THE SECURITIES MARKET
FINAL RECOMMENDATIONS

CORPORATE FINANCE COMMITTEE

21 October 1998

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RECOMMENDATIONS

PHILOSOPHY OF REGULATION

To plug into the international financial system, we must play by the rules of the international financial system to build a market driven securities market. In relying on a free market, it becomes more important that the integrity of the market place is protected, but balanced with the need to encourage innovation, entrepreneurship, efficiency and business flexibility. The disclosure based philosophy, fosters a market driven environment which reduces the cost of capital and avoids the cost of missed opportunities from delays, lowers moral hazard, and encourages innovation and business flexibility.

Recommendation 1
A predominantly disclosure based philosophy of regulation should be adopted as it best fosters a market driven environment that promotes innovation, entrepreneurship, efficiency and business flexibility while protecting the integrity of the securities market.

THE REGULATORY FRAMEWORK

A disclosure based regulatory regime will work effectively only if there is a strong regulatory framework to protect the integrity of the securities market. The regulatory framework must set out fundamental rules which must be enforceable and enforced. To protect the integrity of the securities market, a strong regulatory framework is necessary, to raise the standard of disclosure, increase the transparency and certainty of rules, and provide remedies for enforcement.

Recommendation 2
To raise the standard of disclosure, there should be a comprehensive and stated legal obligation to disclose.

Recommendation 3
Laws and rules applicable to the securities market, as distinct to core company law, should be consolidated into a single legislation.

Recommendation 4
There should be three tiers of rules. These would consist of primary legislation, secondary legislation and non-statutory rules.

Recommendation 5
(a) Securities market rules should as far as possible be made statutory.
(b) The securities regulator and the SES should publish its policies and interpretations on rules to provide greater transparency to the market.
(c) The securities regulator and the SES should also provide reasons for decisions, and allow an avenue of appeal against the decisions.

Recommendation 6
(a) The single securities regulator model should be adopted to clarify responsibility and accountability and raise efficiency. Securities regulation should be consolidated and administered by a securities regulator.

(b) The securities regulator would enforce all aspects of securities law and regulations, including disclosure obligations. The RCB would administer core company law. Criminal prosecution would continue to be done by the CAD or the Attorney General's Chambers. The SES would operate a securities exchange and promote the growth of the securities market. The SES' role as a conduit between market participants and the government, to give feedback to government departments to promote growth, would be enhanced. The SES would approve listing applications, undertake market surveillance, monitor continuing disclosure, promote corporate governance and enforce its Listing Manual. Where a breach of the law is suspected, the matter will be handed over to the securities regulator for investigation and enforcement. It would continue to regulate its member firms.

(c) The securities regulator should be distinct from and should not be subordinated to the banking prudential regulator.

Recommendation 7

(a) The securities regulator should have power to enforce securities regulation, including pursuing civil actions in the public interest.

(b) The public interest test must be properly defined to reduce the uncertainty over when the securities regulator will pursue civil actions, and to avoid moral hazard.

(c) The law should allow for damages awarded to be distributed to investors. The securities regulator should be able to offset its cost against the damages awarded before distribution to investors. It should be allowed to retain the damages awarded unless and until valid claims are made against it by investors. The rights of individual investors to litigate for themselves should be preserved, but the securities regulator should have the right to intervene in litigation brought by private litigants or to initiate litigation on its own in the public interest.

Recommendation 8

The securities regulator should be empowered to impose administrative sanctions for breaches of its rules. The SES should continue to impose contractual sanctions for breaches of its Listing Manual. The power to impose fines for breaches of securities regulation should be reserved for criminal prosecutions.

Recommendation 9

The securities regulator should be granted investigative powers to enforce both statutory and non-statutory securities rules. Where the securities regulator finds evidence of criminality in its investigation it should refer the matter to CAD or the Attorney General's Chambers for criminal investigation.

Recommendation 10

(a) A civil right of action for insider trading, which is independent of a criminal conviction, should be created to enable persons to obtain compensation for losses suffered as a result of insider trading.

(b) The plaintiff must show that the trading was contemporaneous with the insider trading, but not that the counterparty who dealt with the plaintiff's shares was the insider.

(c) The securities regulator should be allowed to intervene in or commence civil actions for insider trading.

(d) The insider trader should be liable for all losses suffered by all contemporaneous counterparties, up to a certain maximum value. If the losses claimed are more than the maximum value claimable, the maximum value is to be distributed to the claimants on a

pro-rata basis. Where the civil action is pursued by the securities regulator, it should be allowed to retain the damages awarded unless and until valid claims are made against it by investors.

A HIGH STANDARD OF DISCLOSURE

A high standard of disclosure levels the playing field between companies and investors. It allows investors to be able to make better informed decisions, and the market can discharge its resource allocation function more efficiently. Legal disclosure obligations expressed in the form of a general test plus checklist, will prescribe a high standard of disclosure that is enforceable, while retaining flexibility in specifying minimum disclosure items in checklist regulations. A high standard of disclosure enhances players' confidence in the market, allowing corporate and investment activities to thrive.

Recommendation 11

(a) The disclosure requirement should be in the form of a general test in primary legislation supplemented by checklists in secondary legislation. The general disclosure test should cover both prospectuses and continuing disclosure. Primary legislation should empower the securities regulator to make disclosure checklists as it considers necessary.

(b) Prospectuses and all continuing disclosure should disclose all information that investors and their professional advisers would reasonably require and expect to find in order to make an informed investment decision.

Recommendation 12

The prospectus checklist for local and foreign issuers should be substantially similar to the proposed International Disclosure Standards on prospectus disclosure with appropriate modifications (which should be kept to a minimum) to meet local requirements.

Recommendation 13

Issuers should be allowed to issue an additional mini prospectus that is more useful to the target audience by providing such investors with the information which they need without unnecessary details. Certain detailed information may also be incorporated by reference in the full prospectus but lodged with a relevant authority and be available for inspection at a website or at the company's registered office.

Recommendation 14

The disclosure checklist for rights issue abridged prospectuses and placement statement of material fact should consist of the items currently required in Part V of the Fifth Schedule of the Companies Act and information on the intended use of the proceeds and how the use of the proceeds will impact on the financial performance of the issuers.

Recommendation 15

(a) The period to present annual reports of listed issuers to shareholders should be shortened to five months from the end of the financial year.

(b) To allow more timely preparation of financial statements, the Companies Act should be amended so that auditors can express their opinion on the consolidated financial statements of the holding company without all the financial statements of the subsidiaries having to be signed off by their respective auditors. The amendment should also allow subsidiaries, especially those located overseas, to have their financial year end not more

than, say, two months earlier than that of the holding company, except in the case of subsidiaries in jurisdictions where financial year ends are mandated by legislation.

Recommendation 16
Listed issuers should be encouraged to report their results on a quarterly basis. Subject to changes to the law to permit more timely preparation of financial statements, interim results should be released within 60 days of the period end.

Recommendation 17
(a) The securities regulator should have the power to prescribe accounting rules for companies that are listed or have made public offers of securities in Singapore and for public offering documents.
(b) Foreign companies not already preparing their financial statements in accordance with the prescribed standards should reconcile their financial statements to accounting standards prescribed by the securities regulator.
(c) The securities regulator may grant exemptions to allow locally incorporated public companies that are listed or are making public offers to comply with prescribed accounting standards other than Singapore accounting standards.

LIBERALISATION AND DEVELOPMENT

Strong market discipline and a sound regulatory framework will protect the integrity of the market. There is less need for rules or regulations that set limits on what can or cannot be done. It is timely to liberalise such rules and regulations to allow the market to drive transactions more fully and efficiently. It is also important to develop regional corporate financing activities done in regional securities markets by professionals, and to develop a regional private venture capital market that is based in Singapore. Technology adoption should be accelerated to raise the efficiency of securities market transactions.

Recommendation 18
(a) The SES should continue with its strategy to have different boards to cater to different market segments, for both local and foreign companies, such that:-
    (i) The Main Board should be a market for companies with an established profit track record or large market capitalisation.
    (ii) SESDAQ should be a market that provides for greater flexibility.
    (iii) The Foreign Board can be abolished as the Main Board and SESDAQ could cater to companies that would have qualified for the Foreign Board.
    (iv) The listing criteria for foreign and local companies should be identical.
(b) Foreign companies should be allowed to decide the currency in which they trade their shares in order to attract more foreign listings to the SES.
(c) The Main Board track record listing criteria would require that the listing applicant's management team remains substantially intact. The continuity of management rule should not apply to companies that seek admission to the Main Board based on the market capitalisation criteria.
(d) The SES should consider providing some quantitative benchmarks in its listings criteria on promoters' integrity. The securities regulator may exercise judgement to decide not to accept the prospectus which a listing applicant has lodged where it has confidential information which creates doubt about the integrity of the promoters.

(e) Singapore should eventually follow the international practice regarding moratorium on securities disposals, which is driven by investors and underwriters. In the interim, it is proposed that the SES Listing Manual be revised to provide as follows:-
   (i) The promoters of Main Board issuers should give a contractual undertaking to the issue manager that, in the first six months, they will not dispose of any part of their holdings, and in the following six months, they will retain at least 50% of their original holdings.
   (ii) The promoters of SESDAQ issuers should give a contractual undertaking to the issue manager such that, in the first year they should not dispose of any part of their holdings, and in the following year, they should retain at least 50% of their original holdings.
   (iii) Promoters subject to the moratorium rule are substantial shareholders who have control over the applicant and associates of such substantial shareholders.
   (iv) Promoters' shareholdings in the listing applicant's holding company which is listed on a stock exchange should not be subject to the moratorium..
   (v) Institutional or strategic investors who take a significant stake in a company within one year prior to the company's listing should be subject to a moratorium period of six months.

Recommendation 19
A listed issuer may raise funds without any specific use of funds subject to disclosure of the rationale for the fund raising and to disclosure of material utilisation of the funds as and when the funds are subsequently deployed.

Recommendations 20
(a) Listed issuers may obtain a general mandate to issue new shares by way of rights shares, bonus shares or placement shares, or any combination thereof, subject to an overall limit of 50% of the issuer's existing issued share capital.
(b) Consideration should be given to allowing the rights shares to trade on a "when-issued" basis immediately after the close of the rights issue.
(c) Listed issuers should have the option to sell excess rights shares in the open market.

Recommendation 21
(a) Listed issuers may include in the annual general mandate, a sub-limit for placements of securities representing up to 20% of the existing issued share capital.
(b) Listed issuers may sell placement shares at up to a discount of 10% from the current share price. The price should be based on the weighted average price for trades done on the day of announcement, which provides a better representation of the price done on the day in question.
(c) A listed issuer may borrow shares from substantial shareholders for placement, in anticipation of the placement shares being issued.

Recommendation 22
(a) The overall limit for warrants and convertibles can be raised to 100% of issued share capital.
(b) The issuer should have the flexibility to determine the exercise price for warrants and convertible securities.

Recommendation 23
Listing approval for debt securities offered to sophisticated and institutional investors could be given when the issue is fully subscribed. Such securities need not comply with any listing criteria.

Recommendation 24
The documentation requirements for listing applications should be simplified to require only a brief listing application covering essential corporate information, with the substantive information about the listing applicant and its offering given in the draft prospectus.

Recommendation 25
(a) Issuers and their underwriters should be allowed to decide how their issues should be distributed, subject to compliance with the SES' rules on prescribed shareholding spread and other rules to prevent undue concentration of holdings, so as to promote liquidity and an orderly market in the securities. It should be left to them to decide whether to distribute the issues by placement or public offer or a combination of both, to choose their end investors, and whether or not to accept multiple applications.
(b) The bookbuilding method of securities distribution should be adopted in Singapore securities as an alternative to or in combination with other methods. Consequent changes are required to permit the issue of "red herring" prospectuses and to allow price stabilisation for Singapore dollar initial public offerings.
(c) Changes should be made to permit "when issued" trading for initial public offerings to commence on the market day following the close of the offer.

Recommendation 26
(a) For the Main Board, SES could consider adopting a graduated scale for size of free float that varies according with the amount of proceeds raised to provide flexibility in raising funds.
(b) To allow SESDAQ companies to have greater flexibility, they should be subject to a spread requirement which is less stringent than Main Board companies.

Recommendation 27
The SES should consider setting continuing free float and spread requirements at a percentage of the levels set for of initial listing, in order to maintain a fair and orderly market.

Recommendation 28
(a) The rules on corporate governance should eventually take the form of principles and best practices which listed issuers should evolve and observe.
(b) Listed issuers should disclose in their annual report, the corporate governance practices and procedures in place during the financial period under review. To achieve wide acceptance, a Code of Best Practices on Corporate Governance should be developed by a body with wide sectoral representation. To give such a code the desired effect, the SES should require listed issuers to disclose how they have applied and complied with the Code or, where appropriate, to make a negative statement.

Recommendation 29
(a) Controlling shareholders (defined as a person with the capacity to dominate decision-making, directly or indirectly, in relation to the financial and operating policies of the company) in executive positions should be allowed to participate in ESOS, subject to specific approval by independent shareholders of their participation and the actual grant of

options. For Main Board companies, the participation by controlling shareholders should be subject to specific individual and aggregate limits.

(b) Participation in ESOS should be extended to non-executive directors as well as directors and employees of the parent group whom the listed issuer considers to have contributed or can contribute to its success, subject to annual disclosure.

(c) Unlisted subsidiaries of a listed issuer are free to implement their own ESOS, subject to approval of the listed parent issuer's shareholders.

(d) For Main Board companies, the current scheme size limit of 5% should be increased to 15% and eventually removed. For SESDAQ, no limit should be imposed on the size of the scheme. There should be no individual or class limits.

(e) Options may be granted at a discount to market price if the options are exercisable only after a specified vesting period, and shareholders have specifically approved the quantum of the discount.

(f) Options should not be exercisable within one year of the date of grant. For employees who have served less than a year, the issuer should have the discretion to decide whether to impose a longer moratorium.

Recommendation 30

(a) The law on directors duties should be augmented to cover interested person transactions, such that a breach of which could attract legal remedies that can be enforced by shareholders and the securities regulator.

(b) In the interim, interested person transaction rules could be streamlined to give greater flexibility to listed issuers, where the interest of public shareholders is not put at risk, as follows:-

  (i) The scope of interested person transactions should be modified to exclude transactions which involve potential conflict of interest that is remote, or no conflict of interest, by narrowing certain definitions as follows:-

    - An "interested person" is a director, chief executive officer, or controlling shareholder of the listed issuer; or an associate of any such director, chief executive officer, or controlling shareholder.
    - An "associate" is a person who is an immediate family member, or company or trust in which the person and his immediate family has control.
    - An "entity at risk" is the listed issuer, its subsidiaries, and associated companies over which the listed issuer and its interested person have control.
    - "Control" means the capacity to dominate decision-making, directly or indirectly, in relation to the financial and operating policies of the relevant company.

  (ii) Materiality thresholds that trigger an announcement and/or shareholders' approval should be expressed in terms of a percentage of the listed issuer's net tangible assets and not as an absolute number.

Recommendation 31

Compliance with the new listing criteria for very substantial acquisitions should be based on the enlarged group, instead of just the acquired assets. Very substantial acquisitions of businesses or assets in a similar line of business which meet certain prescribed conditions should not require SES and shareholders' approval.

Recommendation 32

(a) The formation of business angel networks and other forms of informal funding sources should be supported.

(b) A programme to assist companies to put up coherent business and financial plans should be developed.

Recommendation 33
To cater to companies that may find listing on SESDAQ uneconomical, consideration should be given to setting up an internet based bulletin board to provide an infrastructure for private venture capital transactions, which is restricted to sophisticated investors and venture capitalists.

Recommendation 34
To develop the venture capital sector and to build Singapore into a hub for regional venture capital activities the following initiatives should be considered:-

(a) Continue to attract foreign venture capitalists with the experience and comfort levels in investing in and nurturing start-ups for public listing and foreign investment banks that specialise in underwriting start-up companies and companies with no profit track record.
(b) Leverage off the already established base of regional venture capitalists by promoting a range of services to regional venture capitalists and regional companies from internet bulletin board, business plan assistance, business angels network, and eventual listing on SESDAQ.

Recommendation 35
To further develop investment banking activities in Singapore:-

(a) Focus should be given to attracting clusters of inter-related components of investment banks, as well as supporting legal and accounting and information technology professionals.
(b) Large global investment banks should be targeted to centre their Asian or ASEAN equity divisions in Singapore by facilitating their membership in the SES sooner rather than later.
(c) The Financial Sector Promotion body in MAS should be given a pivotal and authoritative role, both in laying groundwork for development and in promoting Singapore to leading investment banks. The SES should complement the Financial Sector Promotion body with respect to the listing and fund raising activities conducted on the SES.

Recommendation 36
As liquidity is an important magnet for industry participants, the following steps are recommended:-

(a) Introduce derivative contracts on currency, interest rate and index futures of Asian countries.
(b) Clarify the law on the trading of OTC derivatives trading to facilitate the growth of the derivatives business.

Recommendation 37
There should be a review of Singapore's tax environment to make it more competitive and to remove any impediments to innovation in the financial industry and attracting professionals to locate to Singapore, including a review of the need to impose withholding tax on financial instruments.

Recommendation 38

(a) The adoption of technology should be accelerated to better connect into the international financial system, facilitate information distribution, fund raising, trading, and the exercise of shareholders rights.

(b) As a start, internet should be accepted as a medium for distributing prospectuses and other continuing disclosure requirements. If necessary, the law should be changed to allow this.

1. INTRODUCTION

The Corporate Finance Committee ("the Committee") was formed by the Financial Sector Review Group to make recommendations with the view of making Singapore a key financial centre for international corporate fundraising activity.

On 26 May 1998, the Committee issued a Consultative Paper outlining its preliminary views and sought comments on these views. Over 30 responses were received. The Committee issued a summary of the main concerns raised by these respondents on 26 August 1998. The Committee wishes to thank all those who responded to its Consultative Paper and for the high quality and rigour of the views and analyses. In making its final recommendations, the Committee has taken into account these views.

The Committee also acknowledges the assistance and views provided by various market practitioners, including banks, merchant banks, fund managers, venture capitalists, company registrars, lawyers and accountants.

1.1. TERMS OF REFERENCE

The terms of reference of the Committee are:-

(a) To recommend an appropriate framework of rules, regulations and administrative guidelines governing corporate fund-raising that will:-
  (i) Support steady and sustainable growth of corporations in Singapore;
  (ii) Foster innovation and entrepreneurship;
  (iii) Make Singapore an attractive centre for international corporate fund-raising activity.
(b) To recommend ways to improve the efficiency of the fund-raising process, as well as standards of corporate disclosure.
(c) To recommend new or enhanced industry capabilities to better meet the financing needs of corporations, e.g. debt financing, covered warrants, new board for start-ups; and a framework of rules and regulations to promote these activities.
(d) To recommend for Government's consideration suitable respective roles for the Stock Exchange of Singapore ("SES"), the Monetary Authority of Singapore ("MAS") and the Registry of Companies and Businesses ("RCB"), as well as other government agencies as appropriate.
(e) The review should include, but need not be limited to, relevant parts of the Securities Industry Act, SES Listing Manual and the Companies Act.

1.2. NEW OPPORTUNITIES

Singapore is already a capital centre for Asian Dollar Market, loan syndication, foreign currency trading, G7 equity and bond futures trading on the Singapore International Monetary Exchange ("SIMEX"). Fast changing technology, sound market infrastructure, and the need for a well regulated market, provide new opportunities. We believe that Singapore can become an important international capital centre in the same way that it has made itself into a hub for shipping and for air transport by being more efficient and providing better services. Indeed, without a large domestic economic base, it is imperative that we service both the regional and global market.

