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# Independence of the Supervisory Board in Banks: A Comparative Analysis of Indonesian and Malaysian Law

**Michelle Elie Tanujaya**
Student of International Business Law, Universitas Prasetiya Mulya
BSD City Kavling EdutownI.1, Jl. BSD Raya Utama No.1, BSD City, Kec. Pagedangan, Kabupaten Tangerang, Banten 15339
Corresponding author: michelle.tanujaya@student.pmsbe.ac.id / tanujayamichelle@gmail.com

## ABSTRACT

The independence of board members play a crucial role in establishing good corporate governance. This is especially important for banks compared to companies in non-financial industries as they play a key role in the nation's economy. Malaysian corporate governance carries a reputation of effective legal framework and enforcement system amongst ASEAN member states. The report by ACGA shows that Malaysian banks implement better corporate governance than banks in Indonesia. This paper seeks to find the adequacy of Indonesia's regulation on the supervisory board independence in banks to ensure good corporate governance compared to the regulation in Malaysia. Findings to this research show that Malaysian law on independent board members are much more stringent than the requirements in Indonesia. The study also finds that the fundamental structure of the company board model (Indonesia adopts the two-tier model and Malaysia adopts the one-tier model) affects how supervision is upheld and the placement of independent board members within the company. Malaysian legal framework ensures a majority of independent members at both supervisory and managerial function, whereas Indonesian legal framework emphasizes the need for independence only at the supervisory function.
**Keywords:** Corporate Governance, Company Supervision, Banking

## INTISARI

Independendensi merupakan aspek penting dalam membangun tata kelola perusahaan yang baik. Topik ini menjadi lebih krusial bagi perusahaan perbankan dibandingkan perusahaan yang bergerak dalam bidang non-keuangan dikarenakan perannya dalam menggerakkan perekonomian negara. Tata kelola perusahaan di Malaysia dikenakan efektif dibanding negara-negara anggota ASEAN lainnya. Laporan ACGA menunjukkan bahwa bank-bank Malaysia menerapkan tata kelola perusahaan yang lebih baik daripada bank-bank di Indonesia. Tulisan ini berupaya untuk mencari tau sejauh mana regulasi Indonesia tentang independensi anggota dewan pengawas di perbankan telah memadai untuk memastikan tata kelola perusahaan yang baik dibandingkan regulasi di Malaysia. Penelitian ini menunjukkan bahwa Malaysia menerapkan peraturan yang lebih ketat terkait independensi anggota direksi dibanding peraturan di Indonesia. Studi ini juga menemukan bahwa struktur dasar model perusahaan (Indonesia menggunakan *two-tier model* dan

Malaysia menggunakan *one-tier model*) mempengaruhi penegakkan sistem pengawasan dan penempatan anggota independen dalam suatu perusahaan. Peraturan di Malaysia juga memastikan keberadaan anggota independen mayoritas baik pada fungsi pengawasan maupun manajerial, sedangkan peraturan di Indonesia hanya memastikan keberadaan anggota independen pada fungsi pengawasan.
**Kata kunci:** Tata Kelola Perusahaan, Pengawasan Perusahaan, Perbankan

## INTRODUCTION

There is a compelling reason why academic studies of corporate governance have recently become popular. Scandals of director and commissioner abuse of power for personal gains have drawn attention to the need to improve corporate governance. In 2008, Bank Century experienced a series of liquidity problems which led to the suspicion that there had been a trade on illegal investment products. Through government investigation, it was later revealed that there had been a number of fraudulent activities, including the sale of unrecorded banknotes and financial report manipulation.[1] The Bank Century case is said to be the biggest corporate governance scandal since the 1998 reformation. If the Bank Bali case is recorded to have caused losses to state funds of under IDR 1 trillion, the Bank Century case was recorded to cause state funds losses of up to IDR 6.7 trillion.[2] The Bank Century scandal is still remembered today as an important example that emphasizes the need for corporate governance. Corporate governance is necessary as it establishes a set of guidelines that guarantees the smooth running of the company and ensures that the stakeholders' interests are aligned.

