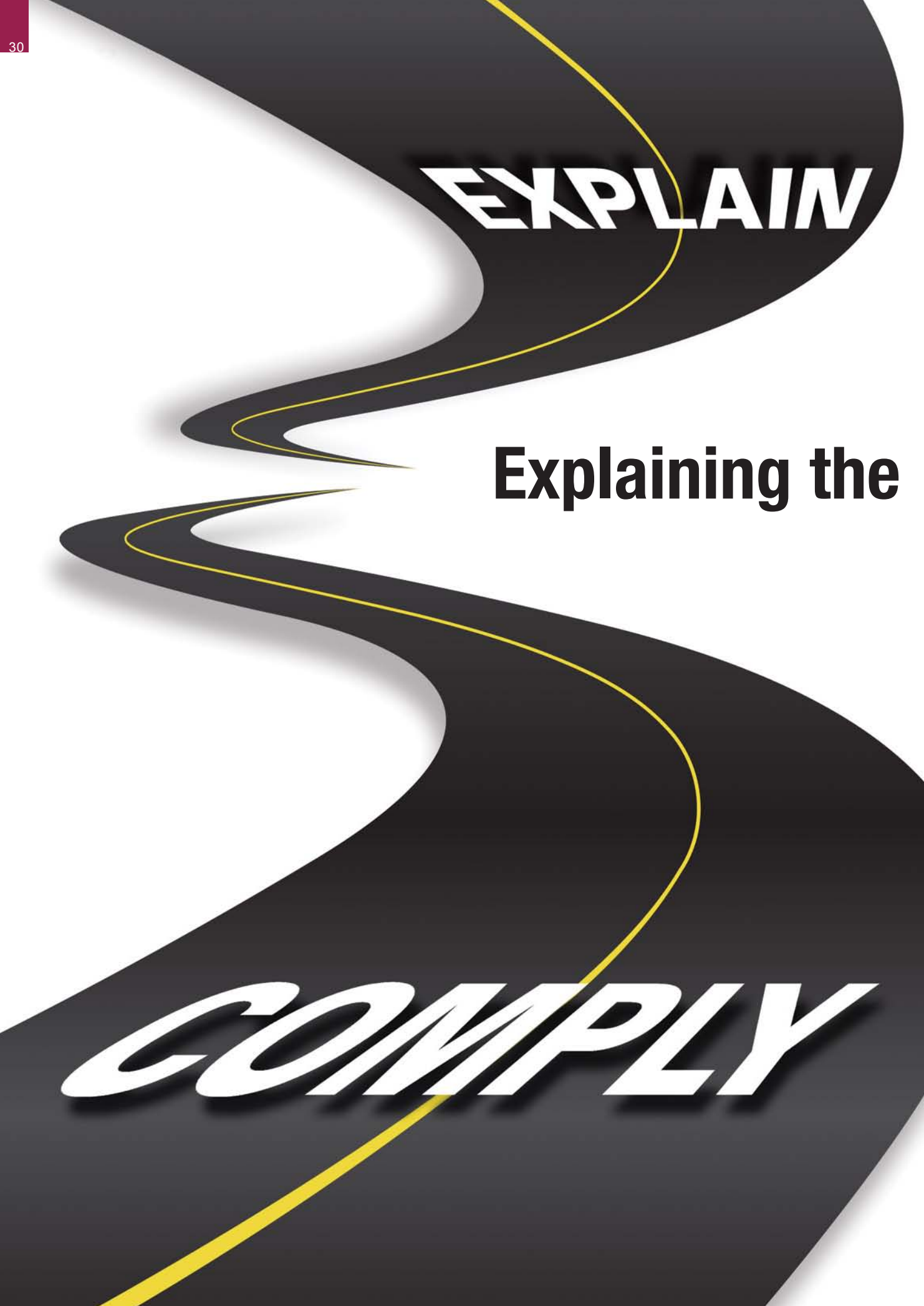

Explaining the

The "comply or explain" approach to the Code of Corporate Governance (the Code) is meant to be a less rigid and prescriptive approach for companies to adopt leading corporate governance practices. However, there are many misconceptions of the regime and unsatisfactory explanations of non-compliances. While SGX takes a progressive approach to facilitate companies' adoption or adaptation of the guidelines of the Code as required by the Listing Rules, it would not hesitate to take enforcement action against recalcitrant companies that are dismissive of the Code.

"Comply or Explain" Regime

By **TAN BOON GIN**
Chief Regulatory Officer, Singapore Exchange

Corporate governance, specifically, the Singapore Code of Corporate Governance, is implemented on a "comply or explain" basis in Singapore. This regulatory approach is aligned with practices of other countries, such as those in the European Union, and in contrast to the prescriptive style adopted in the United States.

The "comply or explain" approach does not mean that companies can pick and choose which guidelines they want to comply with; and where they do not adhere to such guidelines, they can choose to remain silent. Companies should also not adopt a tick-the-box approach or adapt explanations from other companies, including "boiler-plate" disclosures, which do not explain circumstances relevant to the company.

These are common misconceptions among listed companies.

The "comply or explain" approach requires companies to describe their practices in relation to every principle and guideline as well as the elements within each guideline. Where there are deviations from such principle or guideline, explanations must be provided, including the alternative measures taken to mitigate the risks that the principle or guideline deviated from is intended to address. The board is responsible for the contents of disclosures and the disclosures should enable investors to make an informed investment decision about the company.

