

Consultation Paper

Possible Listing Framework for Dual Class Share Structures

16 February 2017

Singapore Exchange

Responding to this Consultation Paper

On behalf of Singapore Exchange Securities Trading Limited (“**SGX-ST**”), Singapore Exchange Limited (“**SGX**”) invites comments on this consultation paper.

Please send your responses through any of the following means:

Mode	Correspondence Details
Email	listingrules@sgx.com
Mail	Singapore Exchange Limited 11 North Buona Vista Drive #06-07, The Metropolis Tower 2 Singapore 138589 (Attention: Listing Policy & Product Admission)

Responses should include a summary of the major points, a statement of interest and reasoned explanations. Please identify the specific policy or rule proposal on which a comment is made. Please also include your full name and, where relevant, the organisation you are representing, as well as your email address or contact number so that we may contact you for clarification. Anonymous responses may be disregarded.

SGX may make public all or part of any written submission, and may disclose your identity. You may request confidential treatment for any part of the submission which is proprietary, confidential or commercially sensitive, by clearly marking such information. You may request not to be specifically identified.

Any policy or rule amendment may be subject to regulatory concurrence. For this purpose, you should note that notwithstanding any confidentiality request, we may share your response with the relevant regulator.

By sending a response, you are deemed to have consented to the collection, use and disclosure of personal data that is provided to us for the purpose of this consultation paper or other policy or rule proposals.

SGX requests all comments by **17 April 2017**.

Contents

I	Introduction	1
1	Background	1
2	Jurisdictional Comparison	2
II	DCS Framework and Possible Admission Criteria	7
1	DCS Framework.....	7
2	Arguments Against DCS Framework	7
3	Arguments in Favour of DCS Framework	8
4	Additional Admission Criteria	11
III	Risks and Regulatory Considerations	13
1	Identified Risks.....	13
2	Regulatory Considerations.....	13
IV	Safeguards against Entrenchment Risks	15
1	Maximum Voting Differential	15
2	Restriction on Issuance of MV shares Post-listing	15
3	Automatic Conversion of MV shares	16
4	Sunset Clause.....	18
V	Safeguards against Expropriation Risks.....	19
1	Independence Element on the Board	19
2	Enhanced Voting Process on Appointment of Independent Directors.....	19
3	Risk Committee	20
4	Coat-tail Provision.....	20
VI	Measures to Increase Clarity to Investors.....	21
1	Require Clear Disclosure of Rights of Shareholders.....	21
2	Raise Awareness of DCS Structures	22
Appendix	LAC Grounds of Decision.....	23

I Introduction

1 Background

- 1.1 A dual class share (“**DCS**”) structure is a governance structure that gives certain shareholders voting power or other related rights disproportionate to their shareholding. Shares in one class carry one vote (“**OV shares**”), while shares in another class carry multiple votes (“**MV shares**”).
- 1.2 Historically under the Singapore Companies Act, Chapter 50 (“**Companies Act**”), public companies and their subsidiaries were restricted to issuing only OV shares. In 2002, the Company Legislation and Regulatory Framework Committee (“**CLRFC**”) conducted a comprehensive review of the Companies Act and recommended removal of such restrictions on private subsidiaries of public companies on the following grounds:

“As private companies that are not subsidiaries of public companies may currently issue different classes of equity shares with multiple, limited or no voting rights, we see no continuing reason why this flexibility should not extend to private company subsidiaries of public companies. Such voting right flexibility would enable joint ventures and strategic alliances to be structured for private company subsidiaries of public companies.”¹

- 1.3 CLRFC’s recommendation was adopted and given effect by virtue of the Companies (Amendment) Act 2003 which came into force on 15 May 2003. The restriction on public companies to issue MV shares was retained due to concerns over corporate governance and equal treatment of all investors.
- 1.4 The Companies Act was further amended to facilitate DCS structures for public companies pursuant to the Companies (Amendment) Act 2014. The amendments, which took effect in January 2016, abolished the requirement for Singapore-incorporated public companies to issue OV shares only.
- 1.5 The Steering Committee for Review of the Companies Act (“**Steering Committee**”) conducted a comprehensive review of corporate legislation in Singapore in arriving at its recommendations to amend the Companies Act. The Steering Committee was tasked to, among others, provide a conducive, effective and efficient regulatory framework for doing business in Singapore, and to keep pace with international legal developments and technological advances.
- 1.6 In permitting DCS structures, the Steering Committee noted that the ability to issue MV shares would allow companies greater flexibility in capital management.² It opined that the necessary safeguards and restrictions should be imposed on listed companies under the SGX-ST Listing Rules (the “**Listing Rules**”) instead of by statute.
- 1.7 In passing the relevant amendments, Parliament took note that the removal of the one-share-one-vote restriction would give companies greater flexibility in raising capital, and investors a wider range of investment opportunities.³ It was also observed:

“The fact of the matter is that capital is like water, it will flow to where it is the most expedient for it to do so. If companies cannot access public markets for capital in Singapore,

¹ CLRFC, *Report of the Company Legislation and Regulatory Framework Committee* (October 2002) at pp 71.

² Ministry of Finance, *Consultation Paper – Report of the Steering Committee for Review of the Companies Act* (June 2011) at pp 3-3 to 3-4.

³ *Singapore Parliamentary Debates, Official Report* (7 October 2014) vol 92 (Josephine Teo).

they will go to a jurisdiction that allows for it. Our key objective must be to maintain the relevance of Singapore as a financial hub and to maintain its competitiveness and attractiveness relative to our competitors. This becomes more pertinent if dual class listings bring about positive externalities to the rest of the economy and especially if we have ambitions to be a tech and biomedical hub for start-ups and to help to bring them to market.”⁴

- 1.8 The Committee on the Future Economy (“CFE”) was convened in January 2016 to review Singapore’s economic strategies. It released its report with key recommendations on 9 February 2017. In its report, CFE recognised that DCS listings are increasingly being considered in industries such as information technology and life sciences. It recommended allowing DCS structures with appropriate safeguards to promote market transparency and mitigate governance risks.⁵
- 1.9 While the Listing Rules do not expressly prohibit DCS structures, the existing provisions are predicated on each equity share conferring only one vote. There is much public interest in whether DCS structures should be allowed for listed companies. Under DCS structures, the controlling shareholders are usually the company’s founders and their families, or other key executives (collectively referred to as “owner managers”).
- 1.10 SGX referred the matter to the Listings Advisory Committee (“LAC”) for advice. After careful consideration, the LAC advised that it was in favour of permitting DCS structures to list on SGX, subject to appropriate safeguards. The LAC also expressed its views on the specific safeguards that ought to be adopted. The advice of the LAC is set out in the [Appendix](#).
- 1.11 SGX has been engaging with various stakeholders since the LAC’s decision was made public. These engagements included the 14 November 2016 roundtable with the National University of Singapore’s Faculty of Law to discuss the possibility of introducing DCS structures in the Singapore market. Present at the round-table were members of the business community, academics, professionals and entrepreneurs.
- 1.12 This consultation paper aims to further draw feedback, views and suggestions from the public regarding broad policy considerations on whether to introduce a listing framework for DCS structures in Singapore (“DCS Framework”). Under the DCS Framework, the owner managers own MV shares which are unlisted, while the investing public is offered the OV shares which are listed. This consultation paper also lays out possible proposals and safeguards for minority investors should a DCS Framework be introduced.
- 1.13 Depending on the outcome of this consultation, it may be necessary to consult the Securities Industry Council on the implications of a DCS structure in the context of a takeover under the Singapore Code on Take-overs and Mergers (the “Take-over Code”) to ensure that potential issues are addressed.

