rights (UNGPs) provide government policy makers and business leaders with a helpful framework for formulating responsible business policy. The UNGPs provide that all businesses must respect human rights. This would apply to state-owned enterprises (SOEs) or government-linked companies (GLCs), as they are commonly known in Malaysia.

In recent years, Malaysian companies working in key industries have made significant commitments to improving their responsible business profiles and managing their environmental, social and corporate governance (ESG) risks. Yet, questions over the effectiveness of these efforts have been raised as abuses of migrant labour continue to capture international headlines.[1]

In a move to reduce human rights risks in business operations in Malaysia, the government of Malaysia announced in 2018 its commitment to drafting a National Action Plan (NAP) on Business and Human Rights. With the Malaysia NAP process now underway, a deeper discussion is required to better understand and leverage the role of Malaysia's government-linked investment companies (GLICs) in helping the country mitigate human rights risks and meet its sustainable development ambitions.

How can GLICs leverage their authority to influence Malaysian enterprises to embrace more fully the guidance provided by the UN Guiding Principles on Business and Human Rights (UNGPs)? How can GLICs be encouraged to consider human rights risks and impacts as a key factor when exercising decision-making power on corporate boards, and while making investment decisions?

Box 1. The UNGP's 'Protect, Respect and Remedy' framework

Divided into three pillars, the UNGPs delineate separate but complementary roles and responsibilities for States and business.

Under Pillar 1, States have the duty to protect human rights in business operations, taking appropriate steps to prevent, investigate, punish and redress abuses through effective policies, legislation, regulations and adjudication.

Under Pillar 2, businesses are encouraged to respect human rights, through efforts to avoid infringing on the human rights of others and addressing adverse human rights impacts with which they are involved.

Under Pillar 3, States and business must provide for access to remedy for those negatively impacted by business operations.

This issue brief assesses how GLICs have translated their responsibilities to respect human rights into their investment practices within the context of their environmental, social and corporate governance policies.[2] The brief also provides insights into the challenges of strengthening these efforts, while providing recommendations to ensure rights-based investment practices are undertaken in greater measure. The brief concludes that if GLICs embrace the UNGPs more fully, they would encourage respect for human rights in business operations, and strengthen Malaysia's standing as a low-risk, high-return investment destination. This would, in turn, attract attention from institutional investors managing substantial funds under the ESG asset class heading.

THE ROLE OF GLICs IN THE MALAYSIAN ECONOMY

GLICs are a group of state-linked investment funds in Malaysia that enjoy a controlling stake in over 35 of the top 100 companies listed on the domestic stock exchange, Bursa Malaysia.[3] Collectively, GLICs maintain direct or indirect holdings in more than 68,000 Malaysian companies including a 42 percent effective ownership interest of all companies on the Malaysian stock exchange, Bursa Malaysia.[4] Seven investment organizations in Malaysia are classified as GLICs: Minister of Finance Incorporated (MoF Inc.), Permodalan Nasional Berhad (PNB), Khazanah Nasional Berhad (KNB), Employees Provident Fund (EPF), Armed Forces Fund Board (LTAT), Retirement Fund Incorporated (KWAP) and Pilgrims Fund Board (LTH).[5]

Importantly, GLICs have significant sway over government-linked companies (GLCs), which play a dominant role in the utilities, plantations, construction, property, energy, banking, health care, services and media sectors.[6] In fact, GLCs serve a pivotal role in the operation of nearly every commercial concern in Malaysia. By some estimates, GLCs in 2020 accounted for more than 40 percent of the market capitalization of Bursa Malaysia.[7]

GLICs AND RESPONSIBLE BUSINESS PRINCIPLES

Boards and senior management teams of Malaysia's leading enterprises, including investment firms, are not unfamiliar with responsible business principles. Both GLICs and GLCs have adopted responsible investing codes, including the Principles for Responsible Investing (PRI). Several major institutional investors have expanded their responsible investment polices to address other ESG issues, including environmental and social matters. Three Malaysian GLICs have become signatories to the PRI, including the Employees Provident Fund, Khazanah Nasional Berhad and Retirement Fund Incorporated.

