

LEGAL UPDATE

27 December 2018

REVISÉD CODE OF CORPORATE GOVERNANCE AND CONSEQUENTIAL AMENDMENTS TO THE SGX LISTING RULES

Annual reports of SGX-listed issuers covering financial years commencing from 1 January 2019 will be subject to the Monetary Authority of Singapore's ("**MAS**") revised Code of Corporate Governance ("**2018 Code**") and accompanying non-binding practice guidance ("**Practice Guidance**"), which were issued on 6 August 2018. Additionally, from 1 January 2019, consequential amendments to the Singapore Exchange Limited ("**SGX**") listing rules (mainboard) and the SGX listing rules (catalist) (collectively, "**SGX Listing Rules**"), announced by the SGX on 6 August 2018, will take effect, except for the nine-year rule for independent directors and the requirement for at least one-third of the board to comprise of independent directors (both of which will be discussed in the succeeding paragraphs below). These amendments will instead take effect on 1 January 2022, to give issuers more time to make the necessary changes to their board composition.

BACKGROUND

The Code of Corporate Governance ("**Code**") was first introduced in March 2001 and came into effect on 1 January 2003. The Code has been revised twice, in 2005 and 2012 ("**2012 Code**"). The aim of the Code is to promote high levels of corporate governance in Singapore. It applies on a comply-

or-explain basis to SGX-listed issuers, which are required under the SGX Listing Rules to disclose their corporate governance practices and explain deviations from the Code.

In February 2017, the Corporate Governance Council ("**Council**") was established to undertake a comprehensive review of the 2012 Code. This was partly in response to observations from market participants that the corporate governance of issuers could still be improved. The revisions to the Code aim to support sustained corporate performance and innovation, and strengthen investor confidence in Singapore's capital markets. Additionally, the Council also recommended amending the SGX Listing Rules to clarify the comply-or-explain regime, and establishing an industry-led corporate governance advisory committee to promote good corporate governance practices.

A public consultation seeking comments on the proposed changes based on the Council's recommendations was conducted from 16 January 2018 to 15 March 2018. All of the Council's final recommendations were accepted by the MAS.

This legal update discusses some of the key changes to the Code, the consequential amendments to the SGX Listing Rules, and the corporate governance advisory committee which the MAS expects to establish by the end of this year.

STRUCTURE OF THE 2018 CODE

The 2018 Code includes an introduction which clarifies how the comply-or-explain regime applies to issuers. Compliance with the Code's broad principles is mandatory, whereas variations from the specific provisions underpinning the principles are acceptable insofar as issuers expressly state and explain how their practices are aligned with the aim and philosophy of the relevant principles. The provisions replace the guidelines of former Codes.

The Code has also been streamlined in three main ways:

- (a) the shifting of important requirements or baseline market practices to the SGX Listing Rules (which, unlike the Code,

- apply on a mandatory basis rather than on a comply-or-explain basis);
- (b) the removal of requirements that are overly prescriptive or are already set out in the SGX Listing Rules; and
- (c) the introduction of a voluntary Practice Guidance that provides guidance on complying with the Code, and best practices to adopt.

This has resulted in a net reduction of three principles and thirty-one provisions, in line with the Council's aim for a more concise and less prescriptive Code that encourages thoughtful application and a shift away from a box-ticking mindset.

REINFORCEMENT OF BOARD COMPETENCIES

Strengthening director independence

Reducing Shareholding Threshold from 10% to 5%

The 2012 Code saw the introduction of the concept of director independence from substantial shareholders in the Code. It adopted a shareholding threshold of 10% in relation to determining director independence. Guideline 2.3 defined an "independent director" as "one who has no relationship with the [issuer], its related corporations, its 10% shareholders or its officers that could interfere, or be reasonably perceived to interfere, with the exercise of the director's independent business judgement with a view to the best interests of the [issuer]" (emphasis added).

At that time, the MAS had decided to adopt that threshold instead of the 5% threshold recommended by the then-Council, to give issuers in Singapore time to adjust to the concept.

