STRENGTHENING INVESTOR PROTECTION IN DELISTING SITUATIONS

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The recent controversy surrounding the unconditional general offer for Great Eastern (GE), which saw its free float dip below 10% and the suspension of trading, raises critical questions about the clarity and enforceability of SGX rules in safeguarding investors' interests in the context of delistings. This is not an isolated case but is, in our view, an unintended consequence of the listing rules, particularly the delisting framework, which incorporates exceptions and modal verbs that lack definitiveness.

Delisting requirements in the SGX rulebook

Part IV in Chapter 13 of the SGX Rulebook for the Mainboard and Catalist deals with delisting from SGX-ST. Specifically, Rule 1307 states that the exchange *may* agree to a voluntary delisting if at least 75% of the total number of issued shares vote in favour of the delisting at a general meeting. There have been three Regulator's Columns which touched on general offers and delistings, and this requirement has been referred to as "*independent approval*" in the third column dated 15 July 2024[1].

Earlier, on 11 July 2019[2], SGX RegCo amended the delisting rules in its Rulebook to "*enhance minority shareholder protection*". A Regulator's Column on the same day explained the changes[3]. The new rules require exit offers in conjunction with voluntary delistings to be *both* reasonable and fair, with the offeror and parties acting in concert with the offeror having to abstain from voting on the voluntary delisting resolution. However, the "blocking" right of minority shareholders was also removed. Before this amendment, if 10% of shareholders voted against the delisting resolution, the resolution would not be carried. On balance, this was a small victory for minority shareholders as delistings cannot proceed unless the offer is both fair and reasonable.

Nevertheless, while the bar to delist a company was raised, it was also stated that an issuer may be considered for exemption from strict adherence to the delisting requirements if the offer is fair and reasonable and, at the close of the offer, the offeror has received acceptance from at least 75% of independent shareholders. In the third Regulator's Column, this was termed "*independent acceptance*".

On paper, SGX has been unambiguous that the issuer *must* meet its continuing obligations under the Listing Rules, including restoring its public float, should it be lost. It stated that trading of an issuer's securities may be suspended if the public float falls below the minimum threshold. However, curiously, the regulator also opened the door to offerors by stating that, should an offer not meet the delisting requirements, the

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[1] https://www.sgxgroup.com/media-centre/20240715-regulators-column-potential-scenarios-when-general-offers-lead-loss
[2] https://links.sgx.com/FileOpen/20190711_SGX_RegCo_requires_fair_and_reasonable_exit_offers_FINAL.ashx?App=Announcement&FileID=569923
[3] https://www.sgxgroup.com/media-centre/20190711-regulators-column-privatisations-through-general-offers

offeror will be able to delist an issuer if a *subsequent* general offer that meets the waiver conditions is made, or if a subsequent scheme of arrangement that complies with the listing rules is proposed.

Outside of the SGX rules, a recent revision to the Companies Act in 2023 also improved minority investor protection by closing a loophole in compulsory acquisitions under section 215 of the Companies Act. Shares associated with the offeror are now excluded from the calculation of the 90% threshold, making it significantly more difficult to squeeze out dissenting shareholders through this route.

Complexities of delisting

The changes to the delisting rules, on balance, gave improved assurance that minority shareholders are protected as delistings can only proceed if the offer has been deemed fair and reasonable by an independent financial adviser (IFA).

However, complexity arises when an offer is not considered fair and/or reasonable and when the free float is lost. Under the amended rules, SGX RegCo may grant waivers from compliance with the requirements imposed on a voluntary delisting if the offeror secures acceptances from independent shareholders representing at least 75%, and the offer is deemed fair and reasonable by the IFA.

In its responses to comments during the public consultation[4], SGX highlighted that the loss of public float *should not* be used as a mechanism to avoid compliance with the principles of a voluntary delisting. To avoid circumvention of its rules by offerors, SGX stated upfront that it *may* waive compliance from the exit offer and shareholders' approval requirements if the offer is fair and reasonable and meets the 75% independent acceptance threshold.

If these conditions are not met, SGX is *unlikely* to allow the issuer to delist, and *may* suspend the trading of the issuer's securities. SGX will require the issuer to comply with the Listing Rules, including the requirement to restore its public float (through private placement or otherwise). For the avoidance of doubt, if there is a subsequent offer or a scheme of arrangement that complies with the requirements of the Listing Rules, the issuer will be able to delist.

