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Corporate governance at the crossroads

Can Singapore companies and directors transcend compliance to a more principle-based approach? BY MAK YUEN TEEN

IN AUGUST, the Monetary Authority of Singapore (MAS) issued the fourth edition of the Code of Corporate Governance for Singapore, after an extensive consultation of changes proposed by the Corporate Governance Council (CGC).

Since the Code was first introduced in 2001, there has been a continual enhancement in standards in areas such as board composition, risk management, and engagement with shareholders and stakeholders. Whether there has been an overall improvement in substance is more debatable.

For this latest review, certain core corporate governance guidelines have been hard-coded in the listing rules. The "comply or explain" approach has been enhanced not only by making compliance with the principles mandatory, but variations from provisions are only acceptable to the extent that companies "explicitly state and explain how their practices are consistent with the aim and philosophy of the Principle in question".

In addition, the explanations for variations should be "comprehensive and meaningful". However, this more prescriptive approach and tone is balanced by streamlining and simplifying other aspects of the Code. A key objective is to reduce boilerplate explanations in corporate governance reports and improve substance.

It is interesting that Malaysia, which released its latest Code in April 2017, and the United Kingdom, which released its' in July 2018, also opted for streamlining and simplification, and a greater focus on applying the spirit of the principles. After years of code revisions, there seems to be some common agreement that corporate governance codes have become too cumbersome and prescriptive.

However, in releasing the latest UK Code, the Financial Reporting Council sounded a cautionary note, emphasising that it is crucial for boards and companies to apply the spirit of the principles and to use the flexibility under the new approach wisely.

Not everyone is convinced about the readiness of the Singapore market for this new approach. Some stakeholders are concerned that with certain guidelines being moved to practice guidance which is not subject to "comply or explain", there will be a regression in standards. This may be particularly so in areas such as director independence, an area that we continue to struggle with after nearly 20 years.

Whether the new approach will work also depends on whether issuers will see the practice guidance as merely "nice to have" rather than good practices that they should have. This includes guidelines that were in the 2012 Code that have now been moved to practice guidance, which means there may be less visibility of non-compliance.

Companies should not see the new Code as necessarily setting a ceiling when it comes to corporate governance standards, especially in areas where stakeholders were consulted on but which did not make it to the final Code and other rule changes. What was finally adopted tries to balance the views of different stakeholders. In every topic that was consulted on, there were stakeholders who held different views, and in some cases, the disparity in views was quite significant.

There are some proposals in the consultation that were not eventually adopted that companies could consider implementing. They may even want to go further than what was consulted on.

Graphics: Mak Yuen Teen

> Independent directors having business relationships with the company, its related corporations, its substantial shareholders or its officers, and independent directors having personal interests in business transactions undertaken by the company, are a relatively common threat to the independence of directors in companies. Companies should be totally transparent about business and other relationships involving independent directors.

Leo E Strine, Jr, the former Vice-Chancellor of the Court of Chancery in the State of Delaware of the United States, wrote in 2002:

"…when an 800-pound gorilla wants the rest of the bananas, little chimpanzees, like independent directors and minority stockholders, cannot be expected to stand in the way, even if the gorilla putatively gives them veto power. Lurking in the back of the directors' and stockholders' minds is the fear that the gorilla will be very angry if he does not get his way."

The ability of controlling shareholders – or as Vice-Chancellor Strine, Jr put it, the "800-pound gorillas" – to appoint and remove independent directors, makes it difficult to achieve true independence for independent directors. Most companies here, of course, have a controlling shareholder.

The CGC considered several options to give more weight to minority shareholders' views in the appointment of independent directors.

First, it consulted on separate disclosure of the votes of non-controlling shareholders when independent directors stand for election. This would not change the ability of controlling shareholders to appoint independent directors, but would provide transparency on the support that independent directors have from minority shareholders. This was dropped following the consultation. However, there is no reason why companies cannot do this voluntarily.

Second, the CGC proposed two options relating to long-serving independent directors. The first option was a hard nine-year limit for independent directors. Under this option, an independent director would either have to be re-designated as a non-executive director after nine years, or step down. The second option was a "binding" two-tier vote under which an independent director who has served more than nine years can only be considered independent if he is approved by an annual vote of both a majority of all shareholders and a majority of non-controlling shareholders.

The hard nine-year limit was not adopted. Instead, effective from January 2022, the listing rules will include a modified form of the second option, whereby the first vote will include the votes of all shareholders, while the second vote will exclude the votes of directors, the CEO, and their associates. This two-tier vote is to be implemented each time a director has to stand for re-election.

