

# Developments In Governance: Revisions To The Singapore Code Of Corporate Governance

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On 2 May 2012, the Monetary Authority of Singapore (“MAS”) issued a revised Code of Corporate Governance. The changes were made after a public consultation and following recommendations made by the Corporate Governance Council (“CGC”). The revisions reflected in the new Code of Corporate Governance (Code 2012) effect changes to the existing Code of Corporate Governance (Code 2005) in several key areas including director independence, board composition, multiple directorships, remuneration practices and disclosures, risk management, and shareholders’ rights and role.

The CGC subsequently issued its Risk Governance Guidance for Listed Boards in May 2012, which complements the principles and guidelines of the Code relating to risk management and internal controls and gives guidance to listed company boards on the carrying out of their risk governance oversight responsibility.

The Code 2012 will generally take effect in respect of annual reports

relating to financial years commencing from 1 November 2012. Accordingly, for companies with financial years commencing 1 January, their annual reports for FY2013 — typically issued in March/April 2014 — should describe their corporate governance practices with specific reference to the principles of the revised Code, including disclosing any deviation from any guideline of the revised Code together

with an appropriate explanation for such deviation. The exception is the requirement for independent directors to make up at least half of the board in the circumstances specified in the Code (as discussed below). Changes to meet this requirement should be made at the annual general meetings following the end of financial years commencing on or after 1 May 2016. Hence, companies with financial years

commencing 1 January should make the necessary changes by their annual general meetings for FY2017.

Since the Code 2012 was issued, much has been written and spoken about the practical steps that need to be taken by listed companies in order for their governance practices to meet the new standards set by it. This article focuses rather on the values introduced or expanded on, which underlie the revisions made to the principles and guidelines of the Code 2012 by the CGC and the MAS.

## Sustainability And Ethics

The role of the board captured in Guideline 1.1 reflects the broader sense of corporate responsibility that has arisen particularly over the last decade. The Code 2012 acknowledges that companies have obligations to a wider group of stakeholders than just its shareholders. As the Guide to Sustainability Reporting for Listed Companies of the Singapore Exchange notes, stakeholders include shareholders, employees, customers, suppliers and communities, with varied nature and interests. The Code 2012 recognises that companies have a responsibility to consider sustainability issues such as environmental and social factors, as part of their strategic formulation. It also specifically refers to the board's responsibility to set the company's ethical standards.

## Long-Term Interest Versus Short-Term-ism

Underlying a number of principles and guidelines of the Code 2012 is the focus on the company's long-term interest and success. This is evident from the various references to it in the sections dealing with the board's role as well as those dealing with remuneration, as well as in the reference to sustainability. The sections on remuneration make several references to long-term incentives that companies are encouraged to adopt as

part of the remuneration of directors and key management personnel ("key management personnel" being defined as the chief executive officer or equivalent, and other persons having authority and responsibility for planning, directing and controlling the company's activities). This emphasis on taking a longer-term view may be construed as a response to the misguided drive to achieve short-term profits at the expense of business sustainability that is widely considered to have contributed to the 2008 global financial crisis.

## Training

Professionalising boards and raising their standards of performance will improve governance standards and enhance value creation. The Code 2012 makes clear that it is the company that is responsible for arranging and funding the training of its directors.

The Code 2012 increases the emphasis on directors' training, expanding on the guidelines of the Code 2005 in several ways: training for incoming directors should be comprehensive and tailored, and first-time listed company directors should receive training in areas such as accounting, legal and industry-specific knowledge as appropriate. The tasks of the Nominating Committee ("NC") have also been expanded to cover the review of training and professional development programs for the board.

The training provided should be disclosed in the company's annual report. In addition, the Code 2012 requires the board to disclose in the company's annual report measures taken by Audit Committee ("AC") members to keep abreast of changes to accounting standards and issues which have a direct impact on financial statements.

## Independence

After considering various perspectives as well as international developments, the CGC arrived at the view, stated in

the Consultation Paper on the Proposed Revisions to the Code issued in June 2011, that to enable independent directors to act effectively in companies, it was important for them not to possess any relationship with stakeholders (which would include 10% shareholders and organisations providing material services to the company). This view has been enshrined in the Code 2012 through various provisions that tighten the existing requirements for independence:

### Formal Measures Of Independence

Independent directors should be able to exercise objective judgment on corporate affairs independently, in particular, not just from management, but also from shareholders with an interest in 10% or more of the total voting shares in the company. Accordingly, an independent director is now defined as one with no relationship with the company, its related corporations, its 10% shareholders or its officers that could interfere, or be reasonably perceived to interfere, with the exercise of his independent business judgment with a view to the best interests of the company.

This means that a director will generally not be considered independent if he, inter alia:

- is a 10% shareholder of the company;
- is an immediate family member of a 10% shareholder of the company; or
- is or has been directly associated with a 10% shareholder of the company (i.e. if he is accustomed or under a formal or informal obligation to act in accordance with its directions, instructions or wishes in relation to the company's affairs) in the current or immediate past financial year.

