

Listing framework for Dual Class Shares - A closer look into safeguards

April 4, 2017

Background

The subject of Dual Class Shares (DCS) has given rise to much debate in the context of public listed companies. Briefly, a DCS structure departs from the default one-share, one-vote concept by allowing companies to issue different classes of shares with different voting rights (e.g. non-voting shares, shares with multiple votes). This results in certain shareholders (typically the founding shareholders) obtaining voting rights disproportionate to their shareholdings and financial investment. The pros and cons of DCS structures have been debated extensively, with proponents advocating that DCS structures allow companies greater flexibility in capital management, and investors a wider range of investment opportunities.

Consultations by the SGX-ST

The Singapore Exchange Securities Trading Limited (SGX-ST) had in April 2016 sought the advice of the Listings Advisory Committee (LAC) on whether companies with a DCS structure (where shares in one class carry one vote each (OV shares) while shares in another class carry multiple votes each (MV shares)) should be permitted to list on the SGX-ST, and if so, the safeguards to be adopted. While voting in favour of permitting DCS structures to list on the SGX-ST, the LAC nevertheless identified the following key risks with DCS structures:

- a. entrenchment risks, where owner managers entrench management control of the company;
- b. expropriation risks, where owner managers seek to extract excessive private benefits from the company, to the detriment of minority shareholders;
- c. risks of poor quality listings; and
- d. risk of lack of clarity when investors invest in DCS structures.

Subsequently on 16 February 2017, the SGX-ST released a consultation paper on "Possible Listing Framework for Dual Class Share Structures", seeking to explore whether such a listing framework for DCS structures should be introduced and if so, what safeguards might be appropriate. This consultation paper comes in the backdrop of recommendations from the Committee on the Future Economy for the Singapore Government to permit DCS structures for listed companies, particularly given that DCS listings are increasingly being considered for industries such as information technology and life sciences.

Proposed safeguards

Additional listing criteria for DCS structures

To address the risks of poor quality listings, the LAC proposed to admit companies with a compelling reason for

adopting a DCS structure, based on a holistic assessment, taking into account the listing applicant's "industry, size, operating track record and raising of funds from sophisticated investors".

Once the SGX-ST assessed the applicant as suitable for listing, the LAC proposed that the SGX-ST refer such applications to the LAC for a second-stage review. It is envisaged that such second-stage review will continue for an initial period after implementation of the listing framework. The restriction to new listing applicants aims to prevent existing listed companies from circumventing this restriction by engineering corporate restructurings, spin-offs or reverse takeovers.

Possible additional listing criterion supplemented by the SGX-ST include restricting listings to new issuers with a minimum market capitalisation of S\$500 million for primary listings on the Mainboard of the SGX-ST and requiring issuers to have raised funds from sophisticated investors.

Safeguards against entrenchment risks

- i. Maximum voting differential between each MV share and OV share to be 10 to 1, where each MV share carries up to 10 votes and each OV share carries one (1) vote – to minimise the concentration of voting rights in owner managers.
- ii. Restriction on issuance of MV shares post-listing, except in the event of a rights issue – to prevent further entrenchment of voting rights in owner managers, or further dilution of voting rights of existing shareholders.
- iii. Automatic conversion of MV shares in the event (A) the owner manager sells or transfers his MV shares (with such transfer being restricted to another owner manager, an executive director or an executive office); or (B) where an owner manager no longer holds the position of the executive chairman or the chief executive officer or equivalent, in both cases unless shareholders approve otherwise in a general meeting where the voting is on the basis that one MV share is limited to only one vote (Enhanced Voting Process) – to ensure that MV shares are solely for owner managers to retain control to facilitate business decisions, and not to make their shares more valuable than OV shares.
- iv. Sunset clauses providing for the automatic conversion of MV shares into OV shares at a fixed future date post-listing – to ensure that special rights are only available for an incubation period during which founding shareholders have the flexibility and security to plan for and make strategic business decisions on the future and growth of the company.

Safeguards against expropriation risks

- A. Independence element on the Board – to provide assurance of independent scrutiny on owner managers' actions.
- B. Enhanced Voting Process on appointment of independent directors – to ensure that holders of OV shares have a greater say on the appointment of independent directors.
- C. Independent risk committee of directors – to oversee the company's risk management framework and policies.
- D. Coat-tail provision in the event there is a change of control of the DCS company – to ensure that holders of OV shares are able to participate in a take-over offer on an equal footing with holders of MV shares, by ensuring that where an offer is made to holders of MV shares, a concurrent and commensurate offer is made to holders of OV shares.

Measures to increase clarity to investors

To complement the safeguards against entrenchment risks and expropriation risks, listing applicants with DCS structures would be required to comply with the disclosure requirements specified in the Companies Act (Chapter 50) of Singapore, regardless of their place of incorporation.

These disclosure safeguards include requiring shareholders' approval by way of a special resolution for issuance of shares with different voting rights, setting out information on the voting rights of each class of shares in the notice of

meeting, and setting out in the constitution of the issuer the rights for different classes of shares. The SGX-ST would also require issuers to disclose holders of MV shares at the point of listing and in the issuer's annual report.

On the other hand, the SGX-ST will clearly demarcate, on trading screens, the securities of issuers with DCS structures.

Issues and alternative safeguards

The proposed safeguards are not without flaws. One key issue with the minimum market capitalisation of S\$500 million is that if DCS structures were intended to support the growth of start-up companies, emerging companies in nascent industries (e.g. fintech) would be unlikely to satisfy this requirement. Alternatives to using a quantitative indicator may be to introduce DCS listings under Catalist instead, or restrict access to only institutional investors and qualified retail investors.

There is also scope to explore expanding the Enhanced Voting Process to cover more trigger events e.g. in board nominations (and not just limited to independent directors), winding up proposals, proposals to vary the rights of non-voting shares. These trigger events need not apply uniformly to all issuers with DCS structures, and the means of implementing these may vary. For example, companies may exclude special rights entirely for certain transactions, or require that an independent committee of directors be set up and/or independent financial advisers be engaged for deliberating and advising shareholders on specified transactions. Taking one step further, if a corporate action is rejected by shareholders after a specified number of times, an additional safeguard may be to restrict any proposals for the same corporate action for a fixed duration after.

To align the interests of owner managers with the issuer, the SGX-ST may also consider imposing a minimum equity threshold to be held by founding shareholders through a moratorium period.

Lastly, the proposed review of and changes to the Code of Corporate Governance to strengthen corporate governance practices and to enhance board independence, would dovetail with and complement the proposed listing framework for DCS structures.

Conclusion

As with the introduction of any new regulatory framework, the listing framework for DCS structures continues to be a work in progress depending on market reactions, investor appetite and investor environment – but it is a start.

What the SGX-ST needs to grapple with, and what investors in Singapore need to understand and appreciate, is finding the optimal balance between promoting Singapore as an attractive investment destination for IPO listings and protecting investors in Singapore from the very issuers that the SGX-ST hopes to attract. Too many safeguards would prove inimical to this pursuit.

The discussions on a listing framework are part of a bigger, evolving conversation on investor environment in Singapore. The hope is that with time, shareholders are given the options, and are empowered to make informed, investment decisions, without a regulatory big brother's oversight. In the context of DCS structure, factors such as an initial discounted share price, the long-term share price potential and the presence of investors other than the founding shareholders, would be relevant considerations to each individual investor depending on his investment priorities.

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