GLICs and other Malaysian institutional investors have also adopted a range of domestic responsible investment policies. Many are signatories to the Malaysian Code for Institutional Investors (MCII)[8] and follow voting guidelines that align with the Malaysian Code on Corporate Governance (MCCG).[9] These domestic, Malaysia-focused standards such as the MCCG are based on several international benchmark policies including the OECD Principles of Corporate Governance.

In complying with these standards, the GLICs have clearly committed to incorporating responsible investment considerations into their investing and due diligence processes across asset classes, disclosing information regarding their stewardship responsibilities and voting guidelines, and monitoring and conducting engagements with investee organizations on material ESG matters.

Box 2. What is ESG investing?

ESG investing refers to a strategy to incorporate environmental, social and governance (ESG) factors into investment decisions. It complements traditional financial analysis and portfolio construction techniques. Examples of material ESG issues include environmental issues (e.g. climate change, pollution and deforestation), social issues (e.g. human rights, modern slavery and child labour) and governance issues (e.g. corruption, executive pay and board diversity).

The two main approaches to ESG investing are: **ESG incorporation** via systematically including ESG issues in investment analysis and decisions, screening out companies based on ESG matters, and thematic approaches such as investing to contribute to an environmental or social outcome. The second approach involves **active ownership** via engaging with companies to improve their handling of ESG issues and proxy voting to formally express approval or disapproval on shareholder resolutions related to ESG matters.

However, it is not always clear what impact GLICs are having in promoting responsible business. As described above, GLICs are not guided by a singular approach on responsible investment practices. Furthermore, each GLIC has its own investment policies and makes decisions in relation to ESG and responsible business in a variety of ways.[10] There is a wide diversity of GLICs in existence, which operate under different corporate forms, including as holding companies, trust fund managers, sovereign wealth funds, pension funds and special purpose funds. And while GLICs can influence the ESG performance of the companies they invest in,[11,12] the different ownership interests of individual GLICs are an important factor in their ability to leverage their influence.

To this end, GLIC investment policies and approaches could be more tightly aligned to the UNGPs to ensure consistency and a stronger human rights focus, through policy action under the NAP on BHR.[13]

ALIGNMENT WITH THE UNGPs

The United Nations Human Rights Council unanimously endorsed the UNGPs in 2011, following a six-year multi-stakeholder process involving contributions from esteemed business associations such as the International Organisation of Employers and the International Chamber of Commerce. The UNGPs are divided into three pillars involving: 1) the State duty to protect; 2) the business obligation to respect; and 3) the responsibility of both to provide for access to remedy (see Box 1 above).

The first pillar of the UNGPs focuses on the State duty to protect against human rights abuses by businesses, including those owned by the State. Under Principle 4 of the UNGPs, State-owned enterprises, such as GLICs, should take additional steps to protect against human rights abuses. According to the UNGPs, "where a business enterprise is controlled by the State or where its acts can be attributed otherwise to the State, an abuse of human rights by the business enterprise may entail a violation of the State's own international law obligations."[14] In this regard, the UNGPs call on GLCs and GLICs to "lead by example."

Box 3. UNGPs and the responsibilities of GLICs: Principle 4

States should take additional steps to protect against human rights abuses by business enterprises that are owned or controlled by the State, or that receive substantial support and services from State agencies such as export credit agencies and official investment insurance or guarantee agencies, including, where appropriate, by requiring human rights due diligence.

Therefore, the state's human rights obligations extend to GLICs' investments and as such, the State should require that human rights due diligence be taken up GLICs and, "by those business enterprises or projects receiving their support. A requirement for human rights due diligence is most likely to be appropriate where the nature of business operations or operating contexts pose significant risk to human rights."[15] In other words, alignment with the UNGPs requires that both GLCs and GLICs conduct thorough human rights due diligence.

The second pillar of the UNGPs outlines the corporate responsibility to respect human rights, which involves developing and communicating a human rights policy. Further, businesses are encouraged to conduct human rights due diligence, which involves: 1) identifying human rights risks; 2) integrating human rights considerations into decision-making; 3) tracking and verifying progress against risk and impact indicators; and 4) communicating progress on human rights issues.