As these considerations have not been incorporated into the Listing Rules, a subsequent May 2020 Regulator's Column[5], the second of the three columns, reiterated this position - SGX may waive strict compliance with delisting rules for issuers that lose

[4] https://api2.sgx.com/sites/default/files/2019-07/Responses%20to%20Comments%20Received%20on%20Voluntary%20Delisting%20Regime%20Consultation%20Paper%20%28SGX%2020190711%29.pdf

[5] https://www.sgxgroup.com/sgxgroup/media-centre/20200504-regulators-column-sgx-regcos-expectations-information-be-provided

their free float, if independent acceptances reach 75% or more and the IFA has opined that the offer is fair and reasonable. It gave an example of an issuer losing its free float following a general offer, where the 75% Acceptance Condition has not been met. As a result, the issuer may be subject to prolonged suspension if the offeror does not intend to take steps to restore free float.

SGX stated that it *may* suspend the trading of the shares if the public float is lost. It presented a view that the issuer is *obligated* to *comply* with its listing rules, including the requirement to restore its public float.

The flawed logic of independent acceptance

The issue with "independent acceptance" is that it can be influenced by shareholding structures, such as the presence of institutional investors who typically cannot hold shares in suspended or delisted companies.

In addition, when the free float is small and/or when the number of shareholders is low, a few shareholders can have an outsized impact on independent acceptance. Nevertheless, it is important to note that investors in such illiquid companies typically take a long-term view, making investor protection even more crucial as these investors risk their capital over extended periods hoping to realise value. Investors in illiquid companies are not day traders.

Yet, independent acceptance is being used as a test of the legitimacy of a general offer. In our view, this is a poor proxy. Shareholders may accept a general offer for reasons unrelated to the offer's fairness or reasonableness, such as avoiding the risk of holding shares in a suspended company. SGX listing rules must protect investors from being forced into accepting an offer due to trading suspension. Many shareholders, resigned to their inability to win against majority shareholders, accept offers to protect their liquidity, creating a chicken-or-egg situation where the current regulations fail to prevent this cycle.

We have no issue with remaining shareholders voting on the delisting in what the regulator calls "independent approval" in cases where the public float is lost. However, in situations where the offer does not meet the requirement of being a fair and reasonable one, the concept of "independent acceptance" takes precedence and dissenting shareholders are left in a limbo.

As in the GE example, shareholders who hold out do not get to exercise their rights via an independent approval. This brings us to the main irony of "independent acceptance" – shareholders who accept the general offer and move on get to decide the fate of shareholders who still have skin the game.

Small shareholders who hold out in general offers once the free float has been lost face a hugely uncertain future and have no say on the direction the issuer takes. Contrast that to a court-sanctioned scheme of arrangement where the outcome impacts all shareholders dissenting or otherwise, which requires two thresholds to be met - a headcount requirement and a share requirement.

SGX RegCo has stated that the requirements for 75% independent acceptance and a fair and reasonable general offer are conjunctive requirements for shareholder protection. We beg to differ. Dissenting shareholders who continue to risk their capital are subject to the actions of accepting shareholders who are no longer vested.

The concept of "independent acceptance" has not been codified into the SGX Listing Rules and it was formulated by SGX RegCo in 2019 following public consultation in which SGX balanced the rights of minority shareholders by considering independent shareholders as a whole and recognised that there are other ways to privatise a company from SGX. But, as we have shown, this approach has gaps, which have become more evident with the recent amendments to the Companies Act that significantly raised the bar for delisting through compulsory acquisition.

