SGX Consults on Listing Framework for Dual-Class Shares

Introduction

In August 2016, the Singapore Exchange’s ("SGX") Listings Advisory Committee¹ ("LAC") ruled in favour of allowing dual-class share ("DCS") structures to list on SGX subject to appropriate safeguards. More information on the LAC’s recommendations, as well as DCS structures, may be found in our September 2016 client update here. Since then, SGX has engaged with various stakeholders to discuss the possibility of introducing DCS structures in Singapore.

In the same time period, the Committee on the Future Economy ("CFE") was convened to review Singapore’s economic strategies. In its report released on 9 February 2017, the CFE recommended, among other things, the introduction of DCS structures, noting that it could be utilised by entrepreneurs and companies to increase capital management and provide greater investor choice while supporting Singapore’s economic transformation.

On 16 February 2017, SGX issued a consultation paper, “Possible Listing Framework for Dual Class Share Structures”, seeking public feedback on whether DCS structures should be introduced, and if so, what safeguards DCS structures should be subject to. The consultation ends on 17 April 2017.

SGX’S PROPOSALS AT A GLANCE

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Proposed Safeguards

Against entrenchment risks:

• Maximum voting differential of 10:1
• Restriction on issuance of shares with multi-votes ("MV shares") post-listing
• Automatic conversion of MV shares to shares with one vote ("OV shares") upon sale or transfer of owner manager’s MV shares or if the owner manager ceases management role
• Sunset clause

¹ The LAC was established on 7 October 2015 by SGX to supplement its listings regulatory process in reviewing Mainboard listing applications and formulating listing policies. The LAC’s advice can be accessed at this link.
Background

The Companies Act was amended in January 2016 to remove the one-share-one-vote restriction in public companies. This paved the way for SGX to consider if it should introduce a framework for listing companies with DCS structures to help attract high-quality companies which may not otherwise consider Singapore as a listing venue, and to attract businesses run by entrepreneurs to list, thereby providing investors access to a wider range of companies and sectors.

A DCS structure typically gives certain shareholders greater voting power or other related rights than others, disproportionate to their shareholdings. OV shares carry one vote while MV shares carry multiple votes. This will allow owners of the company to have voting control without the corresponding financial investment risk.

However, the concentration of control in owner managers in a company with a DCS structure carries with it both entrenchment and expropriation risks. Owner managers may become entrenched in the management of the company, or may seek to extract excessive personal benefits from the company, to the detriment of minority shareholders.

There is also the risk of poor quality listings and lack of clarity for investors when they invest in DCS structures.

Under the proposed listing framework for DCS (“DCS Framework”), the owner managers will own MV shares which are unlisted, while the investing public will be offered OV shares which are listed. In coming up with its proposals, SGX studied the use or proposed use of DCS structures in various jurisdictions, such as the United States, Canada, the United Kingdom, Australia and Hong Kong. SGX recognises that there are opposing views as to whether companies with a DCS structure should be allowed to list in Singapore.

Some arguments in favour of such structures are that DCS structures will support innovation and will improve the competitiveness of Singapore as a listing venue. Allowing DCS structures with appropriate safeguards will also widen the range of financing options, especially for companies in high-technology, biopharmaceutical and life sciences industries.

Those who are against the introduction of DCS structures argue, among other things, that such structures will give owner managers voting power or related rights disproportionate to their shareholdings, and could be detrimental to corporate governance. It is also unclear whether DCS structures would increase the attractiveness of Singapore as a listing venue, as there may be other considerations that potential issuers take into account.
Proposed DCS Framework & Admission Criteria

Given the above, SGX is seeking feedback on whether the introduction of the DCS Framework will be beneficial to companies, investors and the Singapore economy, and if so, whether the proposed criteria and safeguards are appropriate.

Under the proposed DCS Framework, new issuers with DCS structures may seek a primary listing on the Mainboard of SGX-ST, subject to appropriate safeguards. All potential issuers must also fulfil the existing admission criteria set out in Chapter 2 of the SGX-ST Listing Rules (Mainboard) (“Mainboard Rules”).

Existing companies with a one-share-one-vote structure will not be permitted to convert to a DCS structure post-listing as the shareholders of such companies did not invest with the knowledge of risks associated with DCS structures. There is correspondingly no arrangement for existing listed companies on SGX to adopt a DCS structure, though it is unclear if SGX would permit a foreign listed company to adopt a DCS structure in it is dual primary and/or secondary listing on SGX.

The LAC had also recommended that:

- **The one-share-one-vote structure is to remain the default position** for all new listings.

- **A holistic assessment** be conducted when determining the suitability of a listing applicant to list using a DCS structure. Such assessment may take into account factors such as the listing applicant’s industry, size, operating track record and raising of funds from sophisticated investors. Each of these factors, while relevant, is not determinative on its own.