Under the third pillar of the UNGPs, which includes Principles 25 to 31, business and government must ensure victims of human rights violations have access to remedy, which includes creating non-judicial, non-state grievance mechanisms and engaging in collaborative efforts to ensure effective grievance mechanisms are available.

Box 4. GLICs can meet their obligations to respect human rights by:

- Publishing a comprehensive human rights policy directing investment decisions, among other matters
- Conducting human rights due diligence and integrating human rights considerations into investment decision-making processes
- Incorporating human rights and sustainability considerations into ownership and divestment policies
- Monitoring the progress of human rights matters in investee companies by requiring adequate disclosures
- Creating and operating grievance mechanisms that address any human rights abuses that arise from investment decisions

Box 5. The UNGPs and the Norwegian Government Pension Fund Global

The Government Pension Fund Global (GPFG) of Norway is a large sovereign wealth fund that has incorporated human rights considerations into its investment process after the Ministry of Foreign Affairs launched a National Plan on Business and Human Rights. As part of the plan, GPFG's fund manager, Norges Bank Investment Management (NBIM), signed a declaration supporting the UNGPs in 2011.

NBIM operationalized their commitment through their "Strategies for ethical fund management" involving three main elements: exercising ownership through engagement and voting on human rights issues, negative screening, and exclusions. The strategies state that the fund can, together with other investors, demand that companies put in place systems to ensure the company does not contribute to violations of basic human rights. The sale of shares can be a consequence if the engagement does not produce results.

The fund addresses human rights issues in investee entities in a systematic manner informed by the framework provided by the UNGPs. NBIM published a "Human rights expectation document," that outlines the fund's expectations for investee companies to respect human rights and to address human rights matters in business practices.

ENHANCING ESG INVESTING APPROACHES OF GLICS THROUGH THE LENS OF THE UNGPS

GLICs can improve their ESG investing initiatives in relation to the UNGPs with reliable sustainability data, credible policy positions and by enabling robust remediation mechanisms.

SUSTAINABILITY DATA

The lack of standardized sustainability data remains a key challenge in executing an effective ESG strategy or complying with the guidance of Pillar 2 of the UNGPs.[16] Seeking appropriate disclosure is a necessary prerequisite to carry out human rights due diligence, as articulated by Principles 17 to 21. More transparency will allow GLICs to carry out due diligence and verify and monitor the progress of corporations on human rights matters. This will also ensure that GLICs can identify the greatest risks to human rights in their portfolios, and reduce related reputational, operational and legal liability risks to GLICS themselves.

Malaysian regulators have taken steps to improve disclosure with the Securities Commissions' Sustainable and Responsible Investment Roadmap, while the stock exchange Bursa Malaysia has set sustainability reporting guidelines and developed a guide on corporate governance.[17] However, the majority of ESG disclosures have focused on governance matters, and there is limited voluntary disclosure on material human rights matters in many sectors, notably the construction and plantations business sectors.[18] There are also few third-party ESG data providers to verify disclosures via independent sustainability audit and research.

In response to these challenges, the Employees Provident Fund (EPF), one of the largest GLICs in terms of assets, called in 2020 for investment brokerage and research houses to incorporate ESG considerations into their research processes.[19] In this instance, EPF was exercising its role as a GLIC, encouraging corporates to adopt best practices on ESG disclosure and to report standardized, comparable and reliable sustainability data.[20]

Improving sustainability reporting will aid GLICs in securing the necessary information to incorporate material human rights and ESG issues into investment decision-making and stewardship duties. To progress on this, GLICS should: 1) request that ESG matters be incorporated into corporate annual reports; 2) require more information on corporate codes of conduct and compliance measures; and 3) join shareholder initiatives calling for improved disclosures.

