Walking the Tightrope in Regulatory Interventions

By **TAN BOON GIN,** CEO, Singapore Exchange Regulation

Regulators have to deal with the range of investors and plethora of views in their rules and interventions. They have to tread a fine line between falling back on market discipline and imposing tougher measures on companies who are making use of "other people's money".

Martin Wolf, the long-time *Financial Times* commentator, wrote in December 2018 about the "crisis of democratic capitalism". In his commentary, he describes shareholders as being the "least committed" of stakeholders because they can divest their stakes in a company more easily than, say, employees or suppliers.

At the same time, we are seeing a new generation of active shareholders, ranging from institutional to individual retail investors, who are vocal with their concerns and proactive in exercising their voting rights. Along with this are broad market views that share capital is becoming less patient.

However, as James Shipton, Chairman of the Australian Securities and Investments Commission, reminds us, the market and companies are making use of "other people's money". These are savings put in by "real people" who risk financial catastrophe when things go wrong, wrote Mr Shipton in an article for *Company Director* in March 2018.

Is market discipline alone sufficient?

With diverse views on shareholders' needs and priorities, coupled with the fact that shareholders include "real people" investing their life savings, how does a regulator operate?

As a regulator, we must bear in mind two things.

The first is that not everything can be left to market discipline. This must sometimes be complemented by regulatory intervention.

For example, in the area of audits, a company's statutory auditor is typically appointed by the shareholders in a general meeting. Indeed, Singapore's Companies Act expressly reserves the power to change auditors to the shareholders by way of special notice. However, there may be instances where, shareholders' wishes notwithstanding, there is a need for regulators to intervene in the interest of the market as whole.

In the UK Competition and Markets Authority's update of its audit services study in December 2018, there was a suggestion that all FTSE350

companies' audits should be carried out jointly by two audit firms, at least one of which should be from outside the big four.

Tapping on this idea, Singapore Exchange Regulation (SGX RegCo) will be proposing a new power to require the appointment of a second auditor, on top of the existing statutory auditor, but only in exceptional circumstances. This will complement SGX RegCo's current power to require the appointment of a special auditor, who will typically only look into a specific area, whereas the second auditor will sign off on the year-end audit.

SGX RegCo will also be proposing that all listed companies will have to appoint either a Singapore-based auditor or, in the case of companies with significant overseas operations with a foreign auditor, to have a Singapore-based auditor jointly sign off on the year-end audit conducted by the foreign auditor. This will increase regulatory traction, access to working papers and accountability.

Focusing on the long term

The second thing that we must bear in mind is that the creation of long-term shareholder value can be susceptible to the short-term pressures of the market. Again, regulatory intervention may be necessary to encourage the market to focus on the long term.

Dual class shares enable companies to raise funds while retaining the ability to execute a long-term strategy. However, we should not overlook the risk of the controlling shareholder(s) overriding the rights of the "real people"who are non-controlling holders without due consideration of their views.

This is why SGX RegCo is applying safeguards, such as event-based sunset clauses, and mandating enhanced voting where all classes of shares are treated equally for governance matters such as the appointment and removal of independent directors and the winding-up or delisting of the company.

Mandating sustainability reporting is another initiative to prod both companies and investors to focus on more than just the next quarter or the next 12 months.

We will be conducting a review of the sustainability reports that our companies started producing for the first time in 2018. Instead of just checking whether the reports comply with the requirements in our listing rules, we will endeavour to show how real investors use these reports because they believe that companies with good sustainability practices perform well financially in the long term.

The time horizon debate also continues unabated over quarterly reporting (QR). SGX RegCo's own public consultation on possible changes to QR has closed. A significant proportion of respondents favoured removing QR and we have to take their views into account as we continue our deliberations.

Developed markets such as the UK are already moving away from QR on the basis that QR encourages corporate short termism. We must be sensitive to these developments as the world's biggest investors increasingly focus on sustainable long-term growth and profitability.

Balancing needs

Needless to say, we are walking the proverbial tightrope.

Veer too far one way, and one risks creating a "trust deficit". Veer too far the other and one risks encouraging overly short-term thinking.

Ultimately, a balance must be struck, and this requires a pragmatic, rather than a dogmatic, regulatory approach. ■