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AN INEFFECTIVE INSTITUTIONAL INVESTORS LAW IN INDONESIA? WHY BOTHER¹

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Abstract

Corporate governance failures are one of the major factors that have crippled the Indonesian economy through financial crises. In response, the OECD has prescribed Principles II and III of the G20/OECD Principles of Corporate Governance to ensure the rights and equitable treatment of all shareholders and the acknowledged role of institutional investors in improving corporate governance. Institutional investors play a significant role as corporate monitors in protecting the public investors' money and improving corporate financial performance. They are therefore acknowledged as the policies of economic crises, creators of firm values, and drivers of economic development. However, as this paper explains, the existing legal framework of institutional investors in Indonesia is implicit and inadequate to comply with these Principles. It draws hard lessons from, for example, the Malaysian legal framework of institutional investors, which are advanced but flawed, paving for the exceptional 1MDB multibillion dollars of corruption and political mayhems. Stakeholder governance on institutional investors that leaves to private ordering and makes government intervention unnecessary is counterproductive to protect the interests of stakeholders. This paper proposes the rules of the game for institutional investors in Indonesia that could maintain their nimbleness to drive corporate financial performance and economic development.

Keywords: *Corporate governance, corporate monitors, financial crisis, institutional investors.*

Abstrak

Kegagalan tata kelola perusahaan merupakan salah satu faktor utama yang melumpuhkan perekonomian Indonesia dalam krisis keuangan. Sebagai tanggapan untuk menanggulangi permasalahan tata kelola perusahaan, OECD telah menetapkan Prinsip II dan III dari Principles of Corporate Governance G20/OECD untuk memastikan hak dan perlakuan yang adil bagi semua pemegang saham dan peran yang diakui dari investor institusi dalam meningkatkan tata kelola perusahaan. Investor institusional memainkan peran penting sebagai pemantau perusahaan dalam melindungi uang investor publik dan meningkatkan kinerja keuangan perusahaan. Oleh karena itu, mereka diakui sebagai kebijakan dalam krisis ekonomi, pencipta nilai-nilai perusahaan, dan penggerak pembangunan ekonomi. Namun, seperti yang dijelaskan dalam makalah ini, kerangka hukum investor institusional yang ada di Indonesia secara implisit dan tidak memadai untuk mematuhi prinsip-prinsip ini. Ini mengambil pelajaran sulit dari, misalnya, kerangka hukum investor institusional Malaysia, yang maju tetapi cacat, membuka jalan bagi korupsi 1MDB dan kekacauan politik bernilai miliaran dolar. Tata kelola pemangku kepentingan pada investor institusi yang meninggalkan tatanan swasta dan membuat intervensi pemerintah tidak perlu adalah kontraproduktif untuk melindungi kepentingan pemangku kepentingan. Tulisan ini mengusulkan aturan main bagi investor institusi di Indonesia yang dapat menjaga kegesitannya untuk mendorong kinerja keuangan perusahaan dan pembangunan ekonomi.

Kata kunci: *tata kelola perusahaan, pemantauan korporasi, krisis finansial, investor institusional*

¹ An earlier version of this paper was a thesis -- Lie, Luther, An Inquiry into the Governance of Institutional Investors in Indonesia (2019) (Bachelor of Laws thesis, Universitas Indonesia). An initial draft of the thesis was presented and awarded as the Best Paper at the International Conference on Law and Governance (icLave) at The Sakala Resort Bali, Indonesia on November 7-8, 2018.

I. INTRODUCTION

Corporate governance (CG) failures are a global issue that significantly² led to the 2009 Global Financial Crisis³ and the 1997 Asian Financial Crisis.⁴ This applies to Indonesia without exceptions,⁵ with the 1997 Asian Financial Crisis being the most severe – resulting not only in the decline of the composite index of the Indonesia Stock Exchange (IDX) by over 50 percent but also the depreciation of the Rupiah by more than 80 percent within less than a year.⁶ The fact that CG failures have had major effects on a country's economy reaffirms the causality between a sound microeconomic policy and a stable macroeconomic condition.⁷ CG failures refer to the malfunctioning system by which companies are controlled and accountability structures and processes are imposed on those in control of companies,⁸ falling short of attaining long term shareholder value and the interests of other stakeholders;⁹ they do not necessarily mean a violation of legal obligations¹⁰ if CG best practices remain absent or barely prescribed in a particular country.

According to the Organisation for Economic Co-operation and Development (OECD), the answer to CG failures is the governance of a set of CG standards and guidelines.¹¹ CG standards and guidelines are not confined to the role of the Board of Supervisors (BOS) in monitoring the Board of Directors (BOD),¹² but also, equally if not more important, it addresses the significant role of institutional investors in balancing the majority shareholders, which have the power to appoint the BOD.¹³

² CG failures are not the only factor that contributed to the 2009 Global Financial Crisis and the 1997 Asian Financial Crisis. Other factors which caused the two economic crises were, among others, large current account deficits, reversal of capital flows, and/or loose monetary and fiscal policies. See Rakesh Mohan (2009), "Global Financial Crisis – Causes, Impact, Policy Responses and Lessons" (paper presented at the 7th Annual India Business Forum Conference, London Business School, London). This paper, however, focuses on the CG failures which are a significant factor of the two economic crises, as set out by the OECD (discussed below).

³ John Mawutor, "The Failure of Lehman Brothers: Causes, Preventive Measures and Recommendations," *Research Journal of Finance and Accounting* 5, no. 4 (2014): 86.