VOTING GUIDELINES

Most GLICs publish voting guidelines, a policy document that summarizes how the GLIC will vote on matters at statutory meetings. Voting at statutory meetings is an ownership tool used by investors to exert influence.[21] As substantial shareholders, GLICs exercise ownership rights by voicing concerns to management and voting at statutory meetings. Broadly speaking, GLIC voting guidelines do not codify their positions on material environmental and social issues but instead focus on corporate governance matters, such as how the fund will vote on issues of the tenure of Board members, Directors' fees, and corporate actions that relate to company performance and sustainability.[22]

Although many guidelines mention ESG risks as considerations that will influence voting decisions, few GLICs have policies that outline what their positions are on human rights, environmental, and other ESG matters. Principle

16 of the UNGPs stipulates the need to communicate expectations and the commitment to respect human rights to stakeholders via internal and publicly available documents. Such documents, when based on the UNGPs, can form the basis for processes that govern ESG investing activities, voting decisions, and follow-up on sustainability matters during engagements as part of an active ownership policy.

Voting guidelines can be used as a vehicle for GLICs to progress ESG matters. In practice, this can include voting against Directors of companies that do not adequately disclose environmental, social and human rights risks or do not have a convincing plan to reduce those risks (and provide remedy). Voting can also be used to stop the reappointment of auditors where the annual report or accounts fail to report ESG-related material risks.[23]

STAKEHOLDER ENGAGEMENT

GLICs also conduct engagements on ESG issues that include management visits, shareholder letters, and letters concerning ESG matters.[24] These efforts include collaborative, multi-stakeholder engagements that provide the opportunity to identify and follow up on human rights risks. GLICs have conducted engagements through the Institutional Investors Council in Malaysia, but the frequency of engagements has been low with only five engagements reports in 2019 and two in 2020.[25] The lack of more frequent engagements gives little scope to ensuring sustainability commitments by investee entities are met. GLICs have, perhaps, a better track record of collaborative engagement with the GLC Transformation Programme,[26] which focused on performance delivery and corporate governance. Going forward, this programme might include references to human rights and environmental issues.

With regards to the third pillar of the UNGPs and its guidance on access to remedy, GLICs can refocus multi-stakeholder corporate engagements to encourage companies to put in place operational-level non-state, non-judicial remediation mechanisms to provide access to remedy. This might include policies for whistle-blowers, anonymous systems for complaints, and methods for dialogues and negotiations that are culturally appropriate to the backgrounds of key stakeholders, including migrant workers. In practice, this means ensuring all workers can effectively participate in remediation exercises. Collaborative engagements should emphasize that businesses have a social responsibility to all stakeholders,[27] and as investors, GLICs are committed to seeing companies follow through on their environmental and social responsibilities.

RECOMMENDATIONS FOR POLICY AND PRACTICE TO IMPROVE ESG INVESTING IN THE CONTEXT OF HUMAN RIGHTS AND THE UN GUIDING PRINCIPLES

The two main challenges in the implementation of ESG investing policies by Malaysian GLICs in the context of the UNGPs are the lack of reliable and comparable sustainability data and the lack of focus on environmental, social and human rights matters. The following recommendations, based on the best practices described above, seek to enhance the alignment of GLIC investing practices with the UNGPs by encouraging effective sustainability disclosure, and aligning GLIC ESG investing policy with the UNGPs to promote respect for human rights and enable access to remedy for victims of human rights violations.

I. RECOMMENDATIONS FOR GLICs

TO INTEGRATE HUMAN RIGHTS MATTERS INTO ACTIVE OWNERSHIP POLICIES:

Require investee entities to conduct human rights due diligence and report their results

GLICs should require that entities that they invest in make efforts to actively assess and address the human rights impacts of their operations, otherwise referred to as Human Rights Due Diligence (HRDD). GLICs should also use their influence to ensure investee entities have in place HRDD oversight mechanisms, such as board corporate responsibility or sustainability committees, which report on their findings and authenticate them. Where these reports are signed by the senior-most authority in companies, including on delicate issues related to remedy, corporate risk management will likely improve significantly.[28]

Publish expectation statements on environmental, social and governance issues

GLICs should publicly disclose and communicate their expectations of investee entities on material ESG issues and their responsibilities and commitments to those issues. GLICs have already adopted several standards with regards to corporate governance. In line with Principle 16 of the UNGPs, investors should publish a ‘statement’ outlining their commitment to human rights and require investee entities to do the same. Specifically, investors should clearly communicate their expectations to investment managers and corporates on material ESG matters that guide their investment and voting decisions.[29] This includes expectations related to the treatment of migrant workers, gender issues, and environmental issues. Recent research has shown there is some scepticism on whether investors vote in alignment with their ESG policies, especially when proxy voting is used.[30] To that end, GLICs should publish their voting records and rationales to convincingly communicate their track record of how they exercise their statutory meeting voting and ownership rights in accordance with their ESG policies and statements.