The banking industry requires a special attention in the discussion and regulation of corporate governance. First and foremost, banks are highly interconnected with other sectors in the economy. They support other businesses financially in a variety of industries, which is significant for the economy. In fact, banks hold a crucial role in the macroeconomic function of any state. Secondly, because of their heavily leveraged balance sheet structure, banks are susceptible to shocks. This indicates that, compared to other industries, the banking sector places a far greater emphasis on risk management and other internal controls. And thirdly, it is to be noted that the intertemporal character of conventional financial transactions and the growing complexity of financial goods, information asymmetry can cause more fatal consequences within banking rather than in non-financial industries.[3] This asks for greater governance norms, including disclosure and transparency. A failure in bank corporate governance may lead to various economic concerns, even leading to a financial crisis.

The 1997 Asian Financial Crisis is a consequence of the failure in maintaining good corporate governance. One of the primary structural causes of the crisis was the decline in their asset

[1] Aries Heru Prasetyo, 'Tiga Dosa Besar Bank Century Indonesia' *Kontan* (2009).

[2] 'Kasus Century; Skandal Terbesar Sejak Reformasi' (*Kompas*, 2009) <https://www.antikorupsi.org/id/article/kasus-century-skandal-terbesar-sejak-reformasi> accessed 20 January 2023.

[3] Sang-Woo Nam and Chee Soon Lum, 'Corporate Governance of Banks in Asia: A Study of Indonesia, Republic of Korea, Malaysia, and Thailand' 11–17.

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portfolios, which was mostly brought on by faulty credit management.[4] This issue was largely brought on by subpar corporate governance in the nations' banking institutions and industrial conglomerates. Companies are often dominated and run by families, including companies in the financial industry that were frequently found to sometimes be utilized as a vehicle to maximizing family interests and ignore the interests of minority shareholders and stakeholders outside of the family as companies were often a part of broader family-controlled corporate conglomerates (this is especially true in many developing countries, including Indonesia).[5]

A company's independent board members are frequently regarded as essential to its corporate reputation. They should help direct and oversee the operation of the company and make sure that executives are acting in the best interests of shareholders. The required standard of board member independence for banks is generally higher than that of other sectors. Currently in Indonesian law, independence of board members is only emphasized for the Board of Commissioners that carries the role of supervision within a company. This paper shall focus on the study of independence for the purposes of supervision of the company management in banks.

While corporate governance is valued by countries worldwide, there are differences in how it is governed and the result of corporate governance. The outcome of corporate governance regulation varies by nation as a result of each respective company and corporate governance laws. In Indonesia, the Financial Services Authority or the ‘Otoritas Jasa Keuangan’ (hereinafter “**OJK**”) and Bank Indonesia (hereinafter “**BI**”) have released a number of new regulations and/or revisions to already-existing regulations. To satisfy global standards, a more effective regulatory framework is required.

Indonesia is currently still lagging behind other nations in their implementation of corporate governance laws. According to the OJK, countries such as Thailand, Philippines, Singapore, and Malaysia are still ahead of Indonesia in terms of Good Corporate Governance (hereinafter “**GCG**”) implementation in the Association of Southeast Asian Nations (hereinafter **“ASEAN”**) area.[6] The report by the Asian Corporate Governance Association (hereinafter “**ACGA**”) shows that Indonesia only ranks 12 with a value of 34.[7] Thus, the topic of enhancing Indonesian regulation holds importance in improving corporate governance in Indonesian Banks.

In a number of studies, Malaysia is regarded as one of the countries with the best corporate governance in Southeast Asia. Malaysia is ranked only second to Singapore amongst ASEAN countries in GCG implementation according to the report by ACGA.[8] Malaysia is also noted for having some of the strongest banks in ASEAN, and the Bank Negara Malaysia is regarded as one of the top regulators in terms of transparency and stringent implementation of its regulatory rules

[4] Pg 68 World Bank
[5] Pg 137-138 World Bank
[6] Ramsey Ramili and Erna Setiany, ‘Comparative Analysis of Good Corporate Governance Implementation Based on ASEAN Corporate Governance Scorecard from the Indonesian Banking Industry’ (2021) 25 Jurnal Keuangan dan Perbankan 118.
[7] ASEAN Corporate Governance Experts, ‘ASEAN Corporate Governance Scorecard Country Reports and Assessments 2015’ [2017] Asian Development Bank, Manila.
[8] ibid.