⁴ G. Shenoy and P. Koh (2011), "CG in Asia: Some Developments," *Asia Law Review* (31): 24; in G. Shenoy and P. Koh (2014), *The Indonesia CG Manual*, 1st ed. (Jakarta: Indonesia Financial Services Authority and International Finance Corporation), v; in G. Shenoy and P. Koh (2018), *Indonesia CG Manual*, 2nd ed. (Washington, D.C.: International Finance Corporation), 31.

⁵ Thee Kian Wie, *Indonesia's Economy since Independence* (Singapore: ISEAS–Yusof Ishak Institute: 2012), 126–128; Muhammad Chatib Basri and Sjamsu Rahardja, "The Indonesian Economy amidst the Global Crisis: Good Policy and Good Luck," *ASEAN Economic Bulletin* 27, no. 1 (2010): 78.

⁶ Anwar Nasution, "The Meltdown of the Indonesian Economy: Causes, Responses and Lessons," *ASEAN Economic Bulletin* 17, no. 2 (2000): 148.

⁷ William Sun, Jim Stewart, and David Pollard (2011), "Introduction: Rethinking CG – Lessons from the Global Financial Crisis," in *Corporate Governance and the Global Financial Crisis: International Perspectives*, eds. William Sun, Jim Stewart, and David Pollard (Cambridge: Cambridge University Press), 1–2.

⁸ See John H. Farrar, "CG and the Judges," *Bond Law Review* 15, no. 1 (2003): 66.

⁹ See Robert A.G. Monks and Nell Minow, *Corporate Governance*, 5th ed. (West Sussex: John Wiley & Sons Ltd, 2001), 1.

¹⁰ David O. Mbat and Eyo I. Eyo, "Corporate Failure: Causes & Remedies," *Business and Management Research* 2, no. 4 (2013): 19.

¹¹ David O. Mbat and Eyo I. Eyo, *Corporate Governance in Asia: Asian Roundtable on CG* (Paris: OECD Publishing, 2014), 1, <https://www.oecd.org/corporate/48806174.pdf>.

¹² Dan W. Puchniak and Kon Sik Kim, "The Rise of Independent Directors in the West: Understanding the Origins of Asia's Legal Transplants," in *Independent Directors in Asia: A Historical, Contextual and Comparative Approach*, eds. Dan W. Puchniak, Harald Baum, and Luke Nottage (Cambridge: Cambridge University Press, 2017), 1–2.

¹³ In Monks and Minow, *Corporate Corporate Governance*, 215; in Monks and Minow, *Good Corporate*

It is with no doubt that the role of institutional investors in improving CG is acknowledged both regionally and globally. This is evident in various CG standards and guidelines which include institutional investors as one of the benchmarks to implement the principles of CG. The examples include the G20/OECD Principles of CG of 2015 (GCG Principles),¹⁴ Malaysian Code for Institutional Investors of 2014,¹⁵ European Union Directive No. 828 of 2017 regarding the Encouragement of Long-term Shareholder Engagement,¹⁶ and Dutch Stewardship Code of 2018.¹⁷ In reality, there is an unavoidable rise of institutional investors in the capital markets around the world.¹⁸

Nonetheless, as one of us has interviewed, there are no laws and regulations, whether hard laws or soft laws, in Indonesia which mention and define the term 'institutional investors'.¹⁹ Historically, the emergence of the discussion on the roles of institutional investors in Indonesia only began in 2013 during the Asia-Pacific Economic Cooperation (APEC) summits, particularly the APEC Finance Ministers' Process.²⁰ The urge of the 21 APEC economies to stimulate investments in the Asia-Pacific region propelled them to welcome the CG-driven OECD High-Level Principles on Long-Term Investment by Institutional Investors in the 2013 APEC Finance Ministers' Process,²¹ specifically the Indonesia-OECD International Seminar: Enhancing the Role of Institutional Investors in Infrastructure Financing.²²

The concept of institutional investors could only be inferred from the term 'investment manager' (manajer investasi) in Law No. 8 of 1995 regarding Capital Market (Capital Market Law), which is defined as follows:

*"The Party which business activity is to manage the stock portfolio for the clients or manage the collective investment portfolio for a group of clients, except for insurance companies, pension funds, and banks which conduct the business activities on their own in accordance with the prevailing laws and regulations."*²³

This definition is reiterated in Financial Services Authority Regulation No. 43/POJK.04/2015 regarding Investment Managers' Code of Conduct (OJKR 43).²⁴ The term 'Party' (*Pihak*) is in turn defined in Law No. 8 of 1995 regarding Capital Market (Capital Market Law) as follows:

Governance Principles (Paris: OECD Publishing, 2015), 4-5, 31-36, <https://www.oecd.org/daf/ca/Corporate-Governance-Principles-ENG.pdf>.

¹⁴ GCG Principles.

¹⁵ Malaysia, Malaysian Code for Institutional Investors 2014.

¹⁶ European Union, Directive regarding the Encouragement of Long-term Shareholder Engagement, EU Directive No. 828 of 2017 (Shareholder Engagement Directive).

¹⁷ Netherlands, Dutch Stewardship Code 2018.

¹⁸ Petrina Tan Tjin Yi (2018), "Institutional Investor Stewardship in the UK and Malaysia: Functionally Similar, Contextually Different," NUS Law Working Paper (32):1, 6.

¹⁹ Mas Achmad Daniri, interview by Luther Lie (January 11, 2019), Badan Arbitrase Pasar Modal Indonesia [Indonesian Capital Market Arbitration Board], Jakarta.

²⁰ APEC (2018), "2013 APEC Finance Ministerial Meeting," available from: https://www.apec.org/Meeting-Papers/Sectoral-Ministerial-Meetings/Finance/2013_finance [accessed 13 January 2018].