The continuing financial crisis set back many economies in Asia and threatens to spread further afield. However, when the crisis passes, there will again be a need to rebuild economies and their businesses. The need for capital will be huge.

1.3. OVERVIEW

Singapore has a market friendly environment, an open economy which allows free flow of capital, augmented by high standards of integrity and sound financial management.

In order to become an international capital centre, Singapore should deepen its integration with the international financial system. We must continue to maintain an open financial system, foster an efficient and market friendly environment that caters to the needs of the market. Our rules and practices must be consistent with those in the major markets so as to facilitate cross-border transactions

To plug into the international financial system, we must play by the rules of the international financial system. We must build a market driven securities market with greater transparency and a high standard of disclosure, a market friendly regulatory regime, strong and reliable remedies and providing a level playing field for all players.

The market place should allow innovation, entrepreneurship, efficiency and business flexibility. Abuse and manipulation must be checked to protect the integrity of the market place and to maintain investor confidence. The disclosure based philosophy of regulation best reconciles this by encouraging transactions and activities, innovative products and structures to thrive. However, this must be supported by a strong regulatory framework of enforceable rules that must be enforced to protect the integrity of the market place. Where rules are transparent, certain and reliable, and disclosure standards high, the playing field between companies, market intermediaries and investors will be levelled. Players will have the freedom and confidence to maximise business and investment opportunities, knowing that the disclosure is reliable and transactions are enforceable. Investors will be better able to judge the merits of their investments.

In such an environment, there is less need for rules that set limits on what can or cannot be done. Whether a corporate transaction should or should not be carried out should be determined by the market. Rules and regulations should be liberalised in order to allow the market to drive transactions more fully.

This will be the context in which Singapore can play an important role as a hub in mobilising capital to meet the needs of businesses, whether in the immediate region or beyond. Apart from promoting and developing Singapore-based securities market activities (e.g. local and foreign initial public offerings in Singapore), it is equally important to develop regional corporate financing activities done in regional securities markets by professionals based in Singapore, and to develop a regional private venture capital market. We must also attract more foreign institutional investors. This will give the market depth and liquidity and in the process also help to raise the standard of disclosure and corporate governance.

1.4. OTHER COMMITTEES

The Corporate Finance Committee was formed together with the Banking Disclosure Committee and the SES Review Committee. In May 1998 the Banking Disclosure Committee

made recommendations on the standards and practices of Singapore banks with a view to attaining the standard of disclosure in developed countries. In July 1998 the SES Review Committee made recommendations on, among other things, membership and brokerage commissions, operations of SES member companies and the rules and regulations affecting these companies, and scope of activities that can be undertaken in the securities industry. The Committee agrees with and supports the recommendations of those committees, which would raise the standard of disclosure, encourage more international participation, and promote depth and breadth in our market.

2. PHILOSOPHY OF REGULATION

The Committee believes that the market has developed to a stage of maturity and sophistication sufficient to move towards a predominantly disclosure based system of regulation to provide the impetus to become a market driven securities market with greater transparency, a high standard of disclosure, and a market friendly regulatory regime.

2.1. MERIT BASED PHILOSOPHY

In contrast to a disclosure based philosophy of regulation, a merit based regime is one where the securities regulator decides on whether transactions should be allowed to proceed on the basis of their perceived merits and on whether adequate disclosure has been made before the disclosure is allowed to be released. The securities regulator attempts to sieve out the problem cases before they arise in the belief that prevention is better than cure.

This assumes that the securities regulator has better information than investors and thus is in a better position to decide on the merits of the transactions. This is not necessarily so. Even where it is in possession of information, it is not always in a position to verify the information. Faced with the responsibility of judging the merits of transactions, it would seek more information in order to obtain better assurance of the quality of information, the result of which is to raise compliance cost and the cost of missed opportunities from delays. In the case of fraud, chances are that, other than the most egregious cases, they would not be discovered at the review stage. Evidence of such improprieties usually surface only after a corporate collapse or a tip-off. There are occasions when the regulator could well be in a better position to judge. This could be, for example, where it has confidential information that is not publicly available that would cast serious doubts on the integrity of the directors of a company seeking to raise funds from the public.

2.2. DISCLOSURE BASED PHILOSOPHY

The disclosure based philosophy acknowledges that the market is better able to decide on the merits of transactions rather than the securities regulator. The mass of investors, including analysts who are sector or industry specialists, with real-time information and analytical tools, who are continuously exchanging information in the market place, are best able to judge the merits of transactions.

A disclosure based regulatory regime will work effectively only if there is a strong regulatory framework to protect the integrity of the securities market and as a consequence protect investors. The regulatory framework must set out fundamental rules which must be enforceable and enforced. Enforcement would be carried out by ex-post review of disclosure and transactions, and by taking remedial action, including civil action for damages for the losses of investors, against companies who made misleading or inaccurate information, against persons who defraud investors, and against market practitioners who did not exercise due care and diligence. Where necessary, some ex-ante review of documents could be carried out to maintain the standard of disclosure but not on the merit of the transaction. Such review can be minimised or dispensed with where the issuers have a high standard of disclosure and corporate governance. Appropriate civil enforcement, with its lower burden of proof and

damage claims, hitting offenders in the pocket where it hurts, may be a more effective deterrent to would-be offenders, than criminal prosecutions, which require a higher burden of proof.

2.3. BENEFITS OF DISCLOSURE BASED PHILOSOPHY

The disclosure based philosophy which allows transactions to be driven largely by the market, based on a high standard of disclosure will lead to greater investment choice and more vibrant corporate activities. This would draw in more investors, both local and foreign, retail and institutional, thus adding to the market's liquidity. The increased liquidity would in turn attract more companies, local and foreign, to list and raise funds in Singapore. The increased activity would draw more professionals to establish here turning Singapore into a hub for professionals to perform the value-added financial market activities in the region.

In a well developed market with a disclosure based environment, active participation by institutional investors help raised the standard of corporate disclosure and market discipline. It improves corporate governance and thus protection for all investors and should therefore be encouraged.

2.3.1. Reducing Capital Cost

A disclosure based regime will reduce the cost of capital. Experience in disclosure based regimes has shown that it has resulted in a higher standard of disclosure. A higher standard of disclosure and greater transparency coupled with stronger legal remedies and enforcement will give investors greater confidence in the integrity of the market, allowing companies to sell their securities at higher prices, thus reducing the cost of capital.

In a disclosure based regime, there is less need for the regulator to exercise discretion as more information is available for investors to exercise their own judgement. Transactions do not suffer from delays caused by having to obtain the security regulator's approval. Delays can result in missed opportunities.

2.3.2. Reducing Moral Hazard

Where the regulator is required to exercise merit judgement, it would need to review transactions to satisfy itself that they merit its approval. Despite the regulator's pronouncements to the contrary, some investors may still think that a transaction that receives the regulator's approval must be of acceptable quality. Therein lies a moral hazard: investors expecting the regulator to pass the merit of a transaction, instead of judging it themselves based solely on information that has been disclosed about the transaction.

Some companies and their advisers may also see the regulator's approval as official endorsement of their transactions, and may feel less compelled to provide sufficient disclosure to justify their transactions to investors.

In a disclosure based regime, investors know that the regulator does not pass judgement on the merit of transactions. They make and are responsible for their own investment decisions. As for companies and their advisers, they would have to do more to persuade investors of the merits of their transactions.

2.3.3. Promoting Innovation

An important feature of activities in a vibrant capital centre is constant innovation. In a highly competitive industry, the advantages of any single innovation are quickly eroded. It is therefore necessary to allow innovations to flow. Singapore needs to create a regulatory environment which does not stifle innovation and which allows innovations to be implemented in an expeditious and transparent manner.

Delays or unpredictability in the implementation of financial innovations may cause those innovations to be superseded by developments elsewhere or obsolete by the fast-changing requirements of the market. Innovation is an expensive investment when unpredictable regulatory delays are frequent and the rewards of an innovation cannot be fully realised before competitors catch up. The international corporate finance business is therefore attracted to disclosure based regulatory regimes which place the onus of implementing an innovation on an intermediary's legal responsibility to properly disclose and document a transaction and which allows the marketplace to judge and to efficiently price innovations rather than rely on the merit judgement of the regulator.

2.4. CONCERNS REGARDING THE DISCLOSURE BASED REGIME

2.4.1. Retail Investor Protection

Many respondents to the consultative paper of the Committee have expressed concerns that retail investors, which is the dominant constituent in the Singapore market, may not be sophisticated enough to assess the investment merits of transactions.

The Committee is of the view that the higher standard of disclosure in a disclosure based environment would improve retail investor protection. The wider use of information technology, in particular the internet, has made it easier for investors to gain timely access to information. Higher quality of disclosure and more timely access to information will put companies under closer analyst and journalist scrutiny. There will be more analyst opinions and press commentaries, and these will be more informative, incisive and penetrating. Retail investors will be able to rely on these multiple sources of opinions. A disclosure based regulatory environment will, over time, also educate the investor to higher standards as he can now observe how analysts and journalists analyse and draw conclusions from easily accessible information.

2.4.2. Compliance Cost

Many respondents to the Consultative paper voiced concerns that the obligation to comply with a higher standard of disclosure and strengthening the legal remedies as a means to enforce compliance may increase compliance cost.

The Committee acknowledges that certain cost may rise, as issuers and their advisers carry out more thorough due diligence to meet a higher disclosure standard. But weighing against such cost, issuers can expect to benefit in terms of better price for their securities, achieved as a result of greater transparency and investor confidence. Issuers and their advisers will have better control of the timing of their transactions, making them better able to seize windows of opportunity, thus reducing cost. Overall, the benefits should outweigh the higher compliance cost to the issuer, resulting in lower overall capital cost.

A disclosure based regime would also lower the cost of information to the market. From the perspective of the market, having the issuer provide good quality information would reduce the research cost which the whole market of analysts and investors have to incur.

2.5. SOME DISCLOSURE BASED MODELS

The disclosure based regulatory regime was first introduced in the United States in 1933. The Securities and Exchange Commission ("SEC") does not rule on the quality of a share issue, but carries out review of the prospectus lodged before declaring it effective (ex-ante review). The Securities Act 1933 and Securities Exchange Act 1934 provide for disclosure requirements and the SEC's power to enforce disclosure.

Another example of a disclosure based regime is that found in Australia. The Australian Securities and Investments Commission ("ASIC", formerly the Australian Securities Commission) which administers the Australian Corporations Law, reviews prospectuses after registration (ex-post review) on a selective basis and may inspect the issuer's and its advisers' due diligence documents at their premises. Where there is material misrepresentation the ASIC may stop the sale of the shares.

2.6. ADOPTING DISCLOSURE BASED PHILOSOPHY

The current philosophy of regulation, like regulatory systems elsewhere, can be described as somewhere between merit and disclosure. The disclosure based philosophy is already applied in many areas of regulation. The existing regulatory system has served Singapore well so far, but to further promote the development of the market, we need to plug into the international financial system and build a market driven environment. Embracing a disclosure based system of regulation more fully would foster greater efficiency, innovation and entrepreneurship while safeguarding the integrity of the market. This would result in greater choice of products, participation and vibrancy in the market. International corporate finance has thrived in financial centres such as New York and London which have substantially disclosure-based regulatory environments.

Recommendation 1
A predominantly disclosure based philosophy of regulation should be adopted as it best fosters a market driven environment that promotes innovation, entrepreneurship, efficiency and business flexibility while protecting the integrity of the securities market.

3. THE REGULATORY FRAMEWORK

A disclosure based regulatory regime will work effectively only if there is a strong regulatory framework to protect the integrity of the securities market and as a consequence protect investors. The regulatory framework must set out fundamental rules which must be enforceable and enforced. To protect the integrity of the securities market, a strong regulatory framework is necessary to raise the standard of disclosure, increase the transparency and certainty of rules, and provide remedies for enforcement. It levels the playing field between companies and investors, giving players confidence to maximise business and investment opportunities, relying on reliable disclosure and enforceable transactions.

3.1. DISCLOSURE OBLIGATION

In a disclosure based environment, it is critical that companies make adequate disclosure so that investors are able to judge the merits of the transaction for themselves, instead of a review of the transaction's merits by the securities regulator. To ensure adequate disclosure it will be necessary to provide legally for a stronger and more comprehensive obligation to disclose.

A legal obligation rather than a contractual or voluntary obligation will emphasise to the issuer and its directors and advisers the importance of disclosure to the market. A legal obligation is necessary if investors and the securities regulator are to have the legal remedies to enforce the disclosure obligation.

Certain continuing disclosure requirements which listed issuers are required to observe are currently not imposed by law, but by the listed issuers' contractual obligations to the stock exchange. While such a form of disclosure requirements allow the stock exchange the flexibility of varying the disclosure according to the particular circumstances of each listed issuer, it does not provide a means which investors can use to exert discipline on listed issuers. Not having the appropriate contractual relationship with the listed issuers, investors cannot sue for damages for breach of disclosure obligations. While current law does provide for application to be made to the Court to order compliance with a listing rule[1], such a means may not be effective enough. If such a breach does not also involve a contravention of the law, it would also be difficult for the securities regulator to take enforcement action.

Recommendation 2
To raise the standard of disclosure, there should be a comprehensive and stated legal obligation to disclose.

3.2. NATURE AND STRUCTURE OF RULES

3.2.1. Updating Rules

Securities market rules currently reside in certain statutes (such as the Companies Act, Securities Industry Act) and other non-legal documents (such as the SES Listing Manual and the Singapore Code on Take-Overs and Mergers). Laws and rules applicable to the securities market, as distinct to core company law, should be consolidated into a single legislation.

[1] Securities Industry Act section 20.

These securities market rules include rules dealing with the offering, listing and trading of securities.

Recommendation 3
Laws and rules applicable to the securities market, as distinct to core company law, should be consolidated into a single legislation.

3.2.2. Hierarchy of Rules

There should be three tiers of rules. The first tier should comprise primary legislation, in which would reside fundamental principles, including the general disclosure obligation, and the functions and powers of the securities regulator. The second tier would comprise secondary legislation. These are regulations promulgated by the Minister under powers derived from the securities legislation. The third tier would consist of non-statutory rules such as the SES Listing Manual.

Recommendation 4
There should be three tiers of rules. These would consist of primary legislation, secondary legislation and non-statutory rules.

3.2.3. Certainty versus Flexibility

Currently, securities market rules are partly statutory but substantially non-statutory. Statutory rules reside in the Companies Act and its Schedules, and the Securities Industry Act. The non-statutory rules, particularly those governing listed issuers, reside in the stock exchange's Listing Manual. The Listing Manual requirements are non-statutory. Although Section 20 of the Securities Industry Act empowers the MAS, SES or an aggrieved person to apply to the court to compel compliance, breach of a Listing Manual requirement is itself not a statutory offence. The rules on take-overs reside in the Singapore Code on Take-overs and Mergers. This Code is described as a non-statutory code in section 213(18)(a) of the Companies Act.

Transparency and certainty of rules facilitate compliance by companies, enabling them to seize windows of opportunities. The greater level of disclosure in a disclosure based environment reduces the need for the securities regulator to exercise discretion, except where it possesses information that is not available and cannot be made available to the public.

Statutory rules have the advantage of transparency and certainty. Secondary legislation is more flexible than primary legislation as it can be amended without a Bill introduced in Parliament. Nevertheless, secondary legislation, being statutory in nature, still carries the force of law. The advantage of non-statutory rules is that they can be drafted broadly and amended expeditiously, giving the administrator wide discretion to waive or vary the rules to suit the particular circumstances of individual cases.

Where feasible, rules should, as far as possible, be made statutory. It is essential that the securities regulator and SES should publish its policies and interpretations on rules and so as to provide greater transparency to the market. To enhance accountability, it is also desirable that reasons should be given for decisions and an avenue be provided for appeal against the decisions.

Recommendation 5

(a) Securities market rules should as far as possible be made statutory.
(b) The securities regulator and SES should publish its policies and interpretations on rules to provide greater transparency to the market.
(c) The securities regulator and SES should also provide reasons for decisions, and allow an avenue of appeal against the decisions.

3.3. INSTITUTIONAL FRAMEWORK

3.3.1. Current Functions

Currently, securities regulation is diffused among several bodies. The SES is the primary regulator over its member brokers and companies listed on it. It reviews and approves applications for listing of securities on the exchange, enforces listed issuers' compliance with the SES' listing requirements, and maintains market surveillance of trading. The MAS oversees the regulatory work of the SES. The Securities Industry Council ("SIC") administers the Singapore Code on Take-overs and Mergers. Prior to October 1997, the SIC was also involved in listing approvals as well as reviewing prospectuses, and circulars issued to shareholders in connection with interested person transactions. It advised the SES of its views on applications for new listings, rights issues, and issues of shares that involved the interest of a listed issuer's directors or substantial shareholders, and channelled its comments on prospectuses and circulars to the SES. The SES had to take into account the SIC's views when deciding on such matters. Since October 1997, the SIC has ceased to be involved in listing matters.

The RCB is charged under the Companies Act to review the contents of prospectuses before registering them. Serious commercial frauds and offences under the Securities Industry Act and Companies Act are investigated and prosecuted by the Commercial Affairs Department.

3.3.2. Single Securities Regulator

The Committee has considered three institutional models of securities regulation.[2]

In a model where there is a single securities regulator, regulation of prospectus disclosure and listed issuers' continuing disclosure is the responsibility of the securities regulator. The stock exchange operates a trading facility, makes by-laws to govern its members, and its listing rules prescribe rules on eligibility for listing, trading and liquidity matters, such as shareholder spread, rights issue time-tables, book closure dates and corporate governance issues. Listing applications are approved by the stock exchange, but the securities regulator is empowered to stop the securities offering. The stock exchange undertakes market surveillance of trading irregularities and would pass information on suspected violations of law to the securities regulator for further investigation and enforcement. The securities regulator enforces the securities law under its jurisdiction. As a simplification, it can be said that the securities regulator is responsible for investor protection, while the stock exchange is responsible for operating and promoting the market.

[2] The Committee appreciates the briefings on overseas securities regulation from Mr David Simpson of Allens Arthur Robinson on Australian law, Mr Alan Denenberg of Shearman & Sterling on United States law and Mr Guy Lewin-Smith of Linklaters & Paines on United Kingdom law.

This model is observed in the United States and Australia. The United States created the Securities and Exchange Commission ("SEC") in 1934 and consolidated the functions of securities regulation into this body. The role of United States stock exchanges is to provide a market place for trading in securities, exercise prudential supervision of their member companies and market surveillance of trading irregularities. Where information of insider trading or market manipulation is discovered, it is passed to the SEC for further investigation. Since then this model has been adopted by increasingly more countries. In Australia, reforms were made in which a single regulator, the Australian Securities Commission (precursor to the ASIC), was established giving it clear focus and the responsibility of regulating the securities market. The Australian Government has adopted the recommendations of the Wallis Financial System Inquiry[3] to further consolidate the regulatory framework. This involves consolidating consumer protection and regulation of financial services and products (such as securities, retail investment products, and investment advice) into the ASIC. At the same time, prudential regulation which is aimed at promoting the safety of all financial institutions (including broking firms) and superannuation funds will come under the Australian Prudential Regulation Authority. The Australian Stock Exchange ("ASX") operates the market, conducts market surveillance, and jointly monitors continuing disclosure with the ASIC. Where the ASX finds breaches of law or its rules, information is passed to the ASIC for further investigation.