- **Listing applications of companies with a DCS structure should be referred to the LAC for its review and advice**, provided that SGX had first assessed the listing applicant as being suitable for listing.

- **Prospective applicants will be subject to a “compelling reason” test.** Unlike other stock exchanges, where such DCS structures may be permitted for companies in specific industries, SGX has kept this general, but will subject prospective applicants to a “compelling reason“ test. It is currently unclear what would satisfy this requirement and each case may have to be reviewed based on its own merits, after making a holistic assessment of all relevant factors.

In addition to the above, SGX is proposing several other possible listing criteria for DCS structures:

- **Minimum market capitalisation of $500 million.** This figure is based on the issue price and IPO and post-invitation issued share capital. This is to ensure that there is sufficient investor demand to justify accepting the potential risks of a DCS structure.

- **Issuer must have raised funds from sophisticated investors.** As a general guide, the level of participation by sophisticated investors is expected to be no less than 90% of the public float requirement, taking into account the existing public float and distribution requirements under Rule 210(1)(a) of the Mainboard Rules.
Corporate – Capital Markets

While the market capitalisation requirement ensures that only companies of a certain size would be permitted to tap on DCS structures, the distribution requirement of placing 90% of the public float to sophisticated investors may be challenging, given the revised definition for sophisticated investors under the proposed changes to the Securities and Futures Act.

Proposed Safeguards

SGX also identified safeguards to mitigate the risks of entrenchment and expropriation. These safeguards focus on enhancing the corporate governance framework of a listing applicant with a DCS structure and minimizing opportunities for extraction of personal benefits. The CFE, in recommending DCS structures, had also suggested that appropriate safeguards be instituted to promote market transparency and mitigate governance risks.

It may be worth considering whether to further mitigate such risks by confining the multiple votes under the MV shares to be applicable only to specific resolutions where the “compelling reason” to adopt a DCS structure for the company are applicable.

In any event, the safeguards recommended by the LAC will be supplemented by the existing framework for all listed companies, e.g., existing rules governing interested persons transactions which will prohibit a majority shareholder from voting on a transaction in which he has an interest in.

Safeguards against Entrenchment Risks

SGX proposes adopting the following safeguards to minimise entrenchment risks:

- **Maximum Voting Differential of 10:1**: LAC has advised to set a maximum ratio of voting differential between each MV share and OV share at 10 to 1, where each MV share carries 10 votes and each OV share carries one vote. A ratio less than 10:1 is permitted, but the voting differential must be fixed at the point of IPO and may not be changed subsequently by the issuer post-listing.

- **Restriction on Issuance of MV shares post-listing**. LAC has advised prohibiting the issuer from undertaking equity fundraising by issuing MV shares post-listing, except in the event of a rights issue.

- **Automatic conversion of MV Shares to OV shares** upon a sale or transfer of the owner manager’s MV shares, or if the owner manager ceases to assume the management role. SGX is considering imposing a condition that they will not accept the listing of an issuer with a DCS structure that does not have restrictive provisions in its constitutional documents meeting such criteria. In this regard, SGX has provided in the consultation paper, guiding principles for drafting the wording of the restrictive provisions. It is also proposed that shareholders be given the power to waive the automatic conversion requirement through the enhanced voting process where each MV share is limited to only one vote (“Enhanced Voting Process”), to allow some flexibility.

- **Sunset Clause**. A sunset clause provides for the automatic conversion of MV shares to OV shares at a particular future date, such as 5 years after listing. SGX is seeking views on whether it should be mandatory for issuers to adopt a sunset clause, and if so, the terms of such a clause.

Instead of a mandatory sunset clause, it may be worthwhile to consider an alternative arrangement where multiple votes under MV shares will cease to be applicable unless it is renewed and approved by
OV shareholders. When seeking such renewal, the company can further limit the situations where such multiple votes would be triggered and justify the need for retaining a DCS structure in such situations.

**Safeguards against Expropriation Risks**

SGX proposes adopting the following safeguards to mitigate expropriation risks:

- **Independence element on the Board**: LAC advised requiring issuers’ boards, Nominating Committees, Remuneration Committees and Audit Committees to comply with the Code of Corporate Governance’s recommendations relating to independence of board and board committees on a mandatory, instead of a comply-or-explain, basis.

- **Enhanced Voting Process on Appointment of Independent directors**: LAC advised that the appointment of independent directors of companies with DCS structures should be subject to a shareholders’ vote by the Enhanced Voting Process.

- **Establishment of a Separate Risk Committee**: An issuer with a DCS structure must establish a separate board risk committee in carrying out the responsibility of overseeing the company’s risk management framework and policies. The risk committee could comprise at least three directors, the majority of whom, including the chairman, could be independent.

