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Winds Of Change In Executive Compensation

As Propelled By Corporate Governance

Singapore Institute of Directors

MISSION STATEMENT

To promote the professional development of directors and corporate leaders and encourage the highest standards of corporate governance and ethical conduct

THE INSTITUTE'S OBJECTIVES ARE:

- To be the national association of company directors for the local business community. The SID works closely with its network of members, professionals such as accountants and lawyers, and the authorities to identify ways to uphold and enhance standards of corporate governance.
- To act as a forum for exchange of information on issues relating to corporate governance and directorship in Singapore. The SID plays a leading role in holding discussions and providing feedback to the authorities on matters of concern.
- To organise and conduct professional training courses and seminars to meet the needs of its members and company directors generally. Such courses aim to continually raise the professional standards of directors in Singapore by helping them raise their effectiveness through acquisition of knowledge and skills.
- To regularly publish newsletters, magazines and other publications to update members on relevant issues, keeping them informed of latest developments. These publications also serve as reference materials for company directors.
- To be responsible for the discipline of members. The SID has drawn up a code of conduct for directors in Singapore setting out the standards to ensure they discharge their responsibilities dutifully and diligently.

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FROM THE EDITOR

CHAIRMAN'S MESSAGE

Dear fellow members,

Since my message in the last issue of our Bulletin in February when I referred to the concerns of our companies on the challenges to their businesses and the robustness of the local and global economy in 2012, Singapore has registered a modest growth in the first quarter. This was due to an upturn in the manufacturing and strong performance in the construction sectors.

At the same time, there appears to have been some short term resolution in the debt crisis in Greece through the persistent efforts of Germany and France and the EU and IMF. The Euro debt crisis, however, is some way from being over with the recession and high unemployment situation in Spain continuing to be a source of worry. Nevertheless, talks of a collapse of the Euro appear to have largely gone away.

On corporate governance developments in Singapore, we are still awaiting the approval of the recommendations on proposed revisions to the current Code of Corporate Governance submitted to MAS in November 2011. Though approval and comments have yet to come from the authorities, it is heartening to note that a good number of listcos companies have started implementing some of the proposed changes as best practices even before being recommended to do so.

Likewise, approval is also being awaited on the proposed changes to the Companies Act.

Recently one of the changes in the Listing Rules, implemented in September 2011 to strengthen corporate governance practices and foster greater corporate disclosure, had caused some concern among listcos. This relates to the issue of adequacy of internal controls and the requirement for Boards, with the concurrence of the Audit Committee, to express its opinion on its adequacy. To assist companies to comply with the new requirements, the Institute organised three workshops for members and the public. The Institute also sought clarification on the new requirements from the authority. I am glad some clarity and guidance on the subject has been given by SGX in its advisory note in mid-April.

A matter that has attracted much interest in the corporate community in recent months is the on-going issues between China Sky and SGX. One of the independent directors of China Sky has now taken the SGX to court over the issue of a public reprimand and the outcome is keenly awaited.

On 24th June we will be holding our Annual Golf Tournament at Sentosa Golf Club. This coming tournament, our premier networking event each year, is very well supported and all available flights are once again likely to be fully taken up. We are grateful to our many sponsors and participants, in particular, Keppel Corporation who for the third year running is our Platinum sponsor. Minister for Defence, Dr Ng Eng Hen, has kindly agreed to be the Guest-of-Honour for this event. The surplus generated from this event will be used to support the further development of our director training programmes and other initiatives of the Institute.

On 14th September we will be holding our Annual Directors' Conference for 2012 at Marina Bay Sands. Arrangements are being finalised for what promises to be a "must attend" corporate event for all directors and senior members of the corporate community. The keynote speakers for the conference are Mrs Barbara Hackman Franklin, chairman of the National Association of Corporate Directors and Mr Mats Isaksson from OECD. The Guest-of-Honour for the conference is Mrs Josephine Teo, Minister of State, Ministry of Finance and Ministry of Transport. A distinguished list of panellists, comprising corporate leaders and thought leaders from Singapore and the region, has been lined up. I strongly encourage members to "save" the date to join us at this important corporate event. More details about the conference can be found on the back cover of this bulletin.

Other upcoming events include the Institute co-organising the Best Managed Board Award and the Best CEO Award under the auspices of Singapore Corporate Awards.

On director development, apart from the many and various courses and talks targeted at directors, I am pleased to report that we will be launching a new series of talks specially designed for chairmen of boards and committees. These talks and discussion sessions would be more in-depth on issues of particular concern to these chairmen and committee members. The first talk in this new series, for chairmen of Remuneration Committees, will be held in July.

I thank you for your continued support and to see many of you at future SID events.

Warm regards,

John KM Lim
Chairman

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Winds Of Change In Executive Compensation As Propelled By Corporate Governance

By By Brian Dunn, CEO of Global Compensation & Talent, and
Na Boon Chong, Managing Director, Talent & Rewards,
Southeast Asia, Aon Hewitt

Overview

"Say on Pay" is a significant new factor affecting executive pay in North America and the UK. Regulators and shareholder-activists have demanded a shareholder vote on the company's executive compensation program. The trend has started gaining momentum more than three years ago in the U.K. and is now law in the US and Canada. Currently, the requirement is a simple one—each shareholder gets to vote on whether or not they approve of the company's executive compensation program. A typical resolution would read as follows:

RESOLVED, that the stockholders approve the compensation of the companies named executive officers as described in the Proxy Statement under "Executive Compensation" including the Compensation Discussion and Analysis and the tabular and narrative disclosure contained in this Proxy Statement.

As you can see, this is a very blunt instrument that simply asks the shareholders to vote on the entire package. They don't get to say whether it is too high or too low; they don't get to say whether they like the incentives but not the salaries; or they don't even get to say whether they approve of everything but the CEO's pay level.

While the impact of say on pay on corporate decision making is still working its way through, we would like to take stock of the issues and challenges that emerged so far, and postulate what implications say on pay may have in Asia as the executive compensation and corporate governance practices evolve.

Say on pay is premised on the basis that the rationale of any management proposals need to be made transparent to the shareholders in order to win their votes, albeit non-binding votes. First of all, let us review the challenges in making executive compensation decisions.

RESOLVED, that the stockholders approve the compensation of the companies named executive officers as described in the Proxy Statement under "Executive Compensation" including the Compensation Discussion and Analysis and the tabular and narrative disclosure contained in this Proxy Statement.

The Dynamics Of Executive Compensation Decisions

There are a number of key challenges as described below, which if communicated well with the shareholders, would go a long way in gaining their approval.

Performance Information

While it is very much a well-accepted principle that incentives need to be correlated with the financial returns to the business, we have learned in the Global Financial Crisis that the returns need to be adjusted for the risk taken to achieve them as well as the time horizon of the risk. On the other hand, no single measure can adequately capture the true performance of a business. Multiple measures from multiple perspectives must be examined and balanced against one another in the incentive design. Incentives should be delivered only if there is certainty that revenue/profits will be realized—in the current financial reporting period as well as ultimately. In the event that compensation was delivered for performance that never materializes, there should be a mechanism to recover it. The recovery mechanism is via a clawback rule.

Furthermore, people are smarter than any pay-for-performance formulas, and pay decisions need to take into account some of the non-financial behavioral or strategic considerations. Along the same line, the conditions requiring clawbacks have expanded in some situations from the original narrow definition of financial restatement and ethical lapses and mismanagement of employees (who take material risk for the business) to future losses and write offs.

Market Data & Trends

It is important to be clear to shareholders that the market benchmarking is done appropriately. For example, the company must demonstrate that it has chosen the correct peer group (e.g., chosen on the basis of industry, size, business mix, or operating model). They should also demonstrate that the peer group selected is consistent with the investment community's view. The company must also illustrate that any proposed incentive payout takes into account performance in relations to the peer group. In other words, it is no longer a simple static comparison of pay position against the peer group. Investors are expected to challenge the bases of the compensation decisions. A well thought-out benchmarking approach would provide a sound basis for the compensation decisions.

Need For Retention

It is another truism that individuals can add great value to a business, and not adequately rewarding them constitutes an institutional risk. Talent retention need is, however, too often used as a general excuse for high compensation. As a Chairman once mused, "In good times, management asks for performance-based payments. In bad times, management says we must keep compensation competitive to prevent talent taking flight."

Retention incentives need to be thought through, just like any incentive plan. Who is at risk and what is the risk? How do the retentive mechanics work? How is the incentive delivered, over what time frame? Are there mitigating features?

The Role Of A Skeptic

While the corporate governance principle of disclosure and transparency has intended to ensure good practices, the principle on its own clearly has not been effective in preventing malpractices in executive compensation. This is seen time and again in the corporate scandals in the U.S. in the early 2000s and the Global Financial Crisis of 2008. When self governance by the board and management failed, shareholder oversight is seen as a savior. If that does not work, regulatory control is the last resort.

Executive compensation is filled with many interested parties and multi-faceted considerations. Directors have traditionally been nominated by the management and approved by the shareholders. Internal advisors such as CHROs or CFOs report to their CEOs, whose compensation proposals they have to prepare in a delicate fashion. External advisors, although increasingly being hired by the compensation committees, need to tread carefully between the board and the management. Market competition for executive talent, pay for performance, and unique circumstances of the company and executives all warrant due considerations in the compensation design.

The "say-on-pay" trends, and the potential of a "no" vote have surfaced the need to carefully consider these issues in an objective and rational manner. It has been the vehicle where executive compensation proposals have been challenged and has instigated a healthy debate in the board room.

While we are not advocating "say on pay" for Asia because it is an overly blunt tool that was created in an emotional environment, we do however advise companies to begin to review all their programs with an eye on the view of the shareholder. Due to Asia's generally concentrated shareholdings, there is already a powerful shareholder voice. However, as shareholdings become increasingly broadly held, these issues will become more prominent in Asia.

The proposed revised Singapore Code of Corporate Governance includes the following section in Principle 9 Disclosure on Remuneration:

> *9.6 For greater transparency, companies should disclose more information on the link between remuneration paid to the directors, the CEO and key management personnel, and performance. The annual remuneration report should set out a description of performance conditions to which entitlement to short-term and long-term incentive schemes are subject, an explanation on why such performance conditions were chosen, and a summary of the methods to assess whether such performance conditions are met.*

With or without say on pay, compensation committees and boards must demonstrate to investors that they are actively pursuing ways to link executive pay to performance. Investors will be looking for stronger links of short-term and long-term incentive plans and performance that has an impact on share price, and the reduction of unnecessary risk taking.

Call For Action By The Compensation Committee

Compensation committees need to understand that the playing field has fundamentally changed after the Global Financial Crisis, and this is not just a Western phenomenon. Companies should be prepared to discuss all significant compensation decisions and justify anything that could potentially be challenged as poor pay practice. They are expected to discuss actions taken to address any performance shortfall and steps taken to mitigate risks associated with existing compensation programs.

Compensation committees should consider taking the following preparatory steps towards disclosure:

- Understand your shareholder base and if you think shareholders may be critical of certain areas of your program, consider explaining the rationale for these program features and why they continue to make business sense for your company.
- Ensure that compensation committee members and committee advisors are not only independent in thinking but follow a due process to safeguard their independence.
- Assemble a team (internal and external) early, and coordinate efforts among Finance, HR, compensation consultant, management reviewers, and compensation committee reviewers that can challenge many of the assumptions that underlie the current program.
- Ensure that pay levels meet business and talent objectives while considering internal pay relationships (e.g., between the CEO and next-level), and external benchmarks such as those of a peer group.
- Demonstrate how the compensation plans align with financial performance and stock price, and support other business objectives that create shareholder value. This can be done by assessing incentive-pay measures and goals as well as incentive-pay mix (i.e., short-term and long-term incentives, and cash versus equity). Determine whether a quantitative analysis of historical pay-versus-performance makes sense.
- Use shareholder-friendly mechanisms such as stock ownership guidelines, stock holding requirements, and clawback provisions, where applicable.

Most importantly, you must be able to answer affirmatively to the following questions:

- Are your compensation plans performance-based and aligned with shareholders/long-term value creation?
- Are your compensation plans related to the business strategy and tailored based on size, industry, performance and competitive position?
- Does the plan articulate a coherent compensation philosophy appropriate to the company and clearly understood by directors?

Via disclosure, critical information is communicated to the shareholders. Your message should be clear, concise and understood by the shareholders. None of these can be achieved without a rational and well-thought-out compensation design. A good design is a prerequisite to quality disclosure. Both complement each other, but neither can substitute for the other. ■

While the impact of say on pay on corporate decision making is still working its way through, we would like to take stock of the issues and challenges that emerged so far, and postulate what implications say on pay may have in Asia as the executive compensation and corporate governance practices evolve.

Non-Executive Directors' Fees - Is Now The Time For A Significant Increase?

By Jon Robinson
Managing Director
Freshwater Advisers Pte Ltd

Consultants have a tendency to give broad direction rather than committing to verifiable predictions; we try not to. In this article, we will be bold and make a specific forecast: over the next two years, the fees paid by most Singapore listed companies to their non-executive directors will increase by twenty percent or more.

Analysis Thus Far

In our last full review of NED fees, we analysed fee levels in 330 Singapore listed companies paid in respect of the years ending in 2010. A summary of the results is shown in Table A.

TABLE A

Percentile	Total Cash Fees (S$)	% Increase p.a. 1 yr	% Increase p.a. Avg 2 yrs	% Increase p.a. Avg 3 Yrs	Average Cash Fees (S$) per NED	% Increase p.a. 1 yr	% Increase p.a. Avg 2 yrs	% Increase p.a. Avg 3 Yrs
P10	112,000	-5%	-7%	-7%	31,253	-13%	-10%	-8%
P25	158,750	0%	0%	0%	40,000	0%	-1%	0%
Median	231,000	4%	5%	5%	53,333	2%	4%	4%
P75	398,286	16%	12%	12%	75,400	18%	15%	10%
P90	698,620	39%	29%	20%	111,214	42%	23%	18%

The median level of total fees paid in cash (i.e. not including equity or option grants) was S$231,000 with the median average fee for each NED was S$53,333. Over the last few years, the median rate of increase in both total fees and average fees per NED has been running at around 4 to 5% but with some increases substantially higher.

So what leads us to predict that future increases will be higher? We consider three factors:

- Increasing workload and commitment will be needed from directors, especially independent directors.
- The changing nature of independent directors.
- General economic conditions.

The Increasing Workload Of Directors

We see that some directors are beginning to question whether they are being adequately remunerated for their responsibilities and the associated liabilities. More directly, with changes to the Code of Corporate Governance, there will be a further increase in the work of directors in the following areas:

- In many cases, companies will have to appoint a lead independent director who, amongst other duties, will lead separate meetings of all the independent directors. We expect that many companies will make a specific payment for this role.
- The specified role of nominating committees is significantly expanded with particular emphasis on succession planning and board evaluation including assessing whether directors are independent. The fees paid for nominating committee work have typically been the lowest when compared to other roles reflecting the often lighter workload. We expect that this will change.
- The board will need to take on a more direct role in the management of risk. This will require time and, perhaps, directors having to devote time and effort to increase their knowledge in this area.
- In our area of remuneration, the Code encourages companies to disclose more information on pay including how pay and performance are linked and also to consider how risk and remuneration should be related. This and other disclosure requirements will oblige remuneration committees to be in a position to justify their policies and outcomes from those policies.
- All directors are expected to engage and maintain a dialogue with shareholders beyond attending annual general meetings.