The advantage of this model is that securities regulation is consolidated in one body with responsibility for law enforcement and investor protection. This would result in accountability and efficiency. Being a government agency, the securities regulator has the power to enforce securities law and regulation, and immunity from civil liability in the performance of its duties in good faith.

3.3.3. Stock Exchange as Primary Regulator

In the second model, the stock exchange is the primary regulator. The stock exchange operates a trading facility and regulates its members. The stock exchange is responsible for approving listings, and enforcing listed issuer's compliance with listing requirements. It reviews prospectuses and shareholders' circulars, and monitors corporate activity and announcements. It conducts market surveillance but passes information on suspected irregularities to the appropriate body for prosecution.

This is observed in the United Kingdom where the Securities and Investment Board, which oversees the London Stock Exchange ("LSE"), allows the stock exchange, a private body, to regulate offering of securities which are listed on the LSE. Some former British colonies, such as Australia and Hong Kong, also started with the same model. Adopting a similar self-regulatory model, the SES is broadly responsible for market regulation, subject to MAS oversight.

In May 1997, the United Kingdom Government decided to consolidate securities regulation in a single super regulator, the Financial Services Authority, instead of dividing it between the Securities and Investments Board and self-regulatory organisations. However, it appears that LSE's role as the primary regulator for securities offerings and companies listed on that exchange would remain intact. London has evolved as a very successful international capital centre with high standards of corporate governance and disclosure. This could be attributed to its longer history and to the predominance of institutional investors who are active in

[3] *Financial System Inquiry Final Report*, Commonwealth of Australia, 18 March 1997.

enforcing good corporate governance. The entry of United States investment banks into the market after the "Big Bang" in the mid-1980s could also have played a part.

The advantage of this self-regulatory model is that the stock exchange is closer to the market and market practitioners which would aid both market development and regulation. The stock exchange can exercise greater flexibility in adapting its rules to meet a changing market environment. It may be more efficient for a stock exchange which deals directly with listed issuers to monitor their corporate transactions and information disclosure.

As private self-regulating organisations, the LSE and SES do not have strong enforcement powers to ensure compliance. The stock exchanges' jurisdiction over listed issuers is contractual. It does not have a direct hold over directors of listed issuers, as there is no contractual relationship with directors, and must rely on moral suasion.

3.3.4. Functions Shared

In the third model, regulatory functions are shared between the stock exchange and a securities regulator. The stock exchange operates a trading facility and regulates its members. Market surveillance, listing approvals, document review and the monitoring of corporate activity are shared responsibilities.

This model can be observed in Hong Kong where regulation is shared between the Stock Exchange of Hong Kong ("SEHK") and the Securities and Futures Commission ("SFC"). The SFC delegates the review of prospectuses to the SEHK but is also involved in review of corporate transactions and announcements and investigating trading irregularities. In Hong Kong, the SEHK is independent of the SFC. Where the SFC disagrees with the SEHK's position on a transaction, it is empowered to intervene on the market.

The advantage of this two tier system of regulation is that the stock exchange as the self-regulatory organisation can be flexible and adaptable to market development, especially as ethical standards are difficult to legislate. The statutory securities regulator acts as a second line of defence. The disadvantage is the diffusion of responsibility in securities regulation, requiring duplication of resources in both organisations. Having to deal with two sets of regulators may increase compliance cost.

3.3.5. The Securities Regulator and Securities Regulation

The Committee is of the view that it is desirable to adopt the single securities regulator model, which in certain material respects is similar to that practised in the United States.

Securities regulation should be consolidated and administered by a securities regulator. The securities regulator would regulate all aspects of securities law and regulation, including disclosure obligations. However, an independent take-over panel with private sector representation could coexist with the securities regulator, with its secretariat seconded from the securities regulator. The RCB would administer core company law. As criminal prosecution for breach of securities regulation is a specialised area and the preserve of the State, it should be in the hands of the CAD or the Attorney General's Chambers.

The principal role of the SES would be to operate a securities exchange and to promote the growth of the securities market. The SES could engage in promotional activities to attract more listings and investors. The SES' role as a conduit between market participants and the

government, to give feedback to government departments to promote growth, would be enhanced. The SES would approve listing applications, undertake market surveillance, monitor continuing disclosure, promote corporate governance and enforce its Listing Manual. Where a breach of the law is suspected, the matter will be handed over to the securities regulator for investigation and enforcement. It would continue to regulate its member firms.

There are good reasons for consolidating the functions of securities regulation. First, responsibility and accountability would clearly rest in one body and would not be diffused and fall in the cracks between different regulatory bodies. Being clearly accountable to both investors and businesses, the securities regulator would have to balance the acceptability of its actions to various market participants especially from the point of business efficiency and the need to protect investors. This will prevent the securities regulator from being either too pro-investor to the detriment of business efficiency or too pro-business to the detriment of disclosure standards and good corporate governance. Second, consolidation would eliminate inefficiency arising from the duplication of resources. Business compliance cost would be reduced as they do not have to deal with two or more sets of regulators.

A disclosure based environment with a strong legal regulatory framework requires a government agency to enforce compliance and investigate breaches of law and regulation. The securities regulator should have immunity from civil liability for acts carried out in good faith, so that it is not distracted from performing its functions. Only a government agency, and not a private body, should have the legal powers of investigation and enforcement and immunity from civil liability for damages.

The securities regulator should be distinct from and should not be subordinated to the banking prudential regulator. The nature and demands of the securities market and banking are sufficiently different such that a degree of specialisation would be desirable. In particular, it would eliminate the conflicting mindset in risk avoidance in prudential regulation, and the mindset of being neutral on risk but focusing on fraud and misrepresentation in securities regulation, thus allowing the securities market to develop according to the dictates of the market and international practice. It would also enhance the international status of the securities regulator and inspire greater confidence in the securities market among institutional investors and issuers.

Recommendation 6

(a) The single securities regulator model should be adopted to clarify responsibility and accountability and raise efficiency. Securities regulation should be consolidated and administered by a securities regulator.

(b) The securities regulator would enforce all aspects of securities law and regulations, including disclosure obligations. The RCB would administer core company law. Criminal prosecution would continue to be done by the CAD or the Attorney General’s Chambers. The SES would operate a securities exchange and promote the growth of the securities market. The SES’ role as a conduit between market participants and the government, to give feedback to government departments to promote growth, would be enhanced. The SES would approve listing applications, undertake market surveillance, monitor continuing disclosure, promote corporate governance and enforce its Listing Manual. Where a breach of the law is suspected, the matter will be handed over to the securities regulator for investigation and enforcement. It would continue to regulate its member firms.

(c) The securities regulator should be distinct from and should not be subordinated to the banking prudential regulator.

3.4. REMEDIES AND SANCTIONS

To maintain the integrity of the securities market, securities regulations must be enforceable and enforced. The securities regulator must have investigative and enforcement powers.

3.4.1. Civil Action in the Public Interest

Adequate civil remedies for investors and the securities regulator is a powerful means to protect the integrity of the securities market. While protecting the market's integrity, civil remedies would also provide justice to investors by recovering losses suffered as a result of fraud or misrepresentation. The primary purpose of civil action would be as a deterrent. The higher likelihood of being brought to account, because of the lower burden of proof compared to criminal prosecution, and greater punitive effect from an award of damages against the offender which is likely to be greater than the maximum fine for a criminal penalty, would be a strong disincentive against breaches of securities law and regulation.

In Australia, the ASIC may commence or intervene in civil proceedings on behalf of individuals and companies, where it appears to the ASIC to be in the public interest to do so[4]. The civil proceedings may be for the recovery of damages or property of the company, for fraud, negligence, default, breach of duty or other misconduct.

One way of facilitating civil actions is to allow the securities regulator to commence litigation in the public interest to enforce the law. There would be economies of scale if the securities regulator pursues the civil action instead of individual investors. For an investor with a large block of shares, the potential damages award from civil litigation may be more than adequate to offset the cost of litigation. This may not be so for small investors. Where a company's minority shareholders have only small shareholdings, it would not be worthwhile for them to individually take civil action. In such cases, there would be no deterrence for the company's directors to comply with securities law.

3.4.2. Public Interest Test

Some respondents to the Consultative Paper cautioned that a reliance on civil action may lead to a more litigious environment resulting in a multitude of civil suits. A number thought that it was against the principle of caveat emptor for a regulator to take civil action on behalf of investors and may lead to moral hazard, i.e. investors relying on the regulator to protect them and recover their losses rather than taking responsibility for their own investment decisions. One respondent was of the view that the existing legal remedies for shareholders were adequate and preferred to see the market being allowed to evolve by itself. Many noted that the test of public interest was too vague. The Committee is of the view that in situations of abuse or fraud, the integrity of the market needs to be protected by securities law and the securities regulator. Adequate remedies do not exist in statute or common law and legislative change is therefore necessary.

It is acknowledged that the public interest test must be properly defined, possibly in the primary legislation, to narrow the scope of discretion. This is to reduce uncertainty to

[4] Australian Securities Commission Act section 50.

businesses and market practitioners, prevent the securities regulator from getting involved in a multitude of civil actions, and mitigate the concern about investors relying on the securities regulator to protect their investments. The public interest test must be framed in a way that would only allow the securities regulator to pursue civil action in a narrow range of cases. These would include serious infringements of securities law, particularly where there is suspicion of fraud, or where there is a need to test a legal principle or interpretation in court. It would not be in the public interest to pursue civil action where investors suffer loss as a result of the issuer or its directors exercising poor business judgement. This test could be defined in legislation or issued in a policy statement. It may be very difficult to define public interest in legislation, and it may be best to leave it to the securities regulator and the courts to develop its scope over time. The public interest test is not defined in the Australian legislation but the ASIC has issued a policy statement in relation to its intervention in civil action.[5]

Moral hazard arises when investors who can protect themselves but choose not to do so and instead rely on someone else to protect them. There are two types of investor moral hazard. The first is where investors rely on the authorities to review the merits of an investment or transaction instead of doing it themselves. The object of a disclosure based regulatory regime rather than a merit based regime is to avoid this type of investor moral hazard. The second is where investors rely on the securities regulator to take up civil action even where they are able to afford doing it themselves. The securities regulator in taking civil action in the public interest would need to avoid creating the latter moral hazard.

3.4.3. Class Actions and Litigiousness

In some jurisdictions, investors could seek civil remedy by taking up class actions.[6] This has led to concerns about frivolous suits and a more litigious environment. In the Consultative Paper, the Committee had suggested that one way to avoid this was to provide the securities regulator with the power to take up civil actions where it is in the public interest to do so. Some respondents to the Consultative Paper feared an increase in litigation. Some argued that the reason for the abuse of United States-style class actions is not the existence of the class action itself but the high damages awarded by juries and the contingency fees charged by law firms. These factors are not present in Singapore. A respondent suggested allowing a form of class action where a minimum percentage of shareholders may petition the court to commence a civil action. Having shareholder class actions without securities regulator sponsorship would resolve concerns about moral hazard.

The Committee believes that litigation is unlikely to proliferate. We are culturally less inclined to take legal action, except as the last resort. Our judicial system does not promote a litigious environment. Furthermore, as the securities regulator will be taking civil action only if it is in the public interest to do so, it could result in less litigation compared to the current situation where many investors could be suing individually for a single cause of action. Furthermore, as the securities regulator will only take action to enforce breach of market place rules and not for losses due to business judgement, many potentially frivolous claims would be screened out. Concerns regarding moral hazard can be resolved by properly defining the public interest test.

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[5] ASIC Policy Statement 4, 3 June 1991.

[6] In the United States, a person may commence an action and obtain judgement on behalf of all person of a class even if those person were not at that time identified. In Singapore, a number of persons may join in an action to obtain judgement only for those person in that action but not for other persons of that class.

It is probable that the number of lawsuits would be greater if some form of modified shareholder class action is allowed. The issue of class or representative actions of any sort should be considered as part of the review of the legal system as a whole and not just in the context of the securities market. The concept of the securities regulator taking civil action for damages in the public interest already represents a significant departure from existing Singapore legal tradition.

3.4.4. Distribution of Proceeds

The ASIC may take civil actions in its own right or on behalf of investors, and may apply for a court order for the defendant to pay damages to investors. It also administers the distribution of proceeds to investors. The Committee is in favour of allowing the securities regulator to have similar powers.

Where the securities regulator wins its civil action, the cost of the proceedings will be substantially borne by the defendant. It should be allowed to retain the damages awarded unless and until valid claims are made against it by investors. Where the securities regulator loses the case, the cost will necessarily be borne by the securities regulator. These cost, which will be publicly funded, are incurred to maintain confidence in the integrity of the securities market.

The existing rights of individual investors to litigate for themselves should be preserved. Shareholders are not compelled to file a claim with the securities regulator nor to surrender their right to litigate, as some shareholders may prefer to pursue their own actions. However, the securities regulator should have the right to intervene in litigation brought by private litigants as well as to initiate litigation on its own in the public interest.

Recommendation 7

(a) The securities regulator should have power to enforce securities regulation, including pursuing civil actions in the public interest.

(b) The public interest test must be properly defined to reduce the uncertainty over when the securities regulator will pursue civil actions, and to avoid moral hazard.

(c) The law should allow for damages awarded to be distributed to investors. The securities regulator should be able to offset its cost against the damages awarded before distribution to investors. It should be allowed to retain the damages awarded unless and until valid claims are made against it by investors. The rights of individual investors to litigate for themselves should be preserved, but the securities regulator should have the right to intervene in litigation brought by private litigants or to initiate litigation on its own in the public interest.

3.4.5. Fines and Administrative Sanctions

Civil action for damages, or criminal prosecution, will only be pursued where there is serious breach of the law. However, not all securities market rules will be statutory, and there could be breaches of the law which are technical or of a less serious nature. The securities regulator should be empowered to mete out a range of administrative sanctions so that the sanction is commensurate with the breach.

The SES should also be empowered to enforce its listing rules. The LSE and SEHK have the power to censure the company and its directors privately or publicly, suspend or delist

securities for breaches of their listing rules, and to state publicly that the retention of office by a director is prejudicial to the interests of investors. The SEHK may also impose a ban on professional advisers from listings work for a period of time. The SES has the power to suspend or delist a security and has imposed private and public censures on listed issuers and directors. The New York Stock Exchange ("NYSE"), NASDAQ and ASX only have the power to suspend or delist securities. None of these exchanges are provided with the power to impose fines. However, the Kuala Lumpur Stock Exchange may impose fines of up to RM100,000 on issuers, but not on their directors.

At issue is whether the securities regulator or the SES can mete out fines for breaches of listing rules. In particular, should the securities regulator be allowed to impose fines above and beyond an award of damages in a civil action in the public interest. This is because the award of damages in a successful civil action would only compensate the investor and disgorge the gains from errant directors, but not punish them. While fines may not always provide a strong deterrence, it can be more precise in targeting errant directors if they are fined personally.

The imposition of a fine is equivalent to a statutory penalty for a criminal offence. To use the lower civil burden of proof to impose a sanction identified with a conviction for a criminal offence is objectionable. Furthermore, it may be unconstitutional for a non-judicial body to impose fines. Furthermore, fining listed issuers and directors could create the perception that our capital market has a harsher regulatory environment than markets that do not. Making errant directors compensate investors for damages is only fair as the offenders have caused loss to investors. The burden of having to pay for the legal cost of the securities regulator if the civil action is successful, and the public exposure of the court process whether or not the civil action is successful, would be more than adequate to punish the offenders. Fines should only be reserved for criminal prosecutions. Accordingly, the Committee is not in favour of the securities regulator or the SES meting out fines for breaches of the Listing Manual. The power to impose fines for breaches of securities regulation should be reserved for criminal prosecutions.

Recommendation 8
The securities regulator should be empowered to impose administrative sanctions for breaches of its rules. The SES should continue to impose contractual sanctions for breaches of its Listing Manual. The power to impose fines for breaches of securities regulation should be reserved for criminal prosecutions.

3.4.6. Investigation and Enforcement

To enable the securities regulator to pursue civil remedies and administrative sanctions to enforce the law, the securities regulator must have investigative powers. It is essential to give the securities regulator investigative powers to obtain the necessary information to be able to decide whether it is in the public interest to start a civil action. These investigative powers will include the right to conduct hearings or interviews and to inspect documents. Where the securities regulator finds evidence of criminality in its investigation, it should refer the matter to the relevant body. There being some potential overlap between investigation for civil enforcement and criminal prosecution, the securities regulator and the CAD would have to cooperate in their investigations where appropriate according to law.

Recommendation 9
The securities regulator should be granted investigative powers to enforce both statutory and non-statutory securities rules. Where the securities regulator finds evidence of criminality in its investigation, it should refer the matter to CAD or the Attorney General's Chambers for criminal investigation.

3.5. CIVIL REMEDIES FOR INSIDER TRADING[7]

Section 103 of the Securities Industry Act makes insider trading a criminal offence, which is liable under section 104 to a fine of up to $50,000 or imprisonment of up to seven years. The question is whether or not civil remedies for insider trading can be strengthened.

Section 105(1) provides that a person convicted of insider trading is liable to compensate the person who suffered losses by trading with him. The loss is the difference between the price at which the securities were dealt in and the price at which they would have been likely to have been dealt in if the contravention had not occurred. This civil action must be brought within two years after the date of completion of the transaction on which the loss occurred. Section 105(4) preserves for the victims other common law remedies.

3.5.1. Civil Remedies for Insider Trading Independent of Criminal Conviction

Section 105(4) preserves common law causes of action. However, as there are no common law causes of action for insider trading per se, in the absence of statutory rights, a person who cannot claim compensation under section 105(1) will often have no further recourse.

The existing statutory civil remedy for insider trading is also conditional upon a person being convicted of the criminal offence. This may be restrictive. First, a legal action may succeed based on the civil burden of proof but fail based on the criminal burden of proof. There may be deserving civil cases which may not meet the criminal standard of proof but which should nevertheless succeed. It would prevent persons from starting their own legal action, should the prosecutor decide not to start criminal proceedings for lack of evidence to establish the higher burden of proof. Second, as the civil remedy must be commenced within two years of the offence and a criminal conviction may not be secured within that period, the opportunity for redress may disappear.

Therefore, a statutory civil remedy, which is independent of criminal conviction, should be created to enable persons to obtain compensation for losses suffered as a result of insider trading.

3.5.2. Link with Counterparty

To claim compensation, a person would have to establish that he was a counterparty with the person engaging in insider trading. In a market where trades are matched without the investors knowing who their counterparties are, this presents an intractable problem.

[7] In reviewing the law on insider trading, the Committee relied on an unpublished working paper by Margaret Chew, *Civil Remedies for Insider Trading*, Centre for Commercial Law Studies, Faculty of Law, National University of Singapore, 6 July 1998.

In the United States there is a statutory right of action for individuals who have traded contemporaneously with insiders.[8] The issue of what is "contemporaneous" is left to the court to interpret. The current view is that in a widely traded security, contemporaneous trading is that which takes place within a few days of the insider's trading activities, though one view is that it would have to take place within one day.

It is important that the plaintiff should not have to prove that the counterparty was the insider trader. It would be useful to adopt the contemporaneous test, leaving it to the court to interpret it in the light of changing market practices and trading technology.

3.5.3. Legal Standing

It is proposed that a statutory civil remedy be granted to individuals to obtain compensation for losses resulting from insider trading. Currently, neither the MAS nor the SES has any standing to bring a civil action for recovery of profits gained as a result of insider trading.

