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# Economic and Legal Accountability in Malaysian Unit Trust Industry

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## Abstract

This paper, by drawing upon accountability theories, aims to explore and examine practices related to discharging economic and legal accountability in Malaysian unit trust industry. The evidence was primarily constructed from two main sources, documentary review and in-depth interviews. Document review was undertaken on various documents issued by the industry regulators and industry players. Meanwhile, semi-structured interviews were carried out with representative from the regulators, unit trust management companies (UTMCs), a unit trust distributor company, and unit trust advisors. Evidence suggests that economic and legal accountability, which are commonly exercised as a form of external oversight and control, has been dominated the industry, for example, via the issuance and enforcement of various rules, acts, regulations, and guidelines over the industry players. While economic and legal accountability, which typically prioritized a limited range of influential stakeholders, are important and crucial for investors' protection and in developing a sound unit trust industry, too much emphasis, may cause other stakeholders affected – directly or indirectly- by UTMCs activities left unconsidered or received inadequate attention.

**Keywords:** Economic accountability, Legal accountability, Malaysian unit trust industry

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## 1. INTRODUCTION

Accountability has been argued as already situated in organizational life (Munro and Mouritsen, 1996; Mulgan, 2000). It has been regarded as an ethical practice that involves a moral principle (Stewart, 1995 as cited in Miller, 2002; Mulgan, 2000). McKernan and MacLulich (2004, p.327) claim that it is not possible to expect accounting regulations and norms, rules or principles to be effective while they lack moral authority and force. As the ultimate aim of accountability is to measure up to the demands of the other, this ethical requirement should guide the reconstruction of formal systems of accounting (Messner, 2009, p.922). Meaningful accountability, which addressing the exclusion and discrimination of certain group(s) of party e.g. less influential stakeholder, has been argued to be able to shift power imbalance (Shahrokh and Lopez-Franco, 2015). One (general/basic) conception of accountability is as the duty to provide an account (by no means necessarily a financial account) or reckoning of those actions for which one is held responsible that involves two responsibilities or duties: (1) to undertake certain actions (or forbear from taking action) and (2) to provide an account of those actions (Gray et al., 1996).

One broad conception of accountability comes from mainstream accountability literature. Mainstream literature conceives accountability as representation and control (Nelson, 1993). This is particularly obvious from Mulgan's (2000) argument who contends that in its core sense accountability is about being held accountable by

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external authority. From this perspective, accountability is represented by economic, legal, hierarchical, functional form of accountability that is claimed as a form of accountability which dominate market sectors, public sector, and NGO/third sector (see, for example, Gray, Owen & Adam 1996, Pallot, 1991, Ebrahim, 2003, O'Dwyer and Unerman, 2008). On the other hand, various broader conceptions of accountability which include for example, social accountability (O'Dwyer and Unerman, 2007) and downward accountability (Dixon et al., 2006, Christensen and Ebrahim, 2006) have been identified and/or proposed that address the accountability needs of much wider organization's (accountor) stakeholders including social and environmental impacts (Gray et al., 1996).

Malaysian unit trust industry, with tight and close monitoring by the regulators, has been argued as one of the most regulated sectors that emphasize the practice of discharging economic and legal accountability. While these forms of accountability are important for the industry and the investors, too much emphasis on economic and legal accountability, for example, may lead to what Roberts (1991, 1996) argues as encouraging an individualizing character. In addition, reporting and disclosure, as the vital mechanism of these forms of accountability, do only "account for" organization activities that fall under the umbrella of economic activity which normally can be quantified or measured in financial terms and are normally prepared for limited range of powerful stakeholders (Lehman, 1999). Few empirical studies, however, have been conducted to examine the practice of these forms of accountability. This study by employing particularly Chilsom's (1995) and Gray et al.'s (1996) conception of economic and legal accountability, therefore, aims to explore and examine practices related to discharging economic and legal accountability in Malaysian unit trust industry. Further discussion on the conception of economic and legal accountability is undertaken in the following section.

