ISCA INSTITUTE OF SINGAPORE CHARTERED ACCOUNTANTS

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Global Mindset, Asian Insights

13 March 2018

The Secretariat, Corporate Governance Council
c/o Mr Ng Yao Loong
Executive Director
Markets Policy & Infrastructure Department
Monetary Authority of Singapore (MAS)
10 Shenton Way, MAS Building
Singapore 079117
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Dear Sirs,

COMMENT LETTER ON REVISED CODE OF CORPORATE GOVERNANCE, 2018

It is our pleasure to submit the feedback of the Institute of Singapore Chartered Accountants (ISCA) on the proposed revisions to the Code of Corporate Governance, in response to the consultation paper released by the Corporate Governance Council and the Monetary Authority of Singapore on 16 January 2018.

Please find enclosed ISCA's comment letter on the revised Code.

As the national accountancy body, we value the opportunity to provide feedback, which we hope your team will find useful.

Yours sincerely,

Lee Fook Chiew
Chief Executive Officer, ISCA

Tay Woon Teck
Chairman, Corporate Governance and Risk Management Committee (CGRMC), ISCA

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RESPONSE TO CONSULTATION PAPER ON THE RECOMMENDATIONS OF THE CORPORATE GOVERNANCE COUNCIL, JANUARY 2018

Please note that all submissions received will be published and attributed to the respective respondents unless they expressly request Council not to do so. As such, if respondents would like (i) their whole submission or part of it, or (ii) their identity, or both, to be kept confidential, please expressly state so in the submission to MAS. In addition, Council reserves the right not to publish any submission received where MAS considers it not in the public interest to do so, such as where the submission appears to be libellous or offensive. Feedback pertaining to the SGX Listing Rules will be forwarded to SGX.

Consultation topic:	Consultation Paper on the Recommendations of the Corporate Governance Council
Name[1]/Organisation: [1]if responding in a personal capacity	Institute of Singapore Chartered Accountants (ISCA)
Contact number for any clarifications:	Joyce Tang, Director, Strategy |Global Alliances | Insights & Intelligence, Tel: 6597 5640 Loke Hoe Yeong, Manager, Insights & Intelligence, Tel: 6597 5683
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Confidentiality	
I wish to keep the following confidential:	Nil *(Please indicate any parts of your submission you would like to be kept confidential, or if you would like your identity to be kept confidential. Your contact information will not be published.)*

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General comments:

In response to the recommendations of the Corporate Governance Council, ISCA presents in this submission its views and comments.

At the outset, we wish to present one general comment:

ISCA believes that the Principles and Provisions of the revised Code of Corporate Governance are a step in the right direction. However, only listed companies are essentially required to apply them. In the current landscape, there are unlisted entities/organisations (for example, family businesses) that are even larger than some listed companies. The sheer size and reach of these unlisted entities imply that any lapses in corporate governance would have far reaching implications affecting a wide range of different stakeholders, much like listed entities.

For the Code of Corporate Governance to have a meaningful impact, they should at least apply to large unlisted entities/organisations too. To do so, the government could:

a. Consider means for the Code of Corporate Governance to be adopted by unlisted companies, or to incentivise or encourage such adoption;

b. Consider revising the Companies Act to align it with the Principles of the Code of Corporate Governance (for example, section 201B of the Companies Act on Audit Committees (AC) and Section 199 2(A) to modify "system of internal accounting controls" to "internal controls and risk management"), such that it would apply to large entities/organisations above a certain threshold (for example, an audit threshold).

Question 1: The Council seeks comments on the draft Introduction

ISCA supports the current definition of "comply or explain", especially because of the clear distinction made between Principles and Provisions in the Code of Corporate Governance. In this way, companies would have the flexibility to decide for themselves how to apply the Principles and Provisions that would fit their context best without being unduly burdened or constrained by a whole array of requirements and rules that might impose unnecessary costs, or even compromise on the quality of corporate governance. We support the approach that values substance over form.

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Question 2: The Council seeks comments on its proposed approach to streamline the Code as outlined in Paragraph 3.4. In particular, the Council would like to seek views on:

a. **the 12 Provisions (or Guidelines) set out in Annex E, Table 1 to be shifted to the SGX LR;**

b. **the 15 Provisions (or Guidelines) set out in Annex E, Table 2 to be removed from the Code; and**

c. **the 24 Provisions (or Guidelines) set out in Annex E, Table 3 to be shifted to the Practice Guidance.**

The Corporate Governance Council should clarify the rationale and criteria for selectively shifting certain Provisions to the SGX LR.