Although the "contemporaneous" test ameliorates the difficulties involved in an electronic and anonymous market, it does not remove them entirely. Individual investors will often have no recollection of the exact time of their trades nor know that another person is being investigated. As such, the securities regulator should also be allowed to intervene in or commence civil action for insider trading.

3.5.4. Awards and Penalties

Compensating investors who transacted contemporaneously with the insider raises the problem of who to compensate. During the period of contemporaneity, there could be more than one person trading. If so, aggregating their losses may exceed the unfair gains made by the insider trader. It may be argued that this is unfair. Australian law sets out a "first-come-first-serve" principle to avoid the insider trader being liable for more than his gain.[9] United States law limits liability to the gain. The contrary argument is that as the insider put himself in the position in the first place, the additional losses that the insider trader is required to compensate could be seen as punishment for the deed. However, it is acknowledged that the offender may face hundreds of claims totalling many times the amount of profit earned from insider trading. Accordingly, the damages that can be awarded against the insider trader should be capped at a certain maximum value. If the losses claimed is more than the maximum value claimable, the maximum value is to be distributed to the claimants on a pro-rata basis.

In the event that the securities regulator sues instead of an individual investor, the securities regulator should be allowed to keep the disgorged profits of the insider, unless and until investors who transacted contemporaneously file their claims with the securities regulator.

Another issue is whether the securities regulator could impose a fine on top of the damages award as a punishment. The United States SEC may impose fines of up to three times the gain. As earlier discussed, fines should be reserved for criminal prosecutions for breaches of securities regulation.

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[8] Securities and Exchanges Act 1934 Section 20A.

[9] Australian Corporations Law Section 1015.

Recommendation 10

(a) A civil right of action for insider trading, which is independent of a criminal conviction, should be created to enable persons to obtain compensation for losses suffered as a result of insider trading.
(b) The plaintiff must show that the trading was contemporaneous with the insider trading, but not that the counterparty who dealt with the plaintiff's shares was the insider.
(c) The securities regulator should be allowed to intervene in or commence civil actions for insider trading.
(d) The insider trader should be liable for all losses suffered by all contemporaneous counterparties, up to a certain maximum value. If the losses claimed are more than the maximum value claimable, the maximum value is to be distributed to the claimants on a pro-rata basis. Where the civil action is pursued by the securities regulator, it should be allowed to retain the damages awarded unless and until valid claims are made against it by investors.

3.6. CIVIL ACTION AND CRIMINAL PROSECUTION

3.6.1. Priority

A breach of securities law, whether regarding fraud, disclosure or insider trading, could give rise to both civil action and criminal prosecution.

One view is that civil enforcement should not take precedence to criminal prosecution and that CAD should be allowed to decide if it should proceed. In practice, this may not be a problem. Where a civil action is commenced before criminal prosecution, the Court has a discretion to decide whether to stay the civil case so as not to prejudice the criminal prosecution. One advantage of allowing civil enforcement to begin prior to criminal action is that, the securities regulator can get court orders to preserve assets for a future award of damages. It would, however, be important to allow private individuals or the securities regulator to commence civil actions, in case the criminal prosecutor should decide not to pursue criminal prosecution.

3.6.2. Double Jeopardy

There could be a concern that having both criminal prosecution and civil action for breach of the same law may lead to double jeopardy as the defendant is taken to court twice. This may seem particularly objectionable if criminal prosecution fails but civil action succeeds. However, because of the different burden of proof, the courts could properly decide that while the evidence is not adequate to prove that a person behaved criminally, the evidence is sufficient to show that the person caused losses to investors. The Committee does not consider this to be double jeopardy because civil action is directed towards disgorging the unfair profits from the offender and compensating the victim, while criminal prosecution is directed towards punishing a person for a criminal act.

4. A HIGH STANDARD OF DISCLOSURE

A high standard of disclosure levels the playing field between companies and investors. It enables investors to make better informed decisions, and the market can discharge its resource allocation function more efficiently. Legal disclosure obligations expressed in the form of a general test plus checklist, will prescribe a high standard of disclosure that is enforceable, while retaining flexibility in specifying minimum disclosure items in checklist regulations. A high standard of disclosure gives players confidence to maximise business and investment opportunities, relying on reliable disclosure and enforceable transactions.

4.1. THE DISCLOSURE OBLIGATION

United States[10] securities law prescribes detailed rules governing the information to be disclosed whether in a prospectus, proxy statement, results or other announcement ("checklist approach"). The United Kingdom[11] and Hong Kong[12] has a general test plus checklist approach for prospectuses but not for continuing disclosure requirements. Australia[13] provides in the law a general test on the standard of disclosure for prospectuses and continuing disclosure ("general test approach").

The checklist approach is practical and makes compliance easier. But it is difficult to ensure that the detailed requirements would cover all possible types of business situations. The general test approach would overcome this problem by focusing directly on the reasonable requirements of investors and their advisers. The general test approach would also respond more effectively to changes in market expectations, practices and products over time. But market practitioners may find that the general test approach lacks certainty, making compliance difficult. Accordingly, the Committee is of the view that the general test approach should be combined with the checklist approach to take advantage of the benefits of both approaches.

The Committee is of the view that the general test of disclosure should be in the primary legislation to provide certainty as to the legal standard of disclosure. The primary legislation should also empower the Minister to promulgate regulations relating to specific disclosure items in the form of a checklist. The detailed disclosure checklist should be in the regulations, rather than the primary legislation, to provide for flexibility to make amendments from time to time. This checklist will guide companies and practitioners as to the information that the securities regulator believes is the minimum necessary but which may not necessarily be sufficient to meet the general disclosure test depending on the circumstances.

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[10] Securities Act 1933 section 10 and Schedule A sets out specific information to be included in prospectuses.
[11] Financial Services Act section 146 sets out a general disclosure test for prospectuses which supplements the detailed lists of requirements contained in the Public Offers of Securities Regulations 1995 and in the LSE Listing Rules.
[12] The Third Schedule to the Hong Kong Companies Ordinance sets out a general disclosure test as well as detailed requirements for prospectuses. Further requirements are found in the SEHK Listing Rules.
[13] Corporations Law Section 1022 sets out the general test for prospectuses. There are no supplemental checklist items in either the Corporations Law or the ASX Listing Rules. Corporations Law, sections 1001A, 1001B, 1001C, 1001D set out the continuing disclosure rules. See also ASX Listing Rules Chapter 3.

The current standard of listed issuers' disclosure of financial performance and material corporate transactions is not as high as that in developed markets such as the United States. In some cases, the disclosure can be said to be poor. This may be because there is limited legal obligation on companies to disclose information. The Committee is of the view that, similar to prospectus disclosure, continuing disclosure by listed issuers should be subject to requirements and standards which are backed by law.

The Committee is of the view that there should be a general disclosure test for continuing disclosure for companies that have made public offers of securities or are listed in Singapore, in the same way as the general disclosure test for prospectuses. This test should be in the primary legislation and should define the principle of the standard of disclosure as well as to impose an obligation on issuers to make disclosure when a significant event occurs. The Committee observed that many listed issuers tend not to make timely disclosure of the effect of any adverse developments on the business or performance of the issuer, with such disclosure being made at the last possible moment, usually upon the announcement of the half-year or full-year financial results. This could lead to investors trading in the securities of a company at prices that do not reflect the underlying value.

In general the general test of disclosure of the United Kingdom and Australia are in similar language: prospectuses should disclose all information that investors and their professional advisers would reasonably require and expect to find in order to make an informed investment decision. It would be consistent to apply the same test to continuing disclosure.

Historically, the regulatory focus has been on listed issuers and their regulation. The protection of the integrity of the securities market and hence investors extends beyond investments in listed securities but also to equity and debt securities in public but unlisted companies. Investors in certain unlisted companies may need even greater regulatory protection as they do not have the benefit of a liquid market for their securities. With the growth and development of our capital market, such securities could be traded over-the-counter and could even become popular with retail investors. Thus securities regulation should provide for disclosure for both listed or unlisted and publicly offered securities.

Recommendation 11

(a) The disclosure requirement should be in the form of a general test in primary legislation supplemented by checklists in secondary legislation. The general disclosure test should cover both prospectuses and continuing disclosure. Primary legislation should empower the securities regulator to make disclosure checklists as it considers necessary.
(b) Prospectuses and all continuing disclosure should disclose all information that investors and their professional advisers would reasonably require and expect to find in order to make an informed investment decision.

4.2. PROSPECTUS DISCLOSURE

4.2.1. The Prospectus Checklist

The International Organisation of Securities Commissions ("IOSCO") in September 1998 adopted a document captioned "Disclosure Standards to Facilitate Cross-Border Offerings and Listings by Multinational Issuers" ("the IOSCO Standards"). IOSCO believes that it is important for securities regulators to facilitate cross-border offerings and listings by enhancing comparability of information, while ensuring a high level of investor protection. The IOSCO

Standards would not necessarily substitute, or replace, disclosure requirements applicable to any jurisdiction's domestic issuers, but they provide an alternative standard for the preparation of a single disclosure document by foreign issuers.

The IOSCO Standards for prospectuses for listings and public offers will make it easier to attract foreign companies to list in Singapore as part of a dual listing. At the same time it will ensure that these foreign companies' prospectuses will be of a minimum disclosure standard. It promotes harmonisation and lowers cost for potential foreign companies with multiple listings. This would be in line with the goal to promote Singapore as an international capital centre.

There is a very high degree of similarity between the IOSCO Standards and the SES and Companies Act prospectus requirements. In areas where the IOSCO Standards are more stringent, the additional disclosure could usefully be adopted in Singapore. These areas include more comprehensive disclosure about risk factors, disclosure of cash flow statements, differences and movements in home and reporting currency rates, individual disclosure of remuneration of directors, management and key persons, disclosure of corporate governance and board practices, and interests of experts and professionals.

There are also areas where local requirements are more stringent. These include the requirements that audited financial statement must not be more than 9 months old, that unaudited accounts must not be more than 3 months old, disclosure of prospects and forecasts, borrowings and indebtedness at the latest practicable date, conflicts of interest in respect to competing businesses, more detailed disclosure regarding property, and disclosure on directors' integrity.

With such a high degree of similarity between the IOSCO Standards and the present local requirements, the IOSCO Standards serve as a good basis for our checklist requirements on prospectus disclosure, with appropriate modifications to meet local requirements. This will ensure that Singapore's standards are comparable to internationally. The securities regulator should minimise variations to the IOSCO Standards to achieve cross-border comparability.

Recommendation 12
The prospectus checklist for local and foreign issuers should be substantially similar to the proposed International Disclosure Standards on prospectus disclosure with appropriate modifications (which should be kept to a minimum) to meet local requirements.

4.2.2. Mini Prospectuses

The need to include disclosure which will meet the needs of a broad range of investors and their advisers contributes to the level of detail in prospectuses. Institutional and sophisticated investors, professional analysts and advisers may not need certain information that retail investors may need, such as information about the business environment or industry. As retail investors may not have the resources to obtain such information, which may be readily available to the issuer or its advisers, it may be more cost effective if such information is provided in the prospectus. If the offer is being marketed at institutional and sophisticated investors, the issuer should provide only information which these investors need. If, however, the securities are also being offered to retail investors, then the offeror would need to consider the needs of such investors.

Issuers should be allowed to determine whether a mini prospectus will assist in the marketing of an offer and target investor understanding and identify the information which their target audience is likely to be most interested without unnecessary details. This mini prospectus, which will be in addition to the full prospectus required to be produced and registered, will be deemed to be a prospectus under the law. It would consist of extracts from the full prospectus. Certain detailed information, such as detailed valuation reports may also be incorporated by reference in the full prospectus but lodged with a relevant authority and be available at a website or at the company's registered office.

Recommendation 13
Issuers should be allowed to issue an additional mini prospectus that is more useful to the target audience by providing such investors with the information which they need without unnecessary details. Certain detailed information may also be incorporated by reference in the full prospectus but lodged with a relevant authority and be available for inspection at a website or at the company's registered office.

4.2.3. Secondary Offers

Rights issues and placement sales of securities that are already traded and priced in the market are different from initial public offerings. As information about issuers are already publicly available, it would not be necessary to provide as much historical information in the offering documents issued for such purposes. This will reduce the cost of preparing rights issue and placement documents.

Currently, Part V of the Fifth Schedule of the Companies Act on abridged prospectuses for rights issues, prescribes the disclosure of some historical information, the impact of dilution from such share issues and the prospects of the company. Part VI of the Fifth Schedule prescribes the content of a Statement of Material Fact for placements of a new issue of shares which are already listed. The SES Listing Manual requires substantial historical information to be disclosed.

The Committee is of the view that the disclosure checklist for rights issue abridged prospectuses should consist of the items currently required in Part V of the Fifth Schedule together with information on the use of the proceeds and how the use of the proceeds will impact on the financial performance and prospects of the company. In principle, the same information should be given to persons who are being offered placement shares and rights shares.

Recommendation 14
The disclosure checklist for rights issue abridged prospectuses and placement statement of material fact should consist of the items currently required in Part V of the Fifth Schedule of the Companies Act and information on the intended use of the proceeds and how the use of the proceeds will impact on the financial performance of the issuers.

4.3. CONTINUING DISCLOSURE

4.3.1. Disclosure in Annual Reports

If investors are to be able to make meaningful assessment of the performance of a company and the value of its securities, not only must they be given timely financial information, they

must also have meaningful information on the performance of the company's business activities. The annual report should provide disclosure on, among other things, the management's review and analysis of the material factors affecting the performance and financial conditions of the company during the year under review.

The Committee noted that the SES Listing Manual currently prescribes the information which listed issuers are required to disclose in their annual report. Such disclosure includes analysis of the nature of the business activities of the issuer, the performance of such business activities by principal products, activities and geographic locations, discussion of any known trend or factors that had materially affected performance. The Committee is of the view that the disclosure requirements are basically adequate but it is desirable to provide more guidelines to listed issuers on the details of disclosure required.

4.3.2. Timing for issue of Annual Reports

Current law requires a company to present its annual report to its shareholders at the annual general meeting which is to be held no more than six months after the end of the financial year. This would in effect mean that shareholders would in many cases receive the annual report almost half way through the following financial year. This represents a substantial delay before shareholders can have the opportunity to voice their views on the performance of the company and its management. The Committee is of the view that the Companies Act should be amended to require annual reports of listed issuers to be presented to shareholders on a more timely basis. The Committee recommends shortening the period to five months from the end of the financial year. The timing for unlisted companies could remain unchanged at the current six months. As printing and distribution of annual reports take time, earlier availability can be accomplished if listed issuers publish their annual reports on their websites at the same time as the proofs are sent to the printers.

Two reasons have been put forward for companies not being able to finalise their financial statements within a shorter period. First, all companies in a group, comprising the holding company and all its subsidiaries, are required by the Companies Act to have the same financial year end. As the accounts of the holding company can be finalised only after the accounts of the subsidiary have been audited, finalisation of the audit of the holding company's audit is often delayed. Allowing subsidiaries, especially those located overseas, to have financial year ending on a date earlier than that of the holding company would, as is the practice in the United States, enable listed issuers to have more timely accounts. Second, the Companies Act requires that the auditors' reports on the financial statements of all the subsidiaries must be signed off by the auditors of those subsidiaries before the holding company's auditor can sign off its report of the holding company's financial statements. Finalisation of the financial statements of the holding company can be delayed by, for example, an outstanding matter in a subsidiary even though it would not significantly effect the financial statements of the holding company and of the group and would not therefore affect the opinion of the holding company's auditor.

To allow more timely issue of annual reports, the Companies Act should be amended so that auditors can express the opinion on the consolidated financial statements of the holding company without all the financial statements of the subsidiaries having been signed off by their auditors. The amendment should also allow subsidiaries, especially those located overseas, to have their financial year end not more than, say, two months earlier than that of the holding

company, except in the case of subsidiaries in jurisdictions where financial year ends are mandated by legislation.

Recommendation 15

(a) The period to present annual reports of listed issuers to shareholders should be shortened to five months from the end of the financial year.

(b) To allow more timely preparation of financial statements, the Companies Act should be amended so that auditors can express their opinion on the consolidated financial statements of the holding company without all the financial statements of the subsidiaries having to be signed off by their respective auditors. The amendment should also allow subsidiaries, especially those located overseas, to have their financial year end not more than, say, two months earlier than that of the holding company, except in the case of subsidiaries in jurisdictions where financial year ends are mandated by legislation.

4.3.3. Frequency and Timeliness of Interim Results

More frequent and more timely reporting of interim results would underpin the philosophy of more effective disclosure and greater transparency. The SES Listing Manual requires half-yearly results to be provided. These are not required to be audited or reviewed by auditors. The United States and Canadian markets require quarterly results to be furnished within 45 and 60 days, respectively. In Singapore, a few companies have chosen to provide quarterly results. Most companies choose to have their results reviewed by their external auditors before releasing the results.

There may be concerns that more frequent reporting may increase cost. The Committee feels that this is unlikely as companies now have access to computerised accounting systems that can provide financial figures on a more timely basis. Indeed, all companies would require timely information to enable them to effectively manage their day-to-day operations. It should not add to the operating cost since quarterly results do not require to be reviewed or audited by an external auditor.

Concerns may be raised that quarterly reporting causes short-termism. Corporate performance in the United States and Taiwan which require quarterly reporting does not appear to support this view.

The Committee recommends that listed issuers be encouraged to report their results on a quarterly basis. Of equal importance is the timeliness of the release of such results. Subject to changes to the law to permit more timely preparation of financial statements, interim results should be released within 60 days of the period end.

Quarterly or half-yearly results should be reported within 60 days of the period end as against the current 90 days requirement. The quarterly or half-yearly results should include a simplified balance sheet.

Recommendation 16

Listed issuers should be encouraged to report their results on a quarterly basis. Subject to changes to the law to permit more timely preparation of financial statements, interim results should be released within 60 days of the period end.

4.4. FINANCIAL STATEMENTS

4.4.1. Some Comparisons

Audited financial statements are required by the Companies Act to give a "true and fair" view. The "true and fair" test does not, however, apply to the accountant's report in prospectuses, and interim and final results announcements.

Currently, section 201 of the Companies Act requires that the company's directors draw up a "true and fair" profit and loss account and balance sheet. Section 201(14) also requires that the accounts of the company comply with the requirements of the Ninth Schedule. There is presently no statutory requirement for companies' financial statements to comply with accounting standards. Any non-compliance would not strictly affect the "true and fair" view requirements of the Companies Act although the Preface to the Statements of Accounting Standards emphasised that for a set of financial statements to be "true and fair", compliance with Statements of Accounting Standards is essential. It should be noted that one may, however, depart from a standard, if compliance with it would render the financial statements not true and fair, in which event, the departure from the standard and reason for departure must be disclosed and the auditor must concur with the departure. This is consistent with the International Accounting Standards ("IAS").

In the United Kingdom[14], company directors are required to prepare financial statements to give a true and fair view, and to comply with certain detailed prescriptions for financial statements, in particular to state whether the accounts have been prepared in accordance with applicable accounting standards and particulars of any material departure from those standards and the reasons for the departure. Hong Kong[15] requires a company's balance sheet and profit and loss account to give a true and fair view, and to comply with certain detailed requirements for financial statements. In Australia[16], a company's directors are required to ensure that financial statements first comply with regulations relevant to financial statements, then with applicable accounting standards, and finally, if complying with both the regulations and accounting standards would not otherwise give a true and fair view, the directors must provide additional information and explanations as will give a true and fair view.