TABLE B

Percentile	Singapore Companies Average Fees (S$)			U.K. Companies Estimated Average Fees (S$)		
	Large	Mid	Small	Large	Mid	Small
P25	46,843	41,000	37,768	162,500	87,500	51,833
Median	73,564	54,987	48,682	207,500	108,667	69,667
P75	105,900	70,000	62,813	291,667	135,833	79,167

Directors can make their own assessment of the time that they commit to a particular board and then determine if the fees are appropriate compared to other remunerated activities.

Independent Directors

It is not the purpose of this article to comment on the changes to the Code relating to the independence of directors. However, we do think these changes will have an impact on directors' fees in two ways:

- Many directors, who either are substantial shareholders or who have a direct association with a substantial shareholder, could be expected to be willing to serve for lower remuneration than someone who is completely independent of shareholders. There may be other sources of remuneration or long standing relationships that would act as a barrier to increasing fees.
- One criticism of the changes to the Code is that companies will not be able to find enough qualified independent directors. Also, recent cases highlighting directors' liabilities are likely to make independent directors more cautious in accepting nominations. If there is an increase in demand and a shortage of supply then fees should rise.

The board structure of UK companies has some similarities with Singapore with these becoming more so with the new code particularly in the area of director independence. We have compared average NED fees in similar sized UK and Singapore companies with these set out in Table B.

The fee rates in the larger Singapore companies do lag the UK comparators; with some being only a third to a quarter of the amount. However, we are starting to see independent Chairman of larger companies drawing fees significantly higher than the rest of the board and this could be part of a trend.

The comparison for small companies is closer with UK companies only being some 50% higher than Singapore.

Economic Conditions

Our analysis of fee increases dates from the time of the financial crisis. At that time, it was quite reasonable to expect companies to be cautious in all areas of spending including directors' fees. Since then, both price and wage inflation have been at significant levels and fees would have needed to increase at around 3-5% each year just to keep up.

General economic conditions have been positive over the last two years and companies have been able to harness these for increased profits; higher directors' fees should be affordable and, with increasing share prices, comparatively easy to justify to shareholders.

Reviewing fee requests from recent AGM's, we are already seeing signs of higher increases. Our prediction of twenty percent increases over two years in most companies is looking a safe bet. We aim to publish our 2012 review of fees in June this year and then we can see how our prediction is shaping up. ■

Opinion – Paying NEDs Their Worth

By Allan Feinberg
Director
AUSREM

Boards are expected to face mounting pressure to increase non-executive director pay. Allan Feinberg provides some tips on how to determine what fees to set.

Paying NEDs Their Worth

A series of governance disasters over the past two years, most notably at Centro Properties and Babcock and Brown, have thrown the spotlight back onto the role of the non-executive director (NED). Boards must not expect this increased scrutiny to alleviate anytime soon. Their actions are going to be closely monitored and they will need to prove to shareholders that they can be effective in carrying out their corporate governance roles diligently.

What This Means For The Individual NED

Assiduous preparation and commitment to the company. All directors, including NEDs, have a fiduciary duty "to exercise their powers and discharge their duties with an appropriate degree of care and diligence". In August 2009, the NSW Supreme Court penalised former John Hardie NEDs by fining them $30,000 each and disqualifying them from managing a corporation for five years.

The message is clear: pleading ignorance of the facts is not an excuse. The onus is on NEDs to "obtain, read, evaluate and — where appropriate — question all relevant material" before making any important decisions.

Assiduous preparation means NEDs will have to devote additional time and energy to discharge their duties diligently.

What This Means For The Organisation

Good corporate governance is not going to come cheap. NEDs are entitled to be fully and fairly compensated for the time, work and expertise they provide to the organisation and the increased

The message is clear: pleading ignorance of the facts is not an excuse. The onus is on NEDs to "obtain, read, evaluate and — where appropriate — question all relevant material" before making any important decisions.

> Good corporate governance is not going to come cheap. NEDs are entitled to be fully and fairly compensated for the time, work and expertise they provide to the organisation and the increased workload will become apparent. Organisations will have to be on a par and supportive if they are genuinely and equally committed to the expectations of the NEDs carrying out this corporate governance role.

workload will become apparent. Organisations will have to be on a par and supportive if they are genuinely and equally committed to the expectations of the NEDs carrying out this corporate governance role.

If organisations do not offer fees commensurate with the time commitments and responsibilities of the job, it is unlikely that NEDs will accept new appointments or challenges, especially in their existing positions. Given the integral role NEDs play in corporate governance arrangements, the fee paid must be sufficient to attract, retain and motivate the right calibre of individual for the job.

What This Means For Shareholders

It's all good news, because a well-paid, alert and competent board is probably the cheapest form of insurance and most effective comfort public investors can have against expensive nasty surprises.

How Do Boards Determine NED Fees?

Organisations are required to seek shareholder approval on the maximum fee pool for NEDs. Once a fee pool is approved, the board or remuneration committee determines how much individual NEDs should be compensated. For shareholders to make an informed decision, the motivation for an increase in the fee cap needs to be straightforward and justifiable. If boards fail to provide such rationale it is unlikely that shareholders or shareholder-related bodies will approve the request for the cap to be lifted.

Shareholders need to be convinced the fees they are paying are fair and worth the investment they are making.

What Factors Need To Be Considered When Setting NED Fees?

- The size and complexity of the organisation.
- The time needed for the NED to execute his or her duties. This would include interstate and overseas travel, company functions, time spent at board meetings, plant or site visits, preparation for meetings and special projects.
- The purpose of the role and specific responsibilities to be undertaken – for example, group chairman, committee chairman or committee member.
- The company's remuneration policies – director pay should reflect the company's unique business strategy and the internal value of the role to the organisation, for instance, the experience, personal attributes and reputation of the incumbent is essential in determining an appropriate fee.

Increased time commitments, greater levels of scrutiny by the public and regulatory boards, reputational risk and exposure to legal liability may cause NEDs to think twice before accepting new appointments or continuing with their current ones. It's a question of risk versus reward and 2010 will see mounting pressure on boards to increase NED fees to attract and retain the right calibre of individual. ■

> If organisations do not offer fees commensurate with the time commitments and responsibilities of the job, it is unlikely that NEDs will accept new appointments or challenges, especially in their existing positions. Given the integral role NEDs play in corporate governance arrangements, the fee paid must be sufficient to attract, retain and motivate the right calibre of individual for the job.

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Executive Compensation In Asia - Best Practices In A Dynamic Environment

By Fermin Diez,
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Associate, Mercer Singapore

Are publicly-listed companies throughout Asia paying their executives for the performance they help to achieve? Organizations in this part of the world have been mostly unscathed by the recent global economic woes, and are continuing to grow at a brisk pace. In fact, other than Japan and Taiwan, more than 50% of companies in several other Asian countries are expecting profits to increase in their next Fiscal Year (see Figure 1).

Figure 1: Country profit expectations for FY 2011 [Source: 2011/2012 Asia Executive Remuneration Snapshot Survey]

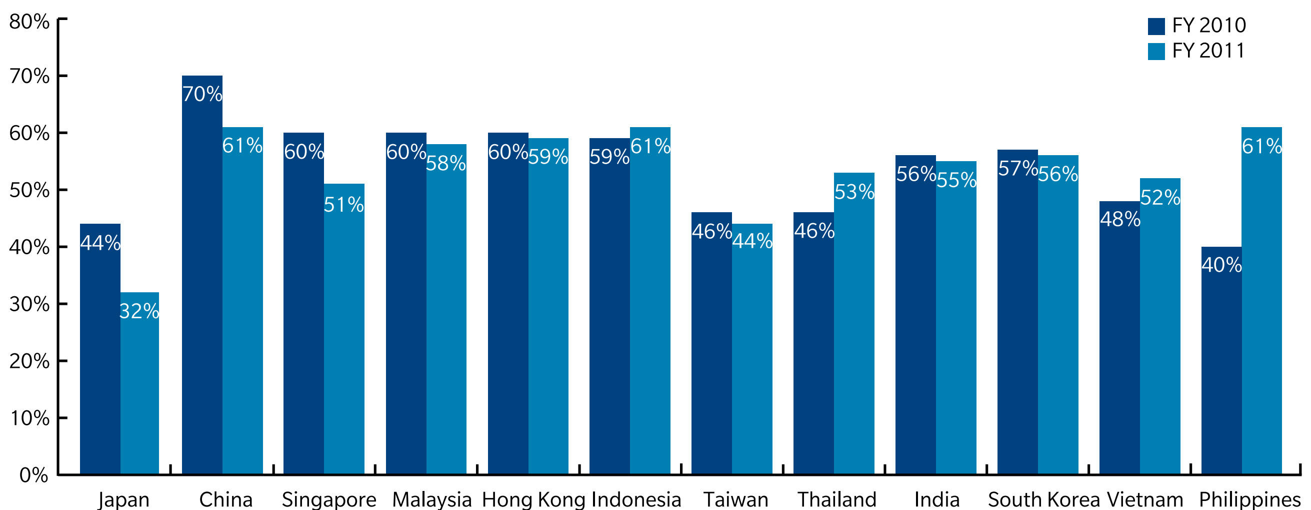
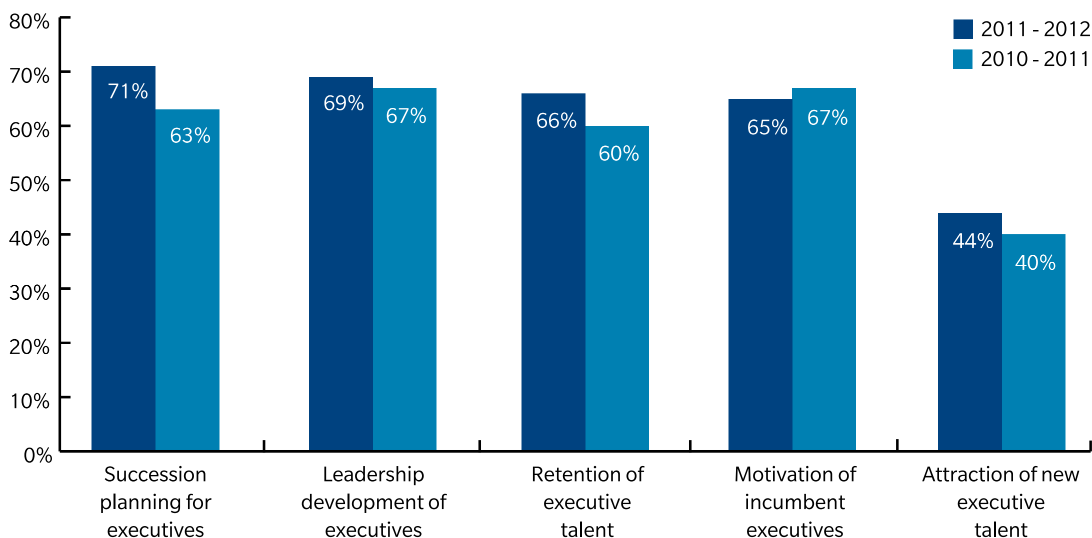


Figure 2: Main executive talent challenges [Source: 2011/2012 Asia Executive Remuneration Snapshot Survey]



Continued Growth

Even organizations in relatively "slow" economies, as Japan, are once again facing concerns related to talent retention. In the region's rapidly evolving economies, there aren't many certainties or even lasting trends. Yet one thing remains constant: An organization's store of talent is vital to its continued growth. The illustration below (see Figure 2) shows that Executive Retention is one of the top three issues for most companies and this concern is increasing, reflecting the fierce competition for talented leaders among Asian organizations in "growth mode"

The resulting dilemma of paying for performance or paying for retention leads to some compelling questions about executive pay programs in general and the pay-for-performance philosophy in particular:

- Are executives paid too much, or is their pay aligned with shareholder value creation?
- What is the proper role of equity in a compensation program?
- What objectives should Remuneration Committees of Asian listed companies pursue: To attract and retain executives, or to deliver pay for results?
- How can companies differentiate between outstanding, average, and below-average performers and ensure that they still retain their key executives?
- And what should time horizons be for both individual and corporate performance assessments, as well as wealth creation over the course of an executive's career?

Complications In Paying For Performance

These questions illustrate that "pay for performance" is far more complicated than the popular press suggests, and more so in Asia's high-growth economic environment. Even though the "pay-for-performance" concept has become widely accepted, many companies have also discovered that the devil is in the details. Simply doling out stock options at all levels of the organization is hardly an effective long-term approach, even if it does appear (even if only on the surface) to tie pay to performance and to foster retention.

Inability To Retain Talents Is A Key Business Risk

The notion of human capital as an investment to be cultivated, as opposed to a bottomless resource that can be tapped on demand, represents one of the most significant shifts in business thinking in recent years. In boardrooms around the region, it has become increasingly accepted that successfully competing for human capital is as important as competing for market share. The latter is not likely to occur without the former. In fact, it could

Even organizations in relatively "slow" economies, as Japan, are once again facing concerns related to talent retention. In the region's rapidly evolving economies, there aren't many certainties or even lasting trends. Yet one thing remains constant: An organization's store of talent is vital to its continued growth.

In Asia, we find that companies provide a greater amount of variable pay than their Western counterparts in the region. In fact, the fact that the fixed pay element for Asian companies has fallen from 60% in 2009-2010 to 41% in 2011-2012 highlights the trend that Asian companies prefer more flexible pay structures which can be adjusted – up or down – based on business performance.

well be that retaining talent is harder than retaining clients. As a matter of fact, according to a recent (July 2011) Conference Board Inc. research in the U.S., human capital risk ranks fourth out of 11 risks in terms of potential business impact. This makes it more important than many other business risks that often get more attention, including IT, finance, supply chain, and reputation. When The Economist Intelligence Unit asked risk managers to rank 13 key risks, human capital topped the list! As a result of the above, effective human capital may become the single most important driver of long- term financial success and shareholder value creation.

In this article we provide an overview of how executive pay programs in Asia attempt to deal with this dichotomy. In our experience in the Region, there is no single "right" or even "best" way to blend all the elements of an effective pay-for-performance program. However, there are certain guiding principles that high-performing companies can follow, when designing and implementing their pay programs. These principles represent our understanding of "Asian current best practices" in this area and can help ensure that any reward program is properly aligned with a company's overall business objectives, that it measures and rewards the appropriate performance factors, and that it delivers meaningful remuneration to support executive retention.

Common Practices In Executive Rewards In Asia

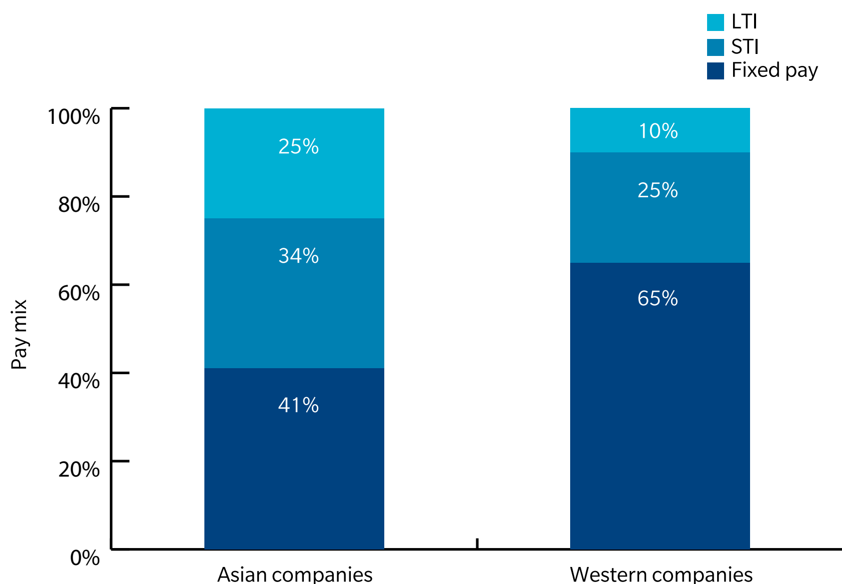
Common Practices of Asian companies must be understood in the context of several key themes that should form the foundation of any successful executive pay program. But their actual implementation can (and in fact often does) vary considerably from organization to organization. In the main, the majority of companies (and by extension the Remuneration Committees of their Board) generally follow these in the pursuit of designing and implementing an effective executive pay for performance system.