## **2. ECONOMIC AND LEGAL ACCOUNTABILITY**

At what can be argued as its narrowest or basic form, economic accountability (Roberts, 2003) has been understood as financially focused accountability which typically requires a formal explanation (Dixon et al., 2006) to limited, powerful stakeholders. Economic accountability concerns with the efficient use of scarce resources (Raffer, 2004), decision making and control (Jones, 1999). This form of accountability which to a larger extent draws upon the "principal-agent" model (Dixon et al., 2006) is commonly exercised as a form of external oversight and control as an important part of mandatory (Dixon et al., 2006), external regulatory approaches to accountability (Ebrahim, 2003). As it stems from contract-based relationships (Raffer, 2004) financial/economic accountability typically comes with one party or the principal, with the ability or power to impose sanctions or seek for remedies (Raffer, 2004) from the other party or the agents.

Financial or economic accountability is also understood as financially focused accountability which typically requires a formal explanation (Dixon et al., 2006) to limited and influential stakeholders particularly to shareholders (Gray et al., 1996), donors (Dixon et al., 2006), other financial providers and government (e.g. regulators) (O'Dwyer and Unerman, 2008). In addition, it emphasizes on accounts disclosed to external shareholders and the public in various forms such as profit and loss statements, earnings announcements, or press statement by the CEO (Messner, 2009) or corporate accountability reports (Christensen, 2016). The exchange of accounts which takes place within the organization or between the organization and some of its contractual stakeholders (e.g. shareholders or suppliers) often by means of reporting and control routines in which costs, profits, returns or other management-related information is communicated (Messner, 2009, p.920). Here the organization is required to provide an account for its decision-making outcomes and the procedures and means used to derive those outcomes (Haigh, 2006). Therefore, it might also be appropriate to refer economic/financial accountability as public accountability since the important characteristic of these accounts is the fact that their 'target'/'recipients' are located outside the organization (Messner, 2009, p.920). The fulfilment of this accountability requirements has been described as meeting the minimum level of legal accountability (Tinker et al., 1991).

Meanwhile, Chisolm (1995, p.141) defines legal accountability as "either an obligation to meet prescribed standards of behaviour or an obligation to disclose information about one's actions even in the absence of a prescribed standard." Legal accountability focuses on deterrence and punitive measures which are regarded as a highly constrained approach that fails to take into account of organizational behaviour. These are not enshrined in law as well as it focuses on external regulation for ensuring accountability, with little regard for internal and less formalized organizational norms or expectations (Ebrahim, 2003, p.195). The law lays down the minimum level of responsibilities and rights, thus the minimum level of legal accountability (Tinker, Lehman, & Neimark, 1991). It has also been argued that tight and detailed regulations imposed by the regulators acts as constraints or restrictions (Roberts and Scapens, 1985).

However, too much emphasis on economic and legal accountability, may lead to what Roberts (1991, 1996) argues as encouraging an individualizing character, “since they promote a sense of the self that is preoccupied with achieving certain norms and standards and... induce the self to relate to others through the lens of these categories alone” (Messner, 2009, p.922). In addition, economic and legal accountability mechanisms, for example, reporting and disclosure, do only “account for” organization activities that fall under the umbrella of economic activity which normally can be quantified or measured in financial terms. Furthermore, the accounts are normally prepared for limited range of powerful stakeholders which is mainly for decision making purposes (Lehman, 1999).