2 Jurisdictional Comparison

- 2.1 The use of DCS structures for public companies is varied across different countries. The New York Stock Exchange (“NYSE”), Nasdaq Stock Market (“Nasdaq”), Toronto Stock Exchange (“TSX”) and Nasdaq OMX Stockholm permit listed companies to adopt a DCS structure. The United Kingdom

⁴ *Singapore Parliamentary Debates, Official Report* (8 October 2014) vol 92 (Ong Teng Koon).

⁵ The Committee on the Future Economy, *Report of the Committee on the Future Economy: Pioneers of the Next Generation*, (09 February 2017), at pp 31.

(“U.K.”) takes a more nuanced approach. The U.K. listing rules for the premium segment⁶ espouse the proportionality principle⁷ (i.e. voting power should be broadly proportionate to economic interest), but companies with DCS structures may list on the standard segment.⁸ Other exchanges like the Australia Securities Exchange (“ASX”)⁹ and the Stock Exchange of Hong Kong (“HKEx”) do not typically permit companies with DCS structures to list.

- 2.2 In jurisdictions that permit DCS structures, individual companies typically voluntarily adopt certain restrictions on the MV shares.

United States (“U.S.”)

- 2.3 DCS structures are permitted under Delaware company law, although the “one-share-one-vote” concept is provided as a default principle.¹⁰
- 2.4 DCS structures are also permitted under the NYSE and Nasdaq rules. The exchanges permit companies with pre-existing DCS structures to list on their markets. Once listed, an issuer with a one-share-one-vote structure is not permitted to implement a DCS structure that would reduce or restrict the interests of existing shareholders.¹¹

Canada

- 2.5 DCS structures are permitted under Canadian federal corporate law, although the “one-share-one-vote” concept is provided as a default principle.¹²
- 2.6 DCS structures are also permitted under the TSX rules, subject to certain safeguards:
- (a) For issuers that are already listed, to create a multiple-voting class of shares, TSX requires approval from a majority of the votes cast by holders voting at a meeting, other than the promoters, directors, officers, insiders of an issuer or proposed recipient of such shares.¹³
 - (b) TSX imposes a coat-tail provision which is discussed in further detail in section 4 of Part V.

⁶ A listing on the premium segment (“**Premium Listing**”) is only available to equity shares issued by trading companies and closed and open-ended investment entities. Issuers with a Premium Listing are required to meet the U.K.’s super-equivalent rules which are higher than the EU minimum requirements. A Premium Listing means the company is expected to meet the U.K.’s highest standards of regulation and corporate governance – and as a consequence may enjoy a lower cost of capital through greater transparency and through building investor confidence. (Source: London Stock Exchange website: <http://www.londonstockexchange.com/companies-and-advisors/main-market/companies/primary-and-secondary-listing/listing-categories.htm>.)

⁷ U.K. Listing Rule 7.2.1A, Premium Listing Principles 3 and 4.

⁸ A listing on the standard segment (“**Standard Listing**”) covers issuance of shares, Global Depositary Receipts, debt and securitised derivatives that are required to comply with the European Union (“**EU**”) minimum requirements. A Standard Listing allows issuers to access the Main Market by meeting EU harmonised standards only rather than the U.K. ‘super-equivalent’ requirements. (Source: London Stock Exchange website: <http://www.londonstockexchange.com/companies-and-advisors/main-market/companies/primary-and-secondary-listing/listing-categories.htm>.)

⁹ ASX Listing Rules state that a company may have only one class of ordinary shares (unless the ASX approves the terms of an additional class) and, for a vote by poll, each ordinary shareholder must be entitled to one vote per fully paid security. See ASX Listing Rules 6.2 and 6.9.

¹⁰ Delaware General Corporation Law §212(a) states: “*Unless otherwise provided in the certificate of incorporation...each stockholder shall be entitled to 1 vote for each share of capital stock held by such stockholder.*”

¹¹ See NYSE Listed Company Manual, Rule 313(A) and Nasdaq Stock Market, Rule 5640, respectively.

¹² Canada Business Corporations Act, Section 140(1).

¹³ TSX Company Manual, Part VI (H), Section 624(m).

- (c) TSX created new stock symbol designations for company shares with different voting rights.¹⁴
- 2.7 In 2013, the Canadian Coalition for Good Governance published its “Dual Class Share Policy” which sets out, *inter alia*, the following best practices principles for DCS companies¹⁵:
- (a) Holders of MV shares should be entitled to nominate a number of directors equal to the least of (i) two-thirds of the board, (ii) the number obtained when the board size is multiplied by the percentage of total voting rights held by the MV shares, and (iii) if the holders of MV shares are related to the management of a company with a controlling shareholder (i.e. able to elect the board or direct the management), then one-third of the board.
 - (b) The share structure should allow a “meaningful equity ownership stake”, which generally requires a voting rights ratio of not more than 4 to 1.
 - (c) There should be standard coat-tail provisions.
 - (d) The DCS structure should collapse at an appropriate time as determined by the board and, if practicable, as set out in the articles, where a one-for-one conversion occurs, unless a majority of the holders of OV shares voting separately as a class approve its continuation (for a period no longer than 5 years at each vote). No premiums should be paid to the holders of MV shares for the collapse.
 - (e) MV shares sold by a holder should convert automatically to OV shares on a one-for-one basis.

U.K.

- 2.8 DCS structures are permitted under U.K. company law, although the “one-share-one-vote” concept is provided as a default principle.¹⁶
- 2.9 DCS structures are also permitted for Standard Listings. For Premium Listings, issuers are subjected to the following principles:¹⁷
- (a) Premium Listing Principle 3: All equity shares in a class that has been admitted to premium listing must carry an equal number of votes on any shareholder vote.
 - (b) Premium Listing Principle 4: Where a listed company has more than one class of equity shares admitted to premium listing, the aggregate voting rights of the shares in each class should be broadly proportionate to the relative interests of those classes in the equity of the listed company.

¹⁴ See TSX Company Manual, Part VI (H), Section 624(c) to (f) for rules on designation of the different types of securities.

¹⁵ Canadian Coalition for Good Governance, *Dual Class Share Policy* (September 2013).

¹⁶ U.K. Companies Act 2006, Section 284. (Specifically, Section 284(4) provides that the provisions of Section 284 (which state the “one-share, one-vote” position) are “*subject to any provision of the company’s articles*”.)

¹⁷ U.K. Listing Rule 7.2.1A, Premium Listing Principles 3 and 4.

- 2.10 The purpose of Premium Listing Principle 4 is to prevent artificial structures involving multiple classes with different voting powers, which are designed to concentrate control in a small group of shareholders.¹⁸

Sweden

- 2.11 DCS structures are permitted under Swedish company law, although the “one-share-one-vote” concept is provided as a default principle.¹⁹ However, no share may carry voting rights more than 10 times greater than the voting rights of any other share.²⁰
- 2.12 DCS structures are also permitted under the Nasdaq OMX Stockholm rules.

Hong Kong

- 2.13 DCS are permitted under Hong Kong company law, although the “one-share-one-vote” concept is provided as a default principle.²¹
- 2.14 However, a company is not permitted to list on HKEx with shares that have a voting power that does not bear a reasonable relationship to the equity interest of those shares.
- 2.15 HKEx consulted the public in August 2014 on whether DCS structures should be permitted.²² In June 2015, HKEx concluded that there was sufficient support to conduct a second stage consultation on acceptable structures, and made a draft proposal. HKEx’s draft proposal envisaged, among others, the following features²³:
- (a) Restriction of DCS structures to new applicants only.
 - (b) A very high expected market capitalisation test.
 - (c) Enhanced suitability criteria related to the applicant’s business and contribution of the founders.
 - (d) Restrictions on who can hold weighted voting rights and the percentage shareholding interest of such persons.
 - (e) Enhanced corporate governance measures around independent non-executive directors, establishment of a corporate governance committee, role of a compliance adviser and communication with shareholders.
- 2.16 Shortly thereafter, the Securities and Futures Commission of Hong Kong (“SFC”) responded that it did not support the draft proposal.²⁴ The SFC’s concerns include the following:
- (a) The size of a company offers no assurance that it would treat its shareholders fairly.

