At The Forefront Of Corporate Governance In Asia – Singapore Strengthens Its Corporate Governance Regime

By Jerry Koh, Partner and Jane Ng, Associate, Allen & Gledhill LLP

Introduction

On 2 May 2012, the Monetary Authority of Singapore ('MAS') issued the revised Code of Corporate Governance (the 'Code'), which supersedes and replaces the previous Code issued in 2005 (the '2005 Code'). The revised Code will take effect largely in respect of annual reports relating to and annual general meetings ('AGMs') held after the end of the financial year commencing from 1 November 2012.

The global financial crisis raised awareness among both regulators as well as listed issuers regarding areas for improvement in Singapore's corporate governance regime, and the amendments to the Code signify a resolve on the part of the regulators to position Singapore at the forefront of corporate governance in Asia, by minimising or mitigating any issues stemming from the problem of systemic risks. The revised Code was the result of a comprehensive review undertaken by the Corporate Governance Council (the 'Council'), a committee specifically set up by MAS to review the Code, and reflects, with some adjustments, all of the recommendations made by the Council.

As with its predecessor, the revised Code is applied by the listing rules of the Singapore Exchange Securities Trading Limited ('SGX-ST') as a 'comply or explain' regime, meaning that while compliance is not mandatory, companies listed on the SGX-ST are expected to adhere to the general principles and guidelines set out in the Code. In the event the company decides not to adhere to certain principles or guidelines, the company is required to explain its reasons for such deviations in its annual report. It should be noted that while this is the general position, the regulators appear to be less permissive of certain deviations than others. This will be discussed further below.

The following paragraphs discuss some of the revisions to the Code, categorised into four topics relating to: (i) the board of directors of a company (the 'Board'); (ii) the rights and role of shareholders of the company; (iii) remuneration practices and disclosure; and (iv) risk management.

The Board

Board Composition

In its Consultation Paper on Proposed Revisions to the Code of Corporate Governance dated 14 June 2011 (the 'Consultation Paper'), the Council noted that independent directors are essential for protecting the overall interests of the company and in providing guidance, supervision as well as checks and balances for effective corporate governance. The issue of directors' independence is therefore of great importance.

The revised Code has focused significantly on tightening the rules relating to Board composition, with the specific goal of strengthening the independent element of the Board. The emphasis on refining when a director is considered independent is evident in the following:

New definition of independence

To qualify as an independent director, the 2005 Code only required that a director be independent from management. The revised Code introduces a new concept of the 'ten per cent shareholder', namely any shareholder having an interest in not less than ten per cent of the total votes attached to all the voting shares (excluding treasury shares) in the company. Under the revised Code, a director is required to be independent from both management and ten per cent shareholders in order to be considered as an independent director.

During the previous review of the 2005 Code, the then Council of Corporate Disclosure and Governance had recommended tightening the definition of independent director to exclude directors who are, or are directly associated with, substantial shareholders. Substantial shareholders are defined in section 81(1) of the Companies Act, Chapter 50 of Singapore as persons who have an interest or interests in one or more voting shares in the company and the total votes attached to those share(s) is not less than five per cent of the total votes attached to all the voting shares in the company. This was eventually rejected by the government after much consideration, as it was felt that substantial shareholders did not pose the kind of principal-agent problems that executive directors could potentially pose. A director's relationship with substantial shareholders was hence not captured under the 2005 Code in the definition of independence for directors.

Since then, however, concerns remained that relationships with substantial shareholders may in certain circumstances influence an independent director's exercise of objective judgment. Revisiting the issue in its review of the 2005 Code and taking into account different perspectives and international developments, the Council reiterated its belief that in order to act effectively, independent directors should not possess any relationship with stakeholders, such as substantial shareholders or organisations providing material services to the company.

This time, the MAS accepted the Council's recommendation in including the concept of independence from shareholders, but raised the shareholding threshold from the proposed five per cent to ten per cent. This was on the grounds that the requirement was being introduced for the first time and therefore should not be too stringent; the MAS noted that the threshold could be adjusted in the future if required. The Board retains its power under the revised Code to justify its decision if it determines that a director is independent notwithstanding certain relationships or circumstances which may prima facie render a director to be non-independent.[1]

Composition of the board in certain circumstances

As with its predecessor, the revised Code provides that independent directors should make up at least one-third of the Board. However, a significant addition to the revised Code is that independent directors should now make up at least half of the Board where:

- the Chairman of the Board (the 'Chairman') and the chief executive officer (or equivalent) (the 'CEO') is the same person;
- the Chairman and the CEO are immediate family members;
- the Chairman is part of the management team; or
- the Chairman is not an independent director.[2]

This new requirement is intended to ensure strong and independent element on the Board which is able to exercise objective judgment on corporate affairs independently. From empirical evidence, this appears to be a core objective which the regulators are particularly keen to safeguard, such that any deviation from these requirements (where applicable) would require very cogent reasons.