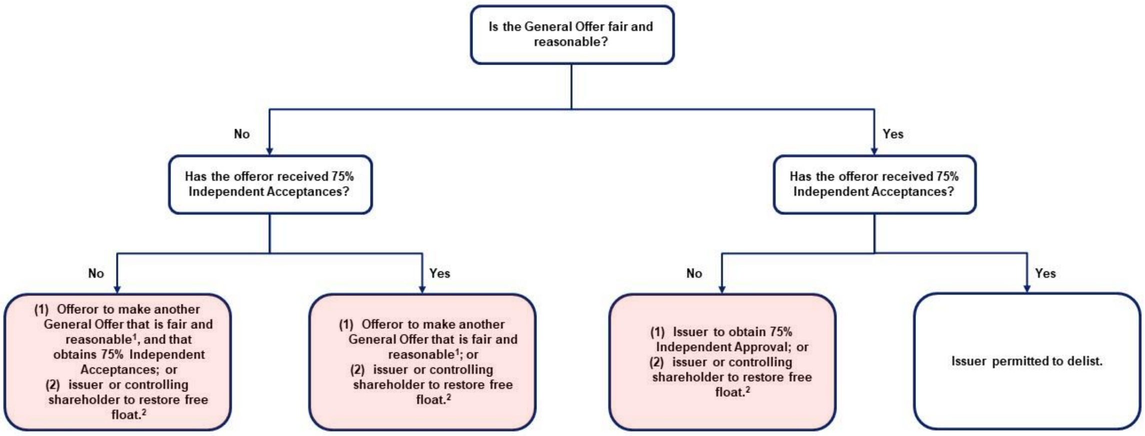
Stronger investor protection should be written into the listing rules. When the free float is lost following an unfair and/or unreasonable offer, SGX must ensure that the issuer or the offeror restore the free float, with no exception.

We further propose that all general offers be made conditional upon receiving a fair and reasonable opinion by the IFA. For any general offers where the offeror intends to delist the company from SGX, we also recommend that the offer be set at a price which is at least equal to the volume-weighted average price (VWAP) or the revalued net asset value (RNAV) per share less a reasonable discount, whichever is higher. We believe a discount in the range of 10 to 15 percent is reasonable as a general guide, though a tiered approach might be appropriate as well with a lower discount being allowed for larger companies. We recognise however that the appropriate discount range is subjective. Another possibility is to provide minority shareholders with a statutory right to apply to the Court to appraise the fair value of their shares. This right exists in every state of the U.S. except one, and in jurisdictions such as Bermuda and Taiwan. Of course, such a right should not come with significant cost or legal hurdles. We should look at what other jurisdictions do to better protect minority shareholders in such situations.

It has been further suggested by an astute market participant that an offeror should not be allowed to make a general offer if the intention of the offeror is to delist the company from SGX. This will prevent many issues associated with the loss of free float and independent acceptance. To delist a company from SGX, the offeror should avail itself to the SGX delisting framework, a scheme of arrangement or selective capital reduction.

SGX RegCo's limited arsenal

Potential scenarios where the issuer has lost its public float pursuant to a General Offer



Notes:
[1] Under the Take-over Code, the offeror may not make another offer on terms better than those made available under the previous General Offer until six months from the closure of the previous General Offer.
[2] The offeror may also explore other privatisation mechanisms, for example, an exit offer that complies with the Listing Rules. Please also see Regulator's Column – Privatisations through General Offers for more details.

One may question whether the decision tree published by SGX RegCo in its 15 July 2024 column, which shows the potential scenarios where an issuer has lost its public float pursuant to a general offer, is a decision tree at all.

Three of the four scenarios, as indicated by the light red shading in the diagram above, are substantively similar. In these three scenarios, SGX RegCo attempts to imply that the option is there for the issuer or the controlling shareholder to restore free float. As we shall see later, SGX RegCo has not been able to enforce this, even though it is in its listing rules.

In the first shaded box from the left, if the current offer is NOT fair and reasonable and if the current offer did not receive 75% independent acceptance, it appears that all the offeror has to do is to make another general offer that is fair and reasonable and try to obtain 75% independent acceptance in the subsequent offer. So why would an offeror make an initial offer which is fair and reasonable if it can have more than one bite of the cherry? It would have an incentive to try its luck with an initial low-ball offer, hoping that it will achieve the 75% independent acceptances, which as we explained earlier, may have nothing to do with whether an offer is fair and reasonable.

In the shaded box in the middle, where the current offer is NOT fair and reasonable, but the offeror has obtained 75% independent acceptance, the offeror has to make another offer that is fair and reasonable. Again, the offeror has an incentive to try its luck first with a low-ball offer.

In the shaded box on the right, where the current offer is fair and reasonable but has not received the 75% independent acceptance, all the offeror has to do is to obtain 75% independent approval.