Market Competitiveness

Given the high priority placed on Talent as we saw in Figure 2 above, it is no surprise that there is a low supply of qualified, experienced, multi-cultural and capable CEOs in Asia. This top talent can demand a higher wage, and therefore companies and their Boards have to be willing to provide a higher level of pay to get the higher calibre of talent that can deliver the results shareholders expect. Otherwise, this talent is likely to go to the highest bidder.

Executive Pay in several countries in the region (e.g. Singapore and Hong Kong but also increasingly in Japan, China and India) is fairly transparent. This allows Boards to determine what competitive pay levels are for the talent they seek to attract and retain in terms of fixed salary, annual bonus, and LTI, along with other executive benefits. The most difficult decision a Remuneration Committee need to make in this respect is about the group of companies to choose for appropriate comparisons. This is not so straight forward in Asia as there are a limited number of large organizations in the same industry in each country (For instance, Singapore has only three locally

Figure 3: Compensation mixes at Asian & Western companies from head of organization to second level reports [Source: 2011/2012 Asia Executive Remuneration Snapshot Survey]



listed Banks) making comparisons more art than science. Many Remuneration Committees opt for choosing companies of a similar size, even if in different industries, under the premise that a CEO in one industry could be poached by a company in another industry.

Another area of concern regarding Market Competitiveness relates to pay mix. How much to provide in Fixed vs. Variable Pay? And how much for Short vs. Long-Term results? How much Cash vs. Equity to use? These are important questions to ponder as Remuneration Committees need to balance the need for retention of executives with the desire of value creation for the shareholders. An appropriately balanced pay program, including both short-term and long-term measures, should address the concerns that "Too much pay is given to Executives" by ensuring there is enough variable pay-at-risk and an adequate link so that non-performance of the executives results in low bonus / long-term payout and thus low overall levels of pay.

In Asia, we find that companies provide a greater amount of variable pay than their Western counterparts in the region. In fact, the fact that the fixed pay element for Asian companies has fallen from 60% in 2009-2010 to 41% in 2011-2012 highlights the trend that Asian companies prefer more flexible pay structures which can be adjusted – up or down – based on business performance (see Figure 3).

> However, it is also important to note that Asian companies generally are less prone than their Western counterparts to provide Long-Term Incentive Programs to their executives

However, it is also important to note that Asian companies generally are less prone than their Western counterparts to provide Long-Term Incentive Programs to their executives (see Figure 4).

And when they do, they are less likely to use shares than cash. There is perhaps less willingness to dilute the shares of the company in general in Asia. However, this is a trend that should wane as more Asian companies become global. For instance, AIA which is the world's fifth largest insurance company, headquartered and listed in Hong Kong, has Long Term Programs which are aligned to global market practices.

Key Performance Indicators

For an organization to develop a successful pay-for-performance program, it must have a clear idea of the objectives it wants to achieve. While this may sound simplistic, without such clarity, it is difficult to identify the type of performance that should be rewarded, or to link performance to compensation. What does success look like next month, next year, and beyond? When such clarity in defining Key Performance Indicators exists, the remaining elements of an effective pay-for-performance program can be put in place.

To align pay to performance requires proper calibration of compensation programs, to ensure that the levels of pay delivered are in line with levels of performance that are actually achieved. Consider a company that, as part of its pay-for-performance philosophy, provides highly leveraged annual incentive opportunities with maximum payouts equal to two to three times an executive's "target" award. Theoretically, the company should only be paying out the maximum bonus amount when actual performance is outstanding. But what does "outstanding" mean? By comparing performance targets to both the recent and expected performance of relevant peer companies, we can determine if the plan's definition of superior performance is, in fact, superior. Without such external validation, usually through annual reports and analyst's reports, a company with a pay-for-performance philosophy risks overpaying for mediocre performance or even underpaying for exceptional performance

In Asia, companies use Profits and Total Shareholder Return as the two most used Key Performance Indicators in share plans (see Figure 5).

In this context, it is important to note that companies are often using a combination of hard internal financial metrics with external validation of performance against peers in implementing their pay programs. Such external calibration is often both retrospective, to assess how the company actually performed compared to its competitors, and prospective, to ensure

Figure 4: Asian and Western companies' prevalence of LTI plans [Source: 2011/2012 Asia Executive Remuneration Snapshot Survey]

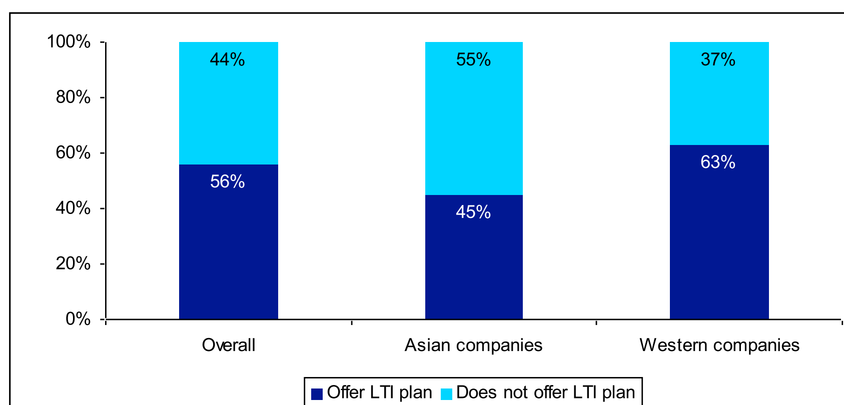
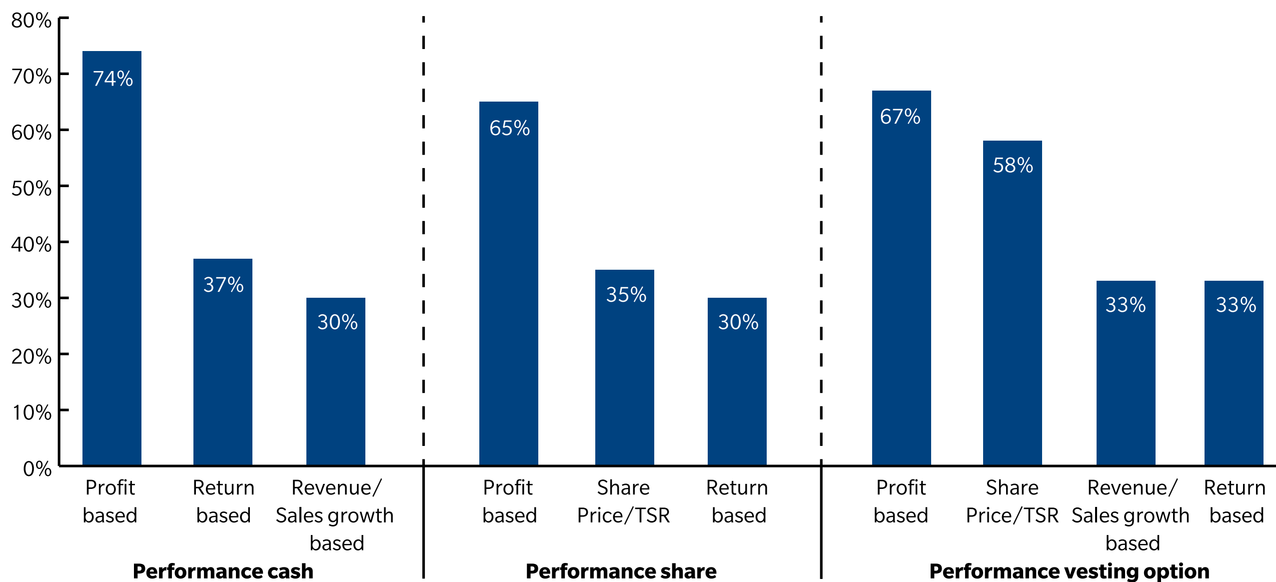


Figure 5: Prevalence of measures used in share plans [Source: 2011/2012 Asia Executive Remuneration Snapshot Survey]



> In Asia, companies use Profits and Total Shareholder Return as the two most used Key Performance Indicators in share plans.

that performance targets include an appropriate degree of "stretch".

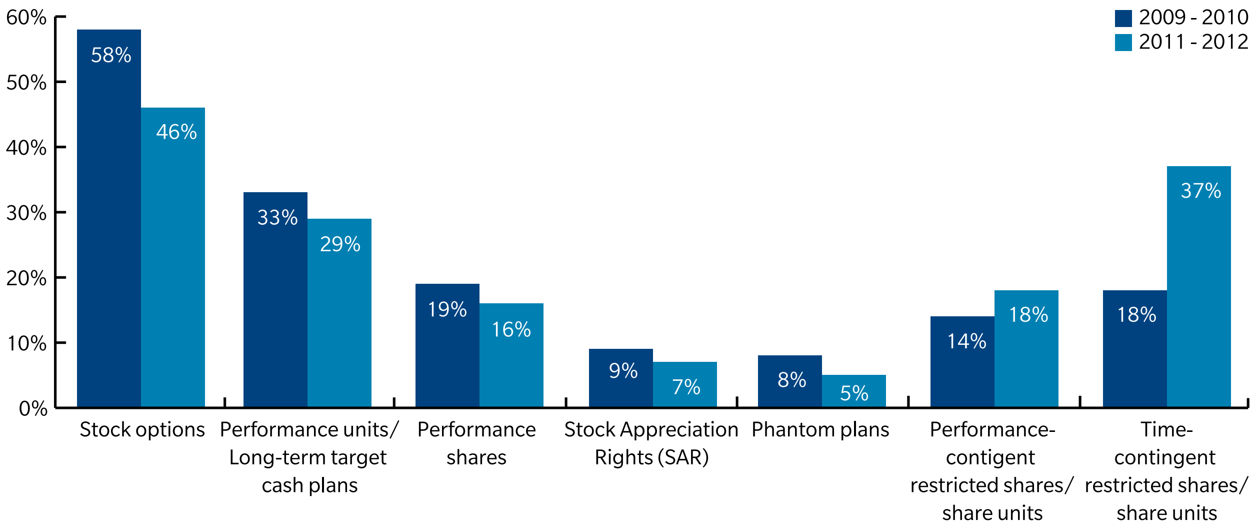
Personal accountability is in many ways the hallmark of an effective pay-for-performance program. A well-aligned program with a rigorous performance evaluation process means little if, at the end of the year, individuals are not held accountable for meeting agreed-upon goals. Traditionally, a strong sense of accountability has meant that "the numbers tell the story." While this notion of "black and white" results is common (numeric targets are either met or they are not), our research shows that 41% of Asian companies (Mercer 2011 ER in Asia) also use non-financial measures in their incentive plans. This can take the shape of a formal "balanced scorecard" in which performance is evaluated in specific areas such as people management, customer satisfaction or process improvements. The measures typically are quantitative, but they can give a more appropriate picture of overall performance than rigidly adhering to a single financial metric such as Return on Equity. In fact, in an environment where, as we have indicated, retention is important and competition is intense, these non-financial metrics can be as strategic as the financial ones are. Take for instance the common criticism that CEOs get paid while employees are laid off. By adding people variables into the incentive plans, Remuneration Committees can address shareholders as well as stakeholders simultaneously. In either case, strong performance should be rewarded and poor performance should not.

Striking The Right Balance

One of the most challenging aspects of any executive pay program is striking the right balance among various compensation elements and performance measures. As Asian organizations grow and become increasingly complex, their multiple objectives are not always compatible. In the short term, many companies believe that meeting or exceeding the analyst's expectations each quarter is critical. But how can they balance that short-term focus with a long-term need for sustainable growth, some of which may require investments that will actually reduce the short-term earnings? Over what time periods should performance be evaluated? In Asia, annual incentive plans are commonplace, but many companies also have multiyear plans to

> One of the most challenging aspects of any executive pay program is striking the right balance among various compensation elements and performance measures. As Asian organizations grow and become increasingly complex, their multiple objectives are not always compatible.

Figure 6: Prevalence of LTI plan types [Source: 2011/2012 Asia Executive Remuneration Snapshot Survey]



ensure that key executives do not lose sight of their longer-term objectives. And what about the balance between cash compensation and equity? It is no surprise that in Asia companies are moving away from Stock Options to other types of plans as the use of Stock Options can lead to retention difficulties in the current volatile market. Instead, Asia companies are using more restricted shares along with cash based plans to aid both in retention as well as linking pay more to performance (see Figure 6)

Good practice suggests that an executive's pay should have both fixed and variable components. The fixed component is designed to pay a competitive wage for the accountability of the position, recognising that there is a competitive market for talent. The variable component should be linked to both short-term and long-term performance periods. The short term measures should furthermore be directly linked to the longer-term strategy of the business (e.g., the annual components of a 3-year strategy), and therefore the successful achievement of these goals should lead to long-term shareholder value creation. In Asia, all these are practiced but, in addition, there is a greater use of LTI plans for retention purposes; companies often have more than one plan to balance their need for performance with their need to retain executives (see Figure 7)

Balancing Performance Against Retention

A frequent criticism in the popular press about executive compensation programs is that sometimes executives receive pay without an adequate performance to justify it. To be fair, this sometimes does happen. However, these types of articles seldom give examples of 'no pay for no performance', of which there are far more. Another delicate balancing act involves rewarding top individual performers when the company as a whole is not doing well. While it may be

Figure 7: Expected changes to LTIPs by Asian companies in 2012
[Source: 2011/2012 Asia Executive Remuneration Snapshot Survey]