Address environmental, social and disclosure matters in voting guidelines

Voting guidelines by investors, including GLICs, tend to focus on corporate governance issues,[31] involving management and shareholder proposals.[32] Voting guidelines could be better leveraged as a vehicle to further GLIC policy positions on corporate respect for human rights. The objective of this recommendation is to improve disclosure for the benefit of investors and incentivize management to address ESG and human rights issues in their operations. Voting guidelines might require a GLIC to vote against Directors of companies that do not adequately disclose material environmental, social and human rights risk matters or do not have a convincing plan to reduce those risks (and provide remedy) or voting against auditors where the annual report or accounts fail to report material ESG risks.[33]

TO INTEGRATE HUMAN RIGHTS MATTERS INTO INVESTMENT DECISION-MAKING:

Incentivize independent research on material ESG and human rights matters

As large institutional investors, GLICs wield significant influence over brokerages and other third-party research providers. GLICs should require research providers, as investment service providers, to understand and incorporate GLICs' commitment to human rights and include ESG issues as a consideration in their work. Promoting ESG research in the securities and investment research industry will ensure that more institutions pay attention to ESG and human rights issues and will aid investment institutions in incorporating ESG and the UNGPs into their investment processes. When ESG considerations in investing become mainstream, investee entities have even more incentive to ensure their operations meet the relevant ESG and human rights standards.

Pledge to divest from entities where the likelihood of human rights abuses is high

GLICs should pledge to, and actually, divest from entities where management has made no significant progress in addressing ESG issues despite engagements on such issues. Further divestment should be considered where management does not have a convincing plan to address material ESG matters, does not provide remedies for human rights violations, or where the likelihood of future human rights violations is high. This will ensure GLICs do not support the operations of entities that actively violate human rights. At the same time, other investee entities will be assured of GLICs' commitment to promote respect for human rights and enable access to remedy for victims of human rights violations by businesses.

II. RECOMMENDATIONS FOR THE GOVERNMENT

Address the role of GLICs in promoting respect for human rights and enabling access to remedy in the National Action Plan on Business and Human Rights

The government has committed to developing a National Action Plan on Business and Human Rights[34] that will operationalize its business and human rights commitments. Given the size and relevance of GLICs as investors, the government should address the role of GLICs in the NAP. Pillar 1 of the UNGPs focuses on the state duty to protect human rights, and in effect this duty extends to state enterprises and statutory agencies like GLICs. The Government should include GLICs in their Action Plan items that involve Pillar 2 of the UNGPs on the corporate responsibility to respect human rights and on Pillar 3 of the UNGPs on enabling access to remediation for victims of human rights abuses. Given the scope and influence of GLICs in corporate Malaysia, their role in the Action Plan should be highlighted across the core content of the NAP and include issues of labour and migrant worker rights, indigenous peoples, environment and climate change impacts on human rights.

Establish a collaborative programme for GLICs to conduct engagements on human rights issues

As a key stakeholder of GLICs, the government should coordinate a programme to improve the environmental, social and human rights performance of GLCs and investee entities of GLICs. Recent research has shown that the coordination of corporate engagements can lower the costs of such engagements while increasing their effectiveness in terms of impact on corporate decision making.[35] This means that coordinated engagements by GLICs on human rights matters will be more effective in influencing the behaviour of corporations than individual engagements. Such a proposal is in line with Principle 30 of the UNGPs that calls for multi-stakeholder, collaborative initiatives to ensure the effectiveness of non-state, non-judicial grievance mechanisms are available to investee entities, while it is also in line with Principle 2 of the PRI to be active owners. To that end, the government should design the programme to run frequent, collaborative engagements among GLICs on ESG and human rights matters, to ensure investee entities have in place mechanisms to provide remedy to victims of potential human rights violations by those entities. Such a programme would then allow GLICs to follow up and continually convey to management their positions on human rights matters.

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