in the banking industry.[9] Other studies by individual researchers had similarly concluded that Malaysia had better legal framework for shareholder rights, financial auditing standards, competence of Directors, and transparency requirements, which in turn results in a more stringent monitoring system. This may be a contributing reason why Malaysia has successfully reduced corruption at company level.[10]

There are several areas where Indonesia could benefit by studying the different legal systems in Malaysia. This particular research paper will examine the variations in board member independence as well as the functions of corporate governance and supervision. This leads to the research question: **To what extent is Indonesia's regulation on the supervisory board independence in banks adequate to ensure good corporate governance compared to the regulation in Malaysia?**

## METHODOLOGY

This research paper is conducted by way of normative legal approach, deriving information through existing legal principles and doctrines. This research will also be conducted by way of comparative study to explore how a different jurisdiction and legal system regulate over independence in the supervisory board within banks. The information in this research is sourced mainly from legislations and regulations (primary sources), as well as journals and articles (secondary sources).

## RESULTS AND DISCUSSION

### I. Independency and Corporate Governance

Independence is important in the establishment of corporate governance. For instance, companies often maintain internal auditors who are independent of the employees they are auditing. It is most crucial that some of the members of the Board of Directors and/or Board of Commissioners hold a certain level of independence as they hold the highest positions within a company, appointed by the shareholders to represent their interest, as well as the best interest of the overall company growth. Each board member's function may change depending on the size, nature of the business, and applicable legislation. The activities and behavior of the Board of Commissioners and the Board of Directors may not be mutually supportive of the company's interests. The interests of shareholders may differ from those of the company.

Independence is a necessary attribute of professional conduct within corporate actions. It refers to avoiding undue influence from personal interests. It refers to the ability to make the correct decisions on matters that require the ability to "stand apart" from personal interests and other influences that do not concern the best interest of the

[9] Dr Lum Chee Soon, 'Corporate Governance of Banks in Malaysia' 39, 13.

[10] Nureni Wijayati, Niels Hermes and Ronald Holzhacker, 'Corporate Governance and Corruption: A Comparative Study of Southeast Asia' 287.

company. The degree of independence does not remain constant over time. In real-life circumstances, networks and friendships develop over time with relationships developing at various intensity.[11] This is a weakness in studies on corporate governance independence, including this work.

Although corporate governance legislations are usually voluntary by nature (guidelines rather than laws) in many jurisdictions, independence is one part of corporate governance that is often strictly regulated, at least for public companies and in the financial sectors where the interest of the general public becomes of relevance. The definition and standard of 'independence' may also vary from different jurisdictions.

This study on the independence of the supervisory board system of a company attempts to understand the legal system and supervisory board structure and how it ensures independence in decision making for the supervisory board of a bank. 'Independence' as referred in this paper is defined as the practical wisdom-guided virtue that implies autonomy and allows a person to behave with integrity, fairness, and truthfulness. In the context of this paper which discusses on the topic of corporate governance, 'independence' is linked to a sincere desire to provide the best service for the best interest of the company.

## II. Corporate Governance Board Model (One-tier Board System vs. Two-tier Board System)

One of the most basic aspects in understanding the supervisory system of a company is determined through the corporate governance model adopted by the law of the company's jurisdiction. There are two types of corporate governance model: the one-tier board system and the two-tier board system. A one-tier board system is also known as the Anglo-Saxon Model, as they are most often applied in countries such as the US, UK and Canada. In Asia, this model is also used by countries that adopt a common law system, including Singapore and Malaysia. Whereas the two-tier model (also known as 'insider models') and is most often applied in Continental European, such as German and Dutch Companies.[12] Indonesia adopts this corporate governance board model. The following explains its application in Indonesia and Malaysia.

### a. Indonesia

Indonesian company law specifies that a company must at least have one director[13] and one commissioner.[14] Within the company law of a state which adopts a two-tier board system, this is typically the case. The Board of Directors manages

[11] 'Independence as a Concept in Corporate Governance | ACCA Global' <https://www.accaglobal.com/uk/en/student/exam-support-resources/professional-exams-study-resources/strategic-business-leader/technical-articles/independence-as-a-concept-in-corporate-governance.html> accessed 11 July 2022.