The Code 2012 also stipulates that where a company or any of its subsidiaries has made or received from certain organisations significant payments (generally, in excess of S\$200,000 per annum in aggregate) or material services

(such as audit, banking, consulting and legal services) in the current or immediate past financial year, a director associated with that organisation (or whose immediate family member is so associated) may not be considered independent. Such association arises by being that organisation's 10% shareholder, its partner with a stake of 5% or more, or its executive officer or director.

The Code 2012 also provides that once an independent director has served for a continuous period of nine years from the date of his first appointment, his continued independence beyond this period should be subject to particularly rigorous review. In doing so, the board should also take into account the need for progressive refreshing of the board, and explain why any such director should be considered independent. This nine year principle, which is new to the Code and which has caused substantial controversy, recognises that directors who have been on the board for a substantial length of time may develop a level of familiarity and cosiness with management and major shareholder which may impede their ability to exercise independent judgment from them.

### Board's Discretion To Determine Independence

In all the above cases, it is, at the end of the day, up to the NC and the board to assess each director's independence, and open to the board to come to the conclusion that he should be considered independent, and to explain its basis for that conclusion in the company's annual report. Assessment of independence is an ongoing requirement and not just to be done annually.

### Half The Board To Be Independent

The Code was further amended to stipulate that at least half of the board should be independent in

specific circumstances. Where these circumstances do not apply, the existing requirement in the Code of at least one-third of the board to be independent continues to apply.

The circumstances that will require that half of the board be independent (which are also the circumstances in which a lead independent director should be appointed) are the following:

- Where the Chairman and CEO is the same person (the Code states that these roles should in principle be held by different persons);
- Where the Chairman and CEO are immediate family members;
- Where the Chairman is part of the management team; or
- Where the Chairman is not an independent director.

As mentioned above, a longer grace period will be given to companies to comply with this requirement.

### Diversity

It is now widely accepted that a diversity of backgrounds and expertise of directors brings with it a diversity and richness of views which, when shared openly and constructively, help companies to make better, more aware and informed decisions.

The Code 2012 specifies that the board and its board committees should comprise directors who as a group "provide an appropriate balance and diversity of skills, experience, gender and knowledge of the company". The reference to gender is notable; while some other jurisdictions have introduced gender diversity on listed boards through mandatory quotas or disclosure requirements, Singapore has gone down the gentler route of a Code recommendation.

It remains to be seen if companies will take note and act accordingly. In any

case, given that there will be an increased demand for independent directors given the changes to the definition and circumstances relating to independence in the Code, it may be inevitable that more women, and indeed, a much wider pool of potential directors with a range of different ages, countries, skills and experiences, will be tapped on to meet the need.

### Board Renewal And Succession

A company's business is dynamic, and over time, its geographical, business and strategic focus will change, and the composition of its board must evolve to meet the company's changing needs.

The Code 2012 places renewed emphasis on board succession and renewal, referring to it in the nine-year principle, the expanded role of the NC to make recommendations to the board on relevant matters relating to review of board succession plans for directors, and the fact that important issues to be considered as part of the process for the selection, appointment and re-appointment of directors include composition and progressive renewal of the board.

### Information Flow

Under the Singapore Companies Act, the business of a company is to be managed by or under the direction of the directors. The Code expresses it another way, specifying that the board's role includes providing entrepreneurial leadership, setting strategic objectives, and ensuring that the necessary resources are in place for the company to meet its objectives.

Because of this fundamental responsibility of the board, it is imperative that directors have independent access to management and full, timely access to information on an on-going basis relevant for them

to make fully informed decisions in the company's interest. The Code 2012 enhances the existing provisions of the Code in this regard.

## Devoting Sufficient Time And Attention

At the same time, directors have to be committed to devoting sufficient time and effort to reading, understanding and digesting all the information provided to them, and arriving at considered views on the matters before them for decision.

The commitment and competencies of a director as well as his contribution and performance (e.g. attendance, preparedness, participation and candour), including, if applicable, as an independent directors, is specified by the Code to be relevant to the determination of whether he is to be re-appointed to the board.

In addition, one matter that has been debated in the media is the issue of whether the recent corporate governance scandals in Singapore were attributable at least in part to directors not having sufficient time to give proper attention to the businesses of the companies whose boards they sit on. Publicity has been given to some prominent examples of persons holding what may be considered to be an excessive number of listed company directorships.

In the light of this, the Code 2012 specifies that the NC's decision whether a director is able to and has been adequately carrying out his duties as director should take into consideration his number of listed company board representations and other principal commitments. "Principal commitments" is defined as all commitments involving a significant time commitment e.g. full-time occupation, consultancy work, committee work, non-listed company board representations and directorships, and even involvement in non-profit organisations. In addition, the Code

2012 requires the board to determine the maximum number of listed company board representations that any director may hold, and disclose this in the company's annual report.

## Transparency

The Code 2012 improves transparency in several areas by requiring enhanced disclosure in the annual report.