¹⁸ U.K. Financial Conduct Authority, *Policy Statement: Response to CP13/15 – Enhancing the effectiveness of the Listing Regime* (PS14/8) (May 2014).

¹⁹ Swedish Companies Act, Chapter 4, Sections 1 to 3.

²⁰ Swedish Companies Act, Chapter 4, Section 5.

²¹ Hong Kong Companies Ordinance, Section 588(4) and Section 50(4) of the Companies (Model Articles) Notice.

²² HKEx, *Concept Paper – Weighted Voting Rights* (August 2014).

²³ HKEx, *Consultation Conclusions to Concept Paper on Weighted Voting Rights* (June 2015).

²⁴ HK SFC, “SFC Statement on the SEHK’s Draft Proposal on Weighted Voting Rights” (June 2015) <<https://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=15PR69>>.

- (b) A regime that relies on the subjective judgement of regulators to determine which listing applicants are eligible for weighted voting rights would give rise to regulatory uncertainty and could result in inconsistent and unfair decision-making.
 - (c) The proposal does not contain adequate safeguards and ring-fencing and anti-avoidance measures to address the risk of DCS structures becoming commonplace in Hong Kong.
- 2.17 In October 2015, HKEx decided that it would not proceed with the draft proposal in light of the SFC statement, as it did not believe that progress could be made on a workable proposal that would meet the stated concerns of SFC whilst providing a regime that would be likely to succeed.²⁵ It has been clarified that the SFC had at no point decided that some form of weighted voting rights would be totally impossible for Hong Kong.²⁶ In January 2017, HKEx announced that it plans to consult on the launch of a third board in an effort to attract more technology and new-economy firms to list. The consultation will cover the dual-class shareholding structure.²⁷

Australia

- 2.18 DCS structures are permitted under Australian corporate law, although the “one-share-one-vote” concept is provided as a default principle.²⁸
- 2.19 However, DCS structures are generally not permitted under the ASX rules, which state that a company may have only one class of ordinary shares (unless the ASX approves the terms of an additional class) and, for a vote by poll, each ordinary shareholder must be entitled to one vote per fully paid security.²⁹
- 2.20 An Australian listed and incorporated company sought to introduce MV shares in 1993. In this instance, the company put a proposal to the ASX for the introduction of a new class of shares bearing 25 votes per share by pro rata entitlement. This proposal was widely condemned from a policy perspective as an entrenchment and anti-takeover device, which would erode general shareholder rights. In light of this criticism, the company withdrew its proposal.³⁰
- 2.21 In December 1993, the Federal Attorney General established an expert panel to examine the ability of listed companies to issue MV shares. The expert panel recommended that the ASX listing rules should continue to apply the “one-share-one-vote” principle. The ASX agreed with this recommendation.³¹

²⁵ HKEx, “Listing Committee Announces Way Forward on Weighted Voting Rights” (5 October 2015). <<https://www.hkex.com.hk/eng/newsconsul/hkexnews/2015/151005news.htm>>

²⁶ HK SFC, Ashley Alder, Chief Executive Officer, “Speech at 7th Pan Asian Regulatory Summit” (8 November 2016). <http://www.sfc.hk/web/EN/files/ER/PDF/Speeches/Ashley_20161108.pdf>

²⁷ Enoch Yiu, “HKEx rekindles plans for dual-class share structure in the city”, South China Morning Post, (19 January 2017).

²⁸ Section 250E of the Australian Corporations Act 2001 adopts a presumption of voting equality, “[s]ubject to any rights or restrictions attached to any class of shares”. Sections 124, 254A and 254B(1) of the Australian Corporations Act 2001 provide that a company may determine the terms on which its shares are issued and the rights or restrictions attaching to the shares.

²⁹ ASX Listing Rules 6.2 and 6.9.

³⁰ Shearman & Sterling LLP, “Proportionality between Ownership and Control in EU Listed Companies: Comparative Legal Study, Exhibit C (Part II)” (18 May 2007) at pp 381.

³¹ *Ibid.*

II DCS Framework and Possible Admission Criteria

1 DCS Framework

- 1.1 Based on the feedback from various stakeholders, comments appear to be divided as to whether companies with a DCS structure should be allowed to list in Singapore.

2 Arguments Against DCS Framework

- 2.1 Commentators who are not in favour of allowing companies with a DCS structure to list in Singapore cite the following key concerns:

Lack of proportionality between ownership and control

- 2.2 The DCS structure will give owner managers voting power or other related rights disproportionate to their shareholdings. Shareholder democracy demands that voting powers should match economic incentives. When voting interest is separated from economic interests, it may lead to other externalities such as misalignment of interests among shareholders, excessive compensation of management, reduced dividend pay-out, management entrenchment and expropriation.

Detrimental to corporate governance

- 2.3 DCS structures have been controversial from the standpoint of minority investor protection and good corporate governance. Owner managers may be insulated from market discipline as ordinary shareholders may be unable to hold them accountable owing to the lack of voting control. Investor rights and protection should not be sacrificed at the altar of attracting listings.
- 2.4 Singapore had emerged at the top of the closely watched regional corporate governance rankings, "Corporate Governance Watch 2016" released by Asian Corporate Governance Association in collaboration with CLSA Ltd.. Some commentators have voiced concerns that DCS structures are injurious to our market's reputation and Singapore's top spot could potentially be in jeopardy if companies with DCS structures are permitted to list on SGX.

DCS structure not sole reason for choice of listing venue

- 2.5 It is unclear whether DCS structures would increase the attractiveness of the Singapore market as a listing venue as there may be other considerations driving the listing decision by companies. For example, non-U.S. companies which choose to list on the U.S. exchanges are often classified as foreign private issuers, which classification exempts them from various requirements relating to corporate governance structures and disclosures. The ease and flexibility afforded by other jurisdictions may also weigh heavily in the choice of listing venue.

Poor performance

- 2.6 There is empirical evidence indicating that the DCS structure reduces firm value and leads to poorer performance in the U.S. companies. There is a concern about whether recourse is available to minority shareholders if owner managers or their successors are unable to deliver results.

- 2.7 Some empirical studies show that a greater share of owner managers' voting rights tended to result in lower efficiency in the use of cash resources by a company, and less successful acquisitions and returns on capital expenditure.³² Others show that companies with DCS structures generally have substantially lower institutional investor ownership, leading to a potentially negative impact on the share price of such companies through reduced investment demand and the restriction of their access to equity capital.³³

Lack of investor awareness

- 2.8 The investing public may not be ready for the DCS structure as they may not fully understand the risks associated with the DCS structure or have sufficient information available to make an informed investment decision.

Exception rather than norm

- 2.9 While DCS structures are allowed in countries like the U.S. and Canada, they are the exception rather than the norm. A study of 580 U.S. "emerging growth companies" that had their initial public offerings ("IPOs") between 1 January 2013 and 31 December 2015 found that only 87 (15%) had multiple classes of stock at the time of their public offerings.³⁴ It is also notable that DCS structures are not common or available in other major or regional capital markets such as the U.K., Hong Kong and Australia.