[12] Eluemen Enoguanbhor, 'Corporate Governance Board Structure/Model (One-Tier Vs Two-Tier Model' 2 <https://www.academia.edu/38636789/CORPORATE_GOVERNANCE_BOARD_STRUCTURE_MODEL_One_tier_Vs_Two_tier_Model> accessed 21 June 2022.

[13] Law No. 40 of 2007 on Limited Liability Companies. Article 92(3).

[14] ibid 108 (3).

company affairs on a daily basis, whereas the Board of Commissioners oversees the day-to-day management conducted by the Board of Directors. As the name suggests, the two-tier board system separates the functions of supervision and management into two different sections within the company structure. The Board of Commissioners is placed one level above the Board of Directors within a company structure as they are essentially tasked to monitor and ensure that the activities led by the Directors are done with the intention the serve the best interest of the company.[15] Hence, the separate layers between management and overseeing the management itself is intended to ensure better legal and ethical compliance.

**b. Malaysia**

Malaysia adopts a one-tier model which originated from the Cadbury Committee.[16] Instead of two separate boards that split the function of management and supervision, the one-tier system in corporate governance combines the two functions in a single board, which is the Board of Directors. The senior management is responsible for establishing a management structure that encourages accountability and monitoring of line managers and officers performing their duties in certain areas in accordance with the policies and procedures established by the board. The number of Board of Director members within a company can often range between 3 to 31 members (although analysts believe that 7 members is the ideal number).[17] A one-tier board model is typically smaller in the number of members compared to a two-tier model. However, as all members of the board in a one-tier model are responsible for the management of the company, there are essentially a greater number of people actively involved in decision making.[18]

There are many relative advantages and disadvantages to both the systems. With regards to supervision, we can see that a two-tier board system adopted in Indonesia enhances the checks and balances that is required in a good corporate governance. Moreover, with an intimate number of people involved in active management of the company within a one-tier board system, it may in fact hinder effective supervision as members may feel reluctant to report the deficiencies of another member.[19] However, a two-tier board system also has its disadvantages, namely that the Board of Commissioners assigned to monitor the Board of Directors may lack the knowledge and information to assess the directors. As the Board of Commissioners do not

[15] Yesica Naomi Situmeang, 'Commissioner Is: The Responsibility as the Holder of the Highest Office in the Company' (2021).

[16] Wawasan Open University, 'Code of Corporate Governance in Malaysia' <https://eiza2.pressbooks.com/chapter/code-of-corporate-governance-in-malaysia/> accessed 21 June 2022.

[17] Saras Sutedja, 'Sistem One-Tier Dan Two-Tier Dalam Tata Kelola Perusahaan -' (15 October 2021) <https://www.esgi.ai/sistem-one-tier-dan-two-tier-dalam-tata-kelola-perusahaan/> accessed 21 June 2022.

[18] 'Banking Regulation in Malaysia: Overview' (*Practical Law*) <http://uk.practicallaw.thomsonreuters.com/w-008-0538?transitionType=Default&contextData=(sc.Default)&firstPage=true> accessed 22 June 2022.

[19] Enoguanbhor (n 9).

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frequently join meetings, the members may have to trace back all previous occurrences and decisions which may take time and cause a slower decision-making process. Interestingly, a study conducted on one-tier and two-tier board structures in ASEAN countries show that a one-tier board structure model resulted in greater disclosure quality score, meaning that a one-tier system provides better information about past events and future predictions to investors.[20]

## III. Threshold to Independence

As previously stated, each jurisdiction may develop their own standard to qualify for 'independence'. To ensure the same understanding, we must seek the definition and threshold to an 'independent' member to a board of commissioner or board of directors.

### a. Indonesia

The OJK Regulation No. 55/POJK.03/2016 concerning Application of Governance for Commercial Banks provides a standard to the understanding of 'independent commissioner'. Article 1 point 4 provides that an Independent Commissioner "*is a member of the Board of Commissioners who have no financial, management, share ownership and/or family relationship with members of the Board of Directors, other members of the Board of Commissioners and/or controlling shareholder, or relationship with Banks that can affect the ability to*
*concerned to act independently*."

