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Singapore's 'comply or explain' approach has not worked as well as hoped

We are fond of saying that one size does not fit all. So should one Code fit them all? BY MAK YUEN TEEN

WHEN the first Code of Corporate Governance was released in March 2001, it was against the backdrop of the East-Asian financial crisis, and the move from a merit-based to disclosure-based approach to regulation. The Corporate Governance Committee formulated the Code based on the shareholder model and adopted the "comply or explain" approach pioneered by the United Kingdom.

It is clear that this approach has not worked as well as hoped. One of the reasons is that our environment is different from that of the UK, where institutional investors play an important role in challenging corporate governance disclosures and practices of companies. Shares of UK-listed companies are mostly held by institutional investors, and such investors therefore have considerable influence there.

This is not the case in Singapore. There has been little pressure on institutional investors here to exercise their stewardship role, notwithstanding the adoption of a stewardship code. The chief executive of one listed issuer recently told me that only foreign asset managers ask them questions about corporate governance, not the domestic ones. Domestic institutional investors have therefore, in my opinion, been a disappointment.

When we moved to a disclosure-based regime, we also failed to strengthen regulatory enforcement and private enforcement by shareholders against disclosure breaches. How can we trust disclosures and explanations by companies under the disclosure-based regime and the "comply or explain" approach if there is little or no accountability for lack of disclosure or false or misleading disclosure?

The shareholder model is also under challenge. While there has been an increasing focus on the interests of other stakeholders and sustainability in the Code and listing rules over the past decade, changes to the Code may be needed.

Some questions we can ask are:

■ Should the responsibilities of directors be enhanced with respect to environmental and social issues?

■ Should provisions on board composition encourage consideration of competencies that are more relevant to wider stakeholders' interests?

■ Should the remit of remuneration committees include ensuring pay equity throughout the company?

■ Should disclosure of remuneration be expanded to include disclosure of the ratio of CEO to median employee pay?

■ Should companies be encouraged to consider introducing employee share ownership plans to improve employee engagement and inclusion, rather than only consider share-based incentives for executive directors and senior management?

■ Should there be a stronger focus on environmental and social risks?

Codes of corporate governance and corporate governance rules around the world have generally failed to address governance issues relating to company groups – that is, how parent companies should govern subsidiaries, joint ventures, associates and other entities within the group, and how to address conflicts that often arise in company groups. Only financial regulators have paid some attention to this issue for financial institutions like banks and insurance companies.

Singapore should take the lead when it next revises the Code of Corporate Governance, and include guidance related to company groups.
PHOTO: PIXABAY

In 2014, I co-authored a report on governance of company groups. Over the years, I have collaborated with my co-author to offer programmes on this topic for Malaysian directors. In many corporate scandals, the problems arose in a group entity that was often many layers below the ultimate parent company. Our experience is that parent and subsidiary companies' directors in our programmes recognise this as an important issue and are looking for more guidance.

During the consultation of the 2018 Code, the company secretary of a large company group asked me why this topic was not considered in the revision of the Code. Perhaps Singapore should take the lead when it next revises the Code and incorporate certain principles, provisions and guidance in the governance of company groups. Or perhaps there should be separate guidance relating to governance of company groups.

The mix and quality of companies have also changed over the past 20 years. The "S-chip" wave started in the mid 2000s, and we have never really dealt satisfactorily with the challenges faced by this group of companies. The number of such companies is now less than half compared to at its peak, with some delisted because of corporate governance or accounting scandals. More are unravelling, and I wonder how many will be left in a few years.

With up to 150 Chinese companies listed in the United States that could be forced to delist in the next 3 years due to the Holding Foreign Companies Accountable Act (HFCAA), some may land on the Singapore Exchange (one has already, through a secondary listing).

It is hoped that this will not lead to a repeat of the problems we have seen with the S-chips. If a market as sophisticated as the US is worried about the governance risks of these companies and their ability to properly regulate them, we should approach the listing of such companies here with great caution.

Many of these companies have variable interest entity (VIE) structures, which carry additional risks. We already have at least 2 Chinese companies listed here with a VIE structure: GHY Culture & Media and Nio (with Nio being a secondary listing). Nio and another secondary listing here – AMTD Idea (formerly AMTD International) – are only required to comply mainly with Cayman Island rules. We should ensure that at least one reputable market is properly regulating secondary listings listed here; otherwise, we better ensure that they have to comply with our rules.

The other significant change over the past 15 years is the increase in proportion of companies listed on Catalist since its launch. These are generally smaller and lower-quality companies, with limited institutional investor following. They are regulated under a sponsor-based regime. I am sceptical about the sustainability of the Catalist regime and believe that it should be reviewed. To put it bluntly, I do not see sponsors looking out for the interests of public shareholders in many cases.

I proposed in a recent article for the *SID Directors Bulletin* a taxonomy approach to regulating different types of companies, which takes into account their different risks. We are fond of saying that one size does not fit all. So should one Code fit them all?

The author teaches corporate governance at the National University of Singapore. He was a member of the Corporate Governance Committee that released Singapore's first Code of Corporate Governance for listed companies.

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