

Improving the Implementation of Corporate Governance Practices in Singapore

Written by Associate Professor Mak Yuen Teen
for
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1. EXECUTIVE SUMMARY

Singapore has an international reputation for good corporate governance, and has been ranked as having the best corporate governance in Asia in several surveys, including the CG Watch 2005 published by Asian Corporate Governance Association and CLSA. However, it is also widely recognized that compared to developed markets like Australia, U.K. and the U.S., there is considerable room for improvement. Improving corporate governance standards in Singapore can enhance Singapore's reputation as an international financial centre, help attract international investment, improve the liquidity of our stock markets, and reduce the cost of capital for our companies. It is therefore important that we continue to look for ways to improve the standards of corporate governance of our companies, especially our listed companies.

In May 2006, the Monetary Authority of Singapore and the Singapore Exchange Limited (SGX) commissioned Associate Professor Mak Yuen Teen, Director of the Corporate Governance and Financial Reporting Centre at the National University of Singapore, to undertake a project aimed at assessing the current state of corporate governance practices in Singapore and proposing measures to raise corporate governance practices in Singapore. The project was aimed at improving the substance of corporate governance practised by companies listed on the SGX within the context of the current rules, regulations, principles and guidelines. It was not focused on proposing new rules, regulations, principles or guidelines.

The project was conducted in two stages. For the first stage, a scorecard was developed to assess the current state of corporate governance practices and disclosures in Singapore, based on key areas in the Singapore Code of Corporate Governance. The scorecard was designed to allow an assessment of not only whether a company has reported the implementation of recommended corporate governance practices, but also the extent to which it has provided details of implementation. A total of 490 Mainboard and 169 SESDAQ companies were included in assessment of corporate governance disclosures and practices using the scorecard, using the 2005/6 annual reports of these companies.

The objective of this assessment was to ascertain the overall implementation of recommended corporate governance disclosures and practices and no ranking of companies was done. A database of directors currently sitting on the boards of SGX-listed companies was also developed. The purpose of this database was to study issues such as number of directorships held by independent directors and the tenure of directors. This stage of the study was completed in December 2006.

For the second stage, two focus group discussions, involving primarily independent directors, were organized by the MAS and SGX in early February 2007. The objective of the focus group discussions was to obtain views on some of the key issues identified in the first stage study. The focus groups discussed issues relating to the implementation of the “comply or explain” requirement, training of directors, independent directors, and audit committees.

This report presents the findings from the project and the author’s recommendations for improving the implementation of corporate governance practices in Singapore. Implementing these recommendations and improving corporate governance practices require the collective effort of regulators, directors, senior management, investors, and other market players and stakeholders. Independent directors can play a particularly important role in improving the corporate governance culture of companies they serve on and championing the implementation of sound corporate governance practices.

The key findings and recommendations from the study are summarised below.

Recommendation 1: Implementation of the “Comply or Explain” Requirement

It was found that non-compliance with the letter or spirit of the “comply or explain” requirement in relation to the Singapore Code of Corporate Governance was relatively common. The implementation of the “comply or explain” requirement can be improved by improving the understanding and acceptance of the “comply or explain” requirement and of certain Code guidelines; providing more guidance to companies on implementing the spirit of Code principles and guidelines; improving the process within companies in

ensuring compliance with the “comply or explain” requirement; and enhancing the monitoring and enforcement of the “comply or explain” requirement.

The following measures should be considered to improve the implementation of the “comply or explain” requirement:

- a) The board of directors of companies should ensure that there is a process in place to ensure proper application of the “comply or explain” requirement and that corporate governance disclosures in annual report reflect corporate governance practices of the company.
- b) Companies should use a checklist internally to ensure that key corporate governance practices relating to each principle are described, and confirming if the company complies with each guideline, and if not, to provide an explanation.
- c) To aid investors in understanding the extent of application of the Code, companies should provide a positive confirmation statement at the beginning of the corporate governance report that the company has applied all the principles and complied with all the guidelines, or to identify deviations where this is not the case.
- d) The committee responsible for reviewing the Code should provide clearer rationale for specific principles and guidelines so that the intent of these guidelines is properly understood by companies.
- e) Regulators should lead initiatives to provide more practical guidance and education on implementing major principles and guidelines within the Code, including good corporate governance reporting practices, for example, through joint efforts between the regulators and the major professional bodies, disseminating guidance developed by regulators and professional bodies in other countries, and by organizing educational forums whereby good practices can be shared.
- f) Shareholders should question companies at AGMs about their corporate governance practices as disclosed in the corporate governance report.
- g) Regulators should lead initiatives to periodically review compliance with the Code and implementation of the “comply or explain” requirement, with a view to educating companies on how to improve the implementation of the Code, identifying challenges faced in implementation, and providing inputs into future revisions of the Code.

Recommendation 2: Independence, Effectiveness and Pool of Independent Directors

The study found that acceptance of the Code's recommendations in terms of proportion of independent directors on the board and on board committees is very high across Mainboard, SESDAQ and foreign companies. However, compared to Mainboard companies, a lower proportion of SESDAQ companies have gone beyond the Code's recommendation of at least one-third of independent directors on the board. SESDAQ companies are also more likely to have family relationships among the Chairman, other directors and senior management. This creates greater challenges to independent directors in discharging their responsibilities. Foreign companies face even more challenges in recruiting good independent directors.