OJK Regulation No. 33 /POJK.04/2014 concerning Board of Directors and Board of Commissioners of Issuers or Public Companies (hereinafter **"OJK Regulation No. 33 /POJK.04/2014"**) also provides regulation on the standard qualifications to which independent Commissioners must fulfill. Article 21 paragraph (2) of OJK Regulation No. 33 /POJK.04/2014 stipulates that an independent commissioner,
"*a. must not be a person who works or has the authority and responsibility to plan, lead, control, or supervise the activities of the Issuer or Public Company within the last 6 (six) months, except for reappointment as Independent Commissioner of the Issuer or Public Company in the following period;*
*b. does not own shares either directly or indirectly in the Issuer or Public Company;*
*c. does not have affiliation with the Issuer or Public Company, member of the Board of Commissioners, member of the Board of Directors, or major shareholder of the Issuer or Public Company; and*
*d. does not have a business relationship, either directly or indirectly, related to the business activities of the Issuer or Public Company."*

[20] Tahseen Mohsan Khan, Safia Nosheen and Naveed ul Haq, 'Corporate Governance Mechanism and Comparative Analysis of One-tier and Two-tier Board Structures: Evidence from ASEAN Countries' <International Journal of Dihttps://doi.org/10.1057/s41310-020-00075-0>.

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Information to certain affiliations that may reduce independence is also required to be disclosed for reasons of transparency.

**b. Malaysia**

Malaysia similarly provides written legislations to the standard of 'independence' for the Board of Directors. Section 11.7 of the Corporate Governance regulation for development financial institutions (BNM/RH/PD 035-5) stipulates that an independent member of the Board of Directors must not have the following qualities:

*"(a) has been an executive in the last two years;*

*(b) is a substantial shareholder of the DFI (development financial institution) or any of its affiliates;*

*(c) is a representative of the stakeholder Ministry of the DFI; or*

*(d) has had a significant business or other contractual relationship with the DFI or any of its affiliates within the last two years."*

As we can see, the standard and understanding of an 'independent' member is already different in Indonesian and Malaysian regulation in many aspects. An interesting observation is that Malaysian law does not require an independent director to be free from familial affiliation with the shareholders, whereas in Indonesia it is required and stated. Moreover, Malaysian regulation appears to apply higher standards with regards to executive or management roles within the company. Malaysian law requires that the independent member is free from the executive role for a minimum of the past two years, whereas Indonesian law only requires 6 months.

Another notable difference is that Malaysian law appears to specify a narrower understanding of the qualification of an 'independent director'. Indonesian law, on the other hand, provides a wider understanding in the qualification of an independent commissioner. Indonesian law provides the principle understanding of qualities that an independent member must have, whereas Malaysian law dismisses members that have qualities that may affect the directors' ability to think and act for the best interest of the company.

The implementation of regulations demonstrates the standards imposed to ensure 'independence' among board members. With only a 6-month interval since leaving an executive position, Indonesian law appears to impose a lower level of autonomy to classify an individual as 'independent' or qualified to make decisions for the firm without conflict of interest. At the same time, it appears that Indonesian law is strongly opposed to familial relationships since they are deemed to cloud independence. This might be owing to previous experience, particularly given that earlier corporate governance failures were created by family-controlled corporations that utilize firms as a vehicle to maximize family interests.

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## IV. Independency of the Supervisory Board Members

It is widely assumed that the goal of any corporate organization is to protect and maximize shareholder value. The firm is owned by the shareholders, but they do not run it, and the company is operated by the management, but they do not own it. The directors serve the function of managing the company in the interest of the shareholders. The independence of independent directors helps align the interests of management and shareholders and enhances the quality of decision-making. Hence, it is necessary to analyze the independence structure of the managerial and supervisory system to better understand the supervisory system and the board members' dynamic within the banking industry.