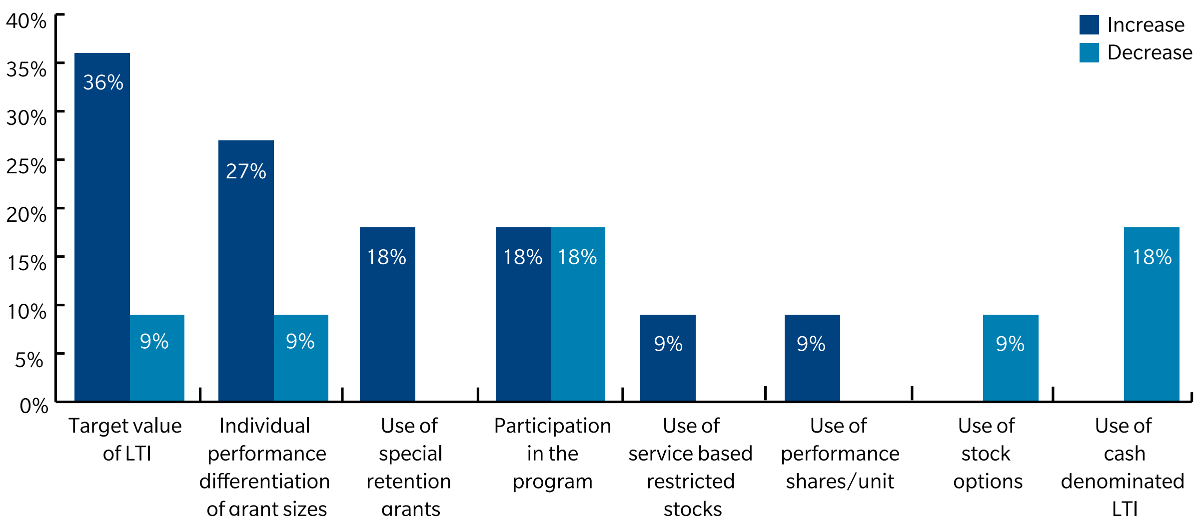
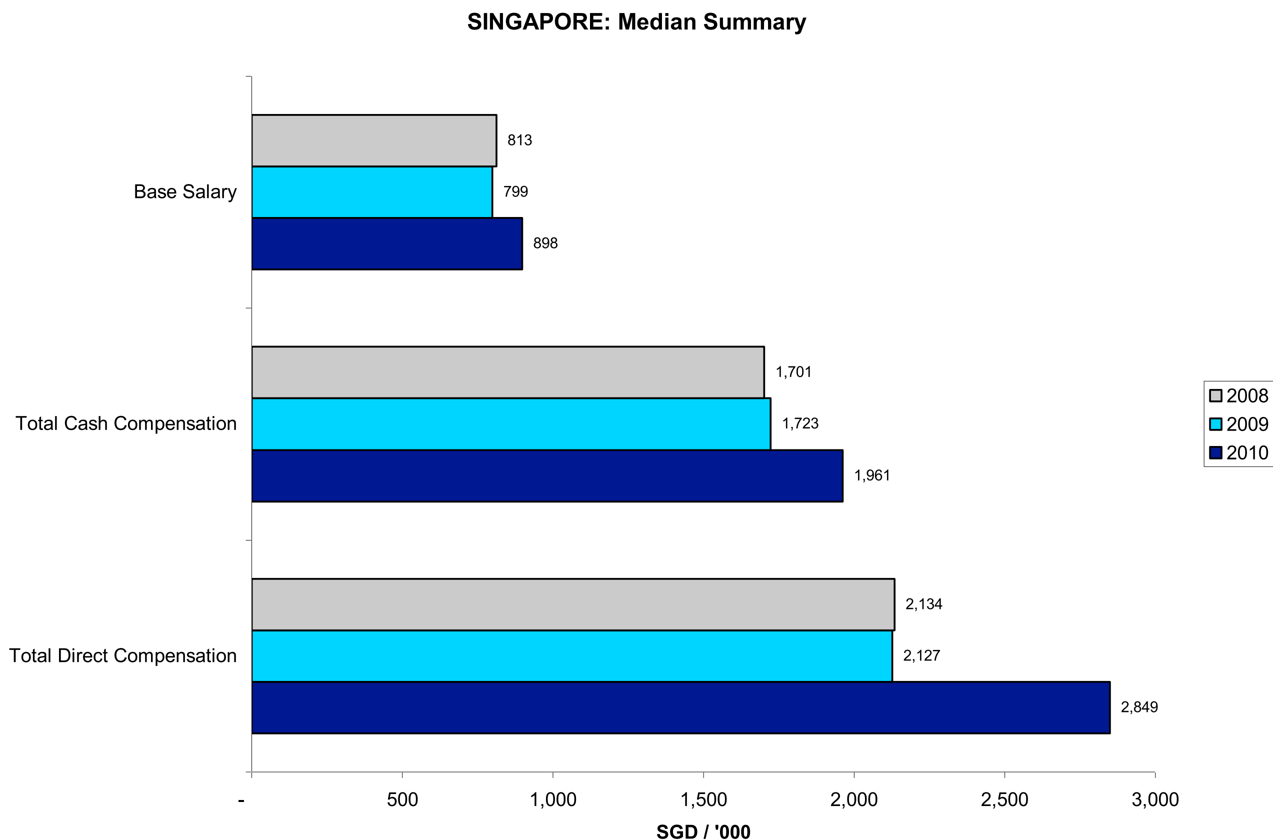


Figure 8: Median base salary, total cash compensation & total direct compensation in Singapore from 2008-2010



tempting to argue that no single person should receive a substantial reward if some baseline level of organization performance is not achieved, such an approach can be shortsighted at a time where good executives are hard to come by and harder still to retain. When an organization is not performing well, the top performers of today are the ones who will drive overall performance improvements in the future. Failure to deliver rewards to top performers in difficult times can result in retention problems that can exacerbate the poor company performance problem even further, because those top performers are most likely coveted by the company's competitors as well.

Corporate Governance

Shareholders have a right to know the financial decisions a company makes, and executive remuneration is effectively an expense that should be disclosed in more detail. Several countries in Asia have made strides in the direction of greater transparency, partly spurred by the Financial Stability Board's guidelines for Financial Institutions. Variations of these good Corporate Governance practices have been adopted by Hong Kong, Singapore and other countries and they have had a spill-over effect on regulators and boards alike of organizations in other industries. To be sure, disclosure leads to greater information which helps regulate and control pay but it has the side effect of potentially inflating pay, as Nomination Committees find they need to go beyond median levels of pay to attract external CEOs. With that said, shareholders should continue to request greater transparency in how executive pay was determined, what benchmarks were used and insist on a long-term element in determining

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pay. Disclosure should be supported by clear guidance and regulation, with the appropriate consultation period prior to implementation.

AN ILLUSTRATION: SINGAPORE

CEO's Compensation Stagnated During The Financial Crisis

Mercer analyzed CEO pay at 36 major Singapore listed companies whose median revenues over the 2008 – 2010 period ranged from approximately S$1 billion to S$1.7 billion. Figure 8 shows that during the years of the financial crisis total compensation did not increase. CEO pay increased in all three compensation elements (base pay, annual bonus and the annualized value of the long term incentive award) in 2010 when business performance and economic conditions in Singapore picked up substantially. Total cash compensation consists of base salary plus actual short-term incentives. Total direct compensation consists of total cash compensation plus the annualized value of the long-term incentive award.

Singapore provides a good case example for analyzing Asia's Executive Compensation trends, as it is has fairly transparent compensation disclosures in company annual reports, a dynamic stock exchange with large volumes of transactions of local companies' shares and a growing economy.

Do Companies In Singapore Pay For Performance?

Mercer conducted a further study to determine if pay for performance is the norm for these companies. We mined data from as many publicly-listed companies as possible, with the proviso that they had available data on levels of pay for their CEOs, separated by salary, annual bonus, and long-term plans. We ended up with 48 companies for our analysis

Total Direct Compensation Correlated To Market Capitalization

Figure 9 shows that the three-year average CEO's total direct compensation for the companies in the analysis is best correlated (r-squared = 28.1%) with

Figure 9: Correlation of 3-year average total direct compensation (2008-2010) against market cap

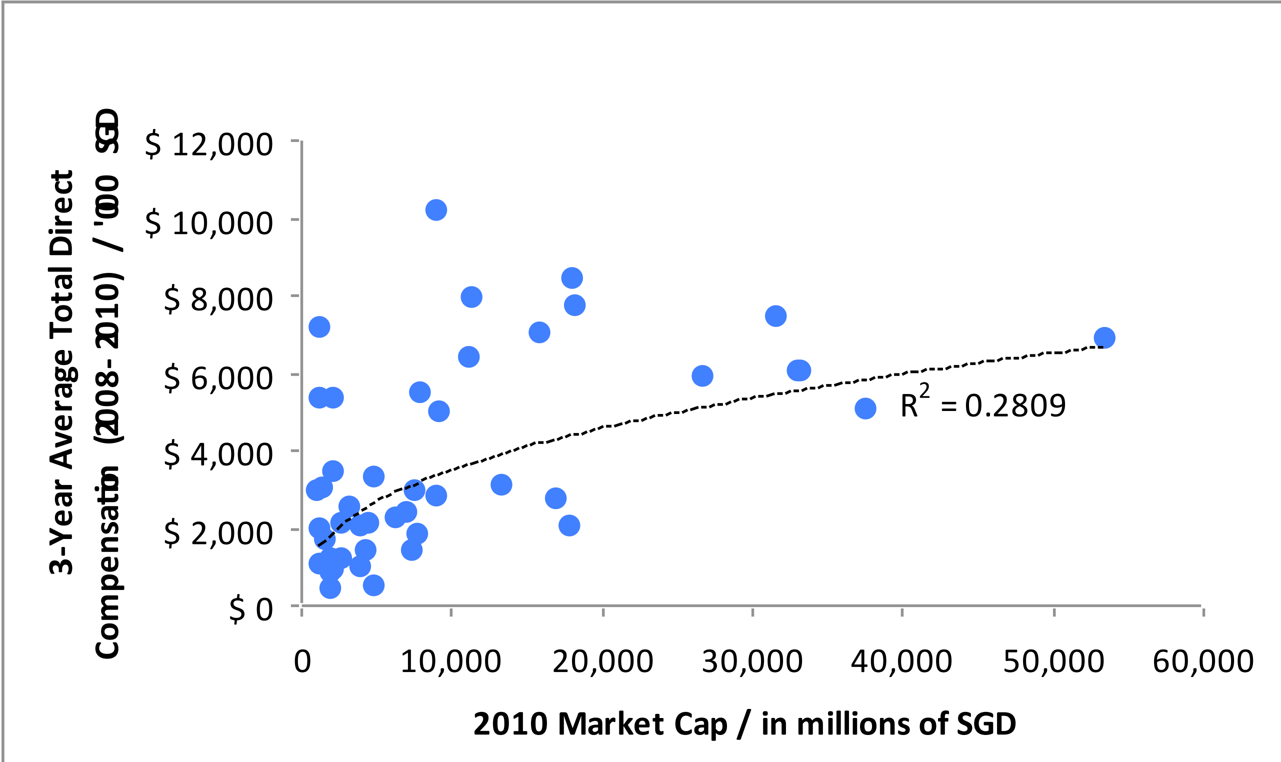
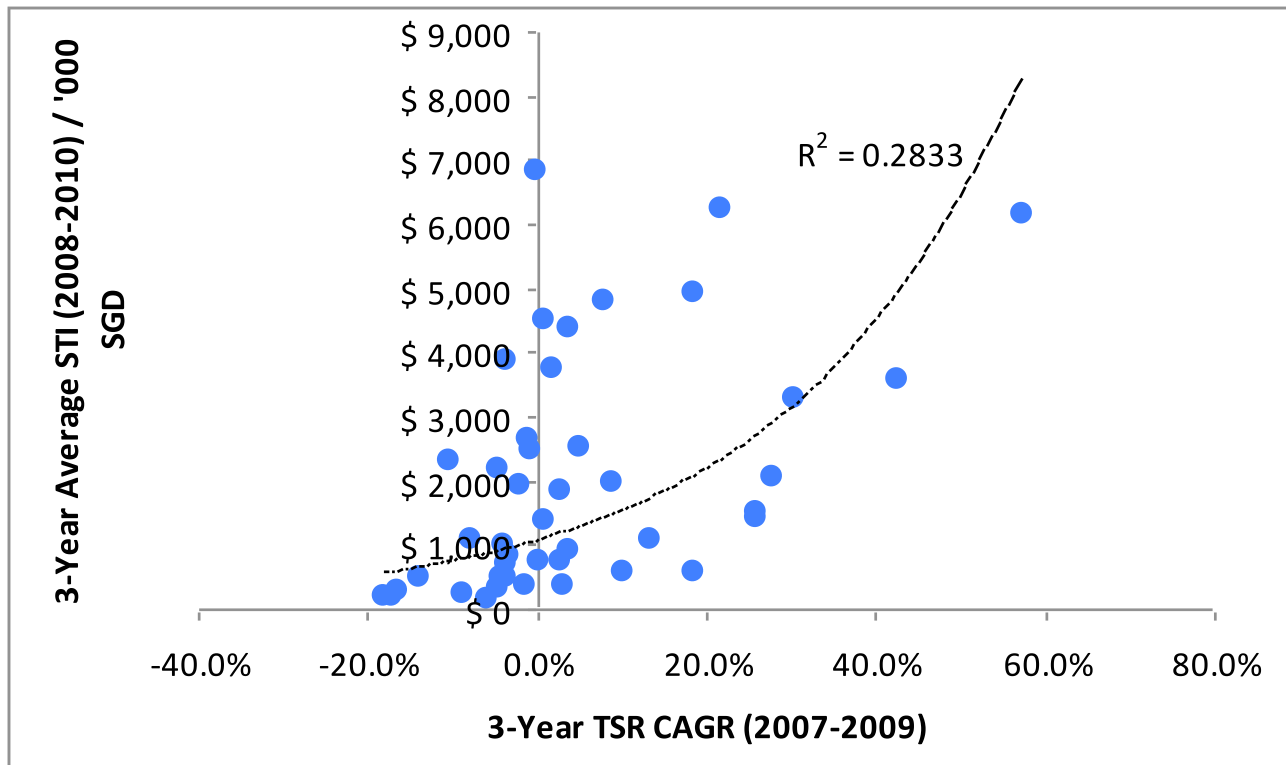


Figure 10: Correlation of 3-year average STI (2008-2010) against 3-year TSR CAGR (2007-2009)



market cap. For the group of companies in the sample, the total pay received by a CEO is best explained by the size of the company.

It is important to note that we also ran the analysis against several commonly used financial measures, including growths of Net Income, EBIT, EBITDA, Return on Assets (ROA) and Return on Equity (ROE). Of these, market cap has the highest correlation, suggesting that overall pay is linked to company size.

Short-Term Incentives (STI) Correlated To Total Shareholder Return (TSR)

When looking separately at each of the components of executive pay, 3-year average annual bonuses correlates best (r-squared = 28.3%) with the same three-year Total Shareholder Return variable for these companies, with a one-year lag. (See Figure 10)

Long-Term Incentives (LTI) Correlated To Market Capitalization

Market cap is the dominant variable for both the base pay and Long-Term Incentives. Base Pay shows a slight correlation of 9.6% with Size of Company (Market cap). Long-Term Incentives show a significant correlation of 64.0% to market cap, as shown in Figure 11.

The Truth About The Compensation Mix

Does this mean that Long-Term Plans do not work in Singapore? No!