Enforcement

- 2.10 Even if the DCS structure works in the U.S. and other markets, it may not work in Singapore given the differences between those markets and Singapore's legal and institutional environment, and approach to corporate governance.
- (a) In the U.S., controlling shareholders owe a fiduciary duty of loyalty to the company and shareholders. Any breach of the duty of loyalty entitles shareholders to seek judicial relief and remedies, providing minority shareholders in the U.S. with far more extensive protection against abusive actions by controlling shareholders than what is provided under Section 216 of the Companies Act dealing with the oppression of minority shareholders.
 - (b) The contingency fee-based class action system in the U.S. gives minority shareholders a viable means for taking actions to seek redress, something that is clearly lacking in Singapore. Singapore investors may not be ready for the DCS structure. Unlike U.S. investors, who would not hesitate to sue to try and enforce their rights, no similar activist shareholder culture exists in Singapore to keep management on their toes.

3 Arguments in Favour of DCS Framework

- 3.1 On the other hand, commentators who are in favour of allowing companies with a DCS structure to list in Singapore cite the following key reasons:

³² Ronald W. Masulis, Cong Wang and Fei Xie, "Agency Problems at Dual-Class Companies" (June 2008).

³³ Kai Li, Hernan Ortiz-Molina and Xinlei Zhao, "Do Voting Rights Affect Institutional Investment Decisions? Evidence from Dual-Class Firms" (November 2007).

³⁴ Investor Responsibility Research Center Institute, *Controlled Companies in the Standard & Poor's 1500: A Follow-up Review of Performance & Risk* (March 2016) at pp 7.

Supporting innovation

- 3.2 Every company faces an extremely context-specific set of circumstances driving its corporate decision-making and a DCS structure affords companies flexibility in capital management. The DCS structure may potentially support the growth of companies by providing an alternative public funding channel for start-ups. A DCS structure allows entrepreneurs to retain greater control while raising equity capital during an incubation period, to expand and focus on growth instead of short-term profits. The provision of an alternative funding route will enhance the financial market infrastructure to facilitate sourcing of deals between Asian enterprises and investors. This is in line with Singapore's economic strategy to strengthen Singapore's innovation ecosystem and enterprise capabilities.³⁵

Market competitiveness

- 3.3 Given that DCS structures could support the growth of start-up companies, by permitting DCS structures, the Singapore stock market could attract high-quality companies that may not otherwise consider Singapore as a listing venue. The result could be a more complete and dynamic market. Specifically, the move could allow SGX to draw high-technology companies and family businesses.

Expand public financing channels for next-generation Asian companies

- 3.4 A well-functioning capital market requires a strong public equities market to properly value companies, and support and incentivise early investors and employees to grow with the company. A public equities market can also act as a source of fresh capital for companies to gain critical mass and reap the benefit of network externalities. Allowing DCS structures with appropriate safeguards will widen the range of public financing options, especially for companies in high-technology, biopharmaceutical and life sciences industries.³⁶

Reliance on owner managers

- 3.5 Some companies rely heavily on the technical expertise or market knowledge of owner managers, especially in technology or intellectual property dependent industries. It may actually be to the advantage of minority shareholders to leverage on resources of owner managers and have them continue in the management of the company.

Long term growth of companies

- 3.6 The DCS structure empowers shareholders who have the long-term interests of the company at heart to build a disruptive business, instead of the shareholders who are more interested in the short-term benefits. An obsessive focus by managers on short-term performance may lead to missed growth opportunities at best, and earnings manipulation at worst.

³⁵ The Committee on the Future Economy, *Report of the Committee on the Future Economy: Pioneers of the Next Generation* (09 February 2017), at pp 28 and 31.

³⁶ The Committee on the Future Economy, *Report of the Committee on the Future Economy: Pioneers of the Next Generation* (09 February 2017), at pp 86.

Alignment of interest

- 3.7 An owner manager whose wealth is invested in the company is as interested in creating value and enhancing performance as other shareholders. They have a vested interest to run firms efficiently and maximise shareholder value. They also have the incentive to collect information and the power to monitor and discipline managers. From this perspective, owner managers' interests could be aligned with those of other shareholders.

Not a new concept

- 3.8 The concept of different classes of shares and the entrenchment of particular shareholders is not novel in Singapore and investors may be ready for DCS structures, given that preference shares and golden or management shares are already in existence.
- 3.9 Also, investors are already investing in warrants and derivatives for their economic rights rather than voting rights. There is nothing *a priori* odious about the separation of economic interests and voting rights, as this concept forms the basis for the modern corporation's separation of ownership from managerial control.
- 3.10 DCS structures are not the only form of proportionality-limiting mechanisms to separate ownership from control. Pyramidal corporate structures (achieved through layers of intermediate holding companies) and shareholder agreements (among major shareholders on certain voting arrangements such as veto rights or the right to appoint directors) are examples of such mechanisms which have been commonly used to entrench control in one-share-one-vote structures.

Better performance

- 3.11 Some studies suggest that the DCS structure is simply one of the mechanisms used by controlled companies and the existence of concentrated shareholding is not undesirable *per se*. Concentrated shareholding in controlled companies may either be efficient or inefficient depending on the effectiveness of the legal system. What matters instead is the manner in which the controlling shareholders exercise their power within the company. In an effective legal system, such a shareholding structure can generate efficiencies that create net benefit to the minority shareholders and to the company as a whole.³⁷
- 3.12 There are also studies that suggest that concerns about divergences in ownership versus control (e.g. DCS structures) appear to be substantially less important than corporate opacity in explaining the performance impacts of founder and heir control. DCS structures and disproportionate founder or heir representation on boards of directors appear not to be value-destroying devices. In transparent founder or heir firms, DCS structures and board representation appear to be associated with better firm performance. In contrast, in opaque environments, controlling shareholders use these mechanisms as a tool to provide additional influence and power in extracting firm resources.³⁸

³⁷ Luh Luh Lan and Umakanth Varotttil, "Shareholder Empowerment in Controlled Companies: The Case of Singapore" (26 November 2015).

³⁸ Ronald Anderson, Augustine Duru, David Reeb, "Founders, heirs, and corporate opacity in the United States" (2009).

Disclosure-based regime and market discipline

- 3.13 Singapore operates a predominantly disclosure-based regime where investors are given the opportunity to judge the suitability of investments and the prospective risks and returns, according to their own needs and appetites. The focus is on full disclosure upfront of the capital structure at the time of the IPO, so that investors have full information to make their investment decisions.
- 3.14 In this regime, all participants, including investors, issuers analysts, market professionals and regulators, play a role in safeguarding transparency and contribute towards market discipline to discriminate in favour of companies with high standards of corporate governance and disclosures, and to punish misbehaviours. The regime is also buttressed by existing safeguards in the Listing Rules, such as restrictions on interested person transactions.
- 3.15 There is a view that it is desirable to broaden the Singapore capital markets by giving investors access to a wider range of companies and sectors, as is already available in other major markets. The adoption of a well-defined DCS Framework could be a progressive step for our capital markets as we ready ourselves to be a capital-raising venue for new industries (for example, the fintech industry). For investors who are willing to accept lesser voting rights as they recognise the benefits of letting the owner manager have greater control in running the company, they should be given the choice to do so.

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.