The proportion of directors who are labeled as independent generally meets the Code's recommendations. Nevertheless, there are concerns about the amount of influence which controlling shareholders have over the appointment of independent directors, the process by which independent directors are typically appointed, the relatively small pool from which independent directors are drawn, and how nominating committees are assessing the independence of directors. These could affect the ability or willingness of independent directors to act independently.

On the issue of number of directorships currently held and the tenure of independent directors, the proportions of directors who serve on many boards or who have served for a long time as independent directors on boards are currently relatively low. Currently, about 6.5 percent of independent directors sit on more than 4 boards of SGX-listed companies and about 10 percent of independent directors have served on their boards for more than 9 years. Nevertheless, shareholders should question boards as to whether directors who serve on many boards are able to commit the necessary time to discharging their responsibilities, and whether independent directors who have served for a long time can continue to be considered to be independent.

Currently, independent directors usually resign without giving reasons, even though their resignation may be due to serious disagreement with the board or concerns about governance of the company. There is often a lack of transparency when directors resign because companies commonly include announcements of resignations together with other announcements.

The following measures should be considered to improve the independence, effectiveness and the pool of independent directors:

- a) Investors, including institutional investors at the IPO stage, should apply more pressure on companies to adopt more open processes for recruiting independent directors and be more proactive in proposing independent director candidates and asking questions about the choice of independent director candidates.
- b) Regulators should consider supporting the creation of an online directors' register to increase the pool of independent directors and to assist companies in finding independent director candidates.
- c) Nominating committees should adopt a more holistic approach, consistent with the spirit of Guideline 2.1, in assessing the independence of independent directors. They should consider the relationships specified in Guideline 2.1 as examples of relationships that may affect the actual or perceived independence of directors and be more stringent in assessing the independence of directors who are also professional advisers for the company.
- d) The SGX should have a separate category for announcements of "resignations of directors and key officers" on the SGXNET. Companies should state more clearly the reasons for director resignations.
- e) Independent directors who are resigning should be encouraged to privately communicate any concerns to the SGX or other regulators.

Recommendation 3: Remuneration Disclosures and Policies

Globally, executive and director remuneration is one of the top issues of concern to shareholders. However, remuneration disclosures and policies for directors and senior executives is a significant area of weakness among Singapore companies. There is also

evidence that many Singapore companies use mainly short-term incentives – such as annual cash bonuses and share incentives that vest over short periods - which are not necessarily consistent with the creation of long-term shareholder value. The lack of transparency in remuneration policies and levels increases the risk of excessive remuneration.

The following measures should be considered to improve remuneration disclosures and policies:

- a) Minority shareholders (including institutional shareholders) should apply more pressure on companies to provide full disclosure of remuneration of individual directors and key executives, especially those directors or key executives who are controlling shareholders or related to controlling shareholders. Minority shareholders should consider using s164A to requisition for full disclosure of individual directors' remuneration. The SGX can also use rule 704(11) to improve disclosure of remuneration of executives who are related to a director, CEO or substantial shareholder.
- b) Companies should be encouraged to have a better balance between short-term and long-term incentives in their remuneration policies. IPO sponsors and major outside investors should be more pro-active in encouraging the use of longer-term incentives in service agreements at the IPO stage.
- c) Companies should pay more attention to the design and implementation of share-based remuneration to ensure that they align the interests of directors and executives to the long-term interests of shareholders, are closely linked to individual or company-specific performance, include challenging targets that reward good rather than average performance, and are disclosed on a timely basis.
- d) Companies should review their non-executive directors' fees and the way these fees are set to ensure that they are able to attract good and committed independent directors. Shareholders should be open to paying higher fees for good independent directors, provided companies are transparent about the setting of fees and able to justify higher fees.

Recommendation 4: Audit Committee (AC)

To be effective, an AC needs to be highly independent, have the necessary mix of expertise and experience commensurate with the nature of its responsibilities, and devote enough time to discharging its responsibilities. Compliance with the Code guidelines on independence of the AC chair and proportion of independent directors on the AC is very high. On average, ACs of Mainboard companies meet 4 times a year, while ACs of SESDAQ companies meet 3 times a year. It should be noted that most SESDAQ companies report only on a half-yearly basis, which may explain their lower frequency of audit committee meetings.

Although the Code recommends that at least two members of the AC should have accounting or related financial management expertise or experience, the interpretation of what constitutes relevant expertise or experience is left to the Board. Based on the biographical information of directors provided in annual reports, it is estimated that between 20 to 25 percent of AC chairmen and between half to 60 percent of all AC members (including the chairmen) do not have qualifications in accounting or finance, nor have they worked in accounting or finance-related positions. Although it is recognized that diversity of background is useful on the AC and that individuals with significant business experience, but not necessarily accounting or financial management expertise or experience, can make excellent AC members, there are questions as to whether some audit committees have the necessary accounting or financial management expertise or experience for them to be truly effective. .