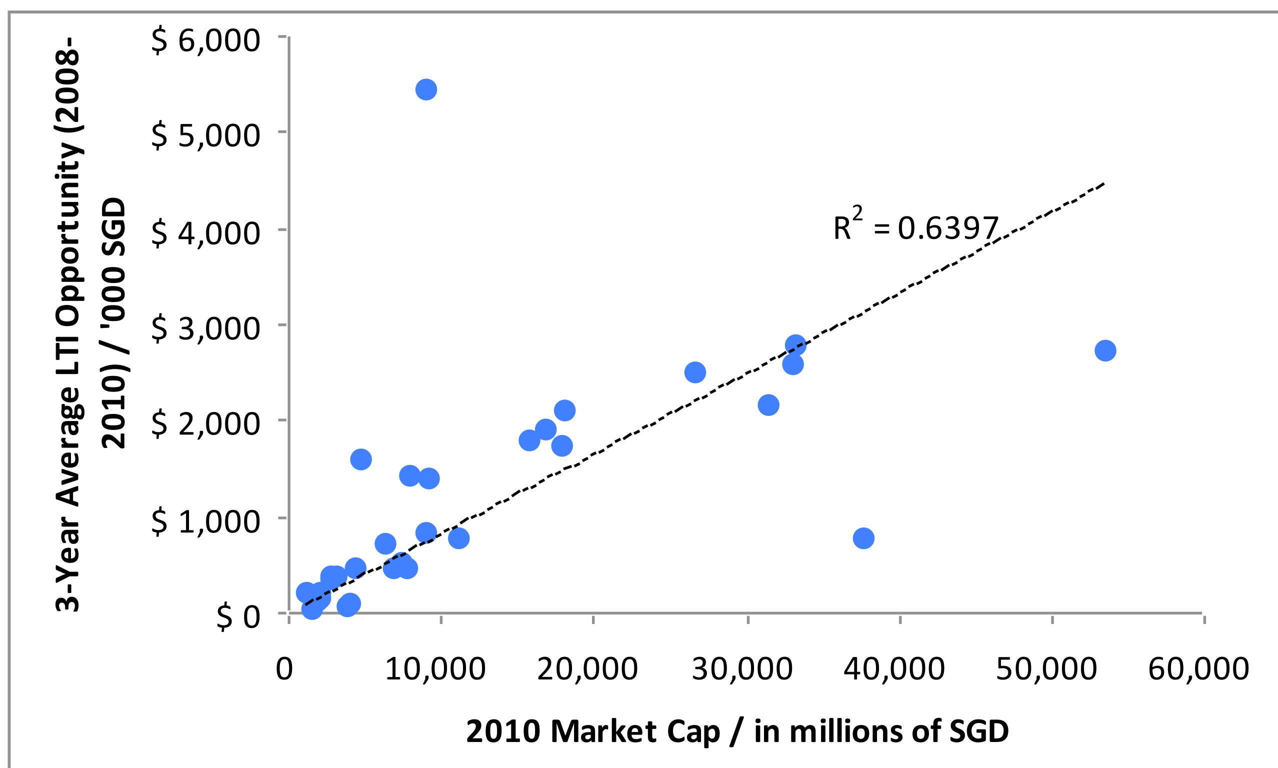
> Mercer analyzed CEO pay at 36 major Singapore listed companies whose median revenues over the 2008 – 2010 period ranged from approximately S$1 billion to S$1.7 billion.

On the contrary, the data supports the notion that the market overall understands the need to both pay for performance and pay for retention of the CEOs.

The need to reward for performance is clear. Remuneration committees are seemingly setting the short term incentive plan amounts to pay for performance aligned to the shareholders, resulting in the correlation of the bonus amounts with the TSRs.

The need for retention is also clear. Remuneration Committees are seemingly setting Base Pay and Long Term Incentive plan amounts against a peer group of companies which are similar in size. This results in the correlation, especially of the LTI, with the market cap. In our experience, Remuneration Committees in Singapore typically compare against other companies in the industry as well as companies in the range of one-half to two-times their Company's market cap. This is done on the premise that they can hire their next CEO from a smaller

Figure 11: Correlation of 3-year average LTI Opportunity (2008-2010) against 2010 market cap



company yet they can lose their current CEO to a company up to twice their own size.

Conclusion

Executive Pay has received a great deal of "bad press" lately. A frequent criticism is that executives do not earn the pay they receive; or that all related parties have a vested interest in increasing levels of executive pay. Sure, there are a few "bad" examples out there which fuel this fire, but comments of this sort really trivialize the role of Directors, and specifically of the Remuneration Committees. In the work that we have been doing in helping companies design and implement Executive Pay Programs for the last fifteen years or so in Asia, our clients (RemCo Chairs) take their role very seriously and objectively. In the main, publicly listed companies in the region understand the need for aligning pay to long term shareholder value creation, yet they temper it with the equally strong need in the region to retain the good talent they have. And they also balance the shareholders' view that quarterly earnings matter with a long term perspective. As Corporate Governance guidelines are honed around the region, we expect the trend towards more responsible Executive Compensation will continue to expand. ■

> Singapore provides a good case example for analyzing Asia's Executive Compensation trends, as it is has fairly transparent compensation disclosures in company annual reports, a dynamic stock exchange with large volumes of transactions of local companies' shares and a growing economy.

Understanding The New "Say on Pay" Governance Provisions In The United States

By Andrew J. Sherman
Partner
Jones Day

On January 25, 2011, the Securities and Exchange Commission ("SEC") adopted final rules under the Dodd-Frank Wall Street Reform and Consumer Protection Act requiring that companies conduct a shareholder advisory vote on named executive officer compensation at least every three calendar years (a "Say-on-Pay Vote"), a shareholder advisory vote on the frequency of the Say-on-Pay Vote at least every six calendar years (a "Frequency Vote"), and a shareholder advisory vote on golden parachute compensation when seeking shareholder approval for various corporate transactions (a "Say-on-Parachutes Vote").

The Rules

There are no major substantive changes between the final rules and the rules as proposed by the SEC in October 2010. While the final rules are not effective until 60 days following their publication in the Federal Register, most calendar year-end public companies should be familiar with and in the process of implementing the Say-on-Pay rules.

Highlights Of The Final Say-On-Pay Rules And Our Initial Observations

Say-On-Pay Vote

Companies must present the Say-on-Pay Vote in the form of a resolution, although no specific language is prescribed. The final rules include the SEC's simple, nonexclusive example, which is:

"RESOLVED, that the compensation paid to the company's named executive officers, as disclosed pursuant to Item 402 of Regulation S-K, including the Compensation Discussion and Analysis, compensation tables and narrative discussion is hereby APPROVED."

Initial Observations – Effective Say-on-Pay Vote proposals will be clear and concise, be simple to read, and, most importantly, make persuasive arguments as to why the

Although the Frequency Vote must take the form of a resolution, shareholders will have a choice to vote for annual, biennial, or triennial frequency, or to abstain from making a selection. As of the date of this Commentary, most companies that have filed their definitive proxy statements for 2011 continue to recommend a triennial vote.

compensation paid to the named executive officers was commensurate with the company's performance for the prior year. Consider using the SEC's nonexclusive example as the baseline for your Say-on-Pay Vote resolution.

Frequency Vote And Board Recommendation

Like the Say-on-Pay Vote, the Frequency Vote must be presented in the form of a resolution. Importantly, the final rules clarify that if the board of directors does not make a Frequency Vote recommendation, the company will not be able to vote uninstructed proxy cards for its Frequency Vote proposal.

Initial Observations – Although the Frequency Vote must take the form of a resolution, shareholders will have a choice to vote for annual, biennial, or triennial frequency, or to abstain from making a selection. As of the date of this Commentary, most companies that have filed their definitive proxy statements for 2011 continue to recommend a triennial vote. We continue to believe that the frequency recommendation depends on each company's particular facts and circumstances, but our sense is that, absent unusual situations, most companies should recommend annual Say-on-Pay Votes for the following reasons:

- Many investors and shareholder advisory firms (e.g., ISS) strongly prefer annual Say-on-Pay Votes;
- Annual Say-on-Pay Votes avoid the question of how management's annual compensation compared to company results over a multi-year period;
- Annual Say-on-Pay Votes may "routinize" the vote (as they have in the European Union); and
- Annual Say-on-Pay Votes provide an outlet to protest compensation practices that may shield compensation committee members and equity plans from negative or withhold votes.

It also should be noted that, just this week, shareholders of Monsanto Company sided with ISS in approving an annual Say-on-Pay Vote even though the board of directors had recommended a triennial frequency (but shareholders went against ISS and voted for Monsanto's Say-on-Pay resolution). Following the vote, Monsanto quickly adopted an annual Say-on-Pay Vote.

Disclosure Of Voting Results, Frequency Policy, And Next Say-On-Pay Vote

Companies must file a Form 8-K (Item 5.07) reporting the results of the meeting, including the Say-on-Pay Vote and Frequency Vote results, and disclosing their decisions regarding how frequently they will conduct subsequent Say-on-Pay Votes. After 2011, each reporting company's proxy statement must also disclose the current frequency of Say-on-Pay Votes and when the next Say-on-Pay Vote will be conducted.

Initial Observations – The key is to monitor your voting results and then take decisive action. The approach reflected in the final rules provides adequate time for companies to consider the Say-on-Pay Vote and Frequency Vote results, and to contact shareholders for discussions, if appropriate, before making a final frequency determination. In cases where there are unexpected voting outcomes, this additional time may be useful in determining the best course of action for your company. When the voting results are closely aligned with the board's recommendation, the frequency decision will be easy. Once the frequency decision has been made, issue prompt and responsive disclosure to show that the board is actively engaged on this matter. A quick and decisive announcement about frequency may also send a strong message of alignment to shareholders where the board of directors and shareholders agree on frequency.

Impact On CD&A Disclosure

Companies must disclose as a mandatory element of their Compensation

The key is to monitor your voting results and then take decisive action. The approach reflected in the final rules provides adequate time for companies to consider the Say-on-Pay Vote and Frequency Vote results, and to contact shareholders for discussions, if appropriate, before making a final frequency determination. In cases where there are unexpected voting outcomes, this additional time may be useful in determining the best course of action for your company.

Discussion and Analysis ("CD&A") whether the company considered the results of the most recent Say-on-Pay Vote in determining its compensation policies and, if so, how that consideration affected compensation policies and decisions.

Initial Observations – Consistent with the principles-based nature of a CD&A, any company that takes earlier Say-on-Pay Votes into consideration as a material factor for its compensation program should disclose and analyze those considerations in the CD&A. In practice, it may be difficult for companies to determine the extent to which Say-on-Pay Votes actually had a material impact on their compensation policies and decisions in subsequent years, especially where many companies are already taking shareholders' and shareholder advisory firms' annual voting guidelines into account when designing and implementing compensation programs.

Effect Of Frequency Policy On Similar Shareholder Proposals

Companies may exclude shareholder proposals related to Say-on-Pay Votes or Frequency Votes under Rule 14a-8 if one of the frequency choices (annual, biennial, or triennial) received the support of a majority of the votes cast in the company's most recent Frequency Vote and the company has adopted and disclosed a policy on the frequency of its Say-on-Pay Votes that is consistent with this majority-recommended frequency choice. The final rules also clarify that the SEC will entertain no-action letter requests to exclude shareholder proposals requesting advisory votes on other aspects of executive compensation.

Initial Observations – As noted above, we continue to support annual frequency for Say-on-Pay Votes, and we continue to expect that a majority of shareholders will support annual frequency. If a majority of the votes cast are in favor of annual frequency, companies should strongly consider implementing annual frequency (regardless of the prior board recommendation) so the company can take advantage of the Rule 14a-8 exclusion in future years.

Golden Parachute Compensation Disclosure And Say-On-Parachutes Vote

In connection with an acquisition, merger, or similar transaction, companies must disclose in tabular and narrative format all golden parachute compensation arrangements between the target or acquiring company and the named executive officers that relate to the transaction. The Say-on-Parachutes Vote requirement does not apply if the golden parachute compensation arrangements were subject to a prior Say-on-Pay Vote and have not changed (subject to limited exceptions). The final rules indicate that these rules will be effective for proxy statement filings with the SEC on or after April 25, 2011.

Initial Observations – It remains to be seen to what degree companies will voluntarily include golden parachute compensation disclosure under the new rules in their annual meeting proxy statements; however, we continue to expect that most companies will refrain from including golden parachute compensation disclosure in the new tabular/narrative format in annual proxy statements. Our view is based in part on the fact that changes to previously approved golden parachute compensation would need to be submitted at the time of the vote for the relevant transaction, and that companies will not want to risk a negative vote in the abstract. We also believe that properly structured change-in-control arrangements enhance shareholder value and that companies may be better served by waiting to submit golden parachute compensation to a Say-On-Parachutes Vote at the time of a relevant transaction so that they can effectively articulate their rationale for the change-in-control arrangements. ■

It remains to be seen to what degree companies will voluntarily include golden parachute compensation disclosure under the new rules in their annual meeting proxy statements; however, we continue to expect that most companies will refrain from including golden parachute compensation disclosure in the new tabular/narrative format in annual proxy statements. Our view is based in part on the fact that changes to previously approved golden parachute compensation would need to be submitted at the time of the vote for the relevant transaction, and that companies will not want to risk a negative vote in the abstract.

Insider Trading In Singapore

By Elaine Beh, Partner
Stephen Walton, Foreign Associate
Colin Ng & Partners LLP

In the 2012 case of *Lew Chee Fai Kevin v Monetary Authority of Singapore*, the Singapore Court of Appeal has given some much-needed clarification to the relevant provisions of the Securities and Futures Act as to what constitutes insider information

Scope Of Insider Trading

In broad terms, the concept of 'insider trading' involves the trading of a corporation's securities by persons who possess information about that corporation which is not generally available (often termed 'inside information'). Because trading in this manner has the potential to create an unlevel playing field where such information could materially affect the price of the corporation's securities, many jurisdictions prohibit the use of inside information in defined circumstances. As BG Lee, then Deputy Prime Minister, stated in 2001 during the parliamentary debates for the Securities and Futures Act, Cap 289 ("SFA"):

"At the core, the mischief of insider trading lies in tilting the playing field unfairly against other market participants. Those who knowingly have inside information should be prohibited from trading, whether or not they are connected with the company. The intent is to address the core evil of trading while in possession of undisclosed market sensitive information, instead of having liability depend on a person's connection with the company".

In Singapore, the SFA imposes civil and criminal penalties for the offence of insider trading, which are set out in sections 218 and 219. Section 218 applies to "connected persons"[1], and section 219 applies to all other persons.

Section 218 – Connected Persons

Liability for insider trading by a connected person will be triggered under section 218 of the SFA where:

- that person possesses information concerning that corporation;
- such information is not generally available;
- if such information was generally available, a reasonable person would expect it to have a material effect on the price or value of securities of that corporation;
- the connected person knows or ought reasonably to know that the

In broad terms, the concept of 'insider trading' involves the trading of a corporation's securities by persons who possess information about that corporation which is not generally available (often termed 'inside information'). Because trading in this manner has the potential to create an unlevel playing field where such information could materially affect the price of the corporation's securities, many jurisdictions prohibit the use of inside information in defined circumstances.

information is not generally available, and

- the connected person knows or ought reasonably to know that if the information were generally available, it might have a material effect on the price or value of those securities.

Two particular questions arise when applying the provisions of this section – firstly, how and when information is determined to be "generally available", and secondly, how and when information is determined to have a "material effect" on the price or value of securities – in other words, what amounts price sensitive information? Fortunately, both of these questions have now been addressed in some depth in the recent case of *Lew Chee Fai Kevin v Monetary Authority of Singapore* [2012] SGCA 12 ("Lew Chee Fai"), discussed below.

Section 219 – Other Persons

The equivalent section 219 provision for other (i.e. non-connected) persons adopts the same test as is set out above. There is an important difference between the section 218 and the section 219 provisions. For section 218, if it is shown that the connected person was at the material time in possession of information concerning the corporation which was not generally available, there arises a rebuttable presumption that such person also knew the information was not generally available and, if it were generally available, might have a material effect on the price or value of the corporation's securities (i.e. the last two limbs of the above test). There is no equivalent presumption in section 219. A higher duty is imposed on connected persons occupying a fiduciary capacity.

Under sections 218 and 219, when a person is in possession of information which satisfies the above test, they must not subscribe for, purchase or sell, or enter into an agreement to subscribe for, purchase or sell, any relevant securities, nor procure any other person to do the same. A person convicted of criminal insider trading under section 218 or 219 may be liable to a fine of up to S$250,000 or up to seven years' imprisonment. Alternatively, civil penalties can be up to the greater of (a) three times the amount of profit made or loss avoided, or (b) S$50,000 (for individuals) or S$100,000 (for corporations).