More than five years on, the 2018 Code now lowers the threshold from 10% to 5% (provision 2.1). This is in line with similar thresholds in Australia and Hong Kong, as well as the definition of "substantial shareholder" under the Companies Act (Cap. 50) (section 81) and the Securities and Futures Act (Cap. 289) (sections 2(4) and (5)).

Rationalising tests of independence

The 2012 Code contained a non-exhaustive list of six detailed examples of situations which would deem a director as non-independent (guideline 2.3). However, the Council observed that a number of issuers regarded this list as a checklist and used it as the basis for assessing director independence.

The 2018 Code seeks to provide greater clarity in this regard.

First, provision 2.1 sets out an overarching principle-based definition of director independence: "an "independent" director is one who is independent in conduct, character and judgement, and has no relationship with the [issuer], its related corporations, its substantial shareholders or its officers that could interfere, or be reasonably perceived to interfere, with the exercise of the director's independent business judgement in the best interests of the [issuer]" (emphasis added).

Secondly, objective and baseline tests of director independence are shifted to the SGX Listing Rules, to reflect that they apply without any exceptions. These tests relate to employment, and deem as non-independent:

- (a) a director who was employed by the issuer or its related corporations for the current or any of the past three financial years; and
- (b) a director whose immediate family member was employed by the issuer or its related corporations for the current or any of the past three financial years, with the family member's remuneration determined by remuneration committee.

Thirdly, the following tests of director independence have now been shifted to the non-binding Practice Guidance i.e. *Practice Guidance 2: Board Composition and Guidance*, thus offering issuers greater flexibility in assessing director independence. The following non-exhaustive examples indicate and serve as a guide as to circumstances or situations where the nominating committee and board of the issuer should deem a director as non-independent:

- (a) a director who, or whose immediate family member, in the current or immediate past financial year, provided to or received from the issuer or any of its subsidiaries any significant payments (as a guide, payments aggregated over any financial year in excess of S\$50,000 should generally be deemed significant) or material services, other than compensation for board service;
- (b) a director who, or whose immediate family member, in the current or immediate past financial year, is or was a substantial shareholder, partner (5% or more stake), executive officer or director of any organisation which provided to or received from the issuer or any of its subsidiaries any significant payments (as a guide, payments aggregated over any financial year in excess of S\$200,000 should generally be deemed significant) or material services; and
- (c) a director who is or has been directly associated with a substantial shareholder of the issuer in the current or immediate past financial year.

Nine-year rule for independent directors

The 2012 Code required the independence of directors who have served beyond nine years to be subject to a "particularly rigorous review" (guideline 2.4). The Council took the view that this requirement was ambiguous, and observed that boilerplate disclosures with scant justifications of the directors' independence were common.

The 2018 revision of the Code sees the hardening and shifting of the nine-year rule to the SGX Listing Rules (to take effect from 1 January 2022). The continued appointment as independent directors of such directors who have served beyond nine years will have to be sought and approved in two separate resolutions by the majority of:

- (a) all shareholders; and
- (b) all shareholders, excluding shareholders who serve as directors or the CEO (and their associates).

Such resolutions for the directors' continued appointment may only remain in force until the earlier of the retirement or resignation of the

director, or the conclusion of the third annual general meeting of the issuer following the passing of the resolutions.

ENHANCING BOARD COMPOSITION AND DIVERSITY

The 2012 Code stated that independent directors should make up at least one-third of the board (guideline 2.1), and at least half of the board where the chairman is not independent (guideline 2.2). The Council noted that these requirements lag behind those in other jurisdictions such as the UK, Australia and the US which require that at least half or the majority of the board is to comprise of independent directors. It also pointed out that Hong Kong's requirement that at least one-third of the board is to comprise of independent directors is contained in its listing rules.

The 2018 revision of the Code imposes more stringent requirements in relation to board composition. The requirement for at least one-third of the board to be comprised of independent directors is shifted to the SGX Listing Rules (to take effect from 1 January 2022). Further, where the chairman is not independent, the proportion of independent directors required is increased from "at least half" to "a majority" (provision 2.2).

The 2018 Code also introduces new requirements. Non-executive directors are to make up a majority of the board (provision 2.3), so as to increase management accountability to the board. In addition, issuers are to disclose in their annual reports the board diversity policy to provide the appropriate balance and mix of skills, knowledge, experience, and other aspects of diversity such as gender and age, and the progress made towards implementing the policy, including objectives set by the issuers (provision 2.4). This is to increase transparency and accountability on such issues, avoid groupthink and foster constructive debate.