As an alternative, a broader forms of accountability have been proposed which include, but not limited to, social accountability (O’Dwyer and Unerman, 2007), downward accountability (Dixon et al., 2006, Christensen and Ebrahim, 2006), holistic accountability (O’Dwyer and Unerman, 2008), and communitarian accountability (Pallot, 1991). In general, broader forms of accountability should address the accountability needs of much wider organization’s (accountor) stakeholders which concern with not only economic issue but also social and environmental impacts that an organization cause or might cause through its activities. It is said or intended to create more fair and just society through i.e. distribution of more information to the society (Gray et al., 1996). It is a form of accountability that sees “the self in ways that enact and reinforce a sense of the interdependence of self and other; an interdependence that includes both an instrumental and a moral dimension” (Roberts, 2001, p.1551). It is not only about satisfying external, regulatory accountability but it is about the responsibility discharging a broader form of accountability that is driven by felt responsibility (Fry, 1995). In contrast with the view of agency theorist who consider accountability as a constraint upon an essential, opportunistic and self-interested human nature (Roberts, 2001) where the accountable-self is always preoccupied with a concern of how the self are measured or assessed (seen) (Roberts, 1991), accountability here, through the creation of self-knowledge and the embrace of failure (Roberts, 1991), is seen as an opportunity for learning and sharing (O’Dwyer and Unerman, 2008).

### **3. METHODS**

The evidence was primarily constructed from two main sources, documentary review and semi structured interviews. A thorough analysis was carried out on various documents such as unit trust industry guidelines, standards, code and by –laws issued by SC Malaysia and Federation of Investment Managers Malaysia (FIMM), the self-regulatory body of the industry. Various documents issued by four UTMCs, which agreed to participate in the study, such as annual reports and fund prospectuses were also thoroughly reviewed. The documents had been content analysed by employing a thematic analysis (Krippendorff, 2004), which involves a theme or combination of several categories. The coding unit consists of words, sentences, paragraphs, section or even a whole document (e.g. a newspaper article) by taking into account the context unit which is normally larger than the coding unit as a means to assist the researcher to understand the coding unit. Evidence from documentation review was corroborated with data from semi-structured interviews.

Before the actual interview session is conducted, a pilot interview was carried out with a unit trust advisor which lasted approximately forty five minutes. This was done in order to test the clarity of the questions as well as to see whether the questions are appropriate for the main study. Based on the pilot interview, several interview questions were refined to make them easier to understand during the main interviews sessions. Data from the pilot interview was analysed manually to identify additional themes or issues that were overlook for the actual interview session.

Twenty one interviews were conducted with the representative(s) from the four UTMCs, FIMM, the SC Malaysia, one unit trust distributor company, and five individual unit trust advisors. The first semi-structured interviews were completed in the period of July to September 2010 followed by a second round of interviews conducted in April to June 2011 to clarify issues or views from the first interview sessions. Between these two rounds of interviews several phone calls were made and emails were used to follow up any issues that needed further clarification and explanation. Each interview, except with one of the regulatory officers, was recorded and lasted between forty five minutes to one and a half hour. The interviews were conducted in English. The transcripts and documents were analysed with Nvivo8 software supplemented by manual coding to identify patterns, deep insights and irregularities of evidence gathered from the transcriptions, field notes, and documents reviewed (O’Dwyer and Unerman, 2008). The initial themes identified were then compared and grouped under broader overarching themes (Bazeley, 2007) which were summarised into a synthesis of the main findings which made extensive use of direct quotations from the transcripts (O’Dwyer and Unerman, 2008). The empirical findings and detailed analysis are provided in the following section.

## 4. FINDINGS AND DISCUSSION

Generally, the practice and emphasize of economic and legal accountability in Malaysian unit trust industry can be observed through, for example, the issuance and enforcement of various acts, guidelines, standards, code and by –laws by the industry regulators. The following sub-sections discuss how, particularly Chilsom’s (1995) and Gray et al.’s (1996), conception of economic and/or legal accountability translated into practices in Malaysian unit trust industry.