On the other hand, it is recognised that Guideline 2.2 will need time to be implemented as a matter of commercial reality, especially as many listed companies in Singapore are likely to have to effect changes to their board composition in order to comply with the new requirements. The Code therefore allows a longer transition period for compliance with Guideline 2.2, specifically, to be made at the AGMs following the end of financial years commencing on or after 1 May 2016.

Reassessment of independence after nine years

Another new provision of the Code requires that the independence of any director who has served on the Board beyond nine years from the date of his/her first appointment be subject to particularly rigorous review. The concern relating to such directors, as set out in the Consultation Paper, is that their independence may be compromised after a long period of service due to their friendship and collegiality with management. The Council in its initial recommendation had provided that such a director would automatically be considered non-independent, but after considering public feedback ultimately decided to allow the Board to retain its discretion in determining whether such a director is independent. The Council arrived at the period of nine years as an appropriate tenure taking into account practices in Singapore and other leading jurisdictions. The Code does require that the Board must, when reviewing the independence of such a director, take into account the need for progressive refreshing of the Board and explain why any such director should be considered independent.[3]

As Singapore moves towards becoming one of the pre-eminent financial centres in Asia and internationally, it becomes increasingly crucial to ensure a culture of accountability and transparency among market participants, in order to shore up and maintain confidence in Singapore's financial markets. These enhancements contained in the revised Code will serve to put in place independent directors who are more able to protect the interests of shareholders at large and, in particular, minority shareholders, and in effect contribute towards raising Singapore's standards of corporate governance.

Multiple Board Representations

Where directors hold multiple board representations, the revised Code now additionally requires that the Board determine the maximum number of listed company board representations which any director may hold.[4] This is a result of the recent focus on the ability of directors holding multiple directorships to carry out their duties effectively.

The United Kingdom has specifically addressed such concerns by specifying the maximum number of directorships a director is allowed to hold. In Singapore, the revised Code does not adopt this approach on the grounds that the different situations facing

each director would make any attempt to dictate a maximum number arbitrary. Instead, listed issuers are given leeway to decide this issue for themselves. Indeed, a number of listed issuers have declined to prescribe a maximum number on the grounds that the number of listed company board representations that a director may hold should be considered on a case-by-case basis, and the Board should primarily be concerned with ensuring that a director has devoted sufficient time and attention to their role as director and to the affairs of the company. Such companies have therefore chosen to deviate from the Code and included their explanations in their annual reports.

Shareholders' Rights And Role

On the international front, there has been a shift by certain jurisdictions globally towards the so-called 'Anglo-American' model of corporate governance, which emphasises the interests of shareholders. This is motivated by the growing recognition that a company's corporate governance framework should involve shareholders in order to establish a strong system of checks and balances.

The revised Code reflects the progressiveness of Singapore's corporate governance practices as it evolves to provide for the recognition and facilitation of shareholder rights by way of the introduction of a new principle enshrining shareholder rights. The new Principle 14 in the revised Code sets out the overarching obligation on companies to treat all shareholders fairly and equitably and to recognise, protect and facilitate the exercise of shareholders' rights, as well as to continually review and update such governance arrangements.[5] To this end, companies should facilitate the exercise of ownership rights by all shareholders[6] and especially ensure that shareholders have the opportunity to participate effectively in and vote at general meetings of shareholders.[7] Companies are therefore strongly encouraged to consider engaging their shareholders, particularly activist shareholders and major shareholders, early in order to garner their support.

One practical measure the Code has endorsed is that companies should put all resolutions to vote by poll, preferably electronic polling.[8] However, electronic polling requires significant expenditure by the company to procure, operate and maintain the requisite electronic polling devices and, as a matter of practicality, certain companies may be reluctant to undertake such expenditure.

As for communication with shareholders, the Code now expressly states that companies should actively engage their shareholders by putting in place an investor relations policy to promote regular, effective and fair communication with shareholders.[9] This may be a point to note for companies which do not yet have such a policy in place. The participation of shareholders, and the resultant communication between shareholders and listed issuers as envisaged by the revised Code, would be integral in fostering good corporate governance practices that are in line with international best practices.

Remuneration Practices And Disclosures

Remuneration Practices

The increased finesse by which the revised Code assesses corporate practices may be seen in its elaboration on the larger goal of remuneration. While the 2005 Code simply required the level of remuneration to be appropriate to attract, retain and motivate directors, the global financial crisis imparted some valuable lessons on structuring remuneration practices. The Consultation Paper noted that it is a widely held view that the lack of correlation between remuneration and risk policies contributed to excessive risk-taking by employees, as employees were motivated to inflate short-term results without regard to the long-term effects and risks such behaviour placed on the company. The lack of transparency of remuneration-related information has also been cited as a contributory factor, as this merely exacerbated the effects of irresponsible remuneration practices. The Council therefore considered that changes were necessary in view of domestic and international developments.

