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Compliance Crucial for SGX-listed Foreign Firms

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According to the 2014 Singapore Exchange (SGX) annual report, 40 per cent of the exchange's 766 listed companies are based outside of Singapore. This makes the Singapore Stock Exchange a world leader in foreign listings, well on its way to being the "Asian gateway for companies seeking to tap international capital markets".

While the strategy of internationalising the local exchange is a sound move given the small size of our domestic market, one concern is whether these foreign firms have implemented adequate governance mechanisms to safeguard the interests of local shareholders.

A key finding of SID-ISCA's *Singapore Directorship Report 2014* was that Singapore-registered firms demonstrated a higher level of compliance with several guidelines of the 2012 Code of Corporate Governance (Code) compared to firms which are registered overseas.

This specific finding deserves to be further examined.

Before we do so, it is first useful to note that firms on the SGX may be categorised as either primary or secondary listings, and second to understand the governance frameworks applicable to these two categories.

PRIMARY AND SECONDARY LISTINGS

A primary listing can be viewed as referring to a firm that launched its initial public offering (IPO) on SGX, with Singapore as its home regulator. If a foreign firm launched its IPO in another country's exchange (known as the home exchange) but still chooses to list its shares on SGX (known as the host or secondary exchange), then it is a secondary listing. There were only 35 secondary listings on SGX as of 8 October 2014.

Primary listings have to fully comply with all SGX regulations including the Listing Manual and the "comply or explain" guidelines of the Code.

For secondary listings, SGX generally relies on the home exchanges to regulate them according to the rules and regulatory frameworks in their home countries. As such, companies already comply with equivalent rules on their home jurisdictions; they generally do not have to comply with continuous listing obligations other than Rules 217 and 751 of the SGX Listing Manual. However, additional continuous listing obligations, such as chapters 9, 10 and 13 of the Listing Rules, may be imposed if these foreign firms originate from

home exchanges in countries classified as "developing markets" (for example, Malaysia, Thailand and Korea).

The regulatory framework for secondary listings exempts these firms from complying with the guidelines in the Code, in favour of equivalent codes in their home jurisdictions. This partly explains why secondary listings registered overseas have a lower level of compliance with the Code when compared with Singapore-registered firms.

Most of the foreign firms are primary listings, which means they should fully comply with SGX regulations.

FOREIGN FIRMS' CODE COMPLIANCE

The *Singapore Directorship Report 2014* compares the level of compliance with certain aspects of the Code by foreign firms versus that of Singapore-registered firms. Foreign firms score lower on these corporate governance practices as compared with local firms:

- Local firms have more independent chairmen than foreign firms (21 per cent versus 3 per cent) and fewer executive chairmen (54 per cent versus 79 per cent);
- Local firms have many more independent director seats (49 per cent versus 40 per cent) and fewer executive director seats (33 per cent versus 39 per cent);
- Local firms have a higher level of separation of the board chairman and CEO positions (71 per cent versus 59 per cent);
- Local firms have a higher level of compliance (55 per cent versus 40 per cent) with Guideline 2.2 when compared with foreign firms that are primary listings, which requires that independent directors make up at least half of the board when the chairman is not independent.

The last set of statistics highlight a need for foreign firms with primary listings to appoint more independent directors in due course so as to comply with Guideline 2.2 of the Code, which is effective for firms with financial years beginning on or after 1 May 2016.

ADDING SAFEGUARDS

A source of comfort for shareholders, in particular minority shareholders, lies in having independent directors. The listing rules already require foreign firms with primary listings to have at least two independent directors who are residents of Singapore. However, a more crucial consideration should be to ensure that the resident independent directors are able to effectively discharge their monitoring duties.

This is because resident independent directors of foreign firms are likely to experience non-trivial information asymmetry problems. After all, they are domiciled in Singapore and it would be counter-intuitive to expect them to monitor top executives located in geographically distant countries with different institutional environments.

This makes it all the more critical for the appointment of resident independent directors who have the competence and drive to seek and obtain the requisite information to effectively monitor foreign top executives. This will mitigate shareholder concerns with irregularities occurring in these foreign firms.

With the challenges of governing firms with primary operations located in foreign jurisdictions, local shareholders would benefit from additional safeguards and disclosure practices to close the information gap between shareholders, resident independent directors and foreign top executives of these firms. ■