4 Additional Admission Criteria

- 4.1 For the sole purpose of soliciting feedback, we set out a 'straw man' proposal on potential additional admission criteria to help respondents concretise the types of companies that may be admitted using the DCS structure. For the avoidance of doubt, potential issuers must also fulfil the admission criteria in Chapter 2 of the SGX-ST Listing Rules (Mainboard) ("**Mainboard Rules**").
- 4.2 Following the LAC's advice, under the suggested DCS Framework, new issuers with DCS structures may seek a primary listing on the Mainboard of SGX-ST, subject to appropriate safeguards. Existing companies which had listed with a one-share-one-vote structure would not be permitted to convert to a DCS structure post-listing. This is because shareholders of such companies did not invest with knowledge of the risks associated with DCS structures. Even if the conversion is subject to shareholders' approval, it would not adequately safeguard against the interests of minority shareholders who may be outvoted into accepting a DCS structure.
- 4.3 The LAC suggested that the one-share-one-vote structure is to remain as the default position for new listings. Its initial view was a DCS structure may only be permitted if a listing applicant has a compelling reason to adopt such a structure.
- 4.4 The LAC was in favour of SGX conducting a holistic assessment when determining the suitability of a listing applicant to list using a DCS structure. The holistic assessment may take into account factors such as the listing applicant's industry, size, operating track record and raising of funds from sophisticated investors. Each of these factors while relevant, is not determinative on its own. The LAC advised that SGX should provide market guidance on SGX's expectations of these factors during a holistic assessment.

4.5 The LAC was in favour of SGX referring listing applications of companies with a DCS structure to the LAC for its review and advice, provided that SGX had first assessed the listing applicant as being suitable for listing. This would allow SGX to benefit from the LAC's collective practitioner experience, until SGX becomes more familiar with such listing applications.

4.6 We have set out below the possible additional listing criteria for DCS structures:

Market Capitalisation

4.7 One reason for the introduction of the DCS Framework is to increase investment opportunities for investors. To justify accepting the potential risks, there must be palpable investor demand. One of the proxy indicators of investor demand is the market capitalisation of the company at the point of listing. An issuer with a DCS structure is therefore expected to have a minimum market capitalisation of S\$500 million based on the issue price at IPO and post-invitation issued share capital.

Sophisticated Investors

4.8 Another safeguard is to require that an issuer must have raised funds from sophisticated investors.³⁹ This safeguard provides some assurance on the quality of the issuer, as these sophisticated investors would have undertaken due diligence and assessment prior to investing in the issuer. It is expected that sophisticated investors must have a substantial/material stake in the issuer with a DCS structure at IPO.

4.9 As a general guidance, the level of participation by sophisticated investors (including pre-IPO investors) is expected to be no less than 90% of the public float requirement, taking reference from the relevant proportion set out in Rule 210(1)(a) of the Mainboard Rules.⁴⁰ For the purpose of determining the public float proportion, investment from a sophisticated investor is included if the sophisticated investor fulfils the requirements as "public" under the Mainboard Rules.⁴¹

Compelling Reason

4.10 The LAC's initial view was that there should be a compelling reason for adopting a DCS structure. Some companies may depend heavily on the strategic vision or management of the owner managers, who should be permitted to drive the direction of the company. Some companies may also require a longer time to become profitable or to secure market share, or may be involved in a greenfield area. In such situations, it may be more effective for owner managers to retain control to build up the company. There is no exhaustive list of reasons which are considered as compelling. The LAC suggested that SGX should make a holistic assessment taking into account factors such as the listing applicant's industry and operating track record.

4.11 We are not aware of any other exchanges which have similar listing criteria for DCS structures. There have been views that SGX should not base its assessment on subjective criteria which may lead to market uncertainty, and issuers with DCS structures should not be subject to additional listing criteria as this could make SGX an unattractive listing venue since other exchanges do not

³⁹ Sophisticated investors may refer to institutional investors, accredited investors or relevant persons, as defined in or contemplated under Sections 274 and 275 of the Singapore Securities and Futures Act, Chapter 289.

⁴⁰ On the assumption that the minimum market capitalisation of an issuer with a DCS structure is S\$500 million, the level of participation by sophisticated investors is (i) 13.5% for an issuer with a market capitalisation between S\$500 million (inclusive) and S\$1 billion; and (ii) 10.8% for an issuer with a market capitalisation of no less than S\$1 billion.

⁴¹ "Public", as defined in the Mainboard Rules, means persons other than (a) directors, chief executive officer, substantial shareholders, or controlling shareholders of the issuer or its subsidiary companies; and (b) associates of the persons in (a).

impose them. Instead, market discipline will eventually lead to the listing of companies that have a compelling reason to adopt a DCS structure.

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.

III Risks and Regulatory Considerations

1 Identified Risks

1.1 Arising from the concentration of control, there may be an increased potential for abuse by owner managers. The risks commonly associated with concentrated control are:

- (a) management entrenchment of owner managers (“**entrenchment risks**”); and
- (b) owner managers seeking to extract excessive private benefits to the detriment of other non-controlling shareholders (“**expropriation risks**”).

1.2 Cases of abuse typically take place in the areas of interested person transactions and excessive executive remuneration. These risks apply to cases where there is a dominant owner manager, regardless of whether DCS structures are used. However, in a DCS structure, it is more inequitable and socially unacceptable that the degree of control exercised by owner managers does not correspond to the level of risks that they assume as owners.

2 Regulatory Considerations

2.1 The Organisation for Economic Co-operation and Development suggested the following safeguards against expropriation risks posed by DCS structures:⁴²

- (a) a strong corporate governance framework;

⁴² OECD Steering Group on Corporate Governance, *Lack of Proportionality between Ownership and Control: Overview and Issues for Discussion* (December 2007).

- (b) laws and regulations preventing extraction of private benefits from reaching socially unacceptable levels;
 - (c) liquid and well-informed capital markets that are able to price correctly the likely disadvantages of DCS structures to outside shareholders; and
 - (d) proper implementation mechanisms, including prompt and affordable legal recourse for all shareholders.
- 2.2 CFE, in recommending that DCS structures be permitted for companies seeking a listing on SGX, suggested that appropriate safeguards be instituted to promote market transparency and mitigate governance risks.⁴³
- 2.3 A DCS framework should thus focus on enhancing the corporate governance framework and minimising opportunities for extraction of private benefits. Some suggested safeguards may include enhanced independence element on boards, limitation on the extent of concentration of control and enhanced disclosure of rights of MV shares. The role of institutional investors in ensuring informed markets and proper recourse for abuses is also important.
- 2.4 The safeguards recommended by the LAC will be supplemented by the existing framework for all listed companies, which already contains safeguards to mitigate some of the identified risks. For example, our existing rules governing interested person transactions will already prohibit a majority shareholder from voting on a transaction in which he has an interest. The DCS Framework must strike an appropriate balance between mitigating the risks posed by a DCS structure, and allowing companies the flexibility for growth. Some commentators have suggested that if a DCS structure is to be adopted, it would be better not to have any safeguards at all to increase the attractiveness of SGX as a listing venue.⁴⁴ SGX recognises that liquid and well-informed markets act as a check on abusive practices. First, institutional investors and analysts provide independent scrutiny and assessment of the risks and expected losses that may arise from the weaker protection of non-controlling shareholders. The increased scrutiny will bring to light any significant weaknesses in such companies which will be reflected in a decrease in value of its shares in a liquid market. Second, market discipline is a natural deterrent as owner managers who wish to extract private benefits from their control of an issuer must consider that it may result in diminished investor interest in the issuer and an overall decrease in value of its shares.
- 2.5 As raised by some commentators, private and public enforcement mechanisms against abuses are also important in controlling managerial opportunism. Institutional investors can lead other shareholders, as they have the wherewithal to commence and organise an action. The Companies Act now allows shareholders of Singapore-incorporated companies that are listed to commence statutory derivative actions, which facilitates shareholders seeking redress for a wrong done to the company. Further, with the introduction of the independent Listings Disciplinary Committee and Listings Appeals Committee and the enhancement of the listings enforcement framework, issuers, their directors, and executive officers are subject to a wider range of enforcement actions by SGX commensurate with the severity of breaches of the Listing Rules.