Our provisions are similar to those of Hong Kong. Singapore and United Kingdom law take the traditional position that the financial statements must present a true and fair view. Where there is non-compliance with accounting standards, the non-compliance and reasons for non-compliance must be disclosed. However, there is no requirement to disclose the information that would have been presented had the financial statements been drawn up according to accounting standards. Australian law is different in that the financial statements must be prepared in accordance with regulations and accounting standards, even if it would result in financial statements that are not true and fair. However, in such a case, additional information must be presented to provide a true and fair view.

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[14] Companies Act 1985 sections 226 and 227. Schedule 4 of the Companies Act 1985 sets out prescribed requirements.

[15] Companies Ordinance section 123. The Tenth Schedule sets out prescribed requirements.

[16] Corporations Law section 297 and 298.

4.4.2. Current Problems

As the law does not require financial statements to comply with accounting standards, it fell on the Institute of Certified Public Accountants of Singapore ("ICPAS"), a self-regulating body, to enforce compliance with accounting standards by its members. ICPAS through its Financial Statements Review Committee ("FSRC") conducts continuing review of annual reports of listed issuers, private companies and companies whose financial statements are gazetted with the objective of enhancing the standards of the accounting profession by ensuring that its members discharge their statutory duties and comply with accounting standards.[17] ICPAS uses its leverage over auditors who are its members in order to enforce compliance with accounting standards.

In practice, it is often difficult for auditors to persuade companies and their directors to adopt accounting standards because the law does not require audited financial statements to comply with accounting standards. The qualification of the financial statements by the auditors due to non-compliance with an accounting standard did not have a strong deterrent effect. Instances of qualifications appear to have increased, such that many audited financial statements may actually not be true and fair. In the absence of regulatory action, some company directors have come to believe that auditors' qualifications of their reports were of little consequence.

4.4.3. Prescribing Accounting Rules

One possible solution to the non-compliance with accounting standards would be to make compliance with accounting standards a legal obligation for all companies that are required to prepare audited financial statements. This could facilitate comparability and make supervision by regulators easier. It is however, outside the jurisdiction of the Committee's terms of reference to consider issues that affect all companies. The Committee is of the view that the issue of mandatory accounting standards should be considered by the accounting profession, with a view to making recommendations to the government.

The Committee is, however, of the view that the securities regulator should have the power to prescribe accounting rules for companies that are listed or have made public offers of securities in Singapore and for public offering documents. This is to ensure a high standard of disclosure and comparability of financial information among such companies. The securities regulator should also have the power to prescribe compliance with particular accounting standards in areas, for example, where there is no equivalent Singapore Statement of Accounting Standard ("SAS"), if it considers it in the interest of the securities market and investors generally to do so. This will ensure that the financial disclosure of companies that are listed or have made public offers in Singapore are of the same high standard and are comparable to other international securities markets.

Many foreign companies would have to prepare financial statements using accounting standards applicable to their respective countries of incorporation. This is normally required by the laws of the countries of incorporation. For the purposes of comparability, the securities regulator should prescribe the accounting standards that could be used in the preparation of financial statements of foreign companies that make public offers or are listed in Singapore.

[17] The Committee appreciates the presentation by Mr Philip Tan, chairman of the Financial Statements Review Committee of ICPAS on its work; and the presentation by Mr Gerard Ee, chairman of the Accounting Standards Committee and Mr Simon Riley of ICPAS, on the accounting standard setting process.

These prescribed standards would include the International Accounting Standards ("IAS") or United States Generally Accepted Accounting Principles ("US GAAP").

In the United States, the SEC requires foreign companies offering securities to investors in the United States to reconcile their financial statements to US GAAP, rather than a reconstruction of the financial statements. Requiring reconstructed financial statements for a listing or public offer in Singapore would put Singapore in an uncompetitive position relative to other markets. The securities regulator should prescribe that foreign companies, not already preparing their financial statements in accordance with the prescribed standards, reconcile their financial statements to the prescribed standards.

Singapore companies usually prepare their financial statements according to SAS. There may be locally incorporated listed issuers that choose to comply with another accounting standard which they consider to be more appropriate to them, in view of their target markets or investor profile. This would provide such companies to have a higher international profile and business flexibility, allowing them to internationalise and access overseas capital markets without having to incur the cost of preparing two sets of financial statements. The securities regulator may grant exemptions to allow locally incorporated public companies that are listed or are making public offers to comply with prescribed accounting standards, other than Singapore accounting standards.

Recommendation 17

(a) The securities regulator should have the power to prescribe accounting rules for companies that are listed or have made public offers of securities in Singapore and for public offering documents.
(b) Foreign companies not already preparing their financial statements in accordance with the prescribed standards should reconcile their financial statements to accounting standards prescribed by the securities regulator.
(c) The securities regulator may grant exemptions to allow locally incorporated public companies that are listed or are making public offers to comply with prescribed accounting standards other than Singapore accounting standards.

5. LIBERALISATION AND DEVELOPMENT

An environment where transactions are driven largely by the market based on a high standard of disclosure will encourage innovations and corporate activities. Strong market discipline and a sound regulatory framework will protect the integrity of the market. In such an environment, there is less need for rules that set limits on what can or cannot be done. Whether or not a corporate transaction should be entered into should be determined by commercial considerations. Liberalising such rules and regulations would allow the market to drive transactions more fully and efficiently while providing a level playing field for all participants.

It is also important to develop regional corporate financing activities done in regional securities markets by professionals, and to develop a regional private venture capital market that is based in Singapore. Technology adoption should be accelerated to raise the efficiency of securities market transactions. These developments would, in the long run, enhance Singapore's role in mobilising funds for capital formation.

5.1. ADMISSION TO LISTING

5.1.1. Segmenting The Market

The SES provides a comprehensive framework to cater to the listing needs of different types of companies, whether local or foreign. The Main Board caters to companies that are generally larger and are more established in terms of track record and profitability. Modelled initially on NASDAQ, SESDAQ was introduced in 1987 to enable local small and medium sized companies that have good growth potential but which have yet to achieve the track record required for a Main Board listing, to access the capital market. On 7 March 1997, SESDAQ was opened to foreign companies for listing. On 8 December 1995, the Exchange established the Foreign Board to facilitate the listing of foreign enterprises which are engaged in infrastructure projects as well as businesses that have shorter track records but have achieved good profit performance.

The Committee is of the view that the SES strategy of having different boards to cater to different market segments is a sound one and should continue. A company that possesses good business prospect and is able to attract investor support would not be prevented from listing just because it does not meet the listing requirements of the Main Board. However, having too many Boards has its disadvantages. The market may find it confusing. Often, companies and investors prefer to wait until a new board has reached a critical mass before coming in. SESDAQ had encountered this problem in its early years.

The Committee is of the view that the combination of the Main Board, with some modifications, and SESDAQ would provide the simplicity and flexibility necessary to attract listings from both local and foreign companies. But it may be desirable to review how the two markets should be better differentiated, so that each will have a distinctive character and image. This would reduce the risk that one market may be perceived as being inferior to the other.

The Main Board can continue to be a market for companies that have achieved a certain minimum standard of track record in terms of profitability. This profit test can take two alternative forms, one of which is the existing three-year profit test required for a Main Board listing. The other form should cater to companies which have only one or two years of profits, but the quantum of profit made in each of the one or two years is higher. In addition to the profit test, a size test can also be applied to enable companies that exceed a certain size, in terms of expected market capitalisation, to qualify for listing on the Main Board. Such a size test will accommodate large companies that have yet to show profits, including infrastructure project companies. Many of the larger technology companies in the United States that are in their early growth phase would also qualify under this size test. With these modifications, the Main Board can cater to a broader spectrum of companies, including companies that would qualify for listing in the Foreign Board. Consequently, the Foreign Board can be abolished. Both the NYSE and NASDAQ have alternative listing criteria based on earnings, asset size and market capitalisation.

Learning from NASDAQ's success, it is desirable to position SESDAQ as the board that provides greater flexibility to companies. Already, a SESDAQ listing confers additional flexibility than a listing on the Main Board, such as a lower shareholding spread and a higher percentage for employee share options scheme. SESDAQ's listing requirements can be reviewed to provide even greater flexibility, such that companies will find being listed there appealing in its own right and not regard SESDAQ as a transit to Main Board.

To attract foreign companies, it is important that foreign companies should be treated equally with local companies. The listing requirements for foreign companies should be the same for those as for local companies.

5.1.2. Trading Currency

Currently, foreign companies listed on SES are required to have their shares quoted for trading in a foreign currency. The Committee understands that this requirement had been imposed in line with the MAS' policy on internationalisation of Singapore dollars.

Many foreign companies have expressed the preference for a Singapore dollar quotation if they were to seek a listing here. They believe that local investors have greater interest in Singapore dollar quoted stocks and one reason for them to seek a Singapore listing is to tap local liquidity. The requirement for foreign companies to list their shares in foreign currency may have deterred some such companies from seeking a listing in Singapore. The Committee is of the view that allowing foreign companies to decide the currency in which to trade their shares is one way to attract more foreign listings to the SES. It is the practice of international markets such as New York, London and Hong Kong to trade foreign shares listed there in the local currency.

5.1.3. Continuity Of Control And Management

The existing listing rules provide that a company seeking a listing on the Main Board must be engaged in materially the same businesses and be under substantially the same management and shareholder control throughout the last three years before the application. The continuity of control and management is an adjunct to the track record listing criteria, which is to set the threshold of quality for a Main Board listing. When the controlling shareholder or management of the listing applicant has changed substantially just before the listing, the

historical track record may not then be representative of the company's performance under the new controlling shareholder or management.

As companies expand, they need new capital and professional expertise. There are valid business reasons for founding owners to sell control. It would be reasonable to accept a listing application based on the track record criteria, if the management team remains substantially intact. Where a founding owner, who was not active in management of the business but relied on professional management to run the business, sells control, his departure from the listing applicant would not be seen to have broken the continuity of control and management as long as the original management team remains. This is in line with the practice in Hong Kong and London.

The continuity rule should not apply to companies that seek admission to the Main Board based on the market capitalisation criteria. This is because the market capitalisation rule proposed for the Main Board sets out the threshold of quality based on the size of the listing applicant and not its track record.

5.1.4. Promoters' Integrity

A higher standard of disclosure reduces the need for the securities regulator to exercise discretion, except where it possesses information that is not available and cannot be made available to the public. One area in which discretion may need to be exercised is regarding the integrity of the controlling shareholders or directors of a listing applicant. The Committee recognises the need for the regulator to exercise judgement on the integrity of a controlling shareholder or director, but it is desirable that such an exercise of discretion should, as far as possible, be done within defined criteria.

The SES Listing Manual currently provides that "the character and integrity of the directors and management and controlling shareholders of the issuer" is a relevant factor for SES' decision on the issuer's listing application. Such a requirement is consistent with the SES' policy of applying a certain minimum standard of quality and probity which it considers to be necessary to maintain investors' confidence in the market. Recognising the SES' policy concern, the Committee is of the view that while the SES has a valid reason to take into account the promoters' integrity, consideration should be given to providing in the listing criteria some quantitative benchmarks. For example, it could be provided that the SES would not normally consider a listed issuer as being suitable for listing if its promoters had been convicted of a criminal offence involving fraud or dishonesty punishable with imprisonment for 3 months or more.

Less clear would be cases where there is no clear evidence but where the confidential information available to the securities regulator creates serious doubts about the integrity of the promoters. In such cases, it should be open to the securities regulator to exercise judgement to decide not to accept the prospectus which the listing applicant has lodged. This would effectively stop the offering and listing of the securities.

5.1.5. Moratorium On Securities Disposals

Currently, the SES may, as a condition for listing, require a listed issuer's promoters to retain their shareholdings in the issuer for a period of time after listing. The SES Listing Manual does not expressly provide for a moratorium for local Main Board companies although as a

matter of practice a one year moratorium is required. The listing rules specify the moratorium requirements for SESDAQ, Foreign Board and foreign currency Main Board listings. The purpose of the moratorium is to ensure that promoters maintain their commitment to the issuer for a certain period after the listing. It also ensures that the promoters will bear the financial consequence if certain disclosure made in the listed issuer's prospectus turn out to be materially wrong or misleading.

In principle, the underlying rationale for imposition of moratorium is fair. Indeed, it serves the interest of listed issuers if their promoters undertake not to sell their shares for a certain period after listing, for investors will view this as a show of confidence in the issuer. Investors may also view this positively as it reduces overhang in the market, reducing potential selling pressure on the issuer's securities. For these reasons, it is a common market practice for underwriters in the United States to require the promoters of their initial public offering clients to contractually agree not to dispose of their shares for a certain period.

In a market driven environment, it is desirable that the imposition of a moratorium should be driven by investors and underwriters, rather than by the stock exchange. The Committee recognises, however, it may take some time for such a practice to develop. In the interim, consideration can be given to revising the listing rules to require the listed issuer, the issue manager and underwriters to contractually agree with the promoters, binding the latter to observing a moratorium. The objective is to institutionalise the moratorium undertaking until it becomes a market practice, at which point (perhaps in three to five years), the listing rule can be dropped.

For Main Board companies, it is proposed that the moratorium period should be for one year following listing, but the target moratorium persons should be allowed to dispose of up to 50% of their holdings at the end of the first six months. The promoters of SESDAQ issuers should give a contractual undertaking to the issue manager that, in the first year they will not dispose of any part of their holdings, and in the following year, they will retain at least 50% of their original holdings.

Promoters subject to a moratorium will include substantial shareholders who have control over the listed issuer and their associates. A substantial shareholder is deemed to have control if he has the capacity to dominate decision-making, directly or indirectly, in relation to the financial and operating policies of the listed issuer. Where a substantial shareholder has an indirect interest in a listed issuer, holding it through another listed company, whether listed on the SES or on another stock exchange, his shareholding in the latter listed company should not be subject to moratorium. It may not be fair to place that shareholding under a moratorium since the substantial shareholder's decision to deal in the latter listed company's shares may be prompted by considerations other than a desire to divest of his interest in the listed issuer.

Institutional or strategic investors who take a significant stake in a company within one year prior to the company's listing should also be regarded as promoters who should be subject to the moratorium to discourage preferential allotment shortly before the company's listing. These investors should be subject to a shorter moratorium period of six months.

Recommendation 18

(a) The SES should continue with its strategy to have different boards to cater to different market segments, for both local and foreign companies, such that:-

(i) The Main Board should be a market for companies with an established profit track record or large market capitalisation.
(ii) SESDAQ should be a market that provides for greater flexibility.
(iii) The Foreign Board can be abolished as the Main Board and SESDAQ could cater to companies that would have qualified for the Foreign Board.
(iv) The listing criteria for foreign and local companies should be identical.

(b) Foreign companies should be allowed to decide the currency in which they trade their shares in order to attract more foreign listings to the SES.

(c) The Main Board track record listing criteria would require that the listing applicant's management team remains substantially intact. The continuity of management rule should not apply to companies that seek admission to the Main Board based on the market capitalisation criteria.

(d) The SES should consider providing some quantitative benchmarks in its listings criteria on promoters' integrity. The securities regulator may exercise judgement to decide not to accept the prospectus which a listing applicant has lodged where it has confidential information which creates doubt about the integrity of the promoters.

(e) Singapore should eventually follow the international practice regarding moratorium on securities disposals, which is driven by investors and underwriters. In the interim, it is proposed that the SES Listing Manual be revised to provide as follows:-
(i) The promoters of Main Board issuers should give a contractual undertaking to the issue manager that, in the first six months, they will not dispose of any part of their holdings, and in the following six months, they will retain at least 50% of their original holdings.
(ii) The promoters of SESDAQ issuers should give a contractual undertaking to the issue manager such that, in the first year they should not dispose of any part of their holdings, and in the following year, they should retain at least 50% of their original holdings.
(iii) Promoters subject to the moratorium rule are substantial shareholders who have control over the applicant and associates of such substantial shareholders.
(iv) Promoters' shareholdings in the listing applicant's holding company which is listed on a stock exchange should not be subject to the moratorium..
(v) Institutional or strategic investors who take a significant stake in a company within one year prior to the company's listing should be subject to a moratorium period of six months.

5.2. SECONDARY OFFERINGS

Issuers come to the market to be able to tap funds for their ongoing business expansion, not only upon initial public offering, but also thereafter. Improving the securities market's ability to raise funds for issuers expeditiously and efficiently reduces the capital cost to issuers. Shortening time-tables for rights issues and placements would, by reducing the underwriting exposure and risk to underwriters, reduce the underwriting fees and the price discount on the offered securities.

5.2.1. Use of Proceeds

Current listing rules limit the amount of proceeds which a listed issuer is permitted to raise without specific use. The cap was introduced to reduce abuse. Some listed issuers had in the past raised substantial funds, stating the purposes as "to take advantage of business

opportunities" or "for working capital". Some companies have been found to have subsequently used the funds for purposes different from those disclosed to shareholders.

While there is a legitimate concern about potential abuse, it is important that listed issuers should be able to tap the market for funds when the market environment is favourable. If listed issuers are permitted to raise funds only when a specific purpose has arisen, the market by then may have become unfavourable. This would operate against the interest of the listed issuers. Listed issuers should be able to take advantage of market windows to raise funds at attractive terms. They should, however, be required to disclose the rationale for the fund raising, and to provide additional disclosure to the market of material utilisation of the funds as and when the funds are subsequently deployed.

The issuer will have to trade off the benefit to it in raising funds at attractive terms and the risk of causing its share price to fall in signalling to the market that its shares may be overpriced. Investors will judge for themselves the merits of investing more money in an issuer which does not disclose the use of proceeds (which is more uncertain thus more risky) versus other investments on which they have more information (which being more certain, thus less risky). The interplay of market forces aided by better disclosure will allow the securities market to resolve the different needs of issuers and investors.

Recommendation 19
A listed issuer may raise funds without any specific use of funds subject to disclosure of the rationale for the fund raising and to disclosure of material utilisation of the funds as and when the funds are subsequently deployed.

5.2.2. Rights Issues

Currently, rights issues in Singapore normally take between 10 and 13 weeks from announcement to listing of the rights shares. If a listed issuer elects to make a confidential submission, the time taken from announcement would be shorter by one to two weeks. The time taken to complete a rights issue is generally considered too long by the standards of established markets. This is attributable to a number of factors, one of which is the need to convene a shareholders' meeting to approve the rights issue. Shortening the rights issue timetable will enable listed issuers to raise funds faster, and will shorten underwriters' exposure period, thus enabling listed issuers to price rights issues closer to market.

The shareholders' approval process typically takes about three to four weeks. If this can be eliminated, the time taken for a rights issue can immediately be shortened by 30% to 40%. This can be readily accomplished by allowing a listed issuer to obtain a general mandate from its shareholders to issue rights shares under Section 161 of the Companies Act, the provision which permits the general mandate which is used to issue placement shares.

Rights and bonus issues do not dilute shareholders' interest, for they are made on a pro-rata basis to shareholders. Consideration should be given to allowing listed issuers to obtain a general mandate to issue new shares representing, say up to 50% of the companies' existing issued share capital, which mandate can be used by the directors to make rights issues, bonus issues or placements, or a combination of these issues, subject to a specific sub-limit for placement shares. If a listed issuer wishes to carry out any rights or bonus issue that exceeds the limit allowed in the mandate, the issuer would need to obtain a specific shareholders' approval at a general meeting. The shareholders' mandate should also cover the issue of

warrants and convertible securities. A sub-limit is proposed for placement, for such an issue may result in dilution of existing shareholders' interest.