²¹ APEC (2018), "Groups: Finance Ministers' Process," available from: <https://www.apec.org/Groups/Other-Groups/Finance-Ministers-Process> [accessed 13 January 2018].

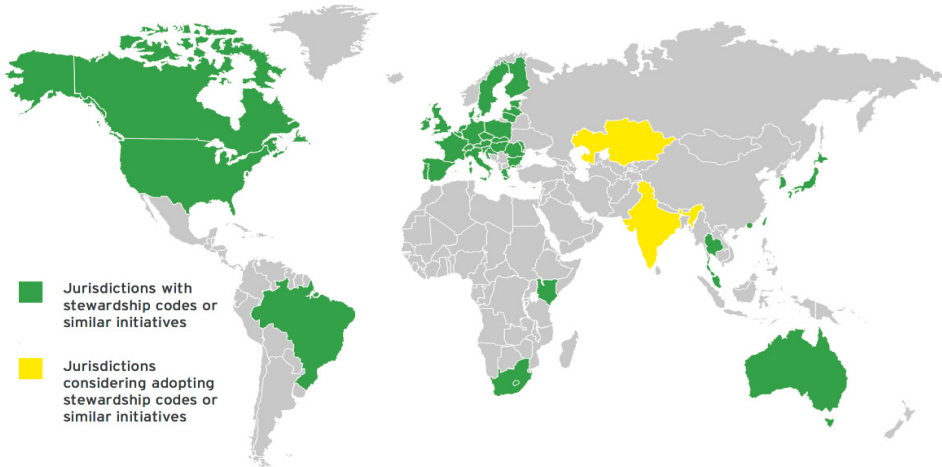
²² OECD (2018), "Indonesia-OECD International Seminar: Enhancing the Role of Institutional Investors in Infrastructure Financing," available from: <https://www.oecd.org/daf/fin/private-pensions/Press-releasepalembang.pdf> [accessed 13 January 2018].

²³ Indonesia, Capital Market Law, art.1.11.

²⁴ Indonesia, OJKR 43, art.1.1.

“A natural person (orang perseorangan or natuurlijk persoon), limited liability company (perusahaan or perseroan terbatas), partnership (usaha bersama or maatschap), association (asosiasi or vereniging), or any organized group (kelompok yang terorganisasi).”²⁵

Figure 1: The Adoption, Initiation, and Absence of Stewardship Codes by Country



Source: Ernst & Young, Q&A on Stewardship Codes, 2017, 2.

Critics question why Indonesia should set the rules of the game for institutional investors, particularly with a stewardship code.²⁶ Only a handful of economies set some legal ground rules for institutional investors.²⁷ In Southeast Asia, only Malaysia, Singapore, and Thailand have developed the Malaysian Code for Institutional Investors of 2014,²⁸ Singapore Stewardship Principles for Responsible Investors of 2016,²⁹ and Thailand Investment Governance Code of 2016,³⁰ respectively. But the absence of a legal framework of institutional investors deviates from the GCG Principles.³¹ And statistical analysis shows that companies that comply with the GCG Principles have better financial performance.³²

Critics also argue that the sole absence of a legal framework of institutional

²⁵ Indonesia, Capital Market Law, art.1.23.

²⁶ David Dyzenhaus, *Development and Regulation of Institutional Investors in Emerging Markets* (Madrid: International Organization of Securities Commissions, 2012), 29.

²⁷ David Dyzenhaus, “Development and Regulation of Institutional Investors”, All the abovementioned countries have had stewardship codes, except India which has started to formulate the India Stewardship Code. The European Union in fact has a hard law on institutional investors, namely the European Union Directive No. 828 of 2017 regarding the Encouragement of Long-term Shareholder Engagement. See European Union, Shareholder Engagement Directive.

²⁸ Malaysia, Malaysian Code for Institutional Investors 2014.

²⁹ Singapore, Singapore Stewardship Principles for Responsible Investors 2016.

³⁰ Thailand, Investment Governance Code.

³¹ GCG Principles, 4–5, 14, 24–25, 31.

³² Benedict Sheehy, Luther Lie, and Sarah Yu, “Does Law Matter in Asia? A Natural Experiment using CG in Indonesia and Malaysia,” 2020. available from: <https://ssrn.com/abstract=3723064>.

investors in a country does not always cause a financial crisis.³³ However, this paper rests on the assumption that the whole set of CG standards and guidelines are intertwined and thus should be treated holistically without canceling the role of institutional investors. Ideally, the most desirable legal, economic, and political outcomes would be achieved when there is explicit and adequate governance of CG standards and guidelines,³⁴ including on institutional investors,³⁵ which holds a major stake in the Indonesian capital market.

The hard truths lie in the fact that the absence of a CG legal framework in Indonesia had caused economic crises and political instability. Many works of literature discuss the importance of CG. But there is hardly any research that explains the existing legal framework of institutional investors in Indonesia.

This paper will examine that, with an explicit and adequate legal framework, institutional investors play a key role in CG by protecting the interests of stakeholders. This role could ultimately drive corporate financial performance and economic development in Indonesia. This paper will not however investigate how OECD-compliant legal ground rules for institutional investors drive corporate financial performance and economic development in Indonesia.

The research will focus on the flaws of the existing legal framework of institutional investors in Indonesia. By definition, the framework is absent. By concept, the framework is implicit and inadequate according to the global standard of CG.

Finally, this paper will propose ways to rectify the framework with the use of both hard and soft laws. It will draw lessons from, for example, the Malaysian legal framework of institutional investors, especially the stewardship code. The agility of institutional investors is an asset driver of the entire pursuit for development. While overregulation is not an option, the existing framework in Indonesia is an oversimplification of institutional investors. Governing them will benefit both themselves and other stakeholders in the long run.