### 4.1 Obligation to Meet Prescribed Standards of Behaviour

The requirement for the Malaysian unit trust industry players to meet prescribed standards of behavior can be observed through, the issuance and enforcement of various acts, guidelines, standards, code issued by SC Malaysia and FIMM, the self-regulatory body of the industry, as can be seen in table 1 and table 2. All of these requirements are compulsory to be met by the industry players in conducting their business operations. It is also necessary for the industry players to comply with the FIMM’s Code of Ethics and Standards of Professional Conduct, which sets out the general principles and minimum standards of good practice, in carrying out their business activities (Tinker et al., 1991). These acts, guidelines as well as standards, prescribe the minimum behaviour (i.e. business operations and activities) expected from the industry players and the minimum information required to be reported and disclosed by the industry players as the law lays down the minimum level of responsibilities and rights, thus the minimum level (Tinker et al., 1991) of economic and legal accountability. This practice indirectly reflects the emphasis given by the regulators of the industry over economic and legal accountability (Ebrahim, 2003) that is defined by Chisolm (1995, p.14) as “...either an obligation to meet prescribed standards of behaviour or an obligation to disclose information about one’s actions even in the absence of a prescribed standard”.

Table 1 Acts and Guidelines issued by SC Malaysia

No.	Acts and Guidelines
1	Capital Market & Securities Act 2007 (CMSA)
2	Guideline on Unit Trust Funds
3	Prospectus Guidelines for Collective Investment Schemes
4	Guidelines on Marketing and Distribution of Unit Trust Fund
5	Guidelines on Advertisements and Promotional Materials
6	Guidelines on Online Transactions and Activities in relation to Unit Trusts

Table 2 Standards, Code, By-Laws and Guidelines issued by FIMM

No.	Standards, Code, By-Laws and Guidelines
1	Investment Management Standards (IMS)- 9 IMSs
2	Code of Ethics and Standards of Professional Conduct
3	FIMM’s Consolidated Rules (9 Chapters)

Furthermore, there is an explicit and clear expectation or requirement of the regulators’ over unit trust industry players to ‘act’ or ‘behave’ according to or in compliance with the legislations such as the Guidelines on Unit Trust Funds, Guidelines on Marketing and Distribution of Unit Trust Fund as well as the Code of Ethics and Standards of Professional Conduct for the Unit Trust Industry. This requirement is clearly stated in the Guidelines on Unit Trust Funds which mentions that “All parties to a unit trust fund are expected to be guided by the letter and spirit of the regulatory requirements” (Securities Commission Malaysia, 2009, p.1-1). As an example, one of the expected business operations (action) that needs to be undertaken by the UTMC (Chilsom, 1995; Gray et al., 1996) before commencing marketing and selling activities of unit trusts is to prepare and register a fund’s prospectus with SC Malaysia. Detailed provisions and guidelines guide the processes of issuances, registration, and amendments of a fund’s prospectus. With the issuance and registration of the prospectus, UTMC is regarded as have fulfilled (partially) it’s economic and legal responsibility as well as discharged (partially) its economic and legal accountability to the potential unit holders and the government (the regulator) (Chilsom, 1995; Gray et al., 1996).

### 4.2 Obligation to Disclose Information about One’s Actions

The duty to provide or disclose (minimum) information is one means to account about the industry player’s actions (Chilsom, 1995; Gray et al., 1996). In the context of the unit trust industry, duty to provide formal (financial) account (Dixon et al., 2006; Messner, 2009) is undertaken through the fund’s annual and interim report that are distributed to the unit holders. These reports are considered as the vital UTMCs’ accountability reports (Christensen, 2016) to particularly its fund holders. UTMCs have to lodge these reports to SC Malaysia within two months after the end of the financial period. Through the preparation and distribution of these

reports, a UTMC is considered discharged of its economic and legal accountability upwardly to unit holders and to the government (the regulators) (Chilsom, 1995; Gray et al., 1996 O'Dwyer and Unerman, 2008).

