Comply or Explain 2.0 casts a wider net

THE BUSINESS TIMES BTINVEST

Published on Monday, 13 August 2018

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Comply or Explain 2.0: What's the Difference?

By Ng Siew Quan

After more than a year of deliberation and public consultation, the Monetary Authority of Singapore has issued a revised Code of Corporate Governance while the Singapore Exchange has updated its Listing Rules.

A fair amount of commentary and debate was involved – much of it revolving around the topics of director independence, the nine-year rule, and the board diversity policy.

But the revised Code casts its net wider. In fact, the very basis of the previous version of the Code was subjected to a fundamental change. In particular, although it did not receive nearly as much focus during the consultative process, the revised "Comply or Explain" regime is something all directors should take note of.

Traditional "Comply or Explain"

The traditional "Comply or Explain" approach is a fairly simple one: either comply with the stated principles and guidelines, or explain any deviation.

This was the approach from the very outset, when the Code of Corporate Governance was first issued in 2001. It took into account the ownership profiles of Singapore-listed companies and the maturity of the governance ecosystem at the time, and represented a "light-touch, disclosure-based" philosophy.

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The second and third versions of the Code, issued in 2005 and 2012 respectively, inherited the "Comply or Explain" approach as a holdover from the first version.

Despite the good intentions, there were problems with this approach. The most obvious was that many companies published boilerplate and copycat disclosures for prescribed practices with which they simply did not wish to comply. This was evident when the Singapore Exchange released the results of its 2016 study which canvassed the state of corporate disclosures of its listed companies and found the extent and quality of disclosures to be uneven across companies and disclosure areas.

In more extreme examples, companies conveniently ignored instances of non-compliance with the Code. Though such neglect to provide any explanations for deviations was technically a breach of the Listing Rules, some companies may have been under the erroneous impression that the "Comply or Explain" nature of the Code made it non-mandatory. This resulted in cases where companies chose not to explain instances of non-compliance in its corporate governance report, leading readers to assume that the Code had been complied with.

"Comply or Explain" from a Global Perspective

It is not just Singapore that has had to contend with challenges involving corporate disclosures. Other jurisdictions which adopted "comply or explain" have also refined their approaches, producing variants such as:

- "Apply and Explain" in South Africa. This approach assumes entities already apply the Code's principles, and requires them to explain how they achieve this. The intention here is to move beyond the "tick-the-box" approach, and to describe how the implemented practices achieve the intent of the principles and to demonstrate the outcomes.
- "If not, why not" in Australia. Here, companies may choose to not adopt Code principles and recommendations, even in the absence of alternatives, so long as they can explain why.
- "Comprehend, Apply and Report (CARE)" in Malaysia. Under this approach, it is no longer sufficient for companies to merely explain the reasons for non-compliance with the Code. Not only must they provide fair and meaningful explanations of how they have applied the practices laid out in the Code, they must also provide, if the requirements have not been

adhered to, details of the alternative steps or actions that have been taken.

Refreshing "Comply or Explain"

The fourth version of the Code was announced on 6 August 2018 and comes into effect for annual reports for financial years commencing from 1 January 2019 onwards. Under this new version, the "Comply or Explain" approach has been fine-tuned and refreshed.

The original 16 Principles in the Code have been condensed and streamlined into 13 now mandatory Principles. In addition, what used to be known as "Guidelines" have been replaced with "Provisions", the idea being that their compliance will, in turn, allow companies to comply with the Principles. Best practices, which are not binding, have been detailed in "Practice Guidance".

The first significant clarification in the revised Code is that compliance with the Principles is mandatory. That is because they are "overarching and non-disputable statements which embody the fundamentals of good corporate governance".

Compliance with the Provisions (the old "Guidelines") remain on a comply-or-explain basis, such that non-compliance constitutes deviation and will have to be explained.

Practice Guidance, on the other hand, are voluntary and do not require disclosure on compliance or otherwise.

The refreshed regime takes an unequivocal step up from generally providing "appropriate explanations". To promote thoughtful compliance, companies now have to go beyond the status quo and explicitly state the Provision that is being departed from, the reason for the variation, and how practices adopted by the company are nonetheless consistent with the intent of the mandatory Principle in question. Companies are also expected to describe their corporate governance practices with reference to the Provisions.

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The final change in the revised Code is that practices which have become mainstream (for example, having an internal audit function and one-third independent directors) are shifted into the Listing Rules and made compulsory.

This approach provides for growth and improvement. When the provisions become default, they are moved or removed, keeping the Code fresh and aspirational.

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