This paper applies normative legal research, with statutory and comparative approaches. One of the authors conducted interviews to explore a 'helicopter' scholarly view on the legal framework of CG in Indonesia.

The statutory approach allows the readers to understand the legal framework of institutional investors in Indonesia: Capital Market Law, OJKR 43, and OJK Regulation No. 23/POJK.04/2016 regarding Mutual Funds in the Form of Collective Investments Contracts (OJKR 23). The comparative approach examines the role of institutional investors to protect the interests of stakeholders. It also explores the best practices of CG on institutional investors based on the GCG Principles. One good example to compare with the formulation of institutional investors in Indonesia is the Malaysian Code for Institutional Investors of 2014 and the Malaysian Code on CG of 2017. Even though the Malaysian legal framework is also far from ideal as this paper will later describe. With these approaches, this research could propose solutions on the ideal governance of institutional investors to drive corporate financial performance and economic development in Indonesia.

³³ See note 1 above.

³⁴ See John E. Morrison et al., *A Cost-Benefit Analysis Applied to Example Proposals for Army Training and Education Research* (Alexandria: Institute for Defense Analyses, 2008), 3.

³⁵ See Bernard S. Black and John C. Coffee, Jr., "Hail Britannia?: Institutional Investor Behavior under Limited Regulation," *Michigan Law Review* 92, no. 7 (1994): 1999–2000.

III. HOW DO INSTITUTIONAL INVESTORS PROTECT THE INTERESTS OF STAKEHOLDERS?

Institutional investors are institutions that invest money on behalf of their beneficiaries – the public. Each country may have a different scope of institutional investors. But institutional investors are globally recognized as one of the pillars of good CG,³⁶ because they protect the interests of stakeholders (*e.g.* minority shareholders, retail investors, and the whole economy) to improve a company's financial performance or long-term shareholder value.³⁷ Explicit and adequate legal ground rules for institutional investors will align with the GCG Principles, specifically Principles II and III to ensure the rights and equitable treatment of all shareholders and the acknowledged role of institutional investors in improving CG. As Bebchuk argued in "The Illusory Promise of Stakeholder Governance", stakeholder governance or stakeholderism, which leaves to private ordering and makes government intervention unnecessary is ineffective and counterproductive to protect the interests of stakeholders.³⁸

The following three sub-sections will explain the ways institutional investors protect the interests of stakeholders by being a minority in other companies and being independent themselves as a corporate: minority shareholders from the abuse of majority shareholders; the beneficiaries which money the institutional investors invest from; and the whole economy or nation.

A. Protection of Minority Shareholders

Principle II of the GCG Principles ensures the rights and equitable treatment of all shareholders,³⁹ including institutional shareholders and the retail investors they represent.⁴⁰ The acknowledgment of equitable treatment of all shareholders is necessary due to the varying interests, goals, and capabilities of each shareholder in a limited liability company.⁴¹ Meanwhile, some shareholders have a greater influence, *i.e.* by voting, than other shareholders in a company's decision-making.⁴² The voting power is often⁴³ determined by the amount of share ownership in a company – the greater the percentage of shares, the higher the voting power.⁴⁴ This means majority shareholders outnumber minority shareholders both in terms of the percentage of shares and power to determine the company's direction, giving the former more power to expropriate the latter.⁴⁵

Given the circumstance, shareholders are not given the responsibility to manage

³⁶ GCG Principles, 4–5, 19, 31.

³⁷ See Robert A.G. Monks and Nell Minow, *CG*, 5th ed. (West Sussex: John Wiley & Sons Ltd., 2001), 1.

³⁸ Lucian A. Bebchuk and Roberto Tallarita, "The Illusory Promise of Stakeholder Governance," *Cornell Law Review* 106 (2020): 91.

³⁹ GCG Principles, 4–5, 19.

⁴⁰ *Ibid.*, 24–25.

⁴¹ *Ibid.*, 19.

⁴² Ole-Kristian Hope, "Large Shareholders and Accounting Research," *China Journal of Accounting Research* 6 (2013): 5–6.

⁴³ Greater shares do not always result in higher voting power, because some shares have no voting right. See Indonesia, Undang-Undang Perseroan Terbatas, UU No. 40 of 2007 (Company Law), art.53(4)(a).

⁴⁴ Howard Bodenhorn, "Voting Rights, Shareholdings, and Leverage at Nineteenth-Century U.S. Banks," *The Journal of Law & Economics* 57, no. 2 (2014): 431.

⁴⁵ Howard Bodenhorn, "Voting Rights, Shareholdings" Hope, "Large Shareholders and Accounting Research," 5–6.

a company.⁴⁶ Rather, it falls within the purview of the BOD.⁴⁷ Notwithstanding, a company remains directed and managed in favor of the majority shareholders at the expense of the minority shareholders for two reasons.

Firstly, there are no laws and regulations which bar majority shareholders from becoming members of the BOD.⁴⁸ In fact, majority shareholders can also become members of the BOS.⁴⁹ These apply whether at the international or national legal landscape; whether in legal principles or positive laws. Recently, there have been widespread adherences to the 'Anglo-American' concept of the independent director in Asia.⁵⁰ In this case, the members of the BOD are independent of, *inter alia*, the majority shareholders.⁵¹ In Indonesia, this lauded 'adherence' is both misleading and ineffective.⁵²

Secondly, even if there are laws and regulations which prohibit majority shareholders to qualify as members of the BOD (and BOS), the company's direction and management remain largely, indirectly influenced by the majority shareholders.⁵³ This is because majority shareholders have a greater say on pay than minority shareholders when it comes to the appointment and removal,⁵⁴ as well as the remuneration⁵⁵ of the members of the BOD (and BOS). Besides, majority shareholders often either are members of the BOD (and BOS) or affiliated with them.