One notable area is in remuneration, where remuneration of individual directors and the CEO must now be disclosed on a named basis to the closest \$1,000, with a breakdown of remuneration earned through fixed salary, variable/performance-related income/bonuses, benefits in kind, stock options, share-based incentives and other long-term incentives. Additional disclosure is required of the aggregate remuneration paid to the top five key management personnel who are not directors or the CEO, and of the aggregate amount of termination, retirement and post-employment benefits that may be granted to directors, CEO and the top five key management personnel. Disclosure is also required of salaries of employees who are immediate family members of a director or the CEO whose annual remuneration exceeds \$50,000. Such disclosure should be made on a named basis, indicating the employee's relationship, and in bands of \$50,000.

An important new requirement which will aid the understanding of shareholders of how performance is rewarded is the requirement that companies disclose more information on the link between remuneration of the executive directors and key management personnel and their performance. The annual remuneration report should set out a description of performance conditions to which entitlement to short-term and long-term incentive schemes are subject, an explanation on why such performance conditions were

chosen, and a statement of whether such performance conditions are met.

## Link Between Remuneration And Risk

It has become common wisdom that a key factor contributing to the global financial crisis was the disconnect of remuneration from risk, thereby resulting in excessive risk-taking to inflate bonuses coupled with a lack of accountability. To address this view, the Code 2012 now expressly refers to the connection between remuneration and risk in several places. Principle 8 states that the remuneration level and structure should be aligned with the long-term interest and risk policies of the company. Guideline 8.1 specifies that performance-related remuneration should take into account the risk policies of the company, be symmetric to risk outcomes and be sensitive to the time horizon of risks.

Additionally, companies are now encouraged to include contractual provisions that allow for clawback of remuneration in exceptional circumstances of misstatement of financial results, or of misconduct resulting in financial loss to the company.

Complementing the Code 2012, the Risk Guidance provides in its sample terms of reference for a board risk committee the duty to provide advice to the Remuneration Committee ("RC") on risk weightings to be applied to performance objectives incorporated in executive remuneration.

## Risk Governance

New Principle 11 and guidelines on risk management and internal controls have been included in the Code 2012, underscoring their importance. Notably, the first statement of Principle 11 makes it clear that the board is responsible for the governance of risk. The new



guidelines relevant to risk management and internal controls included in the Code 2012 clarify the board's role as inter alia being the following:

To determine the company's levels of risk tolerance and risk policies, and oversee management in the design, implementation and monitoring of the risk management and internal control systems.

To comment on the adequacy and effectiveness of the internal controls, including financial, operational, compliance and information technology controls, and risk management systems, in the company's annual report. The board's commentary should include information needed by stakeholders to make an informed assessment of the company's internal control and risk management systems. This obligation supplements the obligation found in the SGX Listing Manual, to set out in the annual report, the opinion of the board, with the concurrence of the AC, on the adequacy of the internal controls, addressing financial, operational and compliance risks.

To comment in the annual report on whether it has received assurance from the CEO and the CFO on the effectiveness of the company's risk management and internal control systems and that the financial records have been properly maintained and the financial statements give a true and fair view of the company's operations and finances.

To establish a separate board risk

committee or otherwise assess appropriate means to assist it in carrying out its responsibility of overseeing the company's risk management framework and policies.

In recognition of the important role of the AC, the Code 2012 states that at least two members, including the AC Chairman, should have "recent and relevant" accounting or related financial management expertise or experience (as the board interprets such qualification in its business judgement).

New provisions in the Code 2012 relevant to internal audit include the assignment of the AC to approve the hiring, removal, evaluation, and compensation of the head of the internal audit function (or the accounting/auditing firm or corporation if the internal audit function is outsourced), and that internal audit should have unfettered access to all the company's documents, records, properties and personnel, including access to the AC.

#### Shareholder Rights And Responsibilities

The most significant change to the Code with respect to shareholders has been to include a new statement on the role of shareholders. While this is not part of the Code, it was issued together with the Code by the CGC in its final recommendations to the MAS in November 2011, and is intended to encourage shareholders to engage constructively with the board and with management. By becoming more actively involved in questioning boards and management and holding

them accountable for their actions and decisions, shareholders can play an important role in improving the corporate governance of companies whose shares they hold, bringing poorly managed or under-performing companies to account, and thereby improving shareholders' value.

The Code 2012 itself places renewed emphasis on recognising the ownership rights of shareholders and facilitating their right to participate and vote at general meetings. Companies are recommended to devise an effective investor relations policy to promote communication with shareholders, and boards to establish and maintain regular dialogue with shareholders, to gather their views and address their concerns. The steps taken by the board in this regard should be stated in the annual report.

## Conclusion

Many of the principles and guidelines of the revised Code are grounded in the values which underpin good corporate governance such as independence, transparency, integrity, professionalism, diversity, ethics and sustainability. Much has already been written about the business case for good corporate governance, and companies should bear this in mind as they approach this transitional period before the coming into effect of the revised Code and decide which of the recommendations of the revised Code they intend to adopt.