In addition, the loss of free float, coupled with unmet delisting requirements, almost guarantees a drawn-out process that would take more than six months as a superior offer may not be made within that period under the Take-over Code. This is an undesirable situation in today's fast capital markets.

Two-stage delistings

If we were to put ourselves in the offerors' shoes, or that of their legions of advisers, the independent acceptance is an exogenous factor that will be met or not met after the offer is launched. What is within the offeror's control is the offer price, an endogenous factor. We think that it is the dominant strategy for an offeror to offer a fairly low price in order to set up a two (or more)-stage privatisation exercise. If the offeror does not meet the requirements to delist, all they have to do is to make another offer after six months under the Take-over Code. We think the current rules actually encourage two-stage delistings.

Shareholders, such as retirees, would generally be fearful of a suspended issuer and as such would generally be inclined to give in at the first stage of this "two-stage" delisting. The unfortunate outcome is that the regulations do not protect the most vulnerable group of investors from low ball offers. In fact, it can be said small retail investors are the targets of such a two-stage delisting strategy. Traditional institutional funds are also forced to accept the offers that do not represent fair value given that they usually do not have the mandate to hold shares in companies that are suspended or delisted.

We see the current remedies as weak and so similar that it does not benefit the offeror to try to get a fair and reasonable opinion for their initial offer, unless SGX RegCo can direct issuers to restore free float, with no exceptions. In GE's case, there may be no real solutions to resolve a hold-out situation unless the free float is restored. Otherwise, the offeror may continue to make offers at six-monthly intervals with no chance of getting the 75% independent approval. SGX RegCo's biggest stick is a directed delisting, which unfortunately is the goal of the offeror.

In addition, in a recent case where an issuer was given extensions of time and issued a Notice of Compliance to restore free float due to the loss of free float following a "not fair but reasonable offer", the offeror (also a listed company) referred to its series of actions as the "natural progression of the delisting process" despite Notices of Compliance being issued by RegCo to the offeror and the offeree. The offeror even cited its continued membership on SGX Fastrack as evidence that has followed the rules and has conducted itself to the highest standards! SGX RegCo has stated that it may utilise the range of its enforcement powers available to it under the listing rules on issuers (and the controlling shareholder, where applicable) who fail to restore free float but we have yet to see any regulatory actions thus far.

The loss of public float

The issues surrounding independent acceptance are compounded by SGX's low public float requirement. At just 10%, Singapore's threshold is among the lowest in the region, if not the lowest. This low threshold allows controlling shareholders to maintain a tight grip on listed companies, reducing liquidity and diminishing the attractiveness of these stocks to institutional investors.

As shown in the saga over the general offer for GE, issuers with low existing public float can easily end up in this no-man's land. Unless SGX RegCo is empowered to compel issuers to restore free float, we think there are other solutions that can be considered in parallel. Does price discovery deteriorate because free float has fallen from 11.56% to 6.48%, as has happened at GE? We believe not and question whether the immediate suspension of trading upon breaching the 10% free float threshold was necessary. While Rule 724 states that trading of the shares *may* be suspended when free float is less than 10%, Rule 1303(1) prescribes a more definitive outcome which states that the exchange *will* suspend trading of the listed securities at the close of the take-over offer once the free float falls below 10%. From the perspective of investor protection, with Rule 724 being applicable even in take-over situations, we feel that Rule 1303(1) may be unnecessary as it unfairly skews the situation in favour of an offeror, disadvantaging minority shareholders.

The value of the GE shares not held by the offeror exceeds $815 million. It is important to note that GE shares have been historically illiquid, with an average of just 19,160 shares traded per day—equating to 0.004% of its issued shares—over the twelve months preceding the offer. We see little to no risk of nefarious parties trying to corner GE shares even though the free float is less than 10%. On a hypothetical basis, had there been a decision by the exchange to not suspend the trading of GE despite the loss of 10% free float, we feel that minority shareholders may have been better positioned to assess the offer independently without the threat of loss of liquidity, potentially offering them greater protection.

The Stock Exchange of Thailand (SET) grants issuers that have lost their free float a twelve-month period during which trading continues and the issuer comes up with a remedy to restore free float. During this period, the company is required to arrange for public presentation every quarter. We see this as an elegant solution which removes the leverage that an offeror has over minority shareholders in a delisting scenario. SGX already places companies on its watch list based on its financial performance and we believe it can also explore putting companies on a low free float watch list.