Institutional investors ought to be minority shareholders.⁵⁶ They exist to ensure a check and balance on company policy and management based on their expertise.⁵⁷ However, this universal concept does not exist without flaws. At least in Malaysia, institutional investors are mostly majority shareholders⁵⁸ and, hence, defeat this objective.⁵⁹ Their existence thus marginalizes minority shareholders, which they aimed

⁴⁶ Milton Harris and Artur Raviv, "Control of Corporate Decisions: Shareholders vs. Management," CRSP Working Paper, 620 (2010): 1-2.

⁴⁷ Paul L. Davies, "The Board of Directors: Composition, Structure, Duties and Powers" (paper presented at the Company Law Reform in OECD Countries: A Comparative Outlook of Current Trends, Stockholm: 2000). For Indonesia, see Indonesia, Company Law, arts. 1(5), 92(1).

⁴⁸ James McConville and Mirko Bagaric, "Why All Directors should be Shareholders in the Company: The Case Against 'Independence,'" *Bond Law Review* 6, no. 2 (2004): 41-42. For Indonesia, see Indonesia, Company Law, arts.92-107.

⁴⁹ See Indonesia, Company Law, arts.108-121.

⁵⁰ For discussion of the American concept of board independence, see Klaus J. Hopt, "Comparative CG: The State of the Art and International Regulation," *American Journal of Comparative Law* 59 (2011): 1, 25-26.

⁵¹ Dan W. Puchniak and Kon Sik Kim, "Varieties of Independent Directors in Asia: A Taxonomy," in *Independent Directors in Asia: A Historical, Contextual and Comparative Approach*, eds. Dan W Puchniak, Harald Baum, and Luke Nottage (Cambridge: Cambridge University Press, 2017), 98.

⁵² Daniri, interview by Lie.

⁵³ Geoff Martin et al., "Conflict between Controlling Family Owners and Minority Shareholders: Much Ado about Nothing?" *Entrepreneurship Theory & Practice* (2016), 7.

⁵⁴ See Clifford G. Holderness and Dennis P. Sheehan "The Role of Majority Shareholders in Publicly Held Corporations: An Exploratory Analysis," *Journal of Financial Economics* 20 (1988): 318-319.

⁵⁵ Shanthi Rachagan, "'Say on Pay' in Emerging Economies - The Way Forward to Improve CG," *Pravni Vjesnik* 31, no. 3/4 (2015): 78, 85.

⁵⁶ See Kuek Chee Ying "Shareholder Activism through Exit and Voice Mechanisms in Malaysia: A Comparison with the Australian Experience," *Bond Law Review* 26, no. 2 (2014): 15, 28.

⁵⁷ Monks and Minow, CG, 215.

⁵⁸ See Effiezal Aswadi Abdul Wahab, Janice How, and Peter Verhoeven, "CG and Institutional Investors: Evidence from Malaysia," *Asian Academy of Management Journal of Accounting and Finance* 4, no. 2 (2008): 69.

⁵⁹ Kamini Singam, "Corporate Governance in Malaysia," *Bond Law Review* 15, no. 1 (2003): 318-319.

to ideally protect; they intensify (rather than solve) the agency⁶⁰ problem because they will be disincentivized to represent the interests of minority shareholders, which are the beneficiaries.⁶¹

The Malaysian Code for Institutional Investors of 2014⁶² has failed to realize the purpose of institutional investors in Malaysia. Foreseen as a potential financial crisis, this failure has then prompted the Malaysian government to establish the Minority Shareholder Watchdog Group and its active role in protecting minority shareholders.⁶³ But the response was not sufficient and would later have manifested in the multi-billion dollars of corruption⁶⁴ involving the 1 Malaysia Development Berhad (1MDB),⁶⁵ leading to the toppling of Najib Rajak's UMNO government.⁶⁶ As the second sub-section will later explain, besides being a minority, institutional investors must also be independent of family-based, political, or economic affiliation.

But the flaw of Malaysian institutional ownership is an exception rather than the general norm of CG in Malaysia. Statistical analysis shows that companies in the Malaysia Stock Exchange are performing better financially than those in the Indonesia Stock Exchange because they are more compliant with the GCG Principles.⁶⁷

Unlike institutional investors, their beneficiaries – the public, which is mostly minority and retail investors – do not generally have the expertise and monitorial role in influencing company policy and undertaking.⁶⁸ There are many instances whereby the interests of the public are marginalized at the expense of those of the majority shareholders.⁶⁹ This is despite the existence of an 'independent director' to monitor management on behalf of minority shareholders.⁷⁰

On the contrary, when we set some legal ground rules, the existence of institutional investors can strengthen the position of minority shareholders in ensuring prudent

⁶⁰ For a discussion of the general agency concept in Indonesia, see J. Satrio, *Perwakilan dan Kuasa [Representation and Power of Attorney]*, 1st ed. (Depok: PT RajaGrafindo Persada, 2018), 96, 98, 100, 107–108.

⁶¹ Alex Edmans, "Blockholders and CG," *European CG Institute Finance Working Paper*, no. 385 (2013): 3.

⁶² The Malaysian Code for Institutional Investors of 2014 is one of the deliverables of the Securities Commission Malaysia-issued CG Blueprint of 2011. CG Blueprint 2011 (Kuala Lumpur: Securities Commission Malaysia), s.2.1, https://www.sc.com.my/wp-content/uploads/eng/html/cg/cg2011/pdf/cg_blueprint2011.pdf.