For instance, the shifting of Guidelines 1.6 and 2.1 to the SGX LR signifies the considerable importance now to be accorded to a board's conduct of affairs, composition and guidance. (Guideline 1.6 requires incoming directors to receive comprehensive and tailored induction on joining the board; guideline 2.1 requires independent directors to make up at least one-third of the board.)

However, Principle 5 of the revised Code – for the board to conduct a formal annual assessment of its effectiveness as a whole and of its board committees and of each director – would appear to be even more important and fundamental to good corporate governance, but yet will not be shifted to the SGX LR.

Question 6. The Council seeks comments on the two options: (i) to incorporate the nine-year rule as a hard limit, or (ii) to subject IDs who would like to serve more than nine years to a two-tier vote – all shareholders and non-controlling shareholders (as defined in the SGX LR). Both options will be SGX LR requirements. The Council also seeks views on the adequacy of a three-year transition period.

ISCA's preference is for option 1 – to incorporate the nine-year rule as a hard limit – for the following reasons:

1. A hard limit would bring clarity.

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2. Some empirical studies on director tenures affirm the phenomenon that board directors start to lose their independence after nine years.[1]
3. An independent director can still serve as a non-independent director on the board, if he/she is truly valued by the company or its shareholders. Thus, cumulative knowledge and valued talent/expertise are not lost.
4. Such a move would also ensure board renewal and inject fresh perspectives.
5. A vote on IDs (who would like to serve more than nine years) could turn out to be a "popularity contest" based on considerations unrelated to a director's independence.

Question 7. The Council seeks comments on the recommendation for companies to separately disclose non-controlling shareholders' votes on appointments and re-appointments of IDs who serve less than nine years.

In principle, we are supportive of this recommendation on the assumption that both controlling and non-controlling shareholders vote in the same way on the appointments and re-appointments of IDs serving less than nine years. Such disclosure can act as a form of endorsement for IDs to do their job as such, and further bolster their credibility as IDs. We would also suggest that such disclosure be extended to other directors, rather than just IDs.

However, there could be a conundrum if controlling and non-controlling shareholders do not vote in the same way on the appointments and re-appointments of IDs. Consider the scenario where the non-controlling shareholders (whose vote is non-binding) vote not to re-appoint an ID serving less than nine years, but the controlling shareholders vote in the opposite manner. The Board can indeed take the feedback of the non-controlling shareholders into account, although this can be acted upon only at the next such vote at

[1] See for instance: Huang, S. and Hilary, G (2017). Zombie Board: Board Tenure and Firm Performance. (2017). 1-78. Research Collection School of Accountancy, available at: http://ink.library.smu.edu.sg/soa_research/1329; and: Li, N. and Wahid, A. S. (2017), Director Tenure Diversity and Board Monitoring Effectiveness. Contemporary Accounting Research. doi:10.1111/1911-3846.12332. Nevertheless, it should be noted that the empirical evidence is still unsettled on the issue.

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an Annual General Meeting (AGM) – that is, presumably by not putting up the ID in question for renewal, if the Board so decides. But this would then mean the Board would be going against the preference of the controlling shareholders and the majority of all shareholders (the group whose vote is binding), at least as expressed at the previous AGM in which they voted to renew the ID in question. Moreover, in between the two AGMs, the ID in question would be in an awkward period of suspended judgement on his/her perceived independence, which could put him/her under pressure in carrying out his/her duties.

Question 9. The Council seeks comments on the recommendation to shift the baseline requirement for at least one-third of the board to comprise IDs to the SGX LR.

Taking together Recommendation 7 in the Consultation Paper (that is, to shift the baseline requirement for at least one-third of the board to comprise IDs to the SGX LR) and Recommendation 8 (that is, majority IDs where the Chairman is not independent), we surmise that perhaps the intent of the CG Council is for listed companies board to have majority independent members in the future. If this indeed so, Recommendation 7 would help to prepare listed companies for this eventual outcome. The threshold for at least one-third of the board to comprise IDs is low compared to some other jurisdictions; but in order to allow time for boards to prepare for the more stringent requirement of majority board independence, the less stringent one-third board independence would suffice for now. Additionally, Singapore could face some constraints as a small market with limited people qualified to be ID, as least in the immediate term.