The current practice is to commence trading of rights shares about one week after the rights issue has closed. Consideration should be given to allowing rights shares to trade on a "when-issued" basis immediately after the close of the rights issue. This would provide liquidity to investors earlier, and would reduce investors' market risk. In Australia and London, trading in rights shares commences immediately after the close of the rights issue.

Currently, excess rights shares are required to be allocated to existing shareholders who have applied for excess shares. Allocation of excess shares to existing shareholders is administratively cumbersome and causes processing delay. Allowing listed issuers to have the discretion to deal with excess rights shares in a manner they deem fit will enable rights issues to be completed within a shorter time. Listed issuers can be allowed to choose the present method, or to choose to sell the excess shares in the market for the benefit of the companies. The latter method is arguably fairer to all shareholders, as opposed to the present method which inevitably results in some shareholders receiving more shares than others. The option for listed issuers to sell excess shares in the market is practicable only if the rights shares are traded immediately after the close of the rights issue.

Recommendations 20

(a) Listed issuers may obtain a general mandate to issue new shares by way of rights shares, bonus shares or placement shares, or any combination thereof, subject to an overall limit of 50% of the issuer's existing issued share capital.
(b) Consideration should be given to allowing the rights shares to trade on a "when-issued" basis immediately after the close of the rights issue.
(c) Listed issuers should have the option to sell excess rights shares in the open market.

5.2.3. Placements

There will be times when issuers need to raise funds even more expeditiously than rights issues to seize windows of opportunities and thus need to raise funds by private placement. Set against this is the potential dilution to existing shareholders as new placement securities are not sold pro-rata to existing shareholders. Placements include placements of shares, convertible securities and loan stock plus warrants. If placement securities are not offered to the controlling shareholders or directors, but to unrelated persons, the controlling shareholders will have an incentive to balance the benefit to the issuer from raising funds by placement and the dilution that all shareholders, including the controlling shareholder will suffer. This market driven incentive can be harnessed to increase flexibility to issuers in liberalising the annual placement limit and the placement issue price.

The SES Listing Manual allow listed issuers to issue new shares representing up to 10% of the listed issuers' existing share capital for placement over a 12-month period. The Committee advocates allowing listed issuers a higher placement limit of 20%. This 20% threshold is in line with other major markets such as Hong Kong. This 20% placement threshold will be a sub-limit within the overall share issue mandate limit of 50% of existing issued share capital, and this applies to issues of shares as well as warrants and convertibles which are exercisable into shares. The issuer may still obtain specific shareholders' approvals for any placement which exceeds 20% of the existing issued share capital.

Listing rules also allow placement shares to be priced at a discount to market of not more than 5% based on the last done price, or up to 10% discount if the listed issuer has not made any placements within the last 24 months. The SES has, in exceptional circumstances, exercised discretion to allow a few placements to be made in excess of the 5% discount. As existing shareholders suffer dilution from placements it is fair that the dilution should not be exacerbated by deep discounts. The deeper the discount, the greater the dilution. A limit on the discount of 10% from the current share price would be reasonable bearing in mind that the listed issuer may need greater flexibility in reaching out to investors who may balk at paying close to the high prevailing market price, either because the price has run up substantially or because the market outlook is unfavourable. The price should be based on the weighted average price for trades done on the day of announcement, which provides a better representation of the price done on the day in question.

Further efficiency in the placement process can be obtained if the issuer may borrow securities from substantial shareholders for placement, in anticipation of the placement securities being issued. This is the practice in Hong Kong.

Recommendation 21

(a) Listed issuers may include in the annual general mandate, a sub-limit for placements of securities representing up to 20% of the existing issued share capital.
(b) Listed issuers may sell placement shares at up to a discount of 10% from the current share price. The price should be based on the weighted average price for trades done on the day of announcement, which provides a better representation of the price done on the day in question.
(c) A listed issuer may borrow shares from substantial shareholders for placement, in anticipation of the placement shares being issued.

5.2.4. Warrants and Convertibles

Current listing rules place an overall limit on the amount of equity convertible securities that a listed issuer can issue in relation to its issued share capital. No new issue will be allowed if the aggregate amount of such outstanding securities has reached 30% of existing issued share capital. The 30% overall limit has been imposed for prudential regulatory reason. It was considered that unfettered growth of such securities could introduce too much speculative activities in the market, heightening systemic risk. While recognising the prudential regulatory concern, the Committee is of the view that the requirements could be fine tuned, taking into account the practices of other markets, without putting the system at risk. The overall limit can be raised to 100% of issued share capital.

The price of warrants or convertibles is determined by a number of factors, including the exercise price, the interest rate or discount on the debt, the price of the warrant premium, and the volatility of the underlying shares, and the time to maturity or expiration. That the exercise price is at a discount to the current market price of the underlying share does not mean that the warrants or convertibles are being sold at a discount to its theoretical value. The issuer would take into account all these factors. In particular it may trade off a lower interest rate or higher warrant price in exchange for a lower exercise price. If convertibles and warrants with a discount of exercise price to market are not offered to the controlling shareholders and directors, but to unrelated persons, the same argument applies that the controlling shareholders will have an incentive to balance the benefit to the issuer from raising

funds against the dilution that all shareholders, including the controlling shareholder will suffer. The exercise price should be a pricing decision left to the issuer.

Recommendation 22

(a) The overall limit for warrants and convertibles can be raised to 100% of issued share capital.
(b) The issuer should have the flexibility to determine the exercise price for warrants and convertible securities.

5.2.5. Debt Securities

Currently, listings of debt issues are subject to profit and size tests. Unlike equity holders which are concerned about the future growth and prospects of the company, the concerns of debt holders are concerned about whether the issuer is able to continue as a going concern, meet interest expenses the principal repayment as and when they fall due.

For debt issues that are only offered to sophisticated or institutional investors, the market itself would be the best judge. An issue which is already fully subscribed would have passed the test of the market. Accordingly, approval to list debt securities offered to sophisticated and institutional investors could be given when the issue has been fully subscribed.

Recommendation 23

Listing approval for debt securities offered to sophisticated and institutional investors could be given when the issue is fully subscribed. Such securities need not comply with any listing criteria.

5.3. APPLICATION PROCEDURES AND DOCUMENTATION

Under current rules, a listing applicant has to submit a listing application, together other supporting documents, including a draft prospectus or abridged prospectus, as the case may be. There is substantial overlap in the information provided in the listing application and draft prospectus. The listing application contains significantly more information than in the prospectus. Its purpose is to provide all relevant information that will be needed by the SES to have a proper understanding of the listing applicant's business, products, manufacturing and distribution processes, the industry it is operating within, and its financial performance.

In a disclosure based market driven environment, it is the prospectus which should contain the principal disclosure, for that is the document that would be issued to investors. The listing review should be focused on the disclosure contained in that document. Much of the disclosure that is already made in the prospectus need not be duplicated in the listing application. For the issue manager, the resources so freed can be devoted to improving the standard of disclosure in the prospectus.

The documentation requirements should be simplified to require only a brief listing application covering essential corporate information, with the substantive information about the listing applicant and its offering given in the draft prospectus.

Recommendation 24

The documentation requirements for listing applications should be simplified to require only a brief listing application covering essential corporate information, with the substantive information about the listing applicant and its offering given in the draft prospectus.

5.4. DISTRIBUTION METHOD

Initial public offering in Singapore are generally required to be distributed by way of a combination of public offering and placement. The SES Listing Manual states that it is a policy of the exchange that investors should be given equal opportunity to subscribe for an issue and that the basis of allotment should be fair and equitable. The listing rules also provide that the SES may allow an issue to be distributed in whole or in part by way of placement if there is insufficient public demand for the securities. In recent periods, the SES has allowed initial public offerings to be distributed largely by placements, in view of market conditions. Underpinning the SES policy on share offering is also the consideration that initial public offerings should be distributed as widely as possible to promote liquidity and orderly market in the shares. Unlike a placement, a public offering would enable the securities to be distributed to a large number of investors. A system of balloting is applied to public offers that are substantially oversubscribed to ensure fair allocation among applicants.

An initial public offering may be distributed by way of a fixed price offering or by a combination of a fixed price offering and a tender offering. In recent years, fixed price offerings are the norm. The issue price is fixed by the issuer and its underwriters just before the offer period, based on their reading of the market. As the issue price has to be fixed up to two weeks before the offering closes, underwriters are faced with a longer exposure period, and hence higher market risks. Consequently, issues tend to be priced lower to take into account the market risk, resulting in higher capital cost to the issuers.

While maintaining the objectives of promoting liquidity and an orderly market, it is crucial that issuers should also be able to raise funds efficiently. It is necessary to allow issuers the flexibility to structure their offerings so as to be able to respond more quickly to changes in market conditions. To achieve both objectives, issuers and their underwriters should be allowed to decide how their issues should be distributed, subject to compliance with the SES' rules on prescribed shareholding spread and other rules to prevent undue concentration of holdings.. It should be left to them to decide whether to distribute the issues by placement or public offer or a combination of both, to choose their end investors, and whether or not to accept multiple applications.

5.4.1. Bookbuilding

The bookbuilding method of pricing enables issuers and underwriters to better gauge market demand and fix the issue prices at a level that would match supply and demand more accurately. It will lower underwriting risk, give issuers a better price for their securities, thus lowering the cost of capital. This method is commonly practised in the United States and used in international offerings.

In a bookbuilding, the bookrunner is privy to the information on potential demand. It exercises considerable discretion in deciding on who should be allocated securities and the quantum of allocations. There may be concern that the allocations may not be fair and equitable, and that undue preference may be shown to favoured investors. Such concern has been levied at times at placements. It is acknowledged that preferential allocations cannot be prevented altogether in a bookbuilding. But the bookrunner and the underwriters have an obligation to the issuers, as well as a self interest, in ensuring the success of the issues, including a satisfactory post listing performance for the shares. They would also feel obliged

to treat investors fairly so that they can count on their continuing support in future issues. That would provide a certain degree of check on the allocations.

The Committee is of the view that the benefits of the bookbuilding method outweighs its potential disadvantages, and should be allowed. It noted that bookbuilding had been adopted in a previous foreign currency listing, although that was used in conjunction with a public offering. To take advantage of the bookbuilding method, certain changes have to be made to existing law, rules and regulations.

5.4.2. "Red Herring" Prospectus

In the United States, the law distinguishes between offering and selling securities. Upon filing a draft prospectus with the SEC, the underwriters may commence marketing and distribute the draft prospectus (commonly referred to as a red herring) to seek indications of interest. At this stage, the red herring prospectus does not contain pricing information, for that would not have been finalised yet. During this period of marketing, the underwriters will build a book to ascertain the level of market interest in the securities. Investors will assess the securities based on information disclosed in the red herring prospectus, and may ask for more information to be incorporated in the prospectus. Upon the SEC declaring the prospectus to be effective, the securities may be sold. Once the offering price has been agreed to, and a price amendment filed with the SEC, the prospectus is declared effective. Trading will start the following day.

This practice benefits both issuers and investors, improves the level of disclosure and efficiency of the securities market and should be adopted in Singapore. Currently, Section 44 of the Companies Act prohibits securities offering without a prospectus. However, the RCB has the discretion to exercise the power of waiver under Section 46 to waive compliance with the disclosure requirements of the Companies Act. While this provision can be invoked to allow the preliminary prospectus to be registered with the RCB and used for marketing prior to pricing, it is desirable to amend the Companies Act to provide for such a practice without the need to invoke the RCB's power of waiver.

5.4.3. Price Stabilisation

Price stabilisation is the means by which underwriters ensure an orderly aftermarket. Through controlled price stabilisation, investors' confidence in the market can be better assured. However, price stabilisation actions may contravene Section 98(3) of the Securities Industry Act which prohibits actions that have, or are likely to have the effect of raising, lowering or maintaining or stabilising the prices of a security. On 22 September 1996, Regulation 37A of the Securities Industry Regulations was introduced to provide a safe harbour from Section 98 of the Securities Industry Act for price stabilisation actions taken in prescribed manners in respect of an initial public offering of a foreign currency security. Price stabilisation is also useful for initial public offerings of Singapore dollar securities. Regulation 37A should be amended to extend the regulation on price stabilisation to initial public offering of Singapore dollar securities.

5.4.4. "When-Issued" Trading

The introduction of "when-issued" trading in May 1993 has enable trading in initial public offering securities to commence very much earlier following the close of the offering. It has significantly reduced investors' market risk, thereby helping raise interest in initial public

offerings. Currently, “when-issued” trading would commence usually on the second day after the offer closes. The practice is to commence trading after the share certificates for the offered securities have been issued to the Central Depository (Pte) Ltd (“CDP”). As the Companies Act permits shares to be allotted and the share certificates issued only after the issuer has received the proceeds, there is some delay to the commencement of trading.

In the United States, the practice is to commence trading on the day after the price is fixed, even though settlement of share subscriptions would take place only a few days later. This provides investors immediate trading liquidity, lowering investors’ holding risk. In principle, a shorter holding period will benefit investors and make the market more efficient. The Committee considers it desirable to provide for trading to commence on the next day after offer closing. Bringing our practice in line with that in the United States will facilitate dual listings in United States and Singapore. Singapore investors will not be disadvantaged by any delay in commencement of trading in such a security in Singapore.

Recommendation 25

(a) Issuers and their underwriters should be allowed to decide how their issues should be distributed, subject to compliance with the SES’ rules on prescribed shareholding spread and other rules to prevent undue concentration of holdings, so as to promote liquidity and an orderly market in the securities. It should be left to them to decide whether to distribute the issues by placement or public offer or a combination of both, to choose their end investors, and whether or not to accept multiple applications.
(b) The bookbuilding method of securities distribution should be adopted in Singapore securities as an alternative to or in combination with other methods. Consequent changes are required to permit the issue of “red herring” prospectuses and to allow price stabilisation for Singapore dollar initial public offerings.
(c) Changes should be made to permit “when issued” trading for initial public offerings to commence on the market day following the close of the offer.

5.5. SHAREHOLDING SPREAD

5.5.1. Initial Listings

Under current SES rules, the minimum public float for Main Board is $4 million or 25% of the listed issuer’s issued share capital (whichever is the higher) to be held in the hands of not less than 1,000 shareholders. A SESDAQ issuer must have a minimum public float of 500,000 shares or 15% of the company’s issued share capital (whichever is the greater). No minimum number of public shareholders is required for SESDAQ.

In principle, it is desirable to increase the size of public float, for that would promote liquidity and a fair and orderly market in the securities. For large issuers, this objective would not be unduly compromised if less than 25% of their issued shares are held in public hands. If the issue size is very large, it may be difficult for the market to absorb it fully. The lack of market appetite will be exacerbated in times of adverse market conditions. In such situations, large issuers should be permitted to scale down their issues. A graduated scale of float sizes (ranging, say from 10% to 25% of issued shares) depending on the size of initial public offering proceeds would provide issuers more flexibility in raising funds during a less favourable market environment.

Currently, there are no minimum spread requirements for SESDAQ listings. Consistent with the policy of promoting liquidity and an orderly market, it is desirable that SESDAQ listings should be subject to a minimum requirement on the number of shareholders. But in line with the previously stated objective of allowing SESDAQ companies to have greater flexibility, SESDAQ companies' spread requirement, should be less stringent than for Main Board companies.

For both Main Board and SESDAQ, the SES should, like other stock exchanges, have the right to make rules on the minimum float and shareholder distribution to promote liquidity and fair distribution, and to main a fair and orderly market. This will prevent concentration of shares in a few hands and reduce the risk of cornering and share manipulation.

Recommendation 26

(a) For the Main Board, SES could consider adopting a graduated scale for size of free float that varies according with the amount of proceeds raised to provide flexibility in raising funds.
(b) To allow SESDAQ companies to have greater flexibility, they should be subject to a spread requirement which is less stringent than Main Board companies.

5.5.2. Continuing Spread

The SEHK, LSE, ASX and United States stock exchanges all have minimum shareholding spread requirements which their listed issuers are required to observe for as long as they are listed on the exchanges. Listed issuers should have a continuing obligation to take such steps as reasonable to promote liquidity and a fair and orderly market in their securities. Recognising that the shareholding spread normally shrinks after a share has started trading, the SES should consider setting a continuing spread requirement that is based on a percentage of the level required for initial listing.

Recommendation 27

The SES should consider setting continuing free float and spread requirements at a percentage of the levels set for of initial listing, in order to maintain a fair and orderly market.

5.6. CORPORATE GOVERNANCE

A recent survey[18] showed that the United Kingdom maintained its first position in corporate governance standards among the world's top five developed nations with United States in second place. The other countries are France, Germany and Japan. In the United Kingdom, the Hampel Report[19] added modest reforms to the Cadbury and Greenbury codes. The LSE issued the Principles of Good Governance and Code of Best Practice ("the Combined Code") in June 1998 as an amendment to its Listing Rules which requires each listed issuer to include in the annual report a statement on how it has applied the principles of good governance set out in the Combined Code by providing explanation to enable the shareholders to evaluate how the principles have been applied. In the United States, the Council of Institutional Investors adopted a code of best practice.

The Committee believes that eventually the rules on corporate governance should take the form of principles and best practices which listed issuers should evolve and observe. Issuers

[18] Davis Global Advisors, *Corporate Governance 1998: An International Comparison,* June 1998.
[19] Committee on Corporate Governance chaired by Sir Ronald Hampel, June 1998.

themselves will be responsible for formulating the principles into working guidelines that are more appropriate to them and it is for the market to judge and reward each issuer for its standard of corporate governance.

Historically, corporate governance evolved in the United States and United Kingdom as a result of greater involvement by institutional investors. The holdings of these institutional investors at times were so significant that it was not an option for them to dispose of their holdings in poorly performing companies without affecting the market price of the securities. This gave them the impetus to become proactive in the oversight of the companies that they invest. Strong civil remedies in the form of shareholder class actions gave these investors an additional powerful tool in which to oversee and discipline company management.

As a result, corporate governance practices in the United States and United Kingdom were almost entirely market driven. Institutional investors in the United States and United Kingdom have greater leverage because of the prevalence of companies that are not controlled by substantial shareholders and are run by professional managers with insignificant shareholdings. Our stock market is characterised by companies controlled by majority shareholders and lower participation by institutional investors.

5.6.1. Initiating Good Corporate Governance Practices

Given the different shareholder profile in Singapore compared to the United States and United Kingdom, it is necessary to initiate the evolution of corporate governance standards to maximise shareholder value and to enhance investor confidence in our market.[20]

The establishment of a strong regulatory framework with rules that are enforceable and enforced by the securities regulator to protect the integrity of the market, will set the basic rules in which high corporate governance standards can evolve. The Companies Act could also expand on directors' duties and obligations to cover more comprehensively areas relating to conflicts of interest of controlling shareholders and directors, and interested person transactions. Corporate governance encompasses issues relating to the practices of the board of directors, the exercise of directors' fiduciary duties and obligations towards shareholders, and resolving conflicts of interest of directors and controlling shareholders, particularly in interested person transactions.

Until a strong regulatory framework with augmented directors' duties and obligations has been established, there is a need for some rules to protect the integrity of the market and investor confidence. Some examples are the SES Listing Manual rules on employee share option schemes ("ESOS") the rationale of which is to align the interest of management closer to that of shareholders, and rules on situations where interested persons may be in a position to influence the listed issuer for his personal benefit.