⁶³ See ASEAN Capital Markets Forum and Asian Development Bank, *ASEAN Corporate Governance Scorecard: Country Reports and Assessments 2014* (Kuala Lumpur: ASEAN Capital Markets Forum and Asian Development Bank, 2016), 27.

⁶⁴ Wall Street Journal, "Malaysia's 1MDB Decoded: How Millions went Missing," available from: <http://graphics.wsj.com/1mdb-decoded/> [accessed 18 January 2019].

⁶⁵ See Reuters, "Malaysia's IJM said to consider buying 1MDB's power assets – The Edge Malaysia," 2019, available from: <https://www.reuters.com/article/malaysia-1mdb-ijm/malysias-ijm-said-to-consider-buying-1mdbs-power-assets-the-edge-malaysia-idU5L4N0XT04320150502> [accessed 15 December 2018].

⁶⁶ Bloomberg, "The Story of Malaysia's 1MDB, the Scandal That Shook the World of Finance," 2018, available from: <https://www.bloomberg.com/news/articles/2018-05-24/how-malaysia-s-1mdb-scandal-hook-the-financial-world-quicktake> [accessed 15 December 2018].

⁶⁷ Sheehy, Lie, and Yu, "Does Law Matter in Asia?"

⁶⁸ See S. Çelik and M. Isaksson, "Institutional Investors and Ownership Engagement," *OECD Journal: Financial Market Trends* (2013/2): 104–105.

⁶⁹ Holderness and Sheehan, "Majority Shareholders in Publicly Held Corporations," 318–319.

⁷⁰ Puchniak and Kim, "Varieties of Independent Directors in Asia," 99.

decision-making and preventing abuse of rights by majority shareholders.⁷¹ This takes place whether in the form of voting power in the General Meeting of Shareholders (GMS) or formulation of CG legal framework. It is the monitorial role of minority shareholders that gives weight.⁷² However, this key ownership function of institutional investors can only be realized with the governance of institutional investors in the first place.

B. Independence of Shareholders

Principle III of the GCG Principles highlights the role of institutional investors as independent decision-makers at the GMS.⁷³ The independence of institutional investors requires them to have no affiliations, whether family-based, political, or economic, with other shareholders and members of the BOD and BOS within the same company and other stakeholders.⁷⁴ The institutional investors' qualification of independence is necessary in order to realize their key ownership function as corporate monitors based on their expertise rather than affiliations. On the contrary, any compromise on the independence of institutional investors will question their role as corporate monitors in ensuring prudent company decision-making.

C. Economic Stability and Development

Prudent corporate decision-making is one of the main prerequisites of a country's stable economic condition.⁷⁵ In other words, microeconomy and macroeconomy are akin to 'twins separated at birth'.⁷⁶ However, prudent company policy and management are hardly voluntary, since in such a case it requires moral conscience on the part of the bodies of limited liability companies – a phenomenon that barely happens.⁷⁷ When the interests of all stakeholders are at stake, the GCG Principles will not become the priority of a company. The initiative to make prudent corporate decision-making requires a *sound CG* in place at the first instance.⁷⁸ In the case of Indonesia, this means clear governance of institutional investors.

Some might claim that governance is mostly driven by economic crises.⁷⁹ This includes Indonesia without exceptions, which was forced to revise some 15 to 20

⁷¹ See Wahab, How, and Verhoeven, "CG and Institutional Investors," 69.

⁷² Bernard S. Black, "Agents watching Agents: The Promise of Institutional Investor Voice," *UCLA Law Review* 39, no. 4, (1992): 812.

⁷³ GCG Principles, 31.

⁷⁴ Rachagan, "'Say on Pay' in Emerging Economies – The Way Forward to Improve CG," 80, 84–85, 91, 93, 95.

⁷⁵ See, for example, Mawutor, "The Failure of Lehman Brothers: Causes, Preventive Measures and Recommendations," 86.

⁷⁶ See OECD (2018), "CG: Effects on Firm Performance and Economic Growth," available from: <https://www.oecd.org/sti/ind/2090569.pdf> [accessed 20 September 2018].

⁷⁷ For a discussion of the importance of the accountability of corporate management, see Bayless Manning, "Thinking Straight about Corporate Law Reform," *Law and Contemporary Problems* 41, no. 3 (1977): 23.

⁷⁸ The national CG codes exist as guidelines and recommendations to implement the GCG Principles in a particular jurisdiction, regardless of its voluntary nature. See GCG Principles, 32. See also Manning, "Thinking Straight," 9–11, 23.

⁷⁹ Wolf-Georg Ringe, "Independent Directors: A Theoretical Framework," in *Independent Directors in Asia: A Historical, Contextual and Comparative Approach*, eds. Dan W. Puchniak, Harald Baum, and Luke Nottage (Cambridge: Cambridge University Press, 2017), 60.

of its business-related statutes upon receiving international financial aid from the International Monetary Fund.⁸⁰ However, the fact that governance is often triggered by economic crises does not mean that an economy should wait for economic crises to happen before a corporate law reform to take place; economic crises are a trigger but not a *conditio sine qua non* for any corporate law reform. A precautionary approach, as opposed to preventive and post damage measures, is most appropriate in dealing with a country's economy.