Question 10. The Council seeks comments on the recommendation for a majority of the board to comprise IDs, if the Chairman of the board is not independent.

ISCA agrees that this is a good move, as only a Board comprising a majority of IDs would have the teeth to counter a non-independent chairman if the occasion calls for it.

This is preferable to the current Code, which calls for only half of the Board to comprise IDs where the Chairman of the Board is not independent – the practical effect for a number of small listed companies currently (which tend to have just two directors and one ID) is simply to add an extra independent director. It is questionable how much sway

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two independent directors would have against two executive directors, one of whom is the Chairman.

Question 11. The Council seeks comments on the recommendation for a majority of the board to comprise directors with no management or business relationships.

It should be clarified how this Provision (Provision 2.4) differs from the Provision for IDs to make up a majority of the Board where the Chairman is not independent (Provision 2.1). Otherwise, there would appear to be two definitions of board independence, which could be confusing. It could be that Provision 2.4 is a stepping stone towards the further development of corporate governance, where the longer-term ideal is for all Boards to have a majority of IDs according to the definition in Provision 2.1; if so, it should be clarified as such.

Question 13. The Council seeks comments on the recommendations for companies to disclose:

a. **the relationship between remuneration and value creation; and**

b. **the names and remuneration of employees who are substantial shareholders or immediate family of substantial shareholders, where such remuneration exceeds S$100,000 during the year (revised from S$50,000), in bands no wider than S$100,000 (revised from S$50,000).**

On question 13 (b), we recommend specific disclosures where the remuneration of employees who are substantial shareholders or immediate family of substantial shareholders be disclosed to the last dollar, or at least that the bands of such disclosure be narrowed rather than widened. This would help improve trust in institutions in Singapore – the scoring of the average trust in institutions in Singapore has slid from the "Trust" range to the "Neutral" range in the 2018 Edelman Trust Barometer.[2] We also do not believe that such specific disclosures would result in the "poaching" of employees by other companies, as is sometimes cited.

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[2] https://www.slideshare.net/EdelmanAPAC/2018-edelman-trust-barometer-singapore

Question 14. The Council seeks comments on the new Principle and Provisions relating to stakeholder engagement as set out in Paragraph 7.3, and whether there will be practical challenges in implementing them.

We would like to clarify whether the intention of the new Principle and Provisions relating to stakeholder engagement (Principle 13) is to align the Code with SGX's Sustainability Reporting guide and if yes, we suggest that the Code indicates as such to provide clarity to users of the Code.

Question 16. The Council seeks comments on the proposed establishment of the CGAC, and the functions and composition of the CGAC as set out in Paragraphs 9.3 to 9.5.

ISCA CGRMC is supportive of the merits of an industry-led committee like the CGAC.

Nevertheless, to ensure proper checks and balances, the intent and powers of this new body need to be further clarified. For instance, to whom does the CGAC report, if it is to "act as a resource to regulators"? Moreover, to opine on corporate governance practices, the CGAC may need to conduct reviews just like what Accounting and Corporate Regulatory Authority (ACRA) does in its Financial Reporting Surveillance Programme and Practice Monitoring Programme – is this the model for the CGAC?

Other comments:

- <u>On Provision 10.2</u>, *for at least two members of the AC, including the AC Chair, to have "recent and relevant accounting or related financial management expertise or experience"* – the provision for the minimum requirement for these two members of the AC should be tightened to require them to be qualified accountants with expertise/experience in financial reporting. These requirements should also apply to the Chief Financial Officer of the company.

  Accounting standards are increasingly becoming more complex and this has resulted in financial statements becoming more complicated and less well-understood by those without accounting or financial reporting expertise. Given that directors are responsible for the choice of accounting treatment undertaken

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by the business and are required to sign off the financial statements, it would be desirable that they have expertise/experience in financial reporting to enable them to make informed choices in terms of business considerations and good corporate governance.

An AC Chair or a Chief Financial Officer who is not trained in accounting starts at a disadvantage. Given the centrality of the AC within the board structure and the frequent oversight of risk management by the AC, it is in the interests of stronger governance for the Provision to prescribe for at least one member of the AC and the Chief Financial Officer to be a qualified accountant or have expertise/ experience in financial reporting.