In other words, controlling shareholders who are not directors, CEO, or their associates would be able to have their votes counted for the second vote. Therefore, in the Datapulse Technology-type situation, where the controlling shareholder is not on the board and is not considered an associate of the directors or CEO, she would be able to vote. Hopefully, we will not see major shareholders appointing their proxies to boards without themselves being on the board, so that they can continue to control the appointment of "compliant" long-serving independent directors.

At Japan Foods, Tan Lye Huat has served more than nine years as an independent director. Before its recent AGM, he discussed with the major shareholder and said that his continuation as an independent director should be subject to a vote by the independent shareholders only. He suggested that the major shareholder voluntarily abstain from voting for his election. Japan Foods is therefore not only an early adopter of the rule change, it goes further than the proposed rule because the controlling shareholder did not vote at all.

Companies like Japan Foods that aspire to go beyond minimum rules are the exception. I more often observe companies approaching the Code like Asian Micro and Chip Eng Seng.

Asian Micro recently re-designated the nephew of the executive chairman from a non-independent non-executive director to an independent director (the chairman's wife is the controlling shareholder), citing the reasons that he is not deemed as an immediate family member under the Code and that "his familial relationship does not interfere, or be reasonably perceived to interfere, with the exercise of his independent business judgement with a view to the best interests of the company".

RECALIBRATING THE BALANCE

At Chip Eng Seng, a new independent director who was appointed following the change in controlling shareholders is the executive director and CEO of another listed company with the same controlling shareholders – again, this is in compliance with the letter of the Code but arguably not in spirit.

Non-binding and binding two-tier voting, and even minority-only voting for independent directors, have already been introduced in some form in certain countries, such as UK, Israel and Italy. What Singapore has done is a "baby step" towards recalibrating the balance of power between controlling shareholders and other shareholders in the appointment of independent directors – and only long-serving ones.

I believe that companies that go beyond the rules, such as what Japan Foods has done, will be able to gain greater confidence from minority shareholders in their independent directors.

The Code guidelines on business and shareholding relationships have now been moved to practice guidance. This has raised some concerns that there will be less visibility over potential conflicts posed by these relationships.

Companies should, however, note Provision 2.1 under which the definition of an independent director refers to the absence of a range of relationships which could affect actual or perceived independence, and Provision 4.4 which states that companies should disclose the details of relationships and the reasons in the annual report if a director is still considered independent. It is not the intent that companies can just deem a director with such relationships as independent and not disclose these relationships at all.

Independent directors having business relationships with the company, its related corporations, its substantial shareholders or its officers, and independent directors having personal interests in business transactions undertaken by the company, are a relatively common threat to the independence of directors in companies. Companies should be totally transparent about business and other relationships involving independent directors.

Although the previous 2012 Code did not prescribe a specific limit on number of directorships, it went further than before in recommending that companies set a maximum number and disclose the number. Many companies simply chose not to do so, giving the reason that the appropriate number depends on various factors. Some companies set a maximum limit and then allowed their directors to exceed it, without explanation.

DIFFERENT LIMITS

The 2018 Code has now removed from the provisions that companies set a limit and disclose it. The practice guidance covers this issue and suggests that companies should consider setting different limits for executive directors and non-executive directors, and those with and without full-time employment. It also says that companies should consider other factors such as whether companies have the same financial year ends.

In countries such as US, UK and Australia, the greater risk of regulatory and private actions against directors and institutional shareholder activism helps mitigate the risks of "overboarding" by directors. Proxy advisory firms, such as Institutional Shareholder Services (ISS) and Glass Lewis, have included "overboarding" as one of the factors when considering whether they will recommend voting against the election of a director, with ISS having a maximum of six listed company directorships, and Glass Lewis having a limit of two for executive officers and five for other directors. Other countries such as China, Malaysia, South Korea and Vietnam, have chosen to impose specific limits.

Companies can still opt to set specific limits on number of directorships, disclose them in the annual report, and comply with them.

There are other areas where we have remained largely static, such as remuneration, and where the gap between what is in the Code and what is considered best practices internationally, is large. There are many opportunities for companies to aim higher.

I see the approach taken in the latest Code review as a test of our corporate governance maturity and whether our companies and directors are truly ready to embrace a more principle-based approach to corporate governance. Given that many companies seem to consider corporate governance as just compliance and compliance as just a cost, it is by no means clear that we have chosen the right path. Fail this test and we may have to go back to the drawing board when the Code is revisited again.

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