A sound CG includes the *governance of institutional investors*.⁸¹ Principle III of the GCG Principles suggests that the role of institutional investors is undeniable in realizing long-term shareholder value and the interests of other stakeholders.⁸² This is because institutional investors act as knowledgeable monitorial shareholders⁸³ and hold an increasing amount of investments in the capital market.⁸⁴ Meanwhile, as part of the GMS, institutional investors affect company policy and management by exercising their voting rights.⁸⁵ It is with no doubt that institutional investors do not only ensure *economic stability* by reducing the vulnerabilities to economic crises,⁸⁶ but also drive *corporate financial performance* and *economic development*.⁸⁷

Principle III of the GCG Principles in turn provides countries to adopt a CG legal framework that strengthens and limits the rights and responsibilities of institutional investors.⁸⁸ The governance of institutional investors, whether through hard or soft law, implies a well-regulated capital market.⁸⁹ When comprehensive, updated capital market law and regulations can meet the demands and dynamic developments in the capital market,⁹⁰ then economic stability if not economic developments are certain. The prescription of a set of CG standards and guidelines attracts investments and enhances the efficiency of the capital market. Because the capital market is the pool of investments and source of funding for economic development and social welfare.⁹¹

II. RULES OF THE GAME FOR INSTITUTIONAL INVESTORS IN INDONESIA

A. Implicit and Inadequate Governance

In Indonesia, there are neither statutory laws nor implementing regulations that explicitly and adequately set the rules of the game for institutional investors. There has not been any initiated reform on Capital Market Law to recognize the role of institutional investors while the global capital markets continue to evolve.⁹²

⁸⁰ Normin S. Pakpahan (1994), "The Indonesian Perspective on Law Reform," *Jurnal Hukum dan Pembangunan* [Journal of Law and Development] 24(6): 509.

⁸¹ See GCG Principles, 4–5, 31–36.

⁸² Çelik and Isaksson, "Institutional Investors and Ownership Engagement," 104–105.

⁸³ *Ibid.*

⁸⁴ GCG Principles, 31.

⁸⁵ *Ibid.*

⁸⁶ The World Bank (2019), "Institutional Investors: From Myth to Reality," available from: <http://www.worldbank.org/en/events/2015/06/01/policy-research-talk-sergio-schmukler> [accessed 18 January 2019].

⁸⁷ Çelik and Isaksson, "Institutional Investors and Ownership Engagement," 104–105

⁸⁸ GCG Principles, 31.

⁸⁹ A well-regulated capital market means sufficient governance in the capital market. This is as opposed to maximized governance in the capital market, which in turn costs us the lack of participation in CG. See Black and Coffee, "Hail Britannia," 1999–2000.

⁹⁰ M. Irsan Nasarudin et al., *Aspek Hukum Pasar Modal Indonesia [The Legal Aspect of Indonesian Capital Market]*, 1st ed. (Jakarta: Kencana Prenadamedia Group, 2014), 42–43.

⁹¹ Nasarudin et al., *Aspek Hukum Pasar Modal Indonesia*; Bernard S. Black, "The Legal and Institutional Preconditions for Strong Stock Markets," *UCLA Law Review* 48 (2001): 782.

⁹² There have been efforts to update the governance of the Indonesian capital market by issuing new

By definition, no Indonesian laws mention and define the term ‘institutional investors.’⁹³ Without a concrete definition, it is impossible to imagine how any law and regulation can set a legal framework of the requirements and responsibilities of institutional investors. Conceptually, there are derived terms of institutional investors, such as ‘investment manager’ (*manajer investasi*), ‘Party’ (*Pihak*), and ‘mutual funds’ (*reksa dana*) in Capital Market Law, OJKR 43, and/or OJKR 23.⁹⁴

Other legal frameworks state the examples of institutional investors without mentioning it verbatim: Law No. 40 of 2014 regarding Insurances (insurance company),⁹⁵ Law No. 11 of 1992 regarding Pension Funds (pension fund),⁹⁶ and Law No. 10 of 1998 regarding No. 7 of 1992 regarding Banking (bank).⁹⁷ Notwithstanding, these laws do not infer the concept of institutional investors.

This paper acknowledges that institutional investors as knowledgeable shareholders should neither be overregulated,⁹⁸ because their nimbleness drives corporate financial performance and economic development. But the existing legal framework of institutional investors in Indonesia is an oversimplification or ignorance of the role of institutional investors for the same objective.

B. Comparison with the Malaysian Code for Institutional Investors of 2014: Example

The Malaysian Code for Institutional Investors of 2014 is the first and most advanced stewardship code in Southeast Asia.⁹⁹ Unlike the Indonesian legal framework, the Malaysian Code for Institutional Investors of 2014 mentions, defines, and sets the guiding principles for institutional investors.¹⁰⁰ Another prevailing instrument of CG which invokes the concept of institutional investors is the Malaysian Code on CG of 2017, which adopts an “apply or explain an alternative” approach – to practice good CG that is suitable with the company’s size, risks, and complexity of the operation and not simply a checklist fulfillment.¹⁰¹ The Malaysian Code on CG of 2017 is the final amendment to the Malaysian Codes on CG of 2000, 2007, and 2012.¹⁰²

implementing regulations. However, implementing regulations cannot substitute a statute. See Maria Fariada Indrati Soeprapto, *Ilmu Perundang-undangan: Jenis, Fungsi, dan Materi Muatan [Science of Legislative Drafting: Types, Function, and Contents]* (Yogyakarta: Penerbit [Publishers] Kanisius, 2011), 197.

⁹³ Daniri, interview by Lie.

⁹⁴ Cf. Malaysia, Malaysian Code for Institutional Investors 2014, Definitions; European Union, Shareholder Engagement Directive, art.2(e)–(f); Netherlands, Dutch Stewardship Code 2018, pmb1.1; the United States of America, 13 Code of Federal Regulations 2009, s.108.50.