Public float requirements do not make sense

The idea that an appropriate public float will lead to well-functioning market price discovery, and a fair and orderly market, free of manipulative trading is a logical one. But do the current SGX requirements pass the common sense test in practice? Based on SGX's own Stock Screener, nearly 520 issuers in its list of 634 issuers have a *total* market capitalisation of less than $800 million (being the approximate value of GE shares not held by the offeror), with the smallest issuer having a market capitalisation of just $275,000. Clearly, these 520 other issuers are not suspended from trading on the SGX-ST. In fact, there are large listed companies with total assets as much as $40 billion and free float as low as 11%. There is even an issuer with just 10.06% in free float with the controlling shareholder holding 88.7%. Naturally, liquidity is poor for many of these tightly-held issuers with close to zero institutional interest. No wonder valuations are depressed on SGX.

Looking at the other exchanges, Bursa and the Hong Kong Exchange require a free float of 25%. The Stock Exchange of Thailand sets a free float of at least 15%, to be held by at least 150 non-strategic shareholders. Japan requires a certain number of tradable shares, with JPY10 billion in tradeable market capitalisation, average trading volume, minimum number of shareholders and a "tradeable share ratio" of 35% or more. In the major North America exchanges, the free float requirements are based on the number of shares in public hands and the share price, which translate into a tradeable market capitalisation measure. London Stock Exchange recently reduced the free float level to 10% in a bid to attract listings – the implications of this regressive approach remain to be seen.

Low free float requirements enable major shareholders to entrench themselves, thus generally leading to low interest from institutional investors, lower perceived governance and a lack of trading liquidity. We believe the current free float requirement of 10% should be reviewed. Shareholders need to have meaningful stakes to make their engagement worthwhile and controlling shareholders should be made less entrenched and be obligated to engage with shareholders. Regulators must comprehend and effectively incorporate such market dynamics into their regulations.

A RegCo that regulates and protects investors

The current delisting framework can be further strengthened to improve investor protection given that the loophole for compulsory acquisitions has now been closed. We may continue to see two-stage delistings if SGX RegCo is unwilling or unable to put its foot down to direct issuers to restore public float. Two-stage delistings hurt the most vulnerable investors, such as retirees who depend on the stock market for dividends and a return of capital. In fact, the loss of liquidity is a dealbreaker for most segments of the capital market, including most traditional funds, and we have seen controlling shareholders use this to their advantage. SGX RegCo cannot let delistings be turned into unfair and prolonged multi-stage sagas, where only deeper pocket investors prepared to endure lengthy suspensions can hold-out in the hope of getting a higher price. It may be worthwhile to prohibit general offers when the offeror has clear intention to delist the issuer. Instead, the offeror should be limited to proposing a delisting resolution, a scheme of arrangement or via selective capital reduction. This approach could ensure a more structured and transparent process for delisting, benefiting all stakeholders involved.

Note: *On 21 October 2024, Great Eastern announced that SGX RegCo had granted it a further extension of time until 24 January 2025. This new deadline is three months after the date when non-assenting shareholders can require GE to acquire their shares under Section 215(3) of the Companies Act. While the final shareholding held by GE will only be determined after 5:30 p.m. on 23 October, we would expect that the company has already evaluated all its options when it made its offer price final on 14 June 2024 and fixed the closing date. It might be overly generous that GE gets three more months to "explore options" to comply with the requirements of the Listing Manual. It has been 5 and a half months since the offer for GE was launched, and it will be 8 and a half months before minority shareholders might be given any clarity about the outcome. As discussed in the article, it would be only fair for the SGX Listing Rules to be strictly enforced. Therefore, it is crucial that GE uses this additional time to take decisive steps toward compliance with the Listing Manual and provide clarity to all shareholders, particularly the minorities. This ongoing uncertainty, already prolonged, undermines investor confidence and fair market practices. Strict enforcement of SGX Listing Rules is not just necessary—it is critical to restoring trust in the regulatory framework and ensuring that all shareholders are treated equitably.*

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The Viewpoint series published by the Centre for Investor Protection is aimed at generating debate on issues relating to corporate governance and investor protection, particularly relating to Singapore. They are written or co-written by members of the Centre. Each issue represents the personal views of the author(s).