

COMPLYING WITH “COMPLY OR EXPLAIN”

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Singapore, like many of its Commonwealth counterparts, has adopted a Code of Corporate Governance based on a “comply or explain” model. This means companies must comply with the principles and guidelines contained in the Code, or explain the non-compliance.

Cynics have cited examples such as non-disclosure of director’s remuneration on a named basis (only 31 per cent of all listed companies did so in their fiscal 2013 annual reports) and lack of gender diversity (less than 10 per cent of directors are female, and 56 per cent of listed boards have no women directors) along with these companies’ failures to provide satisfactory reasons – or even an explanation – as to why the “comply or explain” approach is far

too voluntary and therefore does not work. They have argued for mandatory rules instead.

GOVERNANCE RESPONSIBILITY

This would, however, be failing to understand the nature of “comply or explain” and the factors which make the model work.

In the previous chapter, “Explaining ‘comply or explain’”, it was pointed out that the responsibility for effective governance does not lie only with the companies and their boards, but also with the other stakeholders, and these include the regulators, investors and other industry players within the corporate ecosystem.

First, the company has to recognise that if it does not comply with the Code, it has to explain – and explain adequately – the reasons why it has not complied. While there have been failures to do so, this is somewhat to be expected and action needs to be taken by other stakeholders in the face of non-compliance.

REGULATORS’ ROLE

One of these stakeholders is the investor who receives annual reports and who ought to read the corporate governance sections, ask appropriate questions at annual general meetings and other investor forums and satisfy himself with the explanations for non-compliance.

Other players in the corporate ecosystem who assess companies, such as investment analysts and industry watchers, should factor in the companies’ compliance with the Code in their ratings and recommendations. They could highlight good and poor examples of corporate governance in their reports and to the media.

Singapore Institute of Directors, for example, evaluates companies' corporate governance practices in selecting winners for the Best Managed Board Award, which is part of the annual Singapore Corporate Awards. We rely initially on corporate governance indices to screen the candidates, and then subsequently conduct a review of the substance of their practices and compliance through face-to-face interviews with the companies and their boards.

The regulators have, arguably, the most impact in the "comply or explain" regime. The role of the regulator is to frame the principles and guidelines, and periodically update them to ensure their continued relevance.

On top of that, regulators should keep monitoring compliance with the Code. Regulators should question, nudge and engage with those companies where the levels of non-compliance are unsatisfactory.

Large-scale non-compliance requires urgent attention. When faced with persistent non-compliance, one of the options is to convert the guidelines of the Code into mandatory listing rules in the Singapore Exchange's (SGX) Listing Manual or even enshrining it in legislation.

In the case of gender diversity, SGX formed a Diversity Action Committee in 2014 to address the issue. Several initiatives to address the supply and demand for women directors are in progress.

Yet, the lack of, and perfunctory explanations for, gender diversity is indicative of a broader issue. The free-form narrative of the corporate governance reports in companies' annual reports makes it difficult for authors and readers to determine the completeness of the large number of requisite disclosures in the report.

CHARITY SECTOR

One solution can be found in the charity sector. Charities and Institutions of a Public Character (IPCs) are required to complete and file an annual Governance Evaluation Checklist with the Commissioner of Charities. The completed checklist is available online on the charity portal.

SGX has just implemented a similar checklist, the disclosure guide in question-and-answer format. The key difference between the two is that the charity sector's checklist mirrors the Code of Governance for Charities and IPCs, and SGX's disclosure guide has only "express" guidelines, presumably those which are more important and/or which are generally not adequately complied with. Limiting the checklist does help with focusing the corporates.

EC'S RECOMMENDATION

Another measure that SGX could consider is the recommendation by the European Commission (EC) on the quality of "comply or explain" reporting, issued in 2014. The EC states that a company should describe the reasons for non-compliance and how the decision to depart from it was taken within the company. It also requires the company to describe any measure taken in place of compliance and how that measure achieves the underlying objective of the specific requirement of the Code, or how it contributes to the good corporate governance of the company.

In summary, "comply or explain", when properly implemented, provides a sound basis for a conversation between a company and its stakeholders about its corporate governance practices. There is, however, room for companies and stakeholders to make "comply or explain" more effective by working together, with all parties playing an active part. ■