### a. Indonesia

Independency and the disclosure of independence for banks in Indonesia is strictly regulated. Independency is much more strictly regulated for the Board of Commissioners as the supervisory board of the company rather than the Board of Directors. At least 50% of the Board of Commissioners of a bank must be independent members.[21] The OJK also monitors and assesses the transition from a Non-Independent Commissioner to an Independent Commissioner and vice-versa.[22]

One aspect of a bank corporate governance structure that is visibly more rigid compared to non-financial industries is that the Board of Commissioners are divided into three mandatory committees – each with a specific function to ensure good corporate governance: the Remuneration and Nomination Committee, the Audit Committee, and the Risk Monitoring Committee. Each committee consists of one Independent Commissioner and at least 2 members of that committee with skills in a specified field.[23] The Remuneration and Nomination Committee is responsible for providing evaluation and recommendations to the Board of Commissioners regarding the Remuneration policy and structure of the board, as well as formulate and provide recommendations on the system and procedure for selection and/or replacement of the board members. The Audit Committee is mainly responsible for reviewing and analyzing financial information to be issued by the Bank to the public and/or government authorities. Whereas the Risk Monitoring Committee is responsible for evaluating the compatibility between risk management policy and the implementation of risk management policies. All three committees are required to have at least 51% of the committee to be independent members.[24]

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[21] OJK Regulation No. 55/POJK.03/2016 concerning Application of Governance for Commercial Banks Art. 24(2).
[22] ibid 25(3).
[23] ibid 41–44.
[24] ibid.

The following table provides a simple illustration of the mandatory committees and each of their legal requirements with regards to independency:

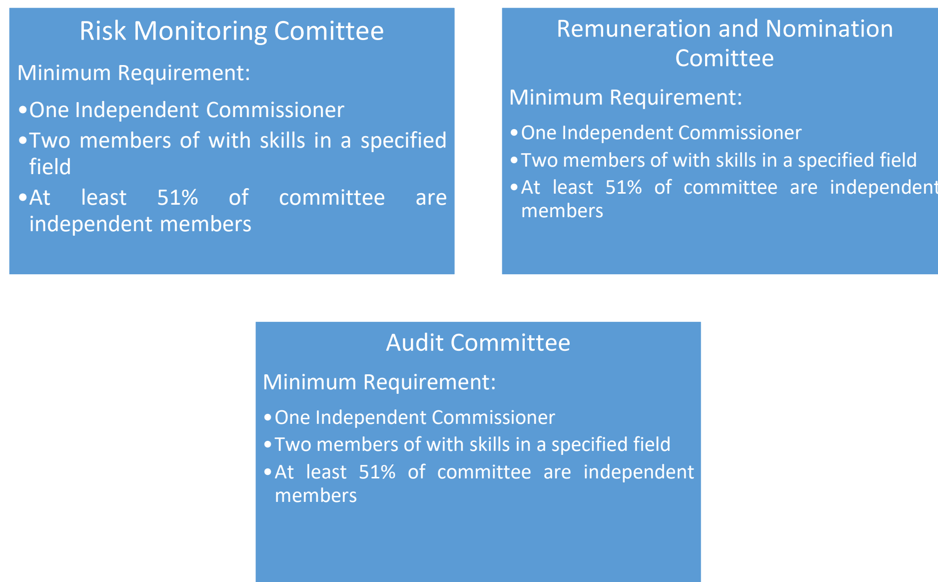


Figure 1. Illustration of Mandatory Committee Independency in Indonesia

The level of independence for the Board of Directors in Indonesian company law is not a large requirement compared to the Board of Commissioner. The Indonesian Stock Exchange no longer requires public companies to have independent Board of Director members. It is assessed that the independence of the board members has been represented by the Independent Commissioners that take the supervisory role of the company.[25] However, as for Banks, the President Director of the Bank must be an independent member of the Board of Director.[26] This is a special requirement for companies in the financial industry to ensure the quality of decision-making for the interest of the company and its shareholders.