⁴³ The Committee on the Future Economy, *Report of the Committee on the Future Economy: Pioneers of the Next Generation* (09 February 2017), at pp 31.

⁴⁴ R Sivanithy, "Better to have no safeguards at all for DCS says Aberdeen", *Business Times*, (22 November 2016).

IV Safeguards against Entrenchment Risks

1 Maximum Voting Differential

- 1.1 To minimise the concentration of voting rights in the owner managers, LAC has advised to set a maximum ratio of the voting differential between each MV share and OV share at 10 to 1, where each MV share carries up to 10 votes and each OV share carries one vote. Under a voting differential of 10 to 1, the owner manager takes on a 9.1% equity stake to control 50% of the votes in the company. Empirically, a voting ratio of 10 to 1 is most common among companies with a DCS structure.⁴⁵
- 1.2 A ratio that is less than 10 to 1 is permitted, as a lower voting differential represents a greater alignment of ownership and control. However, the voting differential must be fixed at the point of IPO and may not be changed subsequently by the issuer to avoid any confusion to investors.

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.

2 Restriction on Issuance of MV shares Post-listing

- 2.1 LAC has advised to prohibit the issuer from undertaking equity fundraising by issuing MV shares post-listing except in the event of a rights issue. For the avoidance of doubt, owner managers should only be allowed to retain (but not increase) their existing control in the event of a rights issue.
- 2.2 The imposition of restrictions on the issuance of MV shares post-listing seeks to act as a check against further entrenchment and prevents the voting rights of existing shareholders from being disparately reduced or restricted through any corporate action or share issuance post-listing. This safeguard also mitigates the effect of owner managers exercising their voting powers in a manner detrimental to the interests of minority shareholders.

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

⁴⁵ A voting differential of 10:1 between each MV share and OV share is common in the U.S. and also practised in Europe (e.g. in Sweden, this is the maximum differential permitted under the Swedish Companies Act).

where issuance of MV shares should be permitted, and provide reasons for your proposals.

3 Automatic Conversion of MV shares

- 3.1 The underlying rationale for DCS structures is the confidence and trust reposed by investors in the owner manager. If the owner manager was to sell or transfer his MV shares to other parties, or if the owner manager ceases to assume the management role, the rationale for according multiple voting rights to the owner manager would cease to exist. LAC has advised that, in such situations, the MV shares should be converted into OV shares.
- 3.2 This safeguard would ensure that the MV shares act solely as a means of retaining control to facilitate strategic business decisions, and not of making the controllers' shares more valuable than those of other shareholders. Thus, in a takeover situation, the owner manager's MV shares to be sold to the takeover offeror will automatically lose their multiple voting rights upon acceptance of the takeover offer.
- 3.3 Such transfer restrictions currently exist in the market. For example, Alphabet Inc. (the parent company of Google Inc.) has 3 classes of shares (not including preference shares): (i) class A common stock, which are ordinary shares traded on Nasdaq with one share per vote; (ii) class B common stock, which carry 10 votes per share and are not publicly traded; and (iii) class C capital stock, which have no voting power and are traded on Nasdaq. As at 31 December 2015, Larry Page, Sergey Brin and Eric Schmidt beneficially owned approximately 92.5% of the outstanding class B common stock, which represented approximately 58.5% of the voting power. The class B common stock will be converted upon sale or transfer to class A common stock unless it is transferred to a permitted holder or otherwise permitted under the Certificate of Incorporation of Alphabet Inc..⁴⁶
- 3.4 Companies that have similar restrictions on transfers of MV shares include Facebook Inc., LinkedIn Corporation, Hyatt Hotels Corporation and Zynga Inc..
- 3.5 Following the LAC's advice, one possible safeguard is that SGX will not accept the listing of an issuer with a DCS structure that does not have restrictive provisions in its constitutional documents meeting the criteria set out in paragraph 3.6 of this Part IV.
- 3.6 As a general guidance, an issuer is expected to bear in mind the following principles when drafting the actual wording of the restrictive provisions. The actual wording of such restrictive provision is the responsibility of the issuer and will be required to be pre-cleared with SGX:
 - (a) At IPO, in the case of a single owner manager, he should assume the role of executive chairman or the chief executive officer or equivalent. In the case of a group of owner managers, at least one of the owner managers must assume the role of the executive chairman or the chief executive officer or equivalent. Each of the remaining owner managers must be either an executive director or executive officer.⁴⁷ This is because the executive chairman or the chief executive officer or equivalent is arguably the most important role in terms of influence on the management of the issuer.

⁴⁶ See Alphabet Inc.'s Form 10-K for the fiscal year ended 31 December 2015 at pp 16, 18 and 89 <https://abc.xyz/investor/pdf/20151231_alphabet_10K.pdf>.

⁴⁷ Executive officers are defined under the Listing Rules as the management team (excluding directors) of an issuer, REIT manager, or trustee manager, as the case may be, including its chief executive officer, chief financial officer, chief operating officer and any other individual, regardless of title, who (a) performs or has the capacity to perform any

- (b) Post-listing, if an owner manager sells or transfers part or all of his MV shares to another owner manager or a third party, such MV shares will be automatically converted into OV shares, unless shareholders approve otherwise in a general meeting where the voting is on the basis that one MV share is limited to only one vote (the “**Enhanced Voting Process**”). In addition to the shareholders’ approval, where the sale or transfer of the MV shares is to a third party, the purchaser or the transferee of MV shares must also be an executive director or an executive officer.
 - (c) Where an owner manager no longer holds the position of the executive chairman or the chief executive officer or equivalent:
 - (i) In the case of a single owner manager, all his MV shares will be automatically converted into OV shares if he ceases to be the executive chairman or the chief executive officer or equivalent, unless otherwise approved by shareholders through the Enhanced Voting Process.
 - (ii) In the case of a group of owner managers, at least one of the owner managers must assume the role of the executive chairman or the chief executive officer or equivalent, otherwise all MV shares (including those held by other owner managers) will be automatically converted into OV shares and the DCS structure of the issuer will cease, unless otherwise approved by shareholders through the Enhanced Voting Process. For the avoidance of doubt, if one of the owner managers ceases to be an executive officer, only that individual’s MV shares will be converted into OV shares, unless otherwise approved by shareholders through the Enhanced Voting Process. The MV shares held by other owner managers will not be affected.
- 3.7 To allow for flexibility, shareholders are given the power to waive the automatic conversion requirement through the Enhanced Voting Process as noted above. Such approval by shareholders must be granted specifically for each case. An additional suggestion is to have the board provide its views to shareholders on such resolution.
- 3.8 For the avoidance of doubt, in the event that shareholders waive the automatic conversion requirement under paragraph 3.6(b) of this Part IV through the Enhanced Voting Process, the Take-over Code will generally apply if there is a change in control of the DCS company as a result of such sale or transfer of MV shares (in its multiple voting form). Under the Take-over Code, the new acquirer of MV shares would be obliged to make a general offer for holders of OV shares.

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 DCS

function or responsibility equivalent to that of the foregoing persons or (b) is responsible for ensuring that the issuer complies with its obligations under the Listing Rules.

company?⁴⁸

- (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?