In addition to such rules, the SES had introduced the Best Practices Guide in May 1998 on Audit Committee and Dealings in Securities. Other corporate governance matters are required by the Listing Manual to be disclosed in the annual report, for example, the disclosure of directors' remuneration. With the introduction of the Best Practices Guide, all listed issuers in Singapore are required to disclose in their annual reports whether and how they have complied

[20] The Committee appreciates the presentation by Mr Gautam Banerjee and Mr Yeoh Oon Jin of Price Waterhouse on the findings of a survey on Corporate Governance of Singapore Listed Companies.

with the principles and best practices. This includes the listed issuers' corporate governance processes and activities.

The Committee notes the establishment of the Singapore Institute of Directors which, among other things, aims to give greater prominence to the establishment and practice of good corporate governance.

5.6.2. Corporate Governance Disclosure

The Committee is of the view that listed issuers should disclose in the annual report, the corporate governance practices and procedures in place during the financial period under review, which should include procedures and practices in respect of the following two broad areas:-

(a) Functions and responsibilities of the board of directors, audit committee, and any other committees as the board may deem appropriate, such as nominations committee and remuneration committee. There should also be disclosure of the responsibilities of all executive directors and on whether there is a clear separation of the functions of the chairman and the chief executive officer. The number and identity of independent directors should be disclosed.

(b) Internal controls and procedures relating to the dealing of securities by directors and senior management and controls and procedures relating to the management of conflicts of interest such as interested person transactions.

To achieve wide acceptance, a Code of Best Practices on Corporate Governance ("the Code") should be developed by a body with wide sectoral representation, i.e. from companies, institutional and retail investors, market professionals and the securities regulator. Further, to give such a code the desired effect, the SES should require listed issuers to disclose how they have applied and complied with the Code or, where appropriate, to make a negative statement.

Recommendation 28

(a) The rules on corporate governance should eventually take the form of principles and best practices which listed issuers should evolve and observe.
(b) Listed issuers should disclose in their annual report, the corporate governance practices and procedures in place during the financial period under review. To achieve wide acceptance, a Code of Best Practices on Corporate Governance should be developed by a body with wide sectoral representation. To give such a code the desired effect, the SES should require listed issuers to disclose how they have applied and complied with the Code or, where appropriate, to make a negative statement.

5.7. EMPLOYEES' SHARE OPTION/OWNERSHIP SCHEME ("ESOS")

A unique objective of an ESOS within a remuneration package is to align directors' and key employees' interests with those of shareholders, incentivising them to work in a way that will increase shareholder value. Only if the issuer is successful will the person benefit from exercising his options. Thus the issuer defers a portion of the person's remuneration and makes it conditional upon the issuer's success.

An issuer's ESOS needs to be competitive with schemes offered by others with whom it competes for talent from the same pool. Thus, companies should be allowed to design their own schemes to meet their desired incentive outcomes.

5.7.1. Shareholders' Approval Required

From the issuer's perspective, share options are an inexpensive means of motivating and remunerating employees since no cash outflow and no accounting charge are involved. The cost of share options is borne by shareholders in the form of dilution of their shareholding interest. Since shareholders bear the cost of ESOS, they should decide on the merits of an ESOS. The SES Listing Manual requires any scheme proposed by the listed issuer to be approved at a general meeting. This rule should be retained.

5.7.2. Eligibility For Participation

Current rules do not allow controlling shareholders to participate in ESOS. It was felt that being substantial equity owners, controlling shareholders already have strong incentive to work towards increasing shareholder value. A participating controlling shareholder would have a conflict of interest, raising possible concern about whether the ESOS is in the best interest of the listed issuers.

This issue should also be considered from another perspective. Controlling shareholders in executive positions contribute as managers and should be rewarded in that capacity as distinct from being owners. In younger companies, it is common for the controlling shareholders to also be the managers of and the driving force behind the business. These controlling shareholders, when they share ownership of the companies with other providers of capital, would expect their contributions as drivers of the business to be duly rewarded. Share options provide an alternative to monetary compensation that would help conserve cash and reduce the companies' operating expenses.

The Committee is of the view that, for these reasons, controlling shareholders (defined as a person with the capacity to dominate decision-making, directly or indirectly, in relation to the financial and operating policies of the company) in executive positions should be allowed to participate in ESOS, subject to controls to prevent abuse. Such controlling shareholders should be allowed to exercise their right as shareholders to vote on the scheme. But their participation in the scheme and the actual grant of options to them should be subject to specific approval by independent shareholders. The resolutions for the scheme and the controlling shareholders' participation should be separate. To enhance transparency, grants of options to individual participating controlling shareholders should be disclosed in the annual reports. The grant of options to such persons should be subject to specific individual and aggregate limits for Main Board listed issuers. For SESDAQ companies, the Committee is of the view that no limits need to be imposed as such companies tend to be smaller. Moreover, it is in line with the previous stated objective to allow SESDAQ companies to exercise greater flexibility.

Current rules provide that ESOS should be reserved for the benefits of group employees, for they are directly accountable to the listed group and can only look to the listed group for the reward of their labour. The Committee is of the view that participation in ESOS should be extended to non-executive directors as well as directors and employees of the parent group ("parent group employees") who the listed issuer considers to have contributed or can

contribute to its success. The listed issuer's interest will be served if it can use share options to incentivise and reward its non-executive directors and those parent group employees who have contributed to its success. However, it is important to make the process transparent by requiring disclosure in the annual report of the aggregate amount of options granted to non-executive directors and to parent group employees, as well as the names of recipients who received significant amounts and the individual amount granted.

The SES Listing Manual also sets out the requirements under which a listed issuer' unlisted subsidiaries may implement their own ESOS. The Committee is of the view the such subsidiaries should be free to implement their own ESOS and set terms which they consider appropriate subject only to the approval of the listed issuer's shareholders. This will give the listed issuer flexibility to design an ESOS for a subsidiary that would enhance the subsidiary's competitiveness.

5.7.3. Limits On Scheme Size and Groups

ESOS is meant to enable listed issuers to increase competitiveness and flexibility in attracting talent (in many cases, from a common global pool). The current thresholds are 5% of existing issued share capital for Main Board and 15% for SESDAQ. The SEHK allows for a limit of 10% of issued share capital. The LSE and United States stock markets do not have any limits taking the view that it is for the company to decide what limits are suitable in relation to the needs and practices in its own industry. Substantial option grants that significantly dilute existing shareholders' interest are of concern to shareholders. In the United Kingdom and the United States, institutional investors exercise significant influence on listed issuers' corporate governance. Listed issuers, particularly those who count institutional investors among their substantial shareholders, will have to take heed of their institutional shareholders' concern about dilution when deciding on option grants. While Singapore has yet to see the same level of shareholder oversight as seen in the United Kingdom and the United States, it is desirable that eventually, the market should decide the size of an ESOS which a listed issuer should be allowed to have.

In the interim, Main Board company's limits should continue to be subject to a size limit, but the existing threshold of 5% of issued share capital should be raised. The Committee is of the view that a 15% limit is appropriate, balancing the interests of listed issuers and that of investors. Over time, the goal should be to leave the scheme configuration entirely to listed issuers to decide. SESDAQ companies, however, should be accorded more flexibility as being young, high growth companies with less resources, they will need to use share options more extensively to hire and retain key managers. Companies listed on SESDAQ should be free to set their own limits as long as they are able to justify the limits to their shareholders.

Grants to a single participant or a group of participants in the same category are remuneration issues. The company should resolve them as part and parcel of its incentive and remuneration policy.

5.7.4. Exercise Price

Options are meant to incentivise employees to improve the issuer's long term performance. Thus, employees' reward should come only when the issuer's share price appreciates beyond the level at the time the options were granted. But it is increasingly common for share options to be used as a substitute for cash compensation as well. In some jurisdiction, such as the

United States and Taiwan, it is common for young technology companies to grant share options that are exercisable, or sell shares at substantial discounts, as substitute for cash compensation and as carrot to attract highly skilled personnel in a tight labour market. In Singapore, the general practice has been to grant options at the market price, although a small number of listed issuers have been permitted to issue options at deep discounts to market. As Singapore promotes more high technology industries, companies would need to have more flexibility, including the ability to grant options at a discount to market price, to attract and retain key talents. To ensure that ESOS does not lose its objective as an incentive scheme, and consistent with the disclosure based philosophy, share options should be issued at a discount only if: the options are exercisable only after a specified vesting period, and shareholders have specifically approved the quantum of the discount.

5.7.5. Exercise Period

The current rule of not allowing employees to exercise their options within one year of the date of grant should be retained since the objective of the scheme is to incentivise employees to work in a way that will increase shareholder value over time. However, the issuer should have the discretion to decide on the terms to impose on employees who have served for less a year. One example is whether a longer vesting period should be imposed on such employees.

Recommendation 29

(a) Controlling shareholders (defined as a person with the capacity to dominate decision-making, directly or indirectly, in relation to the financial and operating policies of the company) in executive positions should be allowed to participate in ESOS, subject to specific approval by independent shareholders of their participation and the actual grant of options. For Main Board companies, the participation by controlling shareholders should be subject to specific individual and aggregate limits.

(b) Participation in ESOS should be extended to non-executive directors as well as directors and employees of the parent group whom the listed issuer considers to have contributed or can contribute to its success, subject to annual disclosure.

(c) Unlisted subsidiaries of a listed issuer are free to implement their own ESOS, subject to approval of the listed parent issuer's shareholders.

(d) For Main Board companies, the current scheme size limit of 5% should be increased to 15% and eventually removed. For SESDAQ, no limit should be imposed on the size of the scheme. There should be no individual or class limits.

(e) Options may be granted at a discount to market price if the options are exercisable only after a specified vesting period, and shareholders have specifically approved the quantum of the discount.

(f) Options should not be exercisable within one year of the date of grant. For employees who have served less than a year, the issuer should have the discretion to decide whether to impose a longer moratorium.

5.8. INTERESTED PERSON TRANSACTIONS

A transaction between a listed issuer and a related party is presumed to give rise to a conflict of interest. There is natural concern that the related party ("interested person") may be in a position to influence the listed issuer for his personal benefit. In principle, where the interests of shareholders could be prejudiced by an interested person transaction, this must be disclosed to and/or approved by them.

NASDAQ does not have the equivalent of the SES Listing Manual's Chapter 9A on interested person transactions, though the NYSE has some rules. However, the United States market relies more on institutional involvement in corporate governance and civil remedies to drive standards. As the standard of corporate governance in Singapore evolves, we should move towards the same direction. There will come a time when we can leave it to the market to decide what interested person transactions its listed issuers should be allowed to do.

In the meantime, the current rules on interested person transactions are workable, but could be streamlined to give greater flexibility to listed issuers, where interest of public shareholders is not put at risk.

5.8.1. The "Interested Person"

The current definitions could be narrowed so as not to capture potential conflicts which are remote.

An "interested person" is a director, chief executive officer, or substantial shareholder of the listed issuer; or an associate of any such director, chief executive officer, or substantial shareholder. This definition is narrower than similar definitions by the LSE, SEHK and in Australia. SEHK and Australia consider persons acting in concert as interested persons, and all three markets extend the definition to past directors.

The scope could be narrowed by excluding non-controlling substantial shareholders. A non-controlling substantial shareholder who is not also a director or chief executive officer would not be in a position to influence the issuer for his private benefit. "Control" means the capacity to dominate decision-making, directly or indirectly, in relation to the financial and operating policies of the relevant company.

Currently, an "associate" is a person who is an immediate family member, or company or trust in which the person and his immediate family, directly and indirectly, owns 25% or more. The 25% quantitative test is based on the 25% threshold adopted in the Singapore Code on Take-overs and Mergers as indication of effective control. It is clear cut and simple to apply, but may not necessarily imply control. For example, a director who owns 25% of a company may not exercise any control over that company. In another case, he may in fact be exercising control over the company although his shareholding is less than 25%. It is preferable to apply the "control" test instead of adopting a quantitative threshold, which is necessarily arbitrary, for this purpose. This may make application, and possibly enforcement, of the rule more cumbersome, but it would be more meaningful as it captures only parties which are within the control of the interested person.

5.8.2. The "Entity At Risk"

The concept of an entity at risk is to bring into the scope of the rules, transactions with interested persons which affects the interest of a listed issuer's subsidiaries and of associated companies that the listed issuer controls. Currently, a "target associated company" is defined as a company of which the listed issuer and its interested person are together the largest shareholder. There is a presumption in the rule that in such a situation the listed issuer exercises control over the target associated company. This may not necessarily be so, particularly where the combined holdings of the listed issuer and its interested person represent a minority stake even though it is the largest among the shareholders.

It would be consistent with the definitions for "interested persons" and "associates" to define "entity at risk" as the listed issuer, its subsidiaries, and associated companies over which the listed issuer and its interested person have control.

Subsidiaries and target associated companies which are listed on a foreign stock exchange are excluded from the definition of "entity at risk" as they are already subject to the listing rules of the foreign stock exchange. Subsidiaries and target associated companies which are listed on SES should similarly be excluded as they are deemed to be independent entities at risk by virtue of their separate listing on SES.

5.8.3. Materiality Thresholds

The materiality thresholds define transactions that do not require announcement nor shareholders' approval; require announcement only; and require announcement and shareholders' approval.

Currently, the materiality thresholds are expressed as the lower of a percentage of the listed issuer's net tangible assets or an absolute quantum. The use of such a threshold would result in a large issuer having to obtain shareholders' approval for interested person transactions which, though large in absolute terms, are small relative to its net tangible assets. As shareholders should only be concerned about transactions which are material in relation to the size of the listed issuer, the materiality thresholds should be expressed as a percentage of the listed issuer's net tangible assets only.

Recommendation 30

(a) The law on directors duties should be augmented to cover interested person transactions, such that a breach of which could attract legal remedies that can be enforced by shareholders and the securities regulator.

(b) In the interim, interested person transaction rules could be streamlined to give greater flexibility to listed issuers, where the interest of public shareholders is not put at risk, as follows:-

  (i) The scope of interested person transactions should be modified to exclude transactions which involve potential conflict of interest that is remote, or no conflict of interest, by narrowing certain definitions as follows:-

   - An "interested person" is a director, chief executive officer, or controlling shareholder of the listed issuer; or an associate of any such director, chief executive officer, or controlling shareholder.
   - An "associate" is a person who is an immediate family member, or company or trust in which the person and his immediate family has control.
   - An "entity at risk" is the listed issuer, its subsidiaries, and associated companies over which the listed issuer and its interested person have control.
   - "Control" means the capacity to dominate decision-making, directly or indirectly, in relation to the financial and operating policies of the relevant company.

  (ii) Materiality thresholds that trigger an announcement and/or shareholders' approval should be expressed in terms of a percentage of the listed issuer's net tangible assets and not as an absolute number.

5.9. VERY SUBSTANTIAL ACQUISITIONS AND REVERSE TAKE-OVERS

Clause 1008 of the SES Listing Manual provides that very substantial acquisitions and transactions that result in a reverse take-over of a listed issuer requires the approval of shareholders and the SES. A very substantial acquisition is defined as one which represents over 100% of the acquiring listed issuer's net tangible assets, or whose profits represents over 100% of the acquiring listed issuer's profits. In deciding whether the acquisition should be approved, the SES would take into account whether the acquired assets meet the criteria for a new listing. The objective of this requirement is to prevent "back-door" listing. If the assets do not qualify for a new listing in their own right, they should not be allowed to gain listing by the "back door".

The principle underlying this rule is acceptable. The Committee is of the view, however, that compliance with the new listing criteria should be based on the enlarged group, instead of just the acquired assets. The SEHK, LSE and ASX have similar rules, but require the enlarged group to meet listing requirements.

The rule can be further fine tuned to facilitate acquisition of a business or asset which is in a similar line of business as that of the acquiring listed issuer. The listed issuer should have flexibility, within prescribed limits, to seek such acquisitions that would enable it to expand its business, without having to be slowed down by the need to obtain SES or shareholders' approval. It is already the SES' policy to exempt such acquisitions from shareholders' approval. It is desirable to formalise this practice. As a safeguard, the following conditions can be imposed:

(a) The acquisition should not be too much larger than the acquiring listed issuer;
(b) The enlarged group meets the criteria for new listing;
(c) There will not be significant change in the control of the listed issuer and in the composition of the board of directors of the listed issuer; and
(d) The business, company or companies to be acquired is or are in a similar line of business as the listed issuer

Recommendation 31
Compliance with the new listing criteria for very substantial acquisitions should be based on the enlarged group, instead of just the acquired assets. Very substantial acquisitions of businesses or assets in a similar line of business which meet certain prescribed conditions should not require SES and shareholders' approval.

5.10. MARKET ACCESS FOR SMALL CAPS

A major engine of economic growth and wealth creation are small start-up firms. As only a fraction of start-ups become profitable, investing in such companies are inherently risky. A well functioning market must meet the capital needs of such firms.

Currently, there are four sources of funds for start-ups and young venture-type companies. These are:-

(a) Focused Start-Up Venture Capital Funds: To date, there are only two such funds supported by the Economic Development Board.

(b) Venture Capital Funds: These are relatively big regional funds which are generally not interested in small companies and start-ups.
(c) Corporate Investors: Strategic and focused, these investors are generally not interested in start-ups.
(d) Business “Angels”: Persons with extensive business network and funds.

In Singapore, some 25 to 30 groups of venture capital or private equity firms have been established since 1983. Apart from these full-time venture capital players, there must be at least 50 others who are either part-time or corporate players who will participate in specific projects which meet their strategic interest. The vast majority of the venture capital players, perhaps some 80%, prefer to focus on funding companies which are expanding their businesses, putting up between S$3 million to S$5 million per project. Another 10% to 15% of the venture capital players prefer the later-stage opportunities, where the investment size is larger between S$10 million to S$30 million. Only a handful of players are specialised in start-ups and seed-stage funding. They will provide capital that can range from S$0.5 million to $3 million per deal. For start-up projects and their entrepreneurs, another alternative source of funds is corporate investors if the projects fall within their narrow strategic area. It is observed that even venture capitalists prefer to avoid absolute start-up firms.

5.10.1.Business Networks

Local entrepreneurs have limited choice in finding funds for their start-up projects despite the existence of many venture capitalists in Singapore. One reason may be the difficulty in finding the right investor. Another reason is the poor quality of the projects. In many developed countries, apart from a sizeable venture capital industry, the presence of business angel networks in the private sector has played an important role in providing capital to start-ups and seed-stage companies. For Singapore, such business angel networks and other forms of informal funding sources are still in their infancy and should be encouraged.

Local entrepreneurs may have an excellent project but do not have the expertise in packaging their proposal attractively in order to convince potential investors of the attractiveness of their projects.

The Economic Development Board (“EDB”), National Science and Technology Board (“NSTB”) and other private sector associations like the Association of Banks in Singapore (“ABS”) and Singapore Venture Capital Association (“SVCA”), Singapore Merchant Bankers’ Association (“SMBA”) and the Association of Small and Medium-Sized Enterprises (“ASME”) should support the formation of business angel networks and other forms of informal funding sources, and the development of a programme to assist companies in putting up coherent business and financial plans.

Recommendation 32
(a) The formation of business angel networks and other forms of informal funding sources should be supported.
(b) A programme to assist companies to put up coherent business and financial plans should be developed.

5.10.2.Third Board or Bulletin Board?

A venture capitalist will invest in a company only if he is able to exit his investment, such as upon initial public offering. Facilitating the avenues in which the venture capitalist can exit his investment may help start-ups and venture-type firms in raising venture capital.