**b. Malaysia**

As previously mentioned, the managerial and supervisory function within a board is combined in Malaysia. The Board of Directors is required to take upon the supervisory job carried by the Board of Commissioners in Indonesia. Similar to the Board of Commissioners in Indonesia, the Board of Directors is divided into four committees that hold specific functions: The Nomination Committee, Remuneration Committee, Audit Committee, and the Risk Management

[25] Monica Wareza, 'Emiten Tak Lagi Wajib Miliki Direktur Independen, Kenapa?' (*CNBC Indonesia*) <https://www.cnbcindonesia.com/market/20181226161205-17-48036/emiten-tak-lagi-wajib-miliki-direktur-independen-kenapa> accessed 23 June 2022.

[26] OJK Regulation No. 55/POJK.03/2016 concerning Application of Governance for Commercial Banks Art. 5.

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Committee.[27] The committees hold a similar role and function as described in Indonesian law.[28] However, unlike in Indonesia where the nomination and remuneration committee is always combined, the nomination and remuneration function may be combined or separated in Malaysian banking corporate governance.[29]

The Board of Directors are required to have a majority of independent members at all times. The Nomination Committee, Remuneration Committee, Audit Committee, and the Risk Management Committee each are required to be chaired by an independent director and are required to have at least three directors in which majority of those directors are independent directors.[30] Hence, the independence of the board is ensured through such regulation.

The following table provides a simple illustration of the mandatory committees and each of their legal requirements with regards to independency:

| Risk Monitoring Comittee | Remuneration Comittee |
| --- | --- |
| Minimum Requirement:<br>•Must be chaired by an independent director<br>•Must have a minimum of 3 directors<br>•A majority of the directors must be independent directors | Minimum Requirement:<br>•Must be chaired by an independent director<br>•Must have a minimum of 3 directors<br>•A majority of the directors must be independent directors |
| **Nomination Committee** | **Audit Committee** |
| Minimum Requirement:<br>•Must be chaired by an independent director<br>•Must have a minimum of 3 directors<br>•A majority of the directors must be independent directors | Minimum Requirement:<br>•Must be chaired by an independent director<br>•Must have a minimum of 3 directors<br>•A majority of the directors must be independent directors |

Figure 2. Illustration of Mandatory Committee Independency in Malaysia

The independence of the supervisory board is ensured equally in both Indonesian and Malaysian law. Both jurisdictions require that at least half of the supervisory board is run by independent members. Both banking laws also require the four functions: the audit committee, the remuneration committee, the nomination committee, and the risk management committee. One difference that can be identified is that Malaysian law would require a greater number of directors to actively take part in each committee -that is requiring at least three board of director members in each committee, whereas in Indonesia

[27] Corporate Governance (BNM/RH/PD 035-5) s 12.1.
[28] ibid Appendix 1.
[29] ibid 12.2.
[30] ibid 12.3.

only requiring one Board of Commissioner member to be a member of each committee. Malaysian banking law also requires that the Board of Directors in each committee must each have a majority of independent directors. Thus, if a bank in Malaysia decided to have a minimum of three directors in each committee, then two of the directors must be independent members. This results in higher participation of every Board of Director member and an a greater assurance for independence.

## V. Enhancing Corporate Governance in Indonesia Through Independency

Independent directors or commissioners are expected to perform as an impartial and unbiased voice on behalf of the company. With regards to the banking industry, this becomes even more important.

Malaysian law, as a common law country who adopts a one-tier board model, may hold some advantages compared to a two-tier board model adopted in Indonesia. A notable advantage is that independence applied for supervision purposes for the supervisory members automatically apply to the managerial members (as a one-tier board model only requires a Board of Directors who hold both the supervisory and managerial functions). Whereas in Indonesia, independence is only required for a minimum of 50% of the Board of Commissioners and the President Director. Hence, Malaysian board structure has higher concentration of independent members compared to Indonesian board structure.

Perhaps independence of the board members in Malaysia is one of which contributes to the renowned success of Malaysian corporate governance. This can be one learning aspect Indonesia may take in order to improve the corporate governance in Indonesian company law. But before we conclude this to be the weakness in Indonesian company law, it is best to analyze further the history and impact of an independent director to corporate governance.