4 Sunset Clause

- 4.1 In the U.S., some companies with DCS structures have adopted sunset clauses in their constitutional documents, providing for the automatic conversion of MV shares into OV shares at a particular future date, such as 5 years after listing.
- 4.2 An automatic conversion of MV shares to OV shares at a particular future date can help to give the owner managers the freedom to run the business for the purpose of maximising growth and value over the longer term and not immediately subject them to the short-termism of markets, while ensuring that entrenchment risks are addressed. Upon conversion, the shareholders may also continue to appoint the owner managers to senior management positions if the owner managers prove to be competent. A variation of this safeguard is to require the issuer to put the question of conversion of MV shares to OV shares to a vote by holders of OV shares, at a particular future date.
- 4.3 While such sunset clauses currently exist in the market, these are voluntary restrictions adopted by individual companies. Some have argued that imposing blanket rules requiring such automatic conversion may limit the popularity of DCS structures with potential issuers.

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?

⁴⁸ The acquirer of MV shares will be obliged under the Take-over Code to make an offer for the DCS company and shareholders will be given a chance to exit the company as a result.

V Safeguards against Expropriation Risks

1 Independence Element on the Board

- 1.1 Majority independent board committees and the enhanced board composition will strengthen the independence element on the board and provide assurance of independent scrutiny of the owner managers' actions, especially in the event where the interests of owner managers and minority shareholders are not aligned. The independence of a director is determined with reference to the Singapore Code of Corporate Governance ("**Code**").⁴⁹
- 1.2 To strengthen the independent element on the board, the LAC has advised to make certain recommendations in the Code on board composition mandatory for an issuer with a DCS structure. First, the majority of the Nominating Committee, Remuneration Committee and Audit Committee, including their respective chairmen, must be independent. Second, if the chairman of the board is not independent, at least half of the board must comprise independent directors, with a lead independent director appointed. If the chairman is independent, at least one-third of the board must be independent.
- 1.3 Some commentators suggest that the reason for companies seeking a DCS structure is the liberty it affords the owner managers to execute their strategy. Requiring an enhanced independence element on boards may limit the attractiveness of the DCS Framework.

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.

2 Enhanced Voting Process on Appointment of Independent Directors

- 2.1 Independent directors play an important role in enhancing corporate governance standards by providing checks and balances on owner managers. Given that DCS structures entrench corporate control in the owner managers through MV shares, it is essential to allow holders of ordinary shares to have a greater say by requiring the appointment of independent directors to be voted through an Enhanced Voting Process (as defined in paragraph 3.6(b) of Part IV). The enhancement of the independence element in the appointment of independent directors serves to balance the disproportionality between the voting powers of the two share classes.
- 2.2 The LAC has advised that the appointment of independent directors of companies with DCS structures should be subject to a shareholders' vote by the Enhanced Voting Process.
- 2.3 Some commentators note that the main reason that founders and management want a DCS structure is to have more control over key corporate decisions and actions. Therefore, excluding or

⁴⁹ Code, Guidelines 2.3 and 2.4. The Code recommends that an independent director is one who has no relationship with the company, its related corporations, its 10% or more 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 company. The Code also recommends that the board should state reasons for determining that a director is independent notwithstanding the existence of relationships or circumstances which may appear relevant to its determination, such as a director being employed by the company or its related corporations for the past three financial years, or who has served on the board beyond nine years.

limiting the superior voting rights in certain situations (such as the voting for independent directors) would reduce the attractiveness of such share structures. They believe that companies are unlikely to accept DCS structures with major exclusions and may seek waivers from SGX for such exclusions.

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.

3 Risk Committee

- 3.1 A possible safeguard to enhance independent scrutiny of the owner managers' actions is to require that an issuer with a DCS structure must establish a separate board risk committee in carrying out its responsibility of overseeing the company's risk management framework and policies. A separate risk committee may be appropriate for DCS issuers for which there could be higher risks of abuse associated with concentrated control. While the board of directors has overall responsibility for risk oversight, the effectiveness of addressing specific risks and regulatory requirements can be enhanced by the establishment of a risk committee. The risk committee could comprise at least three directors, the majority of whom, including the chairman, could be independent.

Question 9: Risk Committee

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

4 Coat-tail Provision

- 4.1 The holders of MV shares and the holders of OV shares should be treated equally in the event that there is a change in control of the DCS company. The purpose of a coat-tail provision is to ensure that holders of OV shares will participate in a take-over offer on an equal footing with the holders of MV shares. A coat-tail provision could address the risk of potential abuse of the DCS structure where the owner manager could potentially be paid a premium for selling his MV shares.
- 4.2 The Listing Rules may require (i) a coat-tail agreement to be entered into among the holders of MV shares, the issuer and a trustee; and (ii) terms of the coat-tail agreement to be pre-cleared with SGX. The coat-tail agreement is designed to prevent transactions that otherwise would deprive the holders of OV shares of rights under the Take-over Code to which they would have been entitled if the MV shares had been OV shares. In general, holders of MV shares under the coat-tail agreement will be obliged not to sell, directly or indirectly, any MV shares unless concurrently an offer is made to purchase OV shares that:
- (a) offers a price per OV share at least as high as the highest price per share paid or required to be paid pursuant to the take-over offer for the MV shares;
 - (b) has no condition attached other than the right not to take up and pay for OV shares tendered if no shares are purchased pursuant to the offer for MV shares; and
 - (c) is in all other material respects identical to the offer for MV shares.

- 4.3 This mechanism is adopted by TSX which requires at least 80% of the holders of the MV shares to enter into a coat-tail agreement with a trustee for the benefit of the holders of OV shares. The terms of the coat-tail agreement must be pre-cleared with TSX.
- 4.4 The coat-tail provision will not prevent the sale of MV shares by a holder if such sale does not or would not constitute a take-over offer or is otherwise exempt from the formal offer requirements under the Take-over Code.
- 4.5 There are views that the coat-tail provision may be difficult to trigger and may be susceptible to circumvention (e.g. staging the sale of MV shares in phases or selling to different parties to secure a premium but to avoid triggering the coat-tail provision), thus challenging its effectiveness. Also, an empirical study has shown that there is not a great deal of difference between the average premiums for coat-tail and no coat-tail companies.⁵⁰
- 4.6 The interaction between a coat-tail provision and an automatic conversion clause in paragraphs 3.6 and 3.7 of Part IV would also need to be considered. If both safeguards are adopted, the coat-tail provision may not be applicable if MV shares are converted into OV shares arising from a sale or transfer under the automatic conversion clause.

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 Code⁵¹ which will likely apply if there is a change in control of the DCS company?

VI Measures to Increase Clarity to Investors

1 Require Clear Disclosure of Rights of Shareholders

- 1.1 The Companies Act requires the following disclosure safeguards for DCS structures:⁵²
 - (a) shareholders must approve the issuance of shares with different voting rights via a special resolution;
 - (b) information on the voting rights of each class of shares must accompany the notice of meeting; and
 - (c) companies must specify the rights for different classes of shares in their constitution and clearly demarcate the different classes of shares so that shareholders know the rights attached to any particular class of shares.
- 1.2 Companies with DCS structures seeking a listing on SGX-ST, regardless of their place of incorporation, will be required to comply with the same disclosure requirements as prescribed in the Companies Act.

⁵⁰ Joseph A. Mccahery, Piet Moerland, Theo Raaijmakers and Luc Renneboog, "Corporate Governance Regimes: Convergence and Diversity" (2002) at pp 433.

⁵¹ Rule 14 (Mandatory offer) and Rule 18 (Comparable offers for different classes of capital) of the Take-over Code.

⁵² Companies Act, Section 64A.

- 1.3 Prominent disclosure of the risks of DCS structures may also be required in the prospectuses of these companies.
- 1.4 Issuers will be required to disclose the holders of MV shares regardless of their shareholding percentage both at the point of listing and thereafter on a continuing basis in its annual report.