Training related to AC-related matters, practical guidance, and sharing of experience among AC members can help enhance the effectiveness of ACs.

The following measures should be considered to improve the effectiveness of ACs:

- a) Boards of directors should ensure that there is adequate accounting or financial expertise and experience on the AC. Shareholders should query companies as to whether there is the necessary expertise or experience on the AC.

- b) Regulators should work with other professional bodies and seek the assistance of experienced AC members to share practical insights into the work of the AC with less experienced AC members and to allow for the exchange of ideas through forums and roundtables.
- c) Regulators should encourage, and work with, professional bodies and other market players to develop and disseminate best practice guidance relating to the AC, such as critical financial reporting issues, external audit, internal audit, internal control and risk management.

Recommendation 5: Internal Controls and Risk Management

Some of the large companies, banks and other financial institutions have established formal risk management systems and internal controls, and provide good disclosures about their risks and approaches to managing risks, and the nature of internal controls and processes for ensuring their adequacy. However, these are exceptions. Many companies do not provide statements of the board's opinion about the adequacy of internal controls – or these statements are ambiguous – even though it is accepted that the board can at best provide reasonable assurance but not absolute assurance about these controls.

There is little practical training and guidance available to directors on internal controls and risk management and insufficient attention to assisting SMEs in implementing cost-effective internal controls and risk management.

The following measures should be considered to improve disclosure and effectiveness of internal controls and risk management systems of companies:

- a) Companies should provide more informative disclosures about their internal controls and risk management systems, and their approaches to ensuring their adequacy.
- b) Shareholders should seek more information from companies about their risks, internal controls, risk management processes, the board's opinion on the adequacy of internal controls, and the basis for the opinion.
- c) More practical guidance and training should be provided to directors on internal controls and risk management.

- d) More guidance should be developed to assist listed SMEs to implement cost-effective internal controls and risk management.

Recommendation 6: Training of Directors

The training of directors in Singapore lags behind the developed markets and a number of emerging markets. This is partly due to both demand and supply issues relating to factors such as the lack of pressure on directors to go for training, lack of formal training roadmaps catering to directors with different experience, over-emphasis on legal and regulatory issues in training programs, lack of practice-oriented training, and lack of appropriate content.

The following measures should be considered to improve the demand and supply of training for directors:

- a) Regulators should work with other professional bodies to specify minimum training requirements for first-time directors based on a formal training roadmap which takes into account the skills and knowledge required to be a director. Regulators and other professional bodies should encourage all directors to attend ongoing training to update themselves. More pressure should be put by shareholders on companies to disclose whether directors have attended training and the type of training attended.
- b) Regulators should support initiatives to develop training roadmaps and content, and the delivery of training, for first-time and experienced directors. Collaboration with institutes of directors in more developed markets, such as Australia, to develop and deliver such programs should be explored. Support for training should include financial support, especially in developing courses and content. Types of training should include learning through case studies of practical issues faced by boards and roundtable discussions which allow the sharing of experience.
- c) Regulators should support initiatives to develop more training programs and content in Chinese.

Recommendation 7: Exemption from SGX Listing Requirements

Companies with a secondary listing on the SGX are not required to comply with SGX continuing listing requirements. They are therefore not required to “comply or explain” to the Singapore Code. Some of these companies may also not “comply or explain” to the corporate governance code of the overseas exchange because the Code in the overseas exchange may not apply to companies which are incorporated in another country.

In the spirit of the disclosure-based approach and *caveat emptor*, the following measure should be considered:

SGX should clearly identify those companies which are not required to comply with its continuing listing requirements.

Recommendation 8: Institutional Shareholder Activism

Institutional shareholder activism is fundamental to raising corporate governance standards in the developed markets, and especially in the successful implementation of the “comply or explain” approach with minimal regulatory intervention. Increasingly, institutional shareholder activism has spread to other emerging markets, partly driven by the actions of international institutional investors and partly by an increase in domestic institutional shareholder activism. In Singapore, institutional shareholder activism remains at a nascent stage of development, with very few institutional investors actively engaging with companies, participating in shareholder meetings, and voting their shares. This has contributed to the lack of market enforcement of the “comply or explain” approach in Singapore. International institutional investors are also increasingly concerned about barriers to effective shareholder engagement in markets they invest in.

The following measures should be considered to promote greater institutional shareholder activism and to enhance the shareholder engagement activities of institutional investors in Singapore:

- a) Barriers to shareholder engagement, including voting proxies and attending meetings, should be further studied with a view to overcoming or reducing them.
- b) More pressure should be placed on institutional investors and fund managers to discharge their fiduciary duty to beneficiaries and to be more transparent in their shareholder engagement policies.

In addition to the above recommendations, the main report includes a number of annexures which listed companies and other stakeholders may find useful. These include Annex 3 which provides a suggested checklist for self-assessment of compliance with the Code of Corporate Governance 2005, Annex 4 which provides examples of good corporate governance reporting practices and Annex 5 which provides examples of poor corporate governance reporting practices.