Lew Chee Fai Kevin v Monetary Authority Of Singapore

In the case of Lew Chee Fai, Mr. Lew had at the material time been a senior employee of an SGX mainboard-listed company. While attending internal executive meetings, he came into possession of certain non-public price-sensitive information about the company's financial performance, including in relation to a loss forecast for its third quarter financial results and the possibility that the company would take an impairment charge due to significant losses made by one of its subsidiaries. Two days after attending one of these internal meetings, and before the information discussed at that meeting was announced publicly, Mr Lew sold some of his shares in the company. The Monetary Authority of Singapore ("MAS") succeeded in an action in the High Court against Mr Lew to impose a civil penalty for insider trading under section 218 of the SFA, and Mr Lew subsequently appealed that decision.

This decision of the Court of Appeal is significant because this was the first civil insider trading case brought since the SFA was passed in 2001, and was also the first to be appealed to the Court of Appeal. While the appeal was ultimately unsuccessful, the case does provide very useful guidance on how the relevant provisions of the SFA should be interpreted.

The Meaning Of "Information"

In Lew Chee Fai, the court noted that "information" is given a very broad meaning, and can include knowledge of an uncertain, predictive or speculative nature. In applying this definition, the courts will look at each piece of information individually, but also holistically as this may effect what can be deduced from the information which was generally available. As such, any person in possession of information which could potentially be said to be inside information must consider each piece of information individually as well as in aggregate.

The Meaning Of "Not Generally Available"

One of the elements of an insider trading offence is that a person used information that was "not generally available". Section 215 of the SFA states that information will be considered generally available (and so consequently not inside information) if (a) it consists of readily observable matter, or (b) it has been made known in a manner which would, or be likely to, bring it to the attention of persons who commonly invest in securities of a kind whose price or value might be affected by the information, and since it has been so made known, a reasonable period for it to be disseminated has elapsed, or (c) it consists of deductions, conclusions or inferences made or drawn from such foregoing information. Singapore is the only jurisdiction to have legislatively removed the requirement to prove an intention to use the inside information.[2]

The Court of Appeal in Lew Chee Fai stated that the approach to interpreting section 215 should be "neither narrow nor broad, but commonsensical", and clarified that "information gained from inferences and deductions through extra diligence or exceptional analytical skills by a sophisticated investor" would be considered generally available.

One particular point to beware is that although there may be rumours already circulating which can fairly be described as generally available, if a person is in possession of further particulars in relation to that rumour which affect the qualitative character of that information, or distinguish a mere possibility or speculation from that which is probable, then when viewed holistically, that information may still be found to be not generally available. For example, there may be generally available rumours which suggest in broad terms that a corporation may potentially be subject to a take-over bid in the near future. However, if a person becomes aware of specific particulars which are not generally available (for example, the likely price of a bid, or the likely date that such bid will be made) then these additional particulars make the underlying information more certain or reliable, such that it is qualitatively of a different character. Unless a "common investor" (being a person who commonly invests in securities) could make deductions, conclusions or inferences which would be of the same character or quality as the information possessed by the insider, then the information in question would not be deemed to be generally available, notwithstanding that there were rumours of a general nature already generally available.

Material Effect On The Price Or Value Of The Corporation's Securities

Information will be deemed to have a material effect on the price or value of the corporation's securities "if the information would, or would be likely to, influence persons who commonly invest in securities in deciding whether or not to subscribe for, buy or sell the securities" (section 216 of the SFA). However, this does not mean that the information must be so significant that it would have the effect of causing the common investor to change their decision; rather, that there would be a substantial likelihood that the common investor would be influenced by that information, such that it would have significantly altered the "total mix" of the information available to that investor.

In determining what is material for the purposes of this provision, courts in other jurisdictions have on occasion adopted a "market impact evidence" test, whereby the movement of the corporation's market price is analysed over the period in which the information is actually made generally available, in the hope of showing whether it did in fact have a material effect on the corporation's market price. However, in Lew Chee Fai, the Court of Appeal held that the use of market impact evidence, while potentially relevant to the question of materiality, should not be the determining factor because it is extremely difficult to attribute the movement in the market price for the corporation's securities solely to a single piece of information. Other external factors may well be affecting the market in general or the corporation's industry sector, and so the market impact evidence test necessarily involves a significant subjective element. As the Court of Appeal pointed out, it could be perfectly feasible that two pieces of information – one positive and one negative, but both material – could effectively cancel each other out and result in no change to the market price, yet a strict application of the market impact evidence test would (incorrectly) conclude that neither piece of information had been material.

One particular point to beware is that although there may be rumours already circulating which can fairly be described as generally available, if a person is in possession of further particulars in relation to that rumour which affect the qualitative character of that information, or distinguish a mere possibility or speculation from that which is probable, then when viewed holistically, that information may still be found to be not generally available.

As such, any expert evidence on the market impact evidence point should be used only to assist the court in determining how a reasonable person would have expected the information to influence a common investor at the time of the alleged insider trade. It should not be used to retrospectively demonstrate what actually happened in the market upon making the information generally available. Indeed, although the Court of Appeal in Lew Chee Fai did agree with the trial judge that the market impact evidence suggested the inside information in that case would have caused a reasonable person to expect it to have a material effect on the market price, the court was also keen to stress that interpreting the market reaction was an inexact science and the difficulties in doing so in that case illustrated the potential risks in relying solely on market impact evidence to assess materiality.

Knowledge

As mentioned above, in the case of insider trading by a connected person under section 218, in order to impose a higher duty on those connected persons occupying a fiduciary capacity, once it is shown that the connected person was at the material time in possession of information concerning the corporation which was not generally available, there arises a rebuttable presumption that such person also knew the information was not generally available and, if it were generally available, might have a material effect on the price or value of the corporation's securities. Such a presumption does not apply to instances of insider trading by other (i.e. non-connected) persons under section 219.

In cases where this rebuttable presumption does not apply, the Court of Appeal in Lew Chee Fai suggested that the question of what the person ought reasonably to have known involves both subjective and objective elements, taking into account all of the relevant circumstances including that person's mental state, experience and level of commercial expertise at the material time. In applying this test, the court should consider whether a reasonable person would consider the information to be not generally available. If so, then the actual person's circumstances will be taken into account to see if there are subjective factors which would have prevented him from coming to the same conclusion.

Practical Advice For Those In Possession Of Inside Information

Lew Chee Fai brings much-needed clarity to the application and interpretation of the relevant provisions of the SFA to insider trading. Although not an exhaustive list, those in possession of inside information should bear in mind the following points:

- Care should be taken when in possession of information which is not generally available, even if certain aspects of that information are generally known, as knowledge of additional particulars which affect the quality or probability of that generally available information can still result in a finding that the information was not generally available.
- Just because there is no movement in a corporation's market price following the release of the relevant information does not necessarily mean that the information was not material, although this may be a factor to be taken into account.
- Although not specifically dealt with in Lew Chee Fai, sections 218 and 219 also prohibit a person in possession of inside information from directly or indirectly communicating it to another person if the insider knows, or ought reasonably to know, that the other person would or would be likely to (a) subscribe for, purchase or sell, or enter into an agreement to subscribe for, purchase or sell relevant securities, or (b) procure that a third party does the same. This would be relevant, for example, where a potential investor is seeking to conduct due diligence on a listed corporation. ■

Note: This update is provided for general information and should not be relied upon as legal advice.

1. Connected persons are defined in section 218(5) as being: (a) an officer of that corporation or of a related corporation; (b) a substantial shareholder in that corporation or in a related corporation, or (c) a person who occupies a position that may reasonably be expected to give him access to information of a kind to which section 218 applies by virtue of any professional or business relationship existing between himself (or his employer or a corporation of which he is an officer) and that corporation or a related corporation, or being an officer of a substantial shareholder in that corporation or in a related corporation.

2. As per Lew Chee Fai at [59]. Section 220 of the SFA overruled the earlier decision in PP v Ng Chee Keon [1999] 2 SLR(R) 1176 which had established a requirement to prove an intent to use the inside information for insider trading.

Practical Issues To Consider When Accepting Appointment As An Independent Director

By Mike Gray
Director
Tricor Singapore Pte Ltd

Many years ago becoming an independent director was like joining an exclusive club more sociable than working. I know of one board that had a one hour board meeting and a four hour lunch. I would expect that this company now has a four hour board meeting and a one hour lunch. In the current corporate environment potential directors need to be much more careful in accepting appointments. This is a result of both significant enhancements in corporate governance and also due to corporate failures, which have exposed directors to legal liabilities and/or financial penalties. This article sets out some of the considerations that I take into account before accepting an independent directorship. The list is not comprehensive but should give some basic guidance.

Initial Considerations

The first question that you should normally ask yourself is; why are you being approached? Is it because you have expertise that they want? Are they desperate for a director due to resignations of incumbent directors? Are you golf club "Kaki"? They cannot find anyone else?

If you are an accountant you may be in demand as audit committees are often chaired by accountants. Lawyers are also wanted for their legal inputs. Outside the professions, those with specific business knowledge can be an asset to the board so are also in demand.

If you are new to the corporate world in general and boards in particular, before progressing any further you need be really sure that you know what is required of you as a director. It is no good taking up a directorship and resigning a few months later as you cannot cope. There are a number of courses run by SID and other organisations. Attend these prior to launching into your first directorship. In addition it is best to

start will a smaller company where you can learn the ropes and move up the ladder to the larger ones on becoming both more confident and experienced.

You must be able to have enough time to do a proper job. If you do not have the time, do not accept the position. There has been much discussion on how many directorships an individual can cope with. This very much depends on whether you are still in employment and the complexity and size of the directorships that you have. Every individual should be able to make that calculation. I am retired, but I have set my personal limit at five, as I think that number I can comfortably deal with. The danger signs that should make you rethink as to whether you are over- stretched are a clashing of meetings, rushing between meetings and not enough time to read the board or committee papers.

Independence

In this article I will not go through the detailed requirements for independence, but it basically means that you should not have any relationships either yourself or your family, such as employment, substantial shareholdings etc. that may impair your independence. The details are set out in law and codes of corporate governance. However, it is not just a matter of law and codes. If you feel that you cannot act independently do not take up the appointment as an independent director. For instance you may have a close relationship with the CEO or senior management, which could impede you asking leading questions at a board meeting. If so avoid that board.

A major part of the duty of being an independent director is to ask the appropriate questions. It is no good to be a mouse on the Board. Management and your fellow board members may not always be right. If you do not challenge and discuss the issues the right decision may not be made.

Some Reasons That You May Want To Accept A Position As An Independent Director

Retirement occupation - Using a retiree can be a benefit for both the company and the retiree. The company can receive the benefit of someone with years of experience and the time to do the job properly. For the retiree it is good to keep occupied mentally. Taking on a directorship helps in this respect and also enables one to get out of home and avoid the "couch potato" syndrome. In addition a recent survey indicated that it is more stressful to stay at home than go to work. Being a director may add a few years to your life!

Additional income – Directors' fees can provide additional income. This can be a major benefit to a retiree as the directors' fees can give that little bit of income that saves them dipping into their savings. Nevertheless a time comes in everyone's life when your usefulness diminishes and it is important for the more aged directors to recognise the time when they should be step down.

Obtaining knowledge and experience of new industries and countries - Being a director can open one up ones knowledge base to the experience of new industries and countries. This can be both challenging and interesting. The converse should also apply. If you have no interest in a particular industry or location, do not take up the directorship. To be an effective director you need to take the time and effort to understand the business of the company you are involved in and the rules and culture of the country is it is located in.

Increasing your skills as a director - One interesting aspect of corporations is that boards often have different dynamics and operate differently. Some committee chairmen are good some not so good. By being on more than one board it is possible to learn from one and apply the knowledge learnt to others. Take note of how the meeting is conducted, what information is provided, what types of questions are asked etc. If you have the time, by being on more than one board, you will gain experience, some good and some bad. You will be able to take the best and apply it to yourself.

Taking on a challenge - In recent times a number of public companies have gone into financial difficulty due to fraud, poor management or economic reasons or have ended up the SGX "Watch List". For someone who wants a challenge, accepting an appointment on one of these troubled boards and being part of the process of sorting out the problems can provide such a challenge. However, one must do adequate due diligence and know your fellow directors, before accepting such an appointment as there could be risks involved. In addition troubled companies always involve a much more significant time commitment. Make sure you are paid extra for the additional work.

Doing Your Due Diligence

On no account should you jump into a particular directorship without doing a comprehensive due diligence. Find out as much as you can about the company. Read up all available reports such as annual reports, press articles and filings from the Stock Exchanges. Search the internet.

Meet up with the chairman and as many of the other board members as possible. You need to make sure that you can work with them. At the minimum you should meet the nominating committee.

Take out some time to visit the company to get a better idea of the operations. Meet with senior management. By asking the right questions you should be able to get some feeling of their competence and the culture of the company.

Ask around your friends and contacts as to whether they have any inside knowledge or the company or know of any adverse issues concerning the company

What To Watch Out For In General

Be wary of companies that operate in locations with poor corporate governance or have major subsidiaries or other entities operating in such locations. However large the fee it is not worth the time and trauma of dealing with an overseas fraud or poor governance. Furthermore your reputation as a good director could suffer.

Read press reports. Look out for adverse comments on the company that you are interested in. In particular any reports that may indicate financial problems or issues of poor corporate governance.

Be wary of those companies that have already fallen foul of Stock Exchanges or other regulatory authorities.

What To Look Out For In Respect Of Audit Issues

Make an assessment whether you think that the audit firm has the expertise to handle the audit. We all know of the multi-million dollar fund that used a one man audit firm as their external auditors. Look out for those situations where there are many audit firms involved in one group. This may indicate a case of a company trying to ring fence issues and hiding them from the parent company auditor.

Review the statutory audit reports and see if the accounts are qualified. If they are you will have to make your own assessment on how serious it is and if it affects your decision to be a director. If possible view the more recent management letters from the external auditors. These may indicate problems in internal controls or with management.

If the external auditors have been changed recently, find out why. It may be because the former auditor was being too tough on management and management wants one with a more cosy arrangement or the auditor may have a disagreement on accounting issues.

Find out about what internal audit arrangements exist. Be wary of those entities that have no internal audit or who have internal audit carried out by an employee. In both cases this should set out alarm signals. In my view only the larger entities should have internalised internal audits. A one man show rarely works and even worse he will often report to the CEO or be a part timer with other functions in the company. If you can, make arrangements to look at the internal audit reports.

Examine The Financial Reports

You should always make a point at looking at the financial reports and examine the key financial ratios. Be very careful with loss making companies or those with financial problems. For listed companies, after several years of making losses, your company could get onto the SGX watch list. The result is that directors may have to spend significant efforts and time to find solutions to turn around the company so as to get off the watch list. A failure in this respect can result in the company being delisted.

Look out for complicated financial structures. They may be hiding losses or moving liabilities off the balance sheet. Other reasons could be tax planning or even worse tax avoidance. Find out the reasons in cases where these structures exist.

Two other issues that can indicate problems are a sharply falling share price or delays in issuing financial statements. In the former the markets may know something that you do not and the latter may indicate financial and/ or audit problems.

Assess The Integrity And Potential Conflicts Of Interest Of Management

In some companies, the major shareholder may also be the CEO. Ordinarily this would not be an issue as the CEO should, in these instances, be mindful of acting in the best interests of the shareholders. However, in the case of a financial problem or loss of business the share price could fall resulting in a dissipation of the CEO's wealth. This could lead to a CEO adopting non conservative accounting or at the worst fraudulently manipulating the accounts to support the share price. This would not normally be the outcome, but has happened in Singapore.

