

## RESPONSE TO CONSULTATION PAPER

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| <b>Consultation topic:</b>   | SGX Public Consultation on Possible Listing Framework for Dual Class Share Structures   |
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### General comments:

CFA Society Singapore welcomes the opportunity to participate in the SGX Public Consultation on Possible Listing Framework for Dual Class Share Structures.

Please note that all feedback is made in our personal capacities as CFA Society Singapore members and do not necessarily represent the views of the organizations where we work.

We would be happy to address any questions you may have and appreciate the time you are taking to consider our points of view. Please feel free to contact us on this feedback or any other issues in future.

## Question 1: DCS Framework

**Do you think that the introduction of the DCS Framework will be beneficial to companies, investors and the Singapore economy? Please give reasons for your views.**

CFA members advocate One Share One Vote but acknowledge that to stay competitive, SGX may be compelled to offer DCS structures. CFA members have considered the arguments for and against the DCS Framework set out in the consultation paper, and on balance, disagree with the introduction of the DCS Framework.<sup>1</sup> We believe that in light of weaknesses in Singapore's existing corporate governance ecosystem – namely the lack of cost effective class action lawsuits for minority shareholders to enforce their rights and ineffective enforcement of non-compliance with corporate governance requirements – the DCS Framework will be detrimental to shareholder value creation and further erode trust in the Singapore public markets.

Supporters of DCS structures often argue that control of a firm's voting power enables management teams to minimize the impact of short-term market pressure, so as to focus on long-term business prospects. They promise higher returns over time in exchange for public shareholders' loss of control. However, analysis from two recent studies suggests that these promises of higher returns do not necessarily hold true.

According to a March 2016 report<sup>2</sup> published by the Investor Responsibility Research Center Institute (IRRCi) and the Institutional Shareholder Services (ISS) which studied the long-term performance and risk profiles of controlled companies in the S&P 1500 universe, controlled companies featuring multiple classes of stock generally underperformed on a broad swath of financial metrics over the long term, are perceived as having more financial risk, and offer fewer rights to unaffiliated shareholders than dispersedly owned firms. Specifically, the study noted:

- Controlled companies underperformed non-controlled firms over all periods reviewed (one-, three-, five- and 10-year periods) with respect to total shareholder returns, revenue growth, return on equity, and dividend payout ratios.
- Controlled companies had a higher occurrence of accounting-related material weaknesses and related-party transactions than non-controlled companies.
- Controlled companies with multi-class stock structures award significantly higher average CEO pay.
- Average volatility at controlled firms is higher than that at non-controlled companies over the one-year and 10-year periods, and lower than that at non-controlled firms over three-year and five-year periods.
- Board tenures are generally lengthier at controlled companies compared with non-controlled firms and the rate of board seat refreshment at controlled entities is lower than at non-controlled companies.
- Women and minority directors are less common at controlled companies compared with non-controlled firms.
- A lower proportion of board members have financial expertise at controlled companies compared with non-controlled firms.

<sup>1</sup> CFA Society Singapore surveyed members on their views with regard to DCS structures in February 2017 prior to the release of the SGX consultation paper. The results of the survey are attached as an appendix to this response paper.

<sup>2</sup> <https://irrcinstitute.org/wp-content/uploads/2016/03/Controlled-Companies-IRRCI-2015-FINAL-3-16-16.pdf>

In a forthcoming report commissioned by CFA Institute, Associação de Investidores no Mercado de Capitais (AMEC), and CFA Society Brazil which focused on Dual Class Shares in Brazil and the Brazilian stock market's experience in setting up of Novo Mercado – a voluntary listing segment with enhanced protection for shareholders, including the rule to only issue one-share one-vote common shares – it is noteworthy that key findings of this study are:

- The stock index of Novo Mercado single-class firms (IGCNM) outperformed the market index IBovespa over the last decade. However, the performance of the Brazilian stock market was not stellar, producing only single-digit average annual returns.
- The Novo Mercado firms with single-class shares produced better operational results in terms of accounting profitability (ROA) and have higher valuations (M/B ratios), while paying lower dividends. There is some evidence that a Novo Mercado single-class share listing is rewarded by investors with a higher M/B ratio, particularly in the cases of the presence of a controlling shareholder.
- Overall, this study documents that the firms that moved to the Novo Mercado single-class structure experienced higher firm performance. However, there are continuing criticisms that these reforms did not eliminate the dominance of controlled companies even in single-class firms and it has not reinvigorated the local equity markets. Progress has stalled particularly in the last five years.

In light of the above, allowing DCS would appear to further legitimize poor shareholder treatment in Singapore where retail investors have gotten burned once too often, and will likely damage Singapore's long term standing as a regional financial hub. If, as some have noted, DCS structures are restricted to only certain types of firms (e.g. those from the technology industry), it is unclear how such firms would add to the long term credibility, appeal and objectives of the Singapore market. 'Big name' firms may generate some fleeting media interest, but there is no guarantee such firms will not disappear into obscurity (think NetScape, Blackberry, etc). The reasons for allowing DCS structures could also be similarly applied to other undesirable control enhancing mechanisms such as pyramids and cross-shareholdings. SGX should continue to strive to be the exchange of choice for investors who know that their interests are clearly safeguarded and who have the ability to be active in protecting their interests.

CFA members also note that listed companies already can issue other financial instruments such as preferred shares if founding members desire to retain control. Preferred shares can be structured to exhibit equity rather than debt characteristics so as to offer investors the upside equity potential similar to ordinary shares but without any voting rights. Preferred shares also give investors a greater claim to the company's earnings. DCS shares will leave retail investors worse off without either of the above.