The revised Code therefore provides that the underlying intention of the provisions on remuneration is to align the level and structure of remuneration for directors and key management personnel with the long-term interest and risk policies of the company.[10] It also states that the performance-related element of remuneration should be aligned with the interests of shareholders and should promote the long-term success of the company, as well as take into account the company's risk policies, be symmetric with risk outcomes and sensitive to the time horizon of risks.[11]

In terms of the mix of remuneration, the revised Code encourages long-term incentive schemes for executive directors and key management personnel,[12] though it also

recommends that the remuneration committee of the Board should consider implementing schemes to encourage non-executive directors to hold shares in the company as well, so as to better align their interests with those of shareholders.[13] More interestingly, the revised Code encourages the use of clawback provisions in relation to executive directors and key management personnel, namely contractual provisions which would allow the company to reclaim incentive components of remuneration in exceptional circumstances of misstatement of financial results, or of misconduct resulting in financial loss to the company.[14]

Disclosure Of Remuneration Policies

The revised Code requires significantly more than its predecessor in terms of disclosure of remuneration policies. However, in coming up with the revisions, the Council was conscious of the need to strike a balance between the desire for fuller disclosure on the one hand, and the need of companies to remain competitive and the possibility of 'wage inflation' on the other.

As such, while previously companies were only encouraged as a matter of best practice to fully disclose the remuneration of each individual director, full disclosure of the remuneration of each individual director as well as of the CEO, on a named basis, is now to be included as a matter of course.[15] The remuneration of the company's top five key management personnel is required by the revised Code to be disclosed in bands of S$250,000 on a named basis, as unchanged from the 2005 Code, but the revised Code encourages full disclosure of the actual remuneration of the top five key management personnel as a matter of best practice.[16]

More significantly, in line with the revised Code's encouragement of performance-related remuneration, it is now required that companies should disclose more information on the link between remuneration paid to the executive directors and key management personnel and performance, so as to achieve greater transparency. 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.[17] It is believed that this requirement is an appropriate solution to the problem of lack of transparency of remuneration-related information, though it remains to be seen whether and how listed issuers would choose to comply.

Risk Management

The revised Code introduces a second new principle governing the Board's responsibility for the governance of risk,[18] in light of the fundamental nature and scope of risk governance of a company. This also appears to be a direct response to the global financial crisis, which underscored the importance of companies taking an integrated, firm-wide perspective of their risk exposure.

The 2005 Code provided that the audit committee of the Board (the 'Audit Committee') is responsible for risk governance of the company, along with other matters such as the company's internal controls and audit function. In line with the corporate governance practices of several other jurisdictions, the revised Code shifts this responsibility of risk governance from the Audit Committee to the Board as a whole.

Thus, under the new Principle 11, read with the Risk Governance Guidance for Listed Boards issued by the Council on 10 May 2012, the Board is charged with a duty to ensure that the management of the company maintains a sound system of risk management and internal controls, and is also required to assess appropriate means to assist the Board in carrying out its responsibility of overseeing the company's risk management framework and policies.

More specifically, the Board is required under the revised Code to provide a commentary in the company's annual report on the adequacy and effectiveness of the company's internal control and risk management systems; this commentary should include information needed by stakeholders to make an informed assessment.

Moreover, the Board is to comment on the assurances it has received from the company's CEO and chief financial officer relating to the financial records and statements of the company and the effectiveness of the company's internal control and risk management systems.[19] This is intended to ensure that the management of the company has explored in depth the issue of whether an effective risk management and internal control system has been put in place, and has directed its mind to the balance between producing short-run profits and long-term risks.

Conclusion

The revised Code fortifies the guidelines and principles constituting Singapore's corporate governance regime and contains notable improvements on the 2005 Code. As Singapore demonstrates its resolve to become the choice destination for listings in Asia and internationally, the current round of revisions are expected to further boost the confidence for investors looking to invest in stocks listed on the Singapore bourse, and should stand Singapore's corporate governance regime in good stead to be commensurate with its standing as an international financial centre. ■

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References:

1. *See Guideline 2.3 of the Code.*
2. *See Guideline 2.2 of the Code.*
3. *See Guideline 2.4 of the Code.*
4. *See Guideline 4.4 of the Code.*
5. *See Principle 14 of the Code.*
6. *See Guideline 14.1 of the Code.*
7. *See Guideline 14.2 of the Code.*
8. *See Guideline 16.5 of the Code.*
9. *See Principle 15 of the Code.*
10. *See Principle 8 of the Code.*
11. *See Guideline 8.1 of the Code.*
12. *See Guideline 8.2 of the Code.*
13. *See Guideline 8.3 of the Code.*
14. *See Guideline 8.4 of the Code.*
15. *See Guideline 9.2 of the Code.*
16. *See Guideline 9.3 of the Code.*
17. *See Guideline 9.6 of the Code.*
18. *See Principle 11 of the Code.*
19. *See Guideline 11.3 of the Code.*