TRANSPARENT REMUNERATION PRACTICES

The 2012 Code required every issuer to provide clear disclosure of its remuneration policies, level and mix of remuneration, and the procedure for setting remuneration, in its annual report (guideline 9).

The 2018 Code goes one step further in helping stakeholders understand issuers' remuneration practices, by also requiring issuers to be transparent on the relationships between remuneration, performance and value creation (principle 8).

Additionally, under the 2012 Code, issuers were required to disclose the names and remuneration of employees who are immediate family members of a director or the CEO, where their remuneration exceeded S\$50,000 during the year, in incremental bands of S\$50,000 (guideline 9.4).

The 2018 Code extends this requirement to employees who are substantial shareholders or immediate family members of substantial shareholders. However, the thresholds were revised, such that such disclosure need only be made where their remuneration exceeds S\$100,000 during the year, and in bands no wider than S\$100,000.

STAKEHODLER ENGAGEMENT

The Council had observed a gap in the 2012 Code in that unlike the corporate governance codes in other jurisdictions such as Australia and Malaysia, it did not expressly address an issuer's engagement with stakeholders other than shareholders. This would include employees, customers, suppliers, creditors, regulators and the wider community. The Council noted that having effective relationships with such stakeholders is important for the long-term success of an issuer.

The 2018 Code introduces a new principle and accompanying provisions relating to stakeholder engagement. Principle 13 requires the board to adopt an inclusive approach by considering and balancing the needs and interests of material stakeholders. The accompanying provisions require that issuers:

- (a) put in place arrangements to identify, engage and manage relationships with material stakeholder groups;
- (b) disclose their strategy and key areas of focus in relation to the management of stakeholder relationships; and
- (c) maintain a current corporate website to communicate and engage with stakeholders.

AMENDMENTS TO THE SGX LISTING RULES

As discussed above, the following important requirements or baseline market practices will be shifted from the Code to the SGX Listing Rules:

- (a) the objective and baseline tests of director independence (to take effect from 1 January 2019);
- (b) the nine-year rule (to take effect from 1 January 2022); and
- (c) the requirement for at least one-third of the board to comprise of independent directors (to take effect from 1 January 2022).

In addition, as mentioned earlier, the SGX Listing Rules will, in accordance with the Council's recommendation, be amended to clarify expectations under the comply-or-explain regime. The SGX Listing Rules currently state that issuers must in their annual report describe their corporate governance practices with specific reference to the principles of the Code, and must disclose any deviation from any guideline of the Code, together with an appropriate explanation for such deviation. The amendments expand on this further by providing that:

- (a) issuers must comply with the Code's principles;
- (b) specific reference must not only be made to the principles, but also the provisions; and
- (c) where their practices vary from the provisions, issuers must also explicitly state the provision they have varied from, explain the reason for the variation and explain how the practices they had adopted are consistent with the intent of the relevant principle.

Further requirements proposed by the SGX will also be added to the SGX Listing Rules. These are discussed below.

Training for first-time directors

Under the amended SGX Listing Rules, a director who has no prior experience as a director of an SGX-listed issuer must undergo training in the roles and responsibilities of the same. This is to

better equip such directors in meeting the demands of their position. The intention is to not only arm them with the necessary knowledge to act as directors in general, but also as members of specific board committees. The training requirements will be set out under a non-binding practice note, with the Singapore Institute of Directors as the first training provider.

Where the nominating committee takes the view that the director has other relevant experience such that training is not required, the director would not need to undergo training. However, the nominating committee must then disclose the basis of its assessment.

Identification of directors

To enhance disclosure and accountability to shareholders, the amended SGX Listing Rules require issuers to disclose the designations of all directors (i.e. independent, non-executive, executive etc.) and their roles (as members or chairmen of the board or board committees) in their annual reports.

Disclosure of relationship between chairman and CEO

The amended SGX Listing Rules increase transparency by requiring issuers to disclose the relationship between the chairman and the CEO, if they are immediate family members.