⁹⁵ Indonesia, Undang-Undang Perasuransian, UU No. 40 of 2014.

⁹⁶ Indonesia, Undang-Undang Dana Pensiun, UU No. 11 of 1992.

⁹⁷ Indonesia, Undang-Undang tentang Perubahan Atas Undang-Undang No. 7 Tahun 1992 tentang Perbankan, UU No. 10 of 1998.

⁹⁸ See Çelik and Isaksson, “Institutional Investors and Ownership Engagement,” 104–105.

⁹⁹ Institutional Investors Council Malaysia (2018), “Publications: Malaysian Code for Institutional Investors,” available from: <http://www.iicm.org.my/malaysian-code-for-institutional-investors/> [accessed 9 December 2018].

¹⁰⁰ Malaysia, Malaysian Code for Institutional Investors 2014, Background no. 1. See CG Blueprint 2011, s.2.3.1.

¹⁰¹ Malaysia, Malaysian Code on CG 2017, ss.5.1–5.3.

¹⁰² *Ibid.*, ss.2.1, 2.4.

Table 1: Definitions and Examples of Institutional Investors in Indonesia and Malaysia

Legal Frameworks	Definitions	Examples
Capital Market Law	<p>Investment Manager (<i>Manajer Investasi</i>) <i>The Party which business activity is to manage the stock portfolio for the clients or manage the collective investment portfolio for a group of clients, except for insurance companies, pension funds, and banks which conduct the business activities on their own in accordance with the prevailing laws and regulations.</i></p> <p>The Party (<i>Pihak</i>) A natural person, limited liability company, partnership, association, or any organized group.</p>	Mutual funds (<i>reksa dana</i>).
Malaysian Code for Institutional Investors of 2014	<p>Institutional Investors <i>Asset owners and asset managers with equity holdings in corporations listed on Bursa Malaysia (Malaysia Stock Exchange).</i></p> <p>Asset Owners <i>Collective investment vehicles collect funds on behalf of their beneficiaries or clients and manage them internally or externally.</i></p> <p>Asset Managers Agents that are responsible to manage the funds on behalf of the asset owners through an investment mandate.</p>	Asset owners, such as pension funds, private retirement scheme providers, insurance companies, <i>takaful</i> (Islamic insurance) operators, and investment trusts.

The Malaysian Code for Institutional Investors of 2014 defines institutional investors as asset owners and asset managers with shares in the Malaysia Stock Exchange-listed companies.¹⁰³ Asset owners are in turn defined as agents that collect and manage, whether internally or externally, funds on behalf of their beneficiaries or clients.¹⁰⁴ Meanwhile, asset managers refer to agents that manage funds on behalf of the asset owners.¹⁰⁵

As a comparison to Malaysia, the derived terms of institutional investors in Indonesia are problematic for two reasons. *Firstly*, Capital Market Law and OJKR 43 implicitly define and limitedly classify institutional investors as ‘investment managers’ (*manajer investasi*)¹⁰⁶ – asset managers – as opposed to both asset owners and managers.¹⁰⁷ *Secondly*, Capital Market Law and OJKR 23 implicitly and limitedly provide one example of institutional investors, *i.e.* mutual funds (*reksa dana*).¹⁰⁸ Table 1 compares the definitions and examples of institutional investors between Indonesia and Malaysia.

¹⁰³ Malaysia, Malaysian Code for Institutional Investors 2014, Definitions.

¹⁰⁴ Malaysia, Malaysian Code for Institutional Investors 2014,.

¹⁰⁵ *Ibid.*

¹⁰⁶ See Indonesia, Capital Market Law, art.1.11; Indonesia, OJKR 43, art.1.1; Indonesia, OJKR 23, art.1.4.

¹⁰⁷ Malaysia, Malaysian Code for Institutional Investors 2014, Definitions.

¹⁰⁸ Indonesia, Capital Market Law, art.1.27; Indonesia, OJKR 23, art.1.1.

IV. CONCLUSION

Sun, Stewart, and Pollard's studies concluded that CG failures caused the financial crisis, especially when the CG frameworks are wrong in general. In this case, the existing legal framework in Indonesia is implicit and inadequate to set the legal ground rules for institutional investors. Further, Bebchuk argued that stakeholderism, which leaves to the visible hand of management is ineffective to protect the interests of stakeholders.

It is, therefore, necessary to set the rules of the game for institutional investors to improve CG. Institutional investors play a significant role as corporate monitors in protecting public investors' money and improving corporate financial performance. They are, therefore, acknowledged as the policies of financial crises, creators of firm values, and drivers of economic development. However, 'institutional investors,' like any other corporate vehicles, may also be misappropriated and used to engineer a multi-billion corruption, leading to political mayhems. This has happened with the 1MDB case and it could serve as hard lessons on how to best regulate institutional investors in Indonesia.

This paper proposes some legal ground rules for institutional investors in Indonesia that align with the GCG Principles. Based on the example of the Malaysian Code for Institutional Investors of 2014, the Indonesian framework should refer to 'Institutional Investor' as both asset owners and investment managers who have shares in the IDX-listed limited liability companies. Asset owners are agents that collect capital on behalf of the principals through an investment mandate, and manage it internally, or externally by the investment managers through an investment mandate. The examples of asset owners should include insurance companies, pension funds, and sovereign wealth funds – which are globally recognized as examples of institutional investors.

The framework could take the form of hard and soft laws by amending Capital Market Law and initiating a stewardship code, respectively. The stewardship code is less restrictive. With adequate governance, the laws could maintain the nimbleness of institutional investors to drive corporate financial performance and economic development while avoiding financial crises many more years to come.

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