- **Mandatory coat-tail provisions**: The purpose of a coat-tail provision is to ensure that holders of OV shares will participate in a take-over offer on an equal footing with the holders of MV shares. A coat-tail provision could address the risk of potential abuse of the DCS structure where the owner manager could potentially be paid a premium for selling his MV shares.

**Measures to Enhance Clarity for Investors**

To increase investor awareness of shareholder rights in DCS structures and to address the risk of lack of clarity to investors, SGX proposes the following:

- **Clear Disclosure of Rights of Shareholders**: Issuers must give disclosure of the rights of shareholders by complying with the safeguards in the Companies Act (regardless of their place of incorporation). As a result, the provisions under the Companies Act against minority oppression and discrimination may apply and it would be interesting to see the court would rule in situations where the decision rights and/or interests of OV shareholders are overruled/disregarded by the MV shareholders under a DCS structure.

- **Prominent Disclosure of Risks in Prospectuses**: Prominent disclosure of the risks of DCS structures may also be required in the prospectuses of these companies. Issuers will also be required to disclose the holders of MV shares, regardless of their shareholding, both at the point of listing and on a continuing basis in its annual report.

- **Raise awareness of DCS structures**: SGX will demarcate clearly on trading screens the securities of issuers with DCS structures. SGX also intends to conduct investor education efforts to raise awareness of investors on DCS structures.
Concluding Words

If you have any questions on the above, or wish to include your views in our submissions to SGX, please contact our team members below who will be happy to assist.

Contacts

Chia Kim Huat
Regional Head, Corporate & Transactional Practice
D +65 6232 0464  
F +65 6428 2188
kim.huat.chia@rajahtann.com

Evelyn Wee
Deputy Head, Corporate & Transactional Practice
Head, Capital Markets
D +65 6232 0724
F +65 6428 2199
evelyn.wee@rajahtann.com

Please feel free to also contact Knowledge and Risk Management at eOASIS@rajahtann.com

ASEAN Economic Community Portal

The launch of the ASEAN Economic Community (“AEC”) in December 2015, businesses looking to tap the opportunities presented by the integrated markets of the AEC can now get help a click away. Rajah & Tann Asia, United Overseas Bank and RSM Chio Lim Stone Forest, have teamed up to launch “Business in ASEAN”, a portal that provides companies with a single platform that helps businesses navigate the complexities of setting up operations in ASEAN.

By tapping into the professional knowledge and resources of the three organisations through this portal, small- and medium-sized enterprises across the 10-member economic grouping can equip themselves with the tools and know-how to navigate ASEAN’s business landscape. Of particular interest to businesses is the “Ask a Question” feature of the portal which enables companies to pose questions to the three organisations which have an extensive network in the region. The portal can be accessed at http://www.businessinasean.com.
Our Regional Contacts

RAJAH & TANN | Singapore

Rajah & Tann Singapore LLP
T +65 6535 3600
F +65 6225 9630
sg.rajahtannasia.com

Christopher & Lee Ong | Malaysia

Christopher & Lee Ong
T +60 3 2273 1919
F +60 3 2273 8310
www.christopherleeong.com

R&T SOK & HENG | Cambodia

R&T Sok & Heng Law Office
T +855 23 963 112 / 113
F +855 23 963 116
kh.rajahtannasia.com

RAJAH & TANN | Myanmar

Rajah & Tann NK Legal Myanmar Company Limited
T +95 9 73040763 / +95 1 657902 / +95 1 657903
F +95 1 9665537
mm.rajahtannasia.com

R&T Sok & Heng Law Office
T +855 23 963 112 / 113
F +855 23 963 116
kh.rajahtannasia.com

RAJAH & TANN | Indonesia

Rajah & Tann Singapore LLP
Shanghai Representative Office
T +86 21 6120 8818
F +86 21 6120 8820
cn.rajahtannasia.com

Assegaf Hamzah & Partners | Thailand

Jakarta Office
T +62 21 2555 7800
F +62 21 2555 7899

Surabaya Office
T +62 31 5116 4450
F +62 31 5116 4560
www.ahp.co.id

RAJAH & TANN | Lao PDR

Rajah & Tann (Laos) Sole Co., Ltd.
T +856 21 454 239
F +856 21 285 261
la.rajahtannasia.com

Gatmaytan Yap Patacsl Gutierrrez & Protacio (C&G Law) | Philippines

Gatmayatan Yap Patacsl Gutierrrez & Protacio (C&G Law)
T +632 894 0377 to 79 / +632 894 4931 to 32 / +632 552 1977
F +632 552 1978
www.cagatlaw.com

RAJAH & TANN | Vietnam

Rajah & Tann LCT Lawyers
Ho Chi Minh City Office
T +84 8 3821 2382 / +84 8 3821 2673
F +84 8 3520 8206

Hanoi Office
T +84 4 3267 6127
F +84 4 3267 6128
www.rajahtannlct.com

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