Establishment of board committees

Under the amended SGX Listing Rules, issuers must establish one or more committees as may be necessary to perform the functions of an audit committee, a nominating committee and a remuneration committee, with written terms of reference which clearly set out their authority and duties. This is to ensure minimum standards of corporate governance.

Re-nomination and re-appointment of directors

As a safeguard against the entrenchment of directors within the board, the amended SGX Listing Rules require all directors to submit

themselves for re-nomination and reappointment at least once every three years.

Key information regarding directors

The amended SGX Listing Rules require issuers to specify certain additional key information in relation to the appointment and re-election of directors, with the aim of increasing transparency and accountability. For instance, while the current requirement is for familial relationships with any director and/or substantial shareholder of the issuer or of any of its principal subsidiaries to be stated, this has been broadened to include "any relationship" (including immediate family relationships) with any existing director, existing executive officer, the issuer and/or substantial shareholder of the listed issuer or of any of its principal subsidiaries" (emphases added). Other additional key information required include, among others, the director's date of last re-appointment (if applicable) and the director's professional qualifications.

Adequacy and effectiveness of internal controls and risk management systems

Under the current SGX Listing Rules, issuers are required to comment on the adequacy of their internal controls in addressing financial, operational and compliance risks in their annual reports.

The amended SGX Listing Rules expand on this requirement. They now require the issuers to comment on "the adequacy and effectiveness of [their] internal controls (including financial, operational, compliance and information technology controls) and risk management systems" (emphases added). In addition, a statement on whether the audit committee concurs with the board's comment must also be provided. If material weaknesses are identified by the board or audit committee, then these weaknesses must be clearly disclosed together with the steps taken to address them.

Internal audit function

The amended SGX Listing Rules impose the additional requirement on issuers to establish and maintain, on an ongoing basis, an effective internal audit function that is adequately resourced and independent of the activities it audits. The audit committee has to comment on whether the internal audit function is independent, effective and adequately resourced.

Disclosure of reasons for not paying dividends

The current SGX Listing Rules require issuers to announce their directors' decision not to declare or recommend a dividend. To help shareholders understand why this is so, the amended SGX Listing Rules also require that the reasons for such a decision be announced.

ESTABLISHMENT OF A CORPORATE GOVERNANCE ADVISORY COMMITTEE

The Council had recommended establishing the corporate governance advisory committee ("CGAC"), after making the observation that there is currently no single body to advocate good corporate governance practices unlike other jurisdictions such as Australia and the UK.

The CGAC will serve as an advisory body with no formal regulatory powers. Its key functions will include:

- (a) monitoring issuers' implementation of the Code;
- (b) providing support to issuers by promulgating good practices and areas for improvement;
- (c) advising regulators on corporate governance issues;
- (d) issuing or revising Practice Guidance to clarify the Code's principles and provisions; and
- (e) monitoring international trends and recommending updates to the Code where appropriate.

The CGAC will comprise senior practitioners with experience as board chairmen or directors, corporate governance experts and representatives from diverse stakeholder groups.

The MAS expects to establish the CGAC by the end of 2018 and more details will be announced in due course.

CONCLUDING REMARKS

Given that the last review of the Code was conducted more than five years ago, the 2018 Code provides a timely update that seeks to foster a culture of substantive compliance as opposed to a checklist approach, with the broader aim of building investor and stakeholder confidence. The alignment of important requirements or baseline market practices under the SGX Listing Rules would serve to ensure stricter compliance with the same, and the establishment of the CGAC would facilitate issuers' implementation of good corporate practices.

If you wish to provide feedback on this legal update, or discuss more about how this update may potentially affect you, please do not hesitate to contact us.

We will continue to monitor developments in the corporate governance landscape and provide further updates at appropriate junctures.

REFERENCES

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3. [Response to Feedback Received on Recommendations of the Corporate Governance Council](#)
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5. [Infographic: Corporate Governance Council's recommendations to enhance corporate governance in Singapore](#)
6. [2018 Code of Corporate Governance](#)
7. [Practice Guidance](#)
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9. [Amendments to the SGX Listing Rules: MAS Media Release on Council Recommendations](#)

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