In addition to reporting to investors or unit holders, under Chapter 13 of the Guidelines on Unit Trust Funds UTMCs are required to report to SC Malaysia. On a monthly basis, all UTMCs are required to submit a UTF Return via the Trust and Investment Management Electronic Reporting System (TIM-ERS). Through the preparation and submission of this report a UTMC is considered as having fulfilled its legal responsibility and discharged its economic accountability upwardly to the government (the regulators) (Chilsom, 1995; Gray et al., 1996; O'Dwyer and Unerman, 2008). On the other hand, this monthly reporting requirement to SC Malaysia, mirrors what has been the concern over accountability as a form of external oversight and control (Ebrahim, 2003) where it encourages rationalizations of action (O'Dwyer and Unerman, 2008) which involves "the constant giving and demanding of reasons for [and results of] conduct" (Roberts, 2001, p.1549).

In general, these (legal/mandatory) reporting and disclosure requirements reflect the emphasis given to economic and legal accountability which are commonly exercised as a form of external oversight and control as an important part of mandatory (Dixon et al., 2006), external regulatory approaches to accountability (Ebrahim, 2003). The evidence presented here, to a certain degree, seems to provide support to a claim made by some interviewees who argued that the Malaysian unit trust industry is highly regulated and monitored. This was expressed by an interviewee:

"As at now, unit trust companies are highly regulated. They are (the industry) highly regulated" (Compliance Officer, R12).

While the practices of economic and legal forms of accountability are important and crucial for investors' protection and in developing a sound capital market, some interviewees argued that the tight and detailed regulations imposed by the regulator as constraints or restrictions (Roberts and Scapens, 1985). This is expressed in the following statement:

"What I was mentioning is more on what is the, what is the issue of our survival with all of these restrictions. On accountability, yes, we are still accountable to all those things right, for everybody that actually looks into us. Be it the SC, be it the FIMM, be it the EPF, be it the investors, we have to address whatever issues that they come back to us. So we are still accountable to all our, our, how we manage their funds. It wouldn't be any different on that. In fact, as time progress possibly there is more that we have to disclose right to the investors. On the investors it will be good because more information gets to them. On us it will be tough. Because you have to run the business, you have to do the reporting, you know". (Compliance Officer, R12).

On the other hand, beside reports and documents such as fund reports and prospectuses that are required by the regulators to be issued, all except one UTMC do not publish any social and environmental reports. The content, for example of both the fund reports and prospectuses is limited to information, particularly financial information, required or mandated by the relevant legislation or guidelines. The absence of accounts on aspects beyond economic matters that might, for example, assist the stakeholders to be critically aware of any impacts the UTMCs activities might have on social and environmental issues (Sawandi, 2016, p.52) to some extent indicates the emphasize given by the industry in discharging economic and legal accountability over other forms of accountability. This also indicates that the industry prioritizes a limited range of financially influential stakeholders such as the unitholders and the regulators over the less powerful, influential stakeholders such as the general public in discharging accountability.

## **5. CONCLUSION**

Evidence suggests that economic and legal accountability, which are commonly exercised as a form of external oversight and control, are the main forms of accountability discharged or emphasized in Malaysian unit trust industry. This is evident via, for example, the issuance and enforcement of various rules, acts, regulations, and guidelines as well as close and tight monitoring by the industry regulators over the industry players. While economic and legal forms of accountability are important and crucial for investors' protection and in developing a sound unit trust industry, too much emphasis, as can be observed in Malaysian unit trust industry, may lead to what Roberts (1991, 1996) argues as encouraging an individualizing character. In addition, as the main economic and legal accountability mechanisms, for example, reporting and disclosure, do only "account for" UTMCs activities and/or performance that fall under the umbrella of economic activity which normally can be quantified or measured in financial terms, activities and/or performance that cannot or difficult to be quantified or measured in financial terms such as social and environmental aspects may be put aside or ignored by the

UTMCs. Hence, it is vital for relevant parties in the industry to encourage and to not overlook the importance of discharging other forms of accountability, e.g. social accountability, to each group of stakeholders in the industry.

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