

THE BUSINESS TIMES

BTINVEST

Published on Monday, 23 November 2015



Making "Comply or Explain" Work

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The SGX is gently turning up the heat on compliance with the Code of Corporate Governance.

In January 2015, the regulator released a disclosure guide in a question-and-answer format for companies, zeroing in on specific principles and guidelines that are often not properly complied with.

Then, in October 2015, the SGX engaged KPMG to examine the annual reports of all mainboard listed companies to assess how they are abiding with the Code. Tan Boon Gin, the SGX's new chief regulatory officer, announced that he plans to deal with errant companies using the exchange's new enforcement powers.

In a way, that the regulator is at the forefront of the "comply or explain" regime is not surprising. After all, it has the means to encourage and enforce compliance.

This raises the question of whether the SGX is doing enough. Yes, the disclosure guidelines are certainly a means to encourage and facilitate compliance. The current review by KPMG and inevitable follow-up actions by the SGX may result in stronger enforcement actions.

Nevertheless, many companies feel that it would be more helpful if the SGX clearly communicates to companies precisely what are acceptable or unacceptable explanations for deviations from the Code, instead of leaving them to make their own judgement calls. For example, is the common explanation of "fear of poaching" an adequate reason for non-disclosure of specific director remuneration?

That said, the responsibility cannot and should not rest entirely on the regulator. It is not the only or even the main actor in the corporate governance ecosystem.

What about the other players?

Boards

It seems axiomatic that one would turn naturally to the listed companies and their boards. After all, they are the ones who have to comply with the Code.

Unfortunately, far too many companies and boards regard the Code as a necessary evil, when they should be encouraged to look at the bigger picture of what it is intended to achieve – good governance practices that all companies should implement for their longer term interests.

Directors sometimes forget that the alternative to "comply or explain" is legislated rules. The "comply or explain" system, prevalent in Commonwealth countries, is often contrasted with the more prescriptive US system. The latter includes the Sarbanes-Oxley and Dodd-Frank Acts that were passed with many burdensome and onerous rules following the Enron scandal and global financial crisis respectively.

The rationale for the less onerous "comply or explain" system is to provide flexibility for companies to respond to the Code. It is a principle-based approach that recognises that alternative strategies can be justifiable if they can achieve good governance.

However, for the system to work, there must be trust. That trust should first come from the companies themselves. Boards must be truly committed to the substance of good governance, and not just its form. They must see value in the practices, do their utmost to comply with the Code, and where there is a deviation, provide satisfactory explanations and alternatives.

Investors

Meanwhile, investors benefit the most from good corporate governance. That being the case, they too must share some responsibility beyond just receiving reports and making self-interested investment decisions.

Investors can help companies improve their governance standards by scrutinising the companies' level of compliance and raising relevant questions at the AGM and other appropriate forums. Institutional investors, in particular, have the means to more actively and substantively engage companies about their practices, while proxy advisors are an emerging force that can influence the provision of timely and complete information.

Other players

Other players such as the media, shareholder associations, trade bodies and industry watchers all have roles to play to promote compliance with the Code and to foster good corporate governance.

The SID, for one, works actively in this regard. It is currently collaborating with the regulators and several professional firms to develop a series of corporate governance guides for the board and its major committees. When complete, these guides will provide helpful

explanations and examples of corporate governance disclosures alongside an examination of the essentials of the "comply or explain" model.

The SID is also deeply involved in two major benchmarking initiatives: the ASEAN Corporate Governance Scorecard, and the upcoming Singapore Governance and Transparency Index. Both are designed to assess companies on their compliance with the Code and other leading practices of good governance.

Furthermore, the Singapore Corporate Awards, which the SID organises with the Institute of Singapore Chartered Accountants and The Business Times, seeks to promote excellence in corporate governance through the Best Managed Board and other awards.

In summary, for the "comply or explain" approach to work effectively, there must be mutual trust among the players in the corporate governance ecosystem. Companies, in particular, must commit to good governance and that commitment must be trusted and their explanations given proper consideration by investors and third party assessors of corporate governance.

Enforcement by the regulators should be a matter of last resort because when that happens, it does not reflect well on the individual company. And if it happens too many times, it certainly does not reflect well on the ecosystem.

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