The "comply or explain" approach, as opposed to a rigid prescriptive approach, is intended to facilitate listed companies' compliance with the principles of the Code. The Code sets out good practices which companies are able to adapt to their individual company's circumstances, to best achieve the highest standards of corporate governance. A one-size-fit-all methodology would reduce the best practices into a mere checklist, and become arguably less effective in developing high standards of corporate governance. It is the letter and spirit of the Code, and not the form, that listed companies should conform to.

Engaging companies' on Code disclosures

SGX developed a guide in February 2015 to provide guidance to listed companies on disclosures.

In early 2016, SGX commissioned a review by KPMG of the corporate governance disclosures of Mainboard listed companies. The review focused on the presence and quality of these disclosures made by the companies. "Presence" indicated the existence of a positive or negative statement, while "quality" measured the extent of forthcoming and meaningful information.

The results of the review were encouraging, and also highlighted areas for improvement.

SGX will review the results and actively engage listed companies on the shortfalls in their corporate governance disclosures. At the same time, listed companies should take the opportunity to improve on their corporate governance practices. With the committed cooperation of the various stakeholders, advances in both governance and transparency of listed companies can and will be accomplished.

Corporate governance under the Listing Manual

Under the Listing Rules, listed companies must, in their annual reports:

- Describe their corporate governance practices with reference to the principles of the Code.
- Disclose any deviation from the Code's guidelines with appropriate explanations for such deviation.

It is often on the second limb that listed companies flounder. Listed companies either fail to disclose the deviations, or provide scant reasons to justify non-compliance.

The broad expectation is for SGX, as the regulator, to prescribe a list of "acceptable" explanations for listed companies to select from. This, again, detracts from the purpose of the Code, and leads to "boiler-plate", repetitive and non-informative disclosures that may not appropriately reflect the circumstances specific to each listed company.

For example, one of the key observations in the KPMG study is the non-disclosure of specific remuneration of directors or key management. Companies should provide transparency relating to the disclosure to assure stakeholders that remuneration is closely-linked to the company's performance.

If listed companies are of the view that it is not in the interest of the company to adhere strictly to the practices of the Code, they should explain the circumstances specific to the company for not providing forthcoming disclosures. Additionally, they should disclose specific practices employed by the company to address the governance concerns.

Going back to the example of disclosures on remuneration, while there is a real risk of talent poaching, companies should explore other means to satisfy shareholders that its remuneration policies are fair. These practices could include engaging an independent consultant to review and opine on their remuneration policies annually, or benchmark these policies against the broader industry.

Companies should note that while it is not mandatory to institute all practices espoused in the Code, it is a requirement to adequately explain any deviations from the Code. Failure to do so is, in fact, a breach of the Listing Rules.

SGX has recognised that strict enforcement should be the last resort, and has thus taken a progressive stance since the introduction of the Code. However, SGX will not hesitate to take enforcement action against recalcitrant companies that continue to be dismissive of the Code.

More on "Comply or Explain"

The following materials will provide more details on the "comply or explain" regime, the Code and the compliances (and non-compliances) with specific provisions of the Code.

SID Board Guide

Section 1.6: The "Comply or Explain" Regime

Appendix 1I: "Comply or Explain" – An Explanation of the Regime

Appendix 1J: "Comply or Explain" – Examples of Non-Compliance

Appendix 1L: SGX Disclosure Guide on Compliance with the Code

SID eGuide to the Code of Corporate Governance

An electronic guide that explains the Code of Corporate Governance that is produced as part of the Corporate Governance Guides for Boards in Singapore series. It will be launched in March 2017.

SID-ISCA Singapore Directorship Report 2016*

SID-SGX Board of Directors Survey 2015*

SGX Review of Mainboard Companies' Code of Corporate Governance Disclosures*

Conducted by KPMG in Singapore, 5 July 2016

SID Boardroom Matters Volume I: Making Sense of Corporate Governance

Chapter 10: For Compliance's Sake by Daniel Ee

SID Boardroom Matters Volume II: Of Conformance and Performance in Corporate Governance

Chapter 11: Explaining "Comply or Explain" by Lyn Boxall

Chapter 12: Complying with "Comply or Explain" by Lyn Boxall

SID Boardroom Matters Volume III: Towards Effective Boards

Chapter 34: "Comply or Explain" or "Comply or Else" by Joyce Koh

Chapter 35: Making "Comply or Explain" Work by Joyce Koh

Chapter 36: How Corporate Governance Disclosures Can Become Drivers of Value by Irving Low

*These studies highlight compliance and non-compliance with specific provisions of the Code.

The future of corporate governance

Going forward, listed companies must be prepared to adopt or adapt the guidelines of the Code. Rather than viewing it as an annual exercise of ticking the box, listed companies should continuously review and develop its governance structures to align the interests of their various stakeholders.

In this regard, a recent survey of retail and institutional investors jointly conducted by ISCA and ACRA showed that directors' experience, remuneration and independence, and the company's internal control and risk management matters, are most common aspects of corporate governance that investors are interested in.

At the same time, SGX understands that some companies may face constraints in complying with certain requirements. This is why it is engaging companies one on one to understand these limitations and explore other ways for these companies to mitigate the underlying risks that the principle or guideline they deviate from is intended to address.

Ultimately, SGX believes in going beyond the structural governance required by the Code, to the strategic governance that will drive trust and confidence in the company. This includes higher quality financial reporting, greater transparency and increased access to management for both retail and institutional investors. ■