2 Raise Awareness of DCS Structures

- 2.1 If companies with DCS structures are listed, SGX will clearly demarcate, on trading screens, the securities of issuers with DCS structures, by identifying them in a distinctive manner.
- 2.2 SGX intends to conduct investor education efforts to raise awareness of investors on DCS structures.

Appendix LAC Grounds of Decision

- **Date of referral (“LAC Referral Date”):**
 - 4 April 2016
- **Listings Advisory Committee Referral:**
 - Possible listing framework for dual class share structures
- **Facts and Key Issues in Listing Policy:**

Background

The amendments to the Singapore Companies Act in January 2016 to remove the one-share-one-vote restriction in public companies paved the way for SGX to consider if it should introduce a framework for listing companies with dual class share (“DCS”) structures.

A DCS structure gives certain shareholders voting power or other related rights disproportionate to their shareholdings. Shares in one class carry one vote each (“**OV shares**”) while shares in another class carry multiple votes each (“**MV shares**”). DCS structures allow holders of MV shares, typically the founders or owners managing the company (“**owner managers**”), to have voting control without the corresponding financial investment risk.

SGX is of the view that a listing framework for DCS structures may help to attract high-quality companies which may not otherwise consider Singapore as a listing venue.

SGX referred to the LAC, a possible listing framework which identified the risks and safeguards for listing of DCS structures on SGX. SGX sought the LAC’s advice on whether SGX should allow companies with DCS structures to list, and if so, the safeguards to be adopted in the framework to address the risks associated with DCS structures.

At the LAC meeting held on 4 April 2016, an overwhelming majority of the LAC members present voted in favour of permitting DCS structures to list on SGX subject to appropriate safeguards principally agreed at the LAC meeting; 1 member abstained from voting.

By permitting DCS structures on SGX subject to appropriate safeguards, Singapore’s capital market could become more attractive for businesses run by entrepreneurs to list, thereby providing investors access to a wider range of companies and sectors.

Risks associated with DCS structures

The concentration of control in owner managers in a company with a DCS structure carries entrenchment risks and expropriation risks. Entrenchment risks arise when owner managers become entrenched in management of the company; expropriation risks arise where owner managers seek to extract excessive private benefits from the company, to the detriment of minority shareholders.

Apart from entrenchment risks and expropriation risks associated with DCS structures, SGX also identified the risks of poor quality listings and the risk of lack of clarity when investors invest in DCS structures.

Safeguards against poor quality listings

To mitigate the risks of listing poor quality companies with a DCS structure, SGX had identified various measures including:

- (1) admission of appropriate companies based on a holistic assessment; and
- (2) SGX referring listing applications of companies with a DCS structure to the LAC for advice, for an initial period after implementation of the listing framework.

Holistic Assessment

The LAC was of the view that the one-share-one-vote structure is to remain as the default position for new listings. A DCS structure may only be permitted if a listing applicant has a compelling reason to adopt such a structure.

The LAC was in favour of SGX conducting a holistic assessment when determining the suitability of a listing applicant to list using a DCS structure. The holistic assessment may take into account factors such as the listing applicant's industry, size, operating track record and raising of funds from sophisticated investors. Each of these factors while relevant, is not determinative on its own. The LAC advised that SGX should provide market guidance on the possible factors considered and SGX's expectations during a holistic assessment.

Industry

The LAC was of the view that adoption of a DCS structure should not be restricted to companies from certain industries. However, given that there must be a compelling reason for adopting a DCS structure, this could naturally limit the type of companies which may successfully qualify to list with a DCS structure.

Size of company

The LAC noted that large listing applicants, whether in terms of market capitalisation or size of the IPO are more likely to attract sophisticated investors. Funding by sophisticated investors may in turn provide the assurances stated below.

Participation by sophisticated investors

Where sophisticated investors have participated in fund raising by a listing applicant with a DCS structure, this could arguably provide some measure of assurance on the latter's quality. This is because sophisticated investors would have independently conducted due diligence and evaluated the listing applicant and its management prior to providing the funding. In addition, as sophisticated investors have access to the listing applicant's management, this could lead to the listing applicant adhering to higher corporate governance standards to satisfy the sophisticated investors' expectations.

The LAC was not in favour of prescribing a minimum shareholding percentage to be held by, or the timing of participation by sophisticated investors, given the qualitative nature of the assessment.

Referral to LAC

The LAC was in favour of SGX referring listing applications of companies with a DCS structure to the LAC for its review and advice, provided that SGX had first assessed the listing applicant as being suitable for listing. The referral to the LAC would be for the initial period after implementation of the listing framework. This would allow SGX to benefit from the LAC's collective practitioner experience, until SGX became more familiar with such listing applications.

Safeguards to mitigate entrenchment and expropriation risks

The safeguards identified by SGX to mitigate entrenchment and expropriation risks, focused on enhancing the corporate governance framework of a listing applicant with a DCS structure and minimizing opportunities for extraction of private benefits.

Entrenchment risks

To minimise the concentration and entrenchment of voting rights in owner managers, the LAC was in favour of SGX adopting the following safeguards to mitigate entrenchment risks:

- (1) a maximum voting differential of 10:1. This is a commonly adopted voting differential in other jurisdictions which permit listing of DCS structures.
- (2) prohibition of post-listing issuance of MV shares, with an exception for rights issues which would not increase the shareholding proportion between the MV and OV shares. Existing companies which had listed with a one-share-one-vote structure would not be permitted to convert to a DCS structure post-listing. This is because shareholders of such companies did not invest with knowledge of the risks associated with DCS structures. Even if the conversion is subject to shareholders' approval, it would not adequately safeguard against the interests of minority shareholders who may be outvoted into accepting a DCS structure.
- (3) auto-conversion of an owner manager's MV shares into OV shares upon:
 - (a) sale or transfer of MV shares unless to permitted holders.

The listing applicant must have restrictions on sale or transfer of MV shares, and consult the Exchange when adopting a conversion clause including the scope of permitted holders. It should not be a given that immediate family members or family trust of an owner manager will fall under the scope of permitted holders; or

- (b) the owner manager ceasing to hold his or her role as either executive chairman or chief executive officer of the company. Any deviation from these defined roles must have a compelling reason.

In these instances, the underlying rationale for according MV rights to the owner managers, which is the confidence and trust reposed by investors in owner managers, would cease to exist.

Expropriation risks

To minimise expropriation risks, the LAC was in favour of SGX enhancing the independence element in companies with a DCS structure by:

- (1) requiring their boards, Nominating Committees, Remuneration Committees and Audit Committees to comply with the Code of Corporate Governance's recommendations relating to independence of board and board committees on a mandatory, instead of a comply-or-explain, basis. This means that if the chairman is not independent, at least half of the board must comprise independent directors, with a lead independent director appointed. If the chairman is independent, at least one-third of the board must be independent. The majority of the Nominating Committee,

Remuneration Committee and Audit Committee, including their respective chairmen must be independent.

- (2) restricting MV shares to having voting power of one vote per MV share when voting on election of independent directors.

The presence of independent directors on the boards of companies with a DCS structure provides some level of assurance of independent scrutiny of owner managers' actions, especially when the interest of owner managers and minority shareholders are not aligned.

Safeguards to increase investor awareness

The LAC agreed with SGX's proposition to increase investor awareness of shareholder rights in DCS structures to address the risk of lack of clarity to investors:

- (1) by requiring companies with DCS structures to provide clear disclosure of shareholder rights;
- (2) through distinctive identification of securities of companies with a DCS structure; and
- (3) through investor education initiatives.

Singapore Exchange
London • Tokyo • Beijing
• Hong Kong • Mumbai

2 Shenton Way
#02-02 SGX Centre 1
Singapore 068804

main: +65 6236 8888
sgx.com