Find out details of the senior management's compensation plans. Some employment contracts may directly relate the individual's remuneration to profits. This can give senior management the incentive to push for short term profits to boost their take home pay. This has been rife in the banking industry. Worse is when profits drop or there is a loss in the next year. Usually these bonuses are not clawed back and the amounts can be substantial.

Be very careful of a dominant chairman or CEO. A dominant chairman may stifle discussion at the board meeting. A dominant CEO may push his ideas to the board and these may be wrong. Both of these situations are not uncommon. It can be difficult to identify these types until you get on the Board. The only way is from market talk, asking around and making your own assessment.

Look out for recent resignations of senior management or board members. These can indicate problems in the Company or problems with management.

Family companies are quite common in Singapore. Many are well run but others leave something to be desired. The issue to watch out for is senior management related to the family, who retain their position due to being part of the family rather than due to skill. As a board member you may know in your heart that they should be replaced, but doing it can be difficult as the family would most block it and class you as a troublemaker. If you anticipate that this situation could arise do not join the board.

Try and find out the culture of management. Some senior executive may be "gung ho". You will need to decide whether they will be a risk to you.

Whether To Accept Or Not To Accept An Appointment

No company is perfect. It will be up to you to assess the risks that may be latent in the board that you may be interested in. In general it is better to be cautious as the results of having to deal with a problem company can be quite traumatic. Even if you avoid legal problems you could be left with the baby to look after as the last remaining Singapore resident director.

Some Issues To Agree On Before Appointment

- Adequate Directors and Officers insurance cover - It is extremely important to ensure that the company has D&O insurance cover and that is high enough to cover any potential liabilities that could hit you. There has been an increasing spate of legal scandals with directors receiving criminal and civil proceedings against them. Without protection directors could end up having to dip into their own pockets to pay legal fees to defend a case or pay claims.
- Committees you are required to serve on - Find out which committees you will be expected to serve on and those of which you will be chairman. You will need to be comfortable that you can do the job. You should also receive additional remuneration for committee work and chairmanship of a committee.
- Number of meetings and dates - Obtain details of the number of meetings and if possible the schedule of meetings for the year. You will need this in advance so that you can plan block off your diary as necessary.
- Fees - Agree the level of fees and when they are paid. The preference is to receive them in advance and not after the AGM. More and more companies are adopting this basis.
- It is difficult to have a scale fee as there are too many variations. The fee must be attractive enough to get experienced and skilled individuals. Fees in Singapore tend to be low. Some of the considerations that can be taken into account when deciding whether the fee is adequate are:
  - Size of the Company – the larger the company usually means more meetings. Papers are more complicated and more time is required to read up the papers. For instance as an audit committee chairman it can take a day to read the relevant papers, understand financials presented, reviewing risk issues and asking questions of management
  - Nature and Complexity Business Operations – The more complex the higher should be the pay. Complexity depends on the specific nature of the business , geographic spread and nature of unusual risks
  - Industry Considerations – some industries have more risk and others are effected by economic factors affecting the particular industry
  - Qualifications of director – nature of qualifications, expertise and experience. These should and are not always taken into account. It should be noted that a qualified accountant or lawyer may be deemed more culpable in the case of an accounting or legal issue respectively
  - Time expended by individual directors – minimum usually 4 board meetings, 8 committee meetings and 1 AGM. In addition some boards hold their meetings overseas. Travelling time needs to be taken into consideration
  - Roles performed by director- extra fees for chairman of the board and committee (some indications of additional fees are chairman 2x basic fee, audit com chairman 50-75% on top of basic fees and other committees 25-50% on top of basic fees)
  - Reimbursements – clear guidance on what is claimable and how much
- Are you expected to buy shares in the Company? - Some companies require directors to have some sort of shareholding in the company. Many years ago it may have been in the articles but that is now rare. Nevertheless, some companies will look to their directors having a small holding, maybe share equating in value to one year of director's fees, as it is felt that this may align directors interest more closely with those of the shareholders
- What continuing education will be paid for and provided by the company? – All directors need to keep updated on current issues. There are numerous good courses provided by SID and others. These tend to be expensive so it is a good idea to get some commitment from the company that you are involved in to get some financial support for further education
- Make sure that you obtain a letter of appointment containing the conditions agreed for you as a director.

Being an independent director can be a good experience or a bad one. If you follow some of the guidelines above it may help towards the former. ■

What Is Strategic Thinking?

By David Wilkins
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Although it may receive less emphasis than the procedural aspects of Governance, hidden within the Companies Act and the SID Code of Conduct are a series of directives that together comprise what we in DPI refer to as Strategic Oversight. Enshrined in legislation, Directors are expected to help set strategic aims, constructively challenge and develop proposals on strategy and ensure adequate resources are allocated to the implementation task. A prerequisite to this is for Directors to become better Strategic Thinkers – to ask and answer the right critical questions in relation to the organization's past, present and future. The biggest obstacle to better Strategic Thinking is the confusion around what exactly it is!

Strategic Thinking

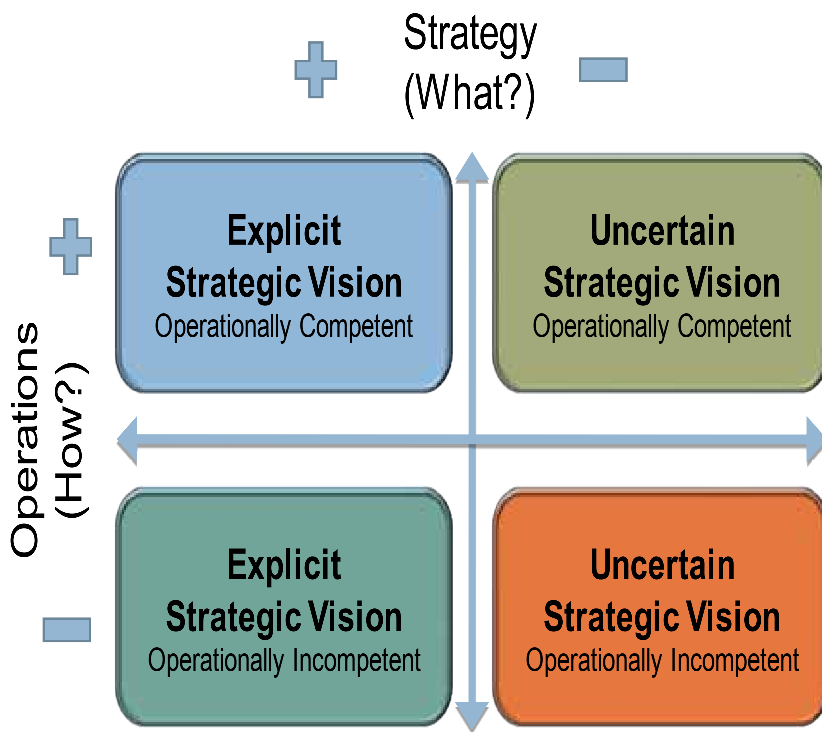
Indeed, Strategic Thinking is easy to say but much harder to achieve in reality. In this article, we hope to demystify the topic to ensure a common understanding what Strategic Thinking is, and how it differs from operational thinking and strategic planning.

Strategy Versus Operations

Strategic Thinking is different from both strategic planning and operational planning. In fact, strategic thinking is the framework for strategic and operational plans.

Strategic thinking is the process of thought that goes on inside the heads of the Board of Directors, CEO and the key management team that helps them determine the "look" of the organization at some point in the future. And that look, or composition, of the business in the future may be different from what it is today.

Strategic thinking can be compared to picture painting. It is the process



Strategic thinking can be compared to picture painting. It is the process that helps the Board, CEO and the management team "paint a picture" or "profile" of what they want the organization to look like at some point in time. It is this "picture" or "profile" that will determine the direction, nature, and composition of the business.

that helps the Board, CEO and the management team "paint a picture" or "profile" of what they want the organization to look like at some point in time. It is this "picture" or "profile" that will determine the direction, nature, and composition of the business.

Strategic thinking, then, is the analytical thought process that goes on within the minds of the Board, CEO and the management, to shape and clarify the organization's future strategic profile. This profile then becomes a filter for strategic decision-making - decisions that "fit" within the parameters of this profile are taken and implemented, and decisions that do not "fit" are rejected – and enables the Board and CEO to allocate precious resources in an optimum manner.

Strategic thinking can also be described as the type of thinking that attempts to determine what the organization should look like. In other words – the strategy.

Operational planning, and even what has become known as strategic planning, is the type of thinking that helps us choose how to get there.

To illustrate the difference between the two types of thinking, we can develop a matrix with the "what" on the horizontal axis and the "how" on the vertical axis.

We can complete the matrix by further dividing each axis into good (+) strategic thinking and poor (-) strategic thinking as well as good (+) operational planning and poor (-) operational planning. Although both of these activities go on in all organizations, what we have noticed is that they go on with varying degrees of proficiency.

Quadrant A

In quadrant A, we find companies that do both very well. They are developed a clear profile and explicit strategy, and they manage their business successfully on an ongoing basis.

Companies that fall into quadrant A include the likes of Air Asia and Apple.

Quadrant B

In quadrant B, we find companies that have been successful by managing their ongoing operations effectively, but which cannot articulate where they are going. In other words, management can keep churning out good operational results quarter after quarter, but they do not have a shared vision of what the company will "look like" as a result of all that churning.

In quadrant C, we find the opposite situation. This is where many "copy cat" firms reside. For example, think back to the years when there were many firms competing in the nascent PC business. Each company probably had a very clear strategy: "Be the best IBM clone we can

be." However, many of these companies had great difficulty making this strategy occur; thus, their fortunes were up and down like yo-yos. Today, most of them are out of business!

Quadrant C

The last quadrant is the worst of both worlds. Here we find organizations that do operational and strategic thinking poorly. Companies that fall into quadrant D usually do not survive very long.

Quadrant D

Which Quadrant Is Your Organization In?

Although we would all like to say that we are in the A quadrant, most of our clients readily agree that they fell into B. That is, they are effective operationally but are not always sure what direction they are pursuing. As a matter of fact, our research and hands-on experience has shown that almost 70 to 80 percent of companies are in that position.

Surprising? Not really, when we explore some of the reasons for this. Here are two major explanations.

Firstly, most of the people who lead and manage organizations got there from the operational ranks. They were promoted from one level to the next because of their operational skills. They were good managers and made good operational decisions. They were able to "make the numbers". They did not, however, spend much time thinking about, or charting, the direction of the company. As a result, they have not acquired the skill of setting direction and being the organization's strategic thinker. That skill takes time to develop.

Secondly, the need for management to think strategically does not arise all of the time. It tends to surface only at "strategic retreats" or when a new "strategic thrust" is being pursued, for example, when deliberating entry into market(s) that represent unfamiliar terrain. Often, the rules of the game are different, hence requiring management to shake itself out of its operational thinking mode. However, if thinking strategically is not an on-going habit, one can hardly expect management to be proficient. As Board Directors who are guardians of the business, it is imperative that strategic thinking becomes a well-honed skill as you critically drill into the reasoning behind executive decisions in the course of your Strategic Oversight duty.

Christopher Columbus School Of Management

Let's then return our attention to "Quadrant B" where 70% to 80% of organizations reside. These companies can be referred to as being part of the Christopher Columbus School of Management, the 15th Century European explorer most well known for discovering the Americas, who:

- When he left, he didn't know where he was going
- When he got there, he didn't know where he was
- When he got back, he couldn't tell where he had been!

But he got there and back three times in seven years! Columbus was operationally very competent but never knew where he was or where he was going. He was an excellent sailor but a very poor strategist!

To avoid being like Columbus a robust strategic thinking process is required. The process should guide and promote the type of thinking necessary as management attempts to determine, and the Board evaluates and approves, how an organization should "look" like in the future. Operational planning systems, on the other hand, can be used to later to help determine how to get there.

Strategic thinking is a fresh approach to the subject of strategy. It identifies the key factors that dictate the direction of an organization, and it is a process that the organization's management uses to set direction and articulate their vision, and makes visible the underlying rationale allowing the Board to analyze in a systematic manner the merits (or absence thereof!) of this vision. For strategic thinking to be successful, it is necessary to obtain sanction by the Board, commitment of the organization's key executives and the commitment of those who will be called upon to implement that vision. Naturally, the vision is greatly shaped by the CEO, assessed and supported by the Board.

It is a process that extracts from the minds of people who run the business their best thinking about what is happening in the business, what is happening outside in the environment, and what should be the position of the business in view of those highly qualitative variables (opinions, judgments, and even feelings) – not the quantitative ones. Strategic thinking produces an explicit profile of what an organization wants to become, which then helps management make vital choices. It enables management to put the corporation in a position of survival and prosperity within a changing environment. ■

Some Food For Thought Left On The Table

By David Sandison
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I must admit to being left in two minds about this year's Budget, which was delivered by the Minister for Finance on February 17. On the one hand, it appeared to be simply moving forward the government's blueprint for the fair, inclusive and innovative society. On the other, it somewhat trampled roughshod over a particularly sensitive area for Singapore based businesses, namely the difficulties posed by the country's tight labour market.

Finding Talent

Running up to the Budget, the signal was pretty clear from the business community, particularly the local SME sector, that finding the right talent, in fact, in many cases any talent at all, was proving increasingly difficult. A common theme was that, despite the government's intention to encourage employment of Singaporeans, what businesses were finding was that either no Singaporean had the requisite skill sets; or alternatively, the job was considered socially unacceptable to them. In addition, it was felt that there was a complacency amongst young Singaporeans about their career choices. They could dictate terms to employers, because of the significant demand for their services. Staff retention (or lack thereof) was, as a result, becoming a major headache and drain on efficiency for many local businesses.

Tightening Dependency Ratios

Enter Singapore Budget 2012, with additional screws put on the so-called dependency ratio ceilings, or DRC's – the ratio of Singaporean to foreign workers that certain industries have to apply to their workforce. The reasons given for the tightening of the ratios was the desire to compel companies to hire more Singaporeans, but at the same time (if there were no Singaporeans willing or able to be hired, and nowhere else for the business to source alternatives) force businesses to look to new productivity measures to help them reduce workforce numbers in general. In other words, find new ways of getting more productivity out of what you already have. Noble motives indeed. However what is not so clear is how the objectives are to be achieved, at least in the short term.

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Productivity improvements require investment; and investments need time to produce results. They also need finance – something else that is in short supply around here. Significant pain is likely while we wait.

Demographic Concerns

Singapore also has a major demographic problem that is not going to go away anytime soon, if at all. In the last 15 years, life expectancy in Singapore has grown from 71 for males and 76 for females, to 77 for males and 81 for females. Not only that, if you actually make it to 62, you can now expect to reach 82, even as a mere male of the species. Fifteen years from now, if you hit the 62 mark, you will be able to count on another 30 years of leisure time post retirement (LOL, as they say in cyber parlance, if you think you will be able to afford it). So that is on one side of the coin. People are living longer.