If SGX decides to eventually implement DCS structures, we recommend that further safeguards be introduced to strengthen corporate governance. Perhaps, it may be worthwhile considering if DCS should be limited to a startup exchange as contemplated in Hong Kong. Finally, we are not aware of any cost-benefit study done by SGX and would recommend that SGX perform a cost-benefit analysis before embarking on the DCS Framework.

## Question 2: Additional Admission Criteria

Do you think there should be additional listing criteria for issuers using DCS structures?

If the answer is yes, SGX seeks views on the following possible listing criteria for issuers using DCS structures:

- (a) a minimum market capitalisation of S\$500 million;
- (b) the level of participation by sophisticated investors (i.e. 90% of the public float requirement), taking into account the existing public float and distribution requirements under Rule 210(1)(a) of the Mainboard Rules; and
- (c) a compelling reason based on holistic assessment of various factors such as industry and operating track record.

You may indicate your preferred thresholds for any of the listing criteria and provide your reasons. For Question 2(c), if you are in favour of this admission criterion, please give your views on what constitutes a compelling reason. You may also propose additional listing criteria and provide reasons for your proposals.

We believe that DCS structures should be subjected to existing listing criteria. We disagree with criterion (b) as a high level of institutional investor participation would destroy the liquidity of the counter and cause its shares to be thinly traded.

## Question 3: Maximum Voting Differential

SGX seeks views on the following:

- (a) whether there should be a maximum voting differential between each MV share and OV share or a fixed ratio applied to all issuers; and
- (b) the appropriate maximum or fixed ratio (as the case may be) of voting differential between each MV share and OV share.

We disagree with the LAC maximum voting differential of 10:1 at the onset just to be in line with other markets like the US. In such scenario, holding 10% could give absolute control of the company disregarding the other 90% equity risk capital – there is too little skin in the game by the founding members. We recommend a more balanced maximum voting differential of 3:1. To achieve majority control, the founding members just need to hold 16.7% to have majority control of 50.1%.

## Question 4: Restriction on Issuance of MV Shares Post-listing

SGX seeks views on the following:

- (a) whether issuance of MV shares post-listing should be prohibited; and
- (b) whether a rights issue should be an exception to such prohibition.

For Question 4(b), you may also propose, in substitution or in addition, other exceptional events where issuance of MV shares should be permitted, and provide reasons for your proposals.

We are of the view that SGX should ensure equal treatment (financially) in the event of the need for future capital raising e.g rights offering. All share classes should face the same dilution threat and subscription offers.

#### Question 5: Automatic Conversion of MV Shares

SGX seeks views on the following:

- (a) Who should be eligible to hold MV shares (e.g. executive officers or executive directors)?
- (b) Do you think that it should be a mandatory requirement that MV shares will be automatically converted into OV shares upon the occurrence of certain events or should such conversion provision be left to issuers to adopt on a voluntary basis, bearing in mind that the Take-over Code will continue to apply if there is a change in control of the company?
- (c) If you are in favour of a mandatory automatic conversion requirement:
  - (i) Do you agree with the possible conversion events listed in paragraph 3.6 of this Part IV? Please indicate your preferred form and combination of the conversion events, and provide reasons for your views.
  - (ii) Do you agree that there should be flexibility for shareholders to waive such automatic conversion requirement?

We believe that this safeguard should be consistent with shareholder protection requirements.

#### Question 6: Sunset Clause

SGX seeks views on the following:

- (a) Do you think it should be mandatory for a DCS issuer to adopt a sunset clause?
- (b) Should a sunset provision always be based on duration? If so, what length of time do you consider an appropriate duration? Should the issuer be allowed to continue having a DCS structure if shareholders allow the issuer to do so at a particular future date?
- (c) Would other factors, such as change of principal business or ownership makeup (for example, where MV shares will be converted into OV shares upon the total number of MV shares falling below certain percentage), be considered appropriate as a sunset provision?

We agree that there should be a sunset clause but SGX should not prescribe the duration of 12-15 year. The duration should be disclosed at IPO and any waiver should be decided only by the minority vote. Upon the founding members' demise/permanent incapacity/departure from the company, these MV shares should be converted to OV shares immediately.

#### Question 7: Independence Element on the Board

SGX seeks views on the possible safeguard to enhance the independence element on the Board by mandating certain recommendations of the Code as set out in paragraph 1.2 of this Part V.

We agree that there should be a greater independent representation on the board. Independent directors should:

- form the majority of the board;
- give a report to minority shareholders as is the practice in other countries, and
- have the authority to require the company pay the costs of civil actions by minority shareholders.

**Question 8: Enhanced Voting Process on Appointment of Independent Directors**

**SGX seeks views on the possible safeguard of requiring the implementation of the Enhanced Voting Process for the appointment of independent directors.**

We believe that minority shareholders should be given supervoting rights in areas such as:

- (1) approval of independent directors;
- (2) related-party transactions;
- (3) decisions affecting listing status of firm;
- (4) major transactions; and
- (5) issuance of substantial number of new shares.

**Question 9: Risk Committee**

**SGX seeks views on the possible safeguard of requiring a risk committee and the composition of such committee.**

We believe that the existing framework (e.g. listing rule 1207 for Mainboard companies which requires the Board to express an explicit opinion about the Group's internal controls) is sufficient.

**Question 10: Coat-tail Provision**

**SGX seeks views on the possible safeguard of a coat-tail provision in a take-over situation. Do you think that a coat-tail provision is necessary in addition to the Take-over Code which will likely apply if there is a change in control of the DCS company?**

We believe the Take-over Code is sufficient in a take-over situation.

**Enclosed:**

- Appendix: CFA Society Singapore survey results