In the past, Indonesia had adopted more requirements for independence for members taking the managerial role. Based on Section III.1.5.1 of BEI Rule Number 1-A it is determined that, "*There must be at minimum of 1 (one) person from the Board of Directors that may be selected through the general meeting of shareholders prior to the listing and begin to effectively act as an Independent Director after the company's shares are listed*." This regulation, however, was repealed by reason that the independent directors are hired only for formality and do not actually take the role of managing the company. Through removing this regulation, companies going public may do so efficiently and more cost-effective without compromising on quality.[31] However, as previously mentioned, companies in the banking industry are still required to have one independent director taking the role of the president director. Therefore, there is still a higher standard for independence for members of the Board of Directors in banks compared to companies in other industries.

[31] Grahanusa Mediatama, 'BEI hilangkan aturan wajib memiliki direktur independen bagi emiten' (*kontan.co.id*, 26 December 2018) <https://investasi.kontan.co.id/news/bei-hilangkan-aturan-wajib-memiliki-direktur-independen-bagi-emiten> accessed 10 July 2022.

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While some degree of board member independence is important, a higher level of independence and impartiality is not guaranteed for better corporate governance. Some studies show that the increased number of independent directors do not come with the expected results. For instance, the typical board of directors now have a greater number of members without firm-specific commitment to their companies and all of its stakeholders, as well as a higher number of directors without in-depth operational expertise of the companies they represent.[32] This results in undesirable results such as inefficiency and lower profitability. Nonetheless, this same study did not reject the notion that independence is necessary, and that a company governed by a majority of independent members is still essential in issues regarding management, directors, or shareholders conflict. The study acknowledges that it is logical to require a majority of independent directors.[33]

Through this analysis, we may see that Malaysia may be successful in maintaining good corporate governance in banks, partly due to the applying independence at both the supervisory and managerial function (an automatic response to adopting a common law system). The Indonesian government may reconsider the application of majority independence at both the supervisory and managerial level for companies in the banking sector. This is because ensuring good corporate governance for banks is crucial than companies in any other sector. It is also important to ensure that the role of the independent director is not only for formality in order to fulfill the regulation requirements. Legislators may consider providing rules that ensure that each independent director holds indispensable positions that are necessary to ensure good corporate governance.

## CONCLUSION

Ensuring good corporate governance is crucial because it establishes a set of guidelines and procedures that control a company's operations and ensure that the interests of all its stakeholders are aligned. Corporate governance for banks is especially important as they are highly interconnected with other industries and hold macroeconomic functions to the state. Empirical evidence shows the severe impact of poor corporate governance during the 1997 Asian financial crisis. Hence, maintaining effective corporate governance for banks is indisputably important.

Through analyzing the regulation of Indonesian and Malaysian legal framework on board member independence, we may draw a conclusion that Malaysian law upholds more stringent rules on board member independence. It is important to note that the board structure is the first fundamental difference which affects independence. Indonesia who adopts a two-tier board model may benefit from the checks and balances system within the company itself, resulting from the separation of the supervisory and managerial function between the Board of Commissioners and Board of Directors respectively. Indonesia determined that the

[32] Theodore N. Mirvis and William Savitt, 'The Dangers of Independent Directors' 40 Delaware Journal of Corporate Law 481.
[33] ibid 488.

requirement of majority independent members is best placed only at the supervisory function, hence only requiring the Board of Commissioners to have a majority of independent members. Malaysian legal framework, on the other hand, adopts the one-tier board model which combines the supervisory and managerial function. This requirement of majority independent members automatically applies at both the supervisory and managerial function.

The implementation of majority independence at both managerial and supervisory positions for businesses in the banking sector may be reconsidered by the Indonesian government. This is due to the fact that banks require better corporate governance than businesses in any other industry. Furthermore, it's critical to make sure that the independent director's position is more than just a legal necessity. Legislators may look into the establishment of a legal framework that guarantee each independent director to hold essential positions required to guarantee good company governance. For instance, only allowing an independent member of the board of directors to serve in particular positions (such as the director of finance and corporate services or the director of legal and compliance).

Independence of board members is only one aspect of the multi-dimensional, complex nature of corporate governance. There are many other factors of the legal framework that have yet to be explored, such as transparency, corporate culture, and enforcement. The development of Indonesian corporate governance throughout the years has been significant. Progress and improvement of the legal framework and enforcement should continue to be encouraged to combat bad corporate practices by the actors of a company.

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