Despite this seemingly happy situation, the population of Singaporeans is set to fall, and at an alarming rate. In order to maintain the Singapore population at its current level, each female has to produce 2.1 children. It is actually producing only 1.1, roughly half. From this, and using the back of an envelope, you can deduce a number of things:

- even if the birthrate was 2.1 per female, the population would not grow (no rocket science here);
- if nobody died at all, and the current birthrate continued, it would take about 45 years for the population to grow to the 6 million the government is targeting (22 years for the population to be born and 20 years for it to become economically useful).
- If something drastic is not done, Singaporeans will have gone the way of the dinosaur by the end of the century; and
- Even if the population remains stable, an increasing portion of it is made up of the silver-haired set, which means an even smaller working-age population.

It should not be difficult to work out from this that the only way to right this leaky ship (even before dreaming of the targeted 6 million population) is to adopt a pro-active immigration policy that embraces and integrates foreigners into the population. And yet the Budget seemed to be moving in the opposite direction. I am no Malthusian scholar, but just the same, I remain somewhat mystified by the logic.

The Technical Goodies

One or two good technical goodies did come out of the Budget however. Interestingly, one of them ties back into the foreign worker issue. It had previously been the view of the IRAS that, where a Singapore based company carried on contract manufacturing activities outside Singapore and it effectively owned the plant and machinery that the manufacturer used, then it was not entitled to any tax allowances in respect of it. This was so notwithstanding the fact that that the income generated from the purchase and sale of the product was regarded as Singapore sourced income and taxed as such. Well two pieces of good news. Firstly the IRAS lost their case

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in the courts. Secondly, they graciously went a step further and announced an "Integrated Investment Allowance" in respect of such plant and machinery. So not only do Singapore companies that operate in this way get their capital allowances (effectively a straight-line write off of the cost over three years), but they get an additional allowance on top. At the time of going to press (and the Editor will know I waited to the last minute…) the rate of allowance had not been announced.

What this little nugget reveals though is quite interesting. For a while now the Economic Development Board has been promoting the model described above, which we call the "entrepreneurial model". The entrepreneur, that is the risk taker and generator of the value, sits in Singapore, with a "risk-free" manufacturer placed in a low cost environment. Tax incentive rates are then applied to the Singapore profits which represent the lion's share. Low profits (usually allocated on some cost plus basis) are then left to be taxed at the (usually higher) rates in the manufacturing location. With the emergence of projects like Iskandar in Malaysia and the part already played by Bintan and Batam, it is likely that this model will be one that the agencies will press ever harder. It does after all, kill two birds with one stone. From a demographic perspective, it allows Singapore businesses to access low cost foreign labour. From a political perspective they don't have to be brought into Singapore. The political issue is deflated, but the value still accrues to Singapore. Neat.

The other change of note, at least for companies wishing to go regional, or for multi-nationals wanting to use Singapore as a holding company location, was the introduction of safe-harbour provisions for gains on the disposal of shares. Although some people tout Singapore as not having a capital gains tax regime, they are only telling half the story. One perennial bone of contention with the IRAS has been whether a gain is capital in the first place. The proposed rules will give automatic exemption for gains on the disposal of shares in a company where the shareholder has owned 20% or more of them for a period of 24 months prior to the disposal. While on the face of it this is a welcome change that had long been asked for (although a lower shareholding percentage and holding period had been on our wish list), the devil is always in the detail, and we will not have the detail until 1 June 2012. It would indeed be concerning if conditions were inserted, as they were in the last brave attempt not to tax certain transactions in Singapore residential property, that denied protection to "trader in shares". (Sigh!). We have already heard that insurance companies will be prevented from coming into the harbour, as their part of the income tax Act is constituted differently from that applying to others. I am not sure I see the connection.

Conclusion

The Budget contained a number of other measures aimed, as they should be, at the less well off and getting the older generation back to work. But there was little of note for businesses, or tax practitioners. Despite this, there is still plenty of food for thought left lying on the table. ■

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Enterprise Risk Management And The Board

On 9 February 2012, at the Marina Mandarin Hotel Singapore, Mr Ong Sim Ho, Head of Tax Practice Group, Drew & Napier LLC, presented a talk on management of enterprise tax risk for the Board of Directors. It was suggested that an overall effective risk management framework within Corporate Governance must include an assessment of the tax risks at the enterprise level. Mr Ong gave a conceptual and practical framework that should allow the Board to appreciate, assess, monitor and manage enterprise tax risks.

SID thanks Mr Ong for his presentation and the participants for their presence. ■

Lessons Learned From CEO & C-Suite Succession

The Institute was happy to have Russell Reynolds Associates ("RRA") present on the issues related to CEO succession on 16 February 2012 at Pan Pacific Hotel Singapore. RRA revealed the reasons why organisations are slow to engage in strategic CEO/C-suite succession management although they are facing more pressure from stakeholders to be more proactive in addressing this matter. Mr Dean Stamoulis, RRA Global EA Lead, explained some useful methods to solve this problem. These involved business strategy discussions with the board, the role of new executive assessment methods, the use of experiences in developing senior talent, the use of follow up assessment, and how to improve board interviews with internal candidates.

Forming the lively panel discussion with Mr Satmoulis were Mr Chew Choon Soo, RRA Singapore Co-Managing Director and Ms Elisa Hukins, RRA APAC EA Lead. Mr Anthony Beaumont, APAC Regional Managing Director and Mr Patrick Fang, RRA Singapore Co-Managing Director gave the opening and closing addresses respectively.

SID thanks the speakers and panellists for sharing their expertise and the participants for their presence. ■

OCEAN 3

SID
Excellence in
Corporate Governance

Members' Networking Event

On 29 February 2012, The Institute held its regular members networking event at Marina Mandarin Hotel. SID Council Member Mr Kevin Kwok welcomed all to the event. Other council members present were Mr Lim Hock San, Mr Yeoh Oon Jin and Mr Willie Cheng.

David Wilkins, Singapore Partner, Decision Process International ("DPI") Asia then engaged SID members in a 15-minute talk on the three most important strategic questions that must be asked by Boards and answered by Executive Leadership. He also shared how the likes of Ascendas, SATS, ST Kinetics and Teckwah have done so in a systematic way to ensure on-going value creation.

All who attended walked away with a complimentary book titled "The New Strategic Thinking Pure & Simple". Participants were also treated to a wide variety of refreshments, courtesy of Marina Mandarin Singapore.

SID thanks Marina Mandarin for kindly sponsoring the event and all members' for their participation. ■

"No Room For No comment": Disclosing Without Defaming In Crisis Communications

On 8 March 2012, The Institute held a joint lunch event together with Drew & Napier and Ogilvy Public Relations Worldwide at the Marina Mandarin Hotel Singapore. The seminar brought across the intersection of communications and legal strategy featuring insights on defamation and corporate disclosure. When it is business as usual or when corporations are in a normal operating environment, boards are able to comply quite easily. But when insolvency looms, or fraud or a crisis threatens, or an unexpected murky corporate situation deepens, other latent issues and needs may surface which may conflict with how immediate and how much a board should disclose or defer disclosing. How should a board handle such conflicts? What fundamental principles should be taken into account? What kind of defensive steps can be taken?

Mr Andrew Thomas, Regional Managing Director, Ogilvy Public Relations Worldwide, Mr Adrian Tan, Director, and Mr Benedict Teo, Director, from Drew & Napier LLC gave their perspectives on the latest best practices through case studies and group discussions.

SID thanks the speakers for their contribution. ■

Adrian Tan
Benedict Teo

How Boards Can Work With The Internal Auditor & The Management To Satisfy Regulatory Requirements On Internal Control

More than 90 people attended the half-day seminar jointly organised by RSM Ethos and The Institute of Internal Auditors Singapore ("IIAS") on 9 March 2012 at the Marina Mandarin Hotel.

The seminar showed how all levels of management must accept that it is their responsibility to ensure the existence of a robust and effective internal control. It also discussed what the Board should do to set the right tone and risk governance to the management and examined how internal audit function can play an effective facilitation role in assisting the Board to discharge their onerous responsibilities.

SID thanks the panellists Mr Reggie Thein, Audit Committee chairman & member of a number of listed companies, Mr Adrian Chan, Corporate Department Head in Lee & Lee, and Mr Uantchern Loh, President of IIAS for their contribution and the speakers Mr Tay Woon Teck, Managing Director of RSM Ethos and Ms Deon Chan, Technical Director of IIAS for their presentation. ■

Long Term Capitalism

At a luncheon event at Marina Mandarin Hotel on 30 March 2012, Mr Chinta Bhagat and Mr Naveen Uni, Partners of McKinsey & Company presented preliminary findings and emerging solutions from their research on the topic of Long Term Capitalism. Their research aimed to better understand the incentives and behaviours driving short-termism in the investment chain – from capital owners to the executive suite – and identify actions to foster longer term perspectives and more efficient capital allocation.

SID thanks the speakers for their contribution and participants for their presence ■

Personal D&O Insurance

Allianz Insurance Company of Singapore Pte Ltd and Aon Singapore Pte Ltd in collaboration with the Singapore Institute of Directors (SID) have recently launched a Personal D&O Insurance program exclusive to SID members, protecting them against liability arising from their responsibilities as a director, of up to $1 million. The first group of policies has already been issued on the 15th October 2011.

Personal D&O Insurance provides similar protection as traditional D&O Insurance policies, but is taken out in the name of an individual director or officer rather than as an entire board of directors. Cover can be provided for up to three separate directorships.

Why Is It Necessary?

Personal D&O Insurance provides directors and officers with an individual, portable policy for their exclusive benefit. Such cover is relevant to all directors, and is of particular importance to the following:

- Directors of companies that do not purchase D&O Insurance.
- Directors of companies that purchase inadequate insurance, whether in terms of breadth of cover or policy limit.
- Independent directors.
- Directors who are resigning or retiring from their positions, and who seek run-off protection.
- Professionals who assume positions on client company boards.

"Independent directors are uniquely exposed to liability arising from the companies whose boards they sit, while lacking the ability to directly assure that the company purchases relevant insurance coverage to respond to these exposures," said Mr James Amberson, Regional Manager of Financial Lines for Allianz Insurance Company of Singapore. He added that the insurance program developed in collaboration with Aon and SID is a proactive response to this issue and provides directors with the opportunity to mitigate this risk for themselves.

"We are delighted to partner with Allianz and the SID in providing this innovative protection to directors in Singapore. Personal D&O Insurance provides the opportunity for directors to control the breadth and level of protection available to them," said Mr Michael Griffiths, Director of Professional Services at Aon Singapore.

Exclusive to SID Members

Personal D&O Insurance cover is available exclusively to SID members.

A $1 million Personal D&O Insurance policy covering up to three separate directorships will cost S$1,000 plus GST.

For further details please refer to the SID Website, or call Gladys Ng at Aon Singapore on 6239 8880 or email gladys.ng@aon.com.

Upcoming Talks/ Courses

Upcoming Events

MAY 2012

Tuesday, 8 May	How boards can satisfy regulatory requirements on internal controls *By RSM Ethos and The Institute of Internal Auditors Singapore*
Thursday & Friday 17 & 18 May	LCD Mandarin Programme in Qingdao, China
Wednesday, 23 May	EBL Module 2 The Board and Fund Raising
Tuesday, 22 May	Restructuring & Debt Financing *By Drew & Napier*
Tuesday, 29 May	LCD Director Programme Module 1 Listed Company Director Essentials: Understanding The Regulatory Environment In Singapore: What Every Director Ought To Know
Wednesday, 30 May	EBL Module 3 Enterprise Risk Management

JUNE 2012

Friday, 15 June	Share Schemes: Design Considerations & Cost/Accounting Implications *By Aon Hewitt*
Thursday, 28 June	EBL Module 5 Investor & Media Relations

JULY 2012

Tuesday, 3 July	EBL Module 4 Financial Governance
Friday, 6 July	Chairing the Remuneration Committee – A Chairman Series *By Mercer*
Wednesday, 11 July	LCD Module 2 Audit Committee Essentials
Tuesday, 17 July	LCD Module 3 Risk Management Essentials
Wednesday, 25 July	LCD Module 1 Listed Company Director Essentials

SID-SMU Executive Certificate in Directorship

Modules	Programme Dates	Assessment Date
Module 4: Risk & Crisis Management	9 & 10 May 2012	Take Home Assessment
Module 2: The Board Level View	21 to 23 May 2012	Take Home Assessment
Module 6: Effective Succession Planning & Compensation Decisions	28 & 29 June 2012	Take Home Assessment
Module 5: Strategic Corporate Social Responsibility & Investor Relations	19 to 20 July 2012	Take Home Assessment

Welcome Aboard

February 2012

Alegue	Gilbert Nguezem
Bardelli	Marco
Bence	Brenda
Brittain	Paul
Cheng	Man Tak Richard
Cheok	Keng Siang Adrian
Chew	Huat Chye Wilson
Chia	Audrey
Chow	Tat Ming Henry
Curtis	Richard
Dieleman	Maria Helena (Marleen)
Godson	Desmond
Hsu	Jiun Shin
Klaassens	Henk Willem
Lim	Chai Hock Clive
Lim	Kei Hin
Loh	Lloyd
Mark	Dennis
Nash	Nicholas A.
Ong	Sing Jye
Rylance	William
Sabhlok	Varun
Schwarz	Martin
Soh	Kian Meng Alex
Stern	Erik
Teng	Wee Chen Richard
Teo	Shih Yee
Van Den Broek	Beike
Yap	Sor Hwa
Yeoh	Wee Jin

March 2012

Carl	Andrea
Chan	Ee Lin
Chan	Kin Fai
Chatterjee	Amitava
Cheong	Chong Khiam
Chew	Dickie
Corden	Julian
Gardner	Ian
Iyer	Subbaraman
Kee	Tsin Siu Carol
Lee	Francis
Lim	Elaine
Lim	Wei Wei
Luk	Ka Man Janet
Markham	Guy
Ng	Kian Guan
Ng	Tiong Gee
O'Reilly	Damien
Ong	Ser Choong Andrew
Shanmugam	Shanmugam s/o Suppiah
Soh	Chiong Siong
Tan	June
Taylor	Joshua
Townrow	Ian Hugh Alan
Wilkins	David
Yeo	See Meng
Yeo	Kan Yen

Call for articles, thoughts, snippets, etc.

The institute would like to hear from you. Send us aricles, thoughts or even short snippets of issues that you are keen on, that you want to share about, or that keeps you awake at night. It only needs to relate to directors and/or corporate governance. For articles, keep it to 1200 to 1500 words at most. Send your materials by email to the Institute at secretariat@sid.org.sg

SAVE THE DATE

SID

Singapore Institute of Directors

SID DIRECTORS CONFERENCE 2012

Corporate Governance – A New Normal

The annual one-day conference organised by Singapore Institute of Directors (SID)

9.00 am to 5.00 pm, Wednesday, 12 September 2012

Marina Bay Sands, Singapore

Guest-of-honour:

Mrs Josephine Teo
Minister of State, Ministry of Finance and Ministry of Transport

Keynote Speaker:

Secretary Barbara Hackman Franklin
Chairman of National Association of Corporate Directors

Lunchtime Keynote:

Mats Isaksson
Head of OECD's Corporate Governance Division

This year's Conference will focus on looking at the New Normal in Corporate Governance. The focus will always be on boards and directors, but looking at critical issues that have plagued and how directors can manage in the new world order.

Divided into 3 panel sessions, the Conference will include a session on "Board Diversification & Dynamics – Who Should Be On The Board" and "Fusion Of Doing Good & Doing Well" in addition to the main Conference theme.

A one day event that will attract senior members of the Corporate Community and Regulators and Academia. The first two years' have seen successful runs, and we hope to raise the level further this year.

For those involved in corporate governance - whether as directors or as observers and supporters - this is the corporate governance conference to attend.