THE BUSINESS TIMES
SND AWARD WINNER
WED, OCT 21, 2015

Enforcing the comply or explain requirement

SGX should apply the full force of its enhanced enforcement powers on errant parties.

By **Mak Yuen Teen**

OCT 20, 2015 5:50 AM

ON Oct 12, Tan Boon Gin, the chief regulatory officer of the Singapore Exchange (SGX), announced at the Global Corporate Governance Conference organised by the Securities Investors Association (Singapore) that the SGX would review 550 mainboard-listed companies' compliance with the Singapore Code of Corporate Governance. He hinted that some issuers have failed to meet the "comply or explain" requirement and expressed surprise that compliance is thought by some to be "voluntary".

Rule 710 of the SGX rulebook makes the "comply or explain" requirement very clear. It states: "An issuer must describe its corporate governance practices with specific reference to the principles of the Code in its annual report. It must disclose any deviation from any guideline of the Code together with an appropriate explanation for such deviation in the annual report."

Section 25 of the Securities and Futures Act provides for the Monetary Authority of Singapore (MAS), the SGX or a person aggrieved by a failure to observe the listing rules to apply to the High Court for an order to direct compliance. The recently introduced enhanced enforcement powers will give SGX more teeth to enforce compliance.

The reason why some issuers have failed to meet the "comply or explain" requirement is the same as why "stop" signs on our roads are now treated as "give way" signs at best, and "give way" signs are treated as "get out of my way" signs by many motorists. It has to do with the lack of monitoring and enforcement.

But the lack of monitoring and enforcement of the "comply or explain" requirement has been a well-known problem for a long time. In my 2007 report, "Improving the implementation of corporate governance practices in Singapore", commissioned by the Monetary Authority of Singapore and SGX, my first recommendation was on improving the implementation of the "comply or explain" requirement. There were seven sub-recommendations under this, one of which was the following.

"Regulators should lead initiatives to periodically review compliance with the Code and implementation of the 'comply or explain' requirement, with a view to educating companies on how to improve the implementation of the Code, identifying challenges faced in implementation, and providing inputs into future revisions of the Code."

In my report, I explained how the Australian Securities Exchange (ASX) had a corporate governance review team which reviewed annual reports for compliance with corporate governance requirements, including reporting obligations under their code. ASX completed and published a series of reviews, and used them to guide issuers about their corporate governance

reporting. Where disclosure is deficient, the issuer is required to make further or clarifying disclosure. In appropriate cases, ASX recommended that issuers attend education sessions. Where issuers have breached their reporting obligations, they are given a certain time period to rectify. The fact that there has been a breach and the time frame to remedy the breach are required to be disclosed to the market.

SGX could consider a similar approach. Although it has no plans to disclose the names of the companies that are found wanting, it should do so when issuers have been given sufficient opportunity to comply with rule 710.

SGX should also extend its review to Catalist companies. Perhaps it believes that the "comply or explain" requirement, which also applies to Catalist companies, can be left to the continuing sponsors which such companies are required to retain. However, there is no guarantee that these sponsors are doing their job properly and SGX should hold the sponsors to account if they fail to flag non-compliance with the "comply or explain" requirement for their clients.

The following are my other six sub-recommendations with respect to the implementation of the "comply or explain" requirement.

- The board of directors of companies should ensure that there is a process in place to ensure proper application of the "comply or explain" requirement and that the corporate governance disclosures reflect the corporate governance practices of the company.
- Companies should use a checklist internally to ensure that key corporate governance practices relating to each principle are described, and confirming if the company complies with each guideline, and if not, to provide an explanation.
- To aid investors in understanding the extent of application of the Code, companies should provide a positive confirmation statement at the beginning of the corporate governance report that the company has applied all the principles and complied with all the guidelines, or to identify deviations where this is not the case.
- The committee responsible for reviewing the Code should provide clear rationale for specific principles and guidelines so that the intent of these guidelines is properly understood by companies.
- Regulators should lead initiatives to provide more practical guidance and education on implementing major principles and guidelines within the Code, including good corporate governance practices, for example, through joint efforts between the regulators and major professional bodies, disseminating guidance developed by regulators and professional bodies in other countries, and by organising educational forums whereby good practices can be shared.
- Shareholders should question companies at AGMs about their corporate governance practices as disclosed in the corporate governance report.

Readers who are interested in the details for each of these sub-recommendations can read the full report available online. I believe that all these recommendations remain relevant, and only the fifth sub-recommendation has been implemented to any significant extent through the issue of "good practice" guides.

In my report, I classified non-compliance with the "comply or explain" requirement into the

following four categories: non-compliance with no explanations; partial compliance with no explanations; uninformative/boilerplate disclosures or explanations; and false or misleading disclosures.

An example of non-compliance with no explanations would be an issuer that does not disclose attendance of individual directors at board and committee meetings and does not explain. An example of partial compliance would be an issuer which fails to disclose all the biographical information set out in the Code, such as all the current and recent listed company directorships, and does not explain. Some companies with busy directors may name some of the directorships and hide the rest under "other public listed companies". An example of uninformative/boilerplate disclosures or explanations would be one that says that they have undertaken a "particularly rigorous review" of the independence of their long-serving independent directors because their review has concluded that the directors continue to exercise independent judgment.

False or misleading disclosures are of course potentially punishable under section 199 of the Securities and Futures Act. However, as I have stated in the past, it is difficult to enforce this for false or misleading disclosures in the corporate governance report because of the necessary conditions required to prove a breach. In China Sky's 2010 corporate governance report, it was stated that the independent directors have confirmed that they do not have any relationship that could interfere, or be reasonably perceived to interfere, with the directors' independent business judgment. When it emerged that the chairman of the audit committee had a huge conflict of interest, a query from the SGX resulted in a further statement that this director is independent "despite his significant business relationships" because of his "unequivocal ability to exercise strong independent judgement", "to act professionally", "to maintain a high standard of duty of care" and to "observe the ethical standards of his profession". Was the first disclosure not misleading? As for the second statement, seldom has so many words been wasted to say nothing useful.

Some explanations border on "false or misleading". Some years ago, there was a company that did not disclose attendance of individual directors at board meetings and offered the explanation that attendance is not an indicator of a director's contribution. Some time after this incident, I met a former senior management of the company and he shared with me that the company did not want to disclose because they had a director who did not attend meetings.

I believe that in recent years, the situation has improved to some extent in terms of non-compliance or partial compliance with no explanations in a number of areas, but I suspect that the SGX review will find that it is still a problem in certain areas. False or misleading disclosures are hopefully rare and are difficult to detect, but when they are discovered, it is important for SGX to apply the full force of its enhanced enforcement powers on those responsible for them.

But the biggest problem is probably uninformative/boilerplate disclosures or explanations. SGX should apply pressure on issuers to improve disclosures or explanations where it feels they are lacking. It may be difficult for SGX to take enforcement action for breach of rule 710 if it does not consider an explanation to be "appropriate" as this may be subjective, but there is nothing

to stop SGX from expressing an opinion that it feels that an issuer's explanation is inadequate. By highlighting what it feels are inappropriate or inadequate explanations, shareholders will be better informed and they can then go to the general meetings and grill the companies. After all, shareholders also have a part to play in improving the implementation of the "comply or explain" requirement and corporate governance in general.

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