SESDAQ caters to companies that require more flexibility than a listing on the Main Board. No quantitative criteria for profit, capital or operating track record is required for a SESDAQ listing. SESDAQ's listing criteria are flexible enough to cater to the listing of start-up or venture-type companies. However, there appears to be a number of impediments for such companies raising funds via a SESDAQ listing. One critical constraint is the difficulty in securing sufficient investor demand for shares of such companies. In the absence of adequate market interest in such securities, it would also be difficult for the companies to secure the services of investment banks to underwrite their share issues. Another severe constraint is the cost of listing relative to their small size.

Cost can only be reduced if there is a reduction in the compliance and disclosure requirements. The compliance cost for a SESDAQ listing, ie from preparing prospectuses and financial reports, and its attendant accounting, legal and investment banking fees, are the result of the prospectus requirements of the Companies Act and the Listing Manual which cannot be avoided if the companies target their offerings to the investing public. Currently, the same standard of disclosure is required of SESDAQ as for Main Board companies. Under the envisaged disclosure based regime with legal obligations of disclosure, the standard of disclosure applicable to Main Board and SESDAQ are expected to be substantially higher. Reducing disclosure requirements for start-up or venture-type companies would go against the move to a disclosure based environment.

There are a number of successful venture boards in the United Kingdom, France and Germany. They are the Alternative Investment Market ("AIM"), Le Nouveau Marche, and Neuer Markt, respectively. Their admission criteria are not unduly restrictive. Both the French and German markets specify minimum equity requirements: FF8 million (S$2.3 million) for the French and DM10 million (S$10 million) for the German market. The disclosure obligations for the French and German markets are stringent. The French market requires a three year business plan at initial public offering. Both the French and German markets require quarterly reporting. AIM has no listing criteria but prospectus disclosure is subject to the same legal requirements for prospectuses as the LSE. The average market capitalisation of each company is about S$100 million on the French board[21], S$800 million on the German board[22] and S$50 million on AIM[23]. In comparison, Singapore companies on the Main Board and SESDAQ have an average market capitalisation of $250 million and $30 million, respectively.[24] This would suggest that listing, even on venture boards, is economical only for the relatively large companies.

The terms of reference of the Committee include considering whether a third board of the SES should be set up for companies that cannot obtain a listing on SESDAQ. A third board will provide an "exit" avenue for venture capitalists to realise their investments. A third board that

[21] As at 31 July 1998.
[22] As at 15 July 1998.
[23] As at 31 December 1997.
[24] As at 31 August 1998. Main Board average market capitalisation excludes Singapore Telecomunications Ltd.

subjects its listed issuers to the same high standards of disclosure under the disclosure based regulatory framework would make it no different from SESDAQ. The key consideration is then whether a third board should allow listing without the normal disclosure and due diligence requirements. From the point of regulatory policy, disclosure and due diligence requirements can be relaxed only where the securities offerings are restricted to sophisticated and institutional investors. As the number of qualified investors in such a market will be limited, the market will be highly illiquid. This will discourage companies from listing in this market which in turn perpetuates the market's illiquidity.

The Committee is of the view that instead of creating a third board, it may be more appropriate at this stage, to consider providing a mechanism that brings together companies with funding needs and suitable investors who may have interest in investing in such companies.

Australia's enterprise market ("e.m.") provides such a facility. It is an internet bulletin board where companies and investors join as subscriber members. Investors contractually acknowledge the risks of the market and the potential for loss and limited redress and are carefully screened to ensure that they understand the risks. It matches companies in search of funds against the investment profile of investors. Information about potential investee companies are emailed to member investors based on their stated investment criteria. Investors who wish to exit their investments do so in the same way as companies who seek capital. The process is strictly caveat emptor. Investors who wish to gain greater comfort about a potential investee company may hire an adviser to conduct due diligence on the company. Companies may seek to lower cost to investors by hiring a sponsor to conduct due diligence in anticipation of investor interest. Australia's e.m. provides an infrastructure for private capital transactions but does not provide a trading infrastructure. Australian law requires a prospectus to be prepared if there are more than 20 investors in a company. Australia's e.m. side steps this by limiting investors in such companies to 20.

Singapore should consider adopting an internet based bulletin board for start-ups and venture-type companies which is similar to the e.m. Over time, this market may grow. To bridge the gap and provide these young companies with follow-on rounds of fund-raising as they grow, consideration should later be given to providing this market with a trading facility which is restricted to sophisticated investors and venture capitalists.

The development of such an infrastructure requires support. This could come from the SES together with other government agencies like the EDB, NSTB and other private sector associations like the ABS, SVCA, SMBA and the ASME.

Recommendation 33
To cater to companies that may find listing on SESDAQ uneconomical, consideration should be given to setting up an internet based bulletin board to provide an infrastructure for private venture capital transactions, which is restricted to sophisticated investors and venture capitalists.

5.10.3.Developing the Venture Capital Sector

There may be other impediments to local entrepreneurs obtaining a listing. Our investment banks are not used to underwriting issues of companies that do not have a profit track record. Our local investors are inexperienced in valuing and investing in companies with no profit

track record. One solution is to continue to attract the appropriate foreign expertise to be established in Singapore: foreign venture capitalists, especially those based in Silicon Valley, with the experience and comfort levels in investing in and nurturing start-ups for public listing; and foreign investment banks that specialise in underwriting start-up companies, and companies with no profit track record.

Many venture fund players are already using Singapore as a regional base for their Asian activities. Since these multinational companies, private equity groups and financial institutions are here mainly to pursue their regional focus and strategic approach, they will not give much attention to small local start-up opportunities. This established base can be leveraged to make Singapore a hub for venture capital activities in the region. A whole range of services can be provided to these Singapore-based regional players, from the internet bulletin board for the initial venture capital financing stages for regional start-ups and venture-type firms, to providing them with an avenue to exit and profit from their investments, with a listing on SESDAQ. Assistance can be provided to regional start-ups and venture-type companies in the form of business angels networking and the preparation of business and financial plans.

Recommendation 34
To develop the venture capital sector and to build Singapore into a hub for regional venture capital activities the following initiatives should be considered:-

(a) Continue to attract foreign venture capitalists with the experience and comfort levels in investing in and nurturing start-ups for public listing and foreign investment banks that specialise in underwriting start-up companies and companies with no profit track record.
(b) Leverage off the already established base of regional venture capitalists by promoting a range of services to regional venture capitalists and regional companies from internet bulletin board, business plan assistance, business angels network, and eventual listing on SESDAQ.

5.11. A REGIONAL CORPORATE FINANCING HUB

Singapore does not have the advantages of a capital centre such as New York or Tokyo with their large domestic economies, or London with its long history. To become an international capital centre, much of Singapore's growth will have to come from activities for the region at large, from South East Asia to India and China. In addition to promoting and developing Singapore-based fund-raising activities (e.g. local and foreign initial public offerings in Singapore) which captures only a small portion of the regional financing activities which can be conducted in Singapore, it is equally important to develop Singapore-based external financing activities to service the entire region. Singapore is already providing value added regional activities in the Asian Dollar Market, trading in G7 equity and bond futures contracts on SIMEX, and foreign exchange trading. To complete Singapore’s range of services and activities as a capital centre and to create a strong propellant for the sector’s growth, it is necessary to grow corporate financing activities to service regional economies and to leverage Singapore’s natural advantages as a hub for South East Asia in particular and Asia in general.

Corporate finance, or investment banking, is an integral part of a global financial centre, and a high value-added sub-sector of the financial services industry. Investment banks spend, on average, three times more per employee than commercial banks on personnel and support services such as information technology.

The financial services industry is one which is characterised by frequent changes in product emphasis and subject to regulatory changes. Specific activities which thrive at any point in time could face dramatic decline in the next as a result of unforeseen circumstances. Such threats can be more easily dealt with if Singapore's financial services industry is vibrant and well diversified with a wealth of talented professionals, so that it can create for itself new opportunities to replace activities which enter into decline. The highest value-added services conducted from Singapore are frequently not booked in Singapore, but the professionals who conduct them in Singapore are well-compensated for those services and therefore contribute to the Singapore economy. It is this ability by market participants (both individuals and corporations) to generate fees in constantly changing market environments which characterises the success of an international corporate finance centre.

Singapore already has some competitive advantage as a regional financial centre for South East Asia (and possibly South Asia). The advantage stems from physical proximity, an efficient hub to locate professionals serving the region, regional knowledge of how business works in the region and a critical mass for Asian commercial banking.

To capture as much of the value-added investment banking activities in the region as possible, the Committee has identified three areas of strategic importance: critical mass, liquidity, and taxation.

5.11.1.Building Clusters

To become the investment banking centre in Asia, Singapore should nurture clusters of investment banking related activities to serve in the first instance, South East and South Asia, and eventually all of Asia. A vibrant investment banking centre must have clusters of investors, companies, intermediaries and their supporting network of professionals in law, accounting and information technology, interacting with each other. The Committee notes that the Government has already initiated the liberalisation of the fund management industry and has a separate committee examining the legal profession.

Similarly, it is also crucial for the various functions of an investment bank (ie, marketing, structuring, capital markets, sales and trading) to be physically close to one another for co-ordination and pooling of resources. The presence of all the functions under one roof encourages the bank to grow organically from the shared infrastructure. The presence of these clusters creates a self-sustaining industry, develops a deep labour pool, and compels other players choosing to expand in Asia to locate in Singapore to benefit from the critical mass.

In order to expedite investment banks to cluster their operations in Singapore, large divisions of investment banks should be targeted initially. The equity division of an investment bank forms the core of a cluster of operations, comprising stockbroking, research, trading, derivatives, risk management, information technology, senior management and support staff. It is the engine of a whole range of corporate financing related activities. An SES membership will incentivise an investment bank to establish a large equity presence in Singapore as it would require a high level of support in settlements, information technology, sales and research. A membership will also encourage the investment banks to increase their focus and activity related to the Singapore market as their transaction cost will be substantially reduced. As a result, increased investment in research, sales and trading professionals can be expected. Once a cluster of personnel, management and infrastructure arising from an SES membership

is established, the marginal cost of locating other businesses such as corporate finance and debt will be low and would encourage them to grow their operations in Singapore organically. In addition, this will increase proprietary trading, hedging, derivatives and basket trading by investment banks. This in turn promotes liquidity in our markets.

To facilitate large global investment banks to shift their equity operations here, Singapore should review the ownership restrictions on SES members or even consider the issue of new memberships at a preferential price against undertakings to locate sufficient critical mass here. Currently, only two of the United States Bulge Bracket investment banks are members of the SES. The Committee notes that the SES Review Committee recommended the removal of restrictions on foreign ownership of SES seats within a period of five years. The Committee is of the view that restrictions should be removed sooner rather than later.

A Financial Sector Promotion body has been set up in the MAS. This body should have the mandate to work with the industry to identify and remove impediments, across various government departments including the tax authorities, to boost the development of the industry in Singapore. It should market Singapore to the leading investment banks to establish a major presence here. To do this, the body should have the stature to promote Singapore to the highest executives of the global institutions and have the clout to work with various government bodies to eliminate bottlenecks in the system. The SES should complement the Financial Sector Promotion body in this role with respect to the listing and fund raising activities conducted on the SES in order to grow the securities market.

Recommendation 35
To further develop investment banking activities in Singapore:-
(a) Focus should be given to attracting clusters of inter-related components of investment banks, as well as supporting legal and accounting and information technology professionals.
(b) Large global investment banks should be targeted to centre their Asian or ASEAN equity divisions in Singapore by facilitating their membership in the SES sooner rather than later.
(c) The Financial Sector Promotion body in MAS should be given a pivotal and authoritative role, both in laying groundwork for development and in promoting Singapore to leading investment banks. The SES should complement the Financial Sector Promotion body with respect to the listing and fund raising activities conducted on the SES.

5.11.2.Liquidity

A key measure of a successful investment banking centre is the market liquidity it provides. Liquidity is important in two forms: active secondary market trading volumes which allow large trades in securities to be made without pressure on price and an active pool of capital managed in Singapore to invest in primary equity and debt issues. The promotion of fund management in Singapore and the liberalisation of investment vehicles for CPF is important but in itself does not capture all the value added activities within Singapore as those funds may be used to provide liquidity in other markets as well. Singapore should also promote itself as a centre where the main decisions on the investment and trading of regional securities, whether listed in Singapore or elsewhere, is located and it should also promote itself as a centre where regional issuers need to come to in order to access expertise and decision makers to structure and sell their new issue of securities, irrespective of whether they are listed in Singapore.

The over-the-counter ("OTC") financial derivatives business has prospects for growth in Singapore as the availability of hedging instruments can contribute significantly towards overall liquidity in the market. In addition, the business creates many high, value-added jobs as it requires strong credit and legal support. Like loans, OTC contracts require intensive individual credit review and documentation. Currently, 95% of trading volumes on SIMEX are related to G7 currencies and stock indices for which Singapore does not have necessarily a competitive advantage beyond a good infrastructure, early presence and good regulatory environment. Singapore can become the centre for trading and hedging Asian and ASEAN risks where Singapore has a natural information and time zone advantage.

OTC derivatives can be a thriving business, as Hong Kong's derivatives industry can testify. But there is currently uncertainty over whether the trading of OTC derivatives in Singapore is illegal and unenforceable because of the law against gaming.[25] This uncertainty has impeded the growth of a thriving OTC derivatives market in Singapore.

Recommendation 36
As liquidity is an important magnet for industry participants, the following steps are recommended:-

(a) Introduce derivative contracts on currency, interest rate and index futures of Asian countries.
(b) Clarify the law on the trading of OTC derivatives trading to facilitate the growth of the derivatives business.

5.11.3.Taxation

The issue of taxation has a significant bearing on activities in international corporate finance. Feedback on the issue of taxation indicate that uncertainty or disadvantages exist in the tax treatment of certain financial market instruments and individual financial professionals. There are legitimate concerns that liberalising the tax environment may lead to loss of tax revenue. On the other hand a less competitive tax environment will drive financial market activities elsewhere, losing the value added from such activities, and the tax revenue from the increased economic activity.

Withholding taxes are generally applicable to all payments in connection with any loan, indebtedness or any arrangement, management, guarantee or service relating to any loan or indebtedness. The wide definition captures all financial instruments. This current approach is widely seen as inappropriate as some financial derivatives (eg, interest-rate swaps and cross-currency swaps) are in effect not loans nor indebtedness.

Gains derived by foreign investors on foreign exchange contracts such as swaps, options and forwards used for hedging investments in Singapore dollars, are subject to taxation at the full corporate rate because the contracts are not deemed "designated investments". This has been a disincentive for foreign investors and fund managers to invest funds in the Singapore market.

Singapore should also examine the personal tax regime to make it competitive with other financial centres in Asia. For example, under current tax legislation, a person is deemed to be in Singapore if he is in the country for any part of the day. Thus, the day of departure and day of arrival would be considered as days in Singapore for taxation purposes. This puts Singapore at a competitive disadvantage in relation to Hong Kong, which deems the day of

[25] Civil Law Act section 6.

departure as being outside Hong Kong and day of arrival as within Hong Kong. As decisions on locating operations are made ultimately by individuals making recommendations to their firms, an attractive income tax regime would encourage consideration of Singapore.

Recommendation 37
There should be a review of Singapore's tax environment to make it more competitive and to remove any impediments to innovation in the financial industry and attracting professionals to locate to Singapore, including a review of the need to impose withholding tax on financial instruments.

5.12. EMBRACING TECHNOLOGY

The availability of almost instantaneous information has narrowed the gap between sophisticated and retail investors. In many ways, technology has revolutionised the securities market, almost levelling the field between institutional and retail investors. The pace of embracing new technology must be accelerated for Singapore to connect further into the international financial system. This will maintain Singapore's competitiveness and attractiveness to foreign investors as a open economy and financial system.

In information dissemination, prospectuses, annual reports and corporate announcement could be distributed using low cost infrastructure. Much of the information currently made available by listed issuers to investors is already accessible through the internet. The SES already makes available the announcements, prospectuses, circulars and annual reports of listed issuers on its website. Listed issuers should be encouraged, and eventually required to have their own websites. Posting in websites can in due course be regarded as an acceptable means of release of announcements and documents, such as prospectuses and shareholders' circulars. In this way companies may avoid the cost of printing and mailing documents. To facilitate such information distribution and lower cost, the law should be changed to deem the publication of information on the internet as sufficient distribution of information. For convenience to investors this information could also be consolidated on the SES website.

The internet can be used to facilitate distribution of securities, both in the primary and secondary market, in order to lower funding cost. Already, investors have been able to subscribe for initial public offerings and rights issues electronically, with payments settled electronically. One can extend it further to the subscription of securities on the internet. The Committee understands that the SES is researching this issue.

The Committee understands that a number of SES member companies are planning to offer internet trading to their clients. Internet trading of Singapore and cross listing securities will provide investors with a convenient and low cost means to access regional securities. The SES has announced that it would be introducing direct internet trading.

Shareholders could be allowed to exercise their rights in internet meetings and internet voting. In the United States, some companies give their shareholders the option of internet voting. Some also make available sound or video recordings of shareholders' meetings or analyst conference calls on their website, or transcripts of such meetings or calls. By overcoming the constraints of geographical location, it could reduce the cost to companies in hiring venues for meetings and yet permit shareholders in geographically distant places to participate in meetings without being physically present. This would raise the standard of corporate governance and make Singapore a more attractive place to invest for both Singapore and foreign investors.

Recommendation 38

(a) The adoption of technology should be accelerated to better connect into the international financial system, facilitate information distribution, fund raising, trading, and the exercise of shareholders rights.

(b) As a start, internet should be accepted as a medium for distributing prospectuses and other continuing disclosure requirements. If necessary, the law should be changed to allow this.

6. THE WAY FORWARD

Our listed issuers and investors are becoming more sophisticated and institutional investor participation is increasing relative to retail investor participation. The market has developed to a stage where it is appropriate to move towards a predominantly disclosure based philosophy of regulation.

Even so, there is a significant number of investors who may not be ready to take responsibility for their own investment decisions and may not be in a position to find their own remedies. Listed issuers would be faced with a legal obligation to meet a higher standard of disclosure and would need time and perhaps an improvement to their management information systems to be able to produce adequate information, explanations and analysis of performance. Some market practitioners in Singapore, may need time to raise their level of expertise to cope with the disclosure based environment. Furthermore, all market practitioners, intermediaries, accounting and law firms, and even the securities regulator, may require additional resources.

To give companies, market intermediaries, investors and professionals time to adjust, the implementation of the envisaged regulatory framework to support a disclosure based philosophy should be gradual and phased in. The implementation process will itself take time as the Committee's recommendations will have to be considered by the Government, laws will need to be drafted, and institutions reorganised. The Committee has also made recommendations to liberalise the SES Listing Manual, as part of the intermediate step of moving towards the disclosure based regime in order to raise efficiency and access to funds.

It is important to signal to foreign institutional investors and foreign market intermediaries that they are welcome to participate in and be active players in our securities market. The participation of foreign investors, intermediaries and professionals will accelerate the process to raise the standard of professional expertise, quality of disclosure and corporate governance in our market. All these factors will contribute to accelerating the sophistication and maturity of our securities market.

The Corporate Finance Committee and Sub-Committees

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Mr Wong Nang Jang
Mr Wong Ngit Liong
Mr Boon Swan Foo
Mr Tan Keng Boon
Dr Tommy Tan
Mr Eric Ang
Mr Lucien Wong
Mr Tan Cheng Han
Mr Ng Boon Yew
Mr Sum Soon Lim
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