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Trust us, we are really independent

Singapore's corporate world provides many examples of questionable independence. The rules need tightening. BY MAK YUEN TEEN

ON OCT 14, Chew Yi Hong and I released the Governance Index for Trusts (GIFT) 2020. In assessing the 45 trusts covered, we re-designated 14 independent directors (IDs) in 11 trusts from independent to non-independent due to their tenure having exceeded nine years or their close relationships with the sponsor, controlling unitholder or related companies of the manager. These 14 IDs were among the 189 ID appointments in the 45 trusts.

Another 19 trusts received demerit points for IDs having other relationships, such as lawyers serving as IDs while their firms provided legal services to the trust, the manager or related companies. It is therefore common for IDs of trusts to have relationships other than being a director of the manager/trustee-manager.

Under the regulations for real estate investment trusts (Reits) and business trusts (BTs), the board can deem a director as independent even if the director has relationships specified by these regulations for determining his independence.

There are only minor exceptions. One is that a director of a Reit manager cannot be deemed by the board to be independent after nine years. Regulations are meant to be prescriptive and clear. Allowing the board to deem a director as independent without any review by the regulators undermines the effectiveness of these regulations.

The IDs we re-designated or applied demerit points to may well be independent in conduct, character and judgement. However, independence is also about perceptions; external stakeholders who are unable to observe the exercise of independent judgement will form their perceptions based on the presence of certain relationships.

For externally-managed trusts, which are prevalent in Singapore, all directors, including IDs, are appointed by the shareholders of the manager or trustee-manager and can be removed by them unilaterally. This adds to the challenge of ensuring independence of directors in trusts.

EAGLE HOSPITALITY TRUST

We saw that recently at Eagle Hospitality Trust (EHT), where ID Carl Gabriel Florian Stubbe was not re-elected by the sponsors, who indirectly own EHT's manager. Unitholders had no say in Mr Stubbe's removal and he had strong support from the board. With the dispute between the sponsors and manager, it was not surprising that he was not re-elected.

Ironically, in an article posted on my website on July 1 based primarily on information disclosed in EHT's prospectus, I had questioned whether Mr Stubbe was truly independent in the first place. He joined Jones Lang LaSalle Property Consultants (JLLPC) in Singapore as a senior executive in May 2019 – the same month when EHT was listed – and JLLPC's fellow subsidiary in the US was the "independent market research consultant" which produced a 189-page report that was included in EHT's prospectus. The fees paid for this work were not disclosed, but would undoubtedly have been substantial.

Mr Stubbe joined EHT as an ID in August 2018. While his employment relationship at JLLPC and the appointment of its fellow subsidiary as the market research consultant were both disclosed in the prospectus, the prospectus was silent on whether this was considered in determining his independence.

He would presumably have been in discussions about joining JLLPC as he was discharging his responsibilities as an ID pre-listing. These responsibilities would include reviewing the prospectus and the market research consultant's report. Would he be in a position to question the work done by the subsidiary of the company he was about to join as a senior executive?

SABANA REIT

Compliance with the letter of the rules for IDs and the board's discretion in deeming a director as independent was also in the spotlight recently at the manager of Sabana Reit.

On Sept 22, I posted an article on my website questioning the re-designation of Ng Shin Ein from non-independent to independent. The day before, Sabana had issued a belated addendum to its 2019 annual report (released on April 7) to justify the re-designation.

Ms Ng is the chair of the Nominating and Remuneration Committee (NRC), which, among other responsibilities, "determines the independence of directors". In the addendum, Sabana said that she recused herself from the determination of her independence. This does not remove concerns about her independence.

On Oct 5, Sabana issued a six-page response to my article, giving reasons she could be considered independent. Some of the concerns I had raised were that she had sold her 4.5 per cent indirect stake in the manager to the current controlling shareholder of the manager, and she had previously been a non-executive director (NED) for more than six years, before rejoining the board as NED and then re-designated to ID.

The response provided justifications that can be summed up as follows: the rules are not strictly applicable to her circumstances; where they may be, compliance is voluntary; the NRC and board had considered it; and the regulations allow the board to deem her as independent anyway.

The response does not address the perception that she may be or feel obliged to support the current controlling shareholder of the manager, especially as there were no details about the sale price and how it was determined, which I had raised.

Sabana also did not address my questions about the search process that was undertaken, and why she was specifically selected from among all possible candidates in the market.

The concern about IDs is arguably even worse for listed companies for which most of the rules relating to director independence are in the Code of Corporate Governance, which is based on "comply or explain". With certain relationships now moved to the listing rules, observance of the letter in certain areas would undoubtedly improve, but the spirit would likely remain lacking.

FAMILY RELATIONSHIPS

Take the case of family relationships. The listing rules (and previously the Code) say that a director who has an "immediate family member" whose remuneration is determined by the remuneration committee is not independent. At Asian Micro in 2018, the nephew of the executive chairman and controlling shareholder was re-designated from non-independent to independent, with the concurrence of the continuing sponsor.

It is absurd that a nephew can transform from non-independent to independent. I am sure there are other companies with family members such as in-laws, nephews, nieces and cousins acting as independent directors because they are not considered "immediate family members" under the rules; I have come across such cases from time to time.

EMPLOYMENT RELATIONSHIPS

Then we have companies like China Sunsine, CWX Global and Hyflux, where employees or executive directors morphed into non-executive directors and then into independent directors after "cooling off" periods for employment relationships.

If someone had never left the company after having been an employee, I do not see how he or she can be perceived as independent. Relying on the "cooling off" period to justify a director as independent only makes sense to me if that person has left the company and returned after the cooling off period – and arguably only if the management and controlling shareholder have substantially changed.

LONG TENURE

We also have many companies navigating around the guidelines on tenure. Take the case of Santak Holdings. Two independent directors who have served on the board for 19 years are on the nominating committee (NC), including one who is NC chairman, with the group managing director being the third NC member.

The company said that the NC had undertaken a rigorous review and considered the recommendations in the 2018 Code in determining that the two long-serving directors are still independent. Part of the justification was that they "are valuable to the Group in terms of their experience and knowledge in finance, understanding of the precision components business and the markets notwithstanding their long tenure".

The company also said "the Board considers continuity and stability of the Board important". However, the company has been making losses for the past seven years (excluding discontinued operations). I guess it is possible that without the long-serving directors, it could have been worse.

In this case, each of the two long-serving directors would presumably have taken turns recusing themselves, while the other long-serving director and the group MD "rigorously review" whether the recusing ID is independent. The latter would then "rigorously review" the ID who had just "rigorously reviewed" him. Presumably, both IDs will later "rigorously review" the performance and remuneration of the group MD too.

It gets worse because, according to Santak's annual reports, a firm in which the "independent" chairman has a substantial financial interest in had been providing advisory and consultancy services worth S$88,000 to S$199,240 a year from FY2006 to FY2017. That adds up to nearly S$1.5 million over a 12-year period. He is also one of the two long-serving IDs on the NC – so he was deemed independent despite long tenure and having a long and substantial business relationship with the company.

OTHER COUNTRIES

Other countries have taken different approaches for director independence. Countries like Hong Kong, Malaysia and US include all or most of the criteria for determining independence in the listing rules, while also requiring the NC/board to assess independence. This means that any deviation from the criteria is a deviation from the listing requirements.

In HK, the listing rules say that the exchange will take into account the factors relating to independence included in these rules when assessing the independence of directors, and state that independence is more likely to be questioned by the Exchange if a director is caught by any of those factors. IDs are required to submit a written confirmation to the Exchange, which must state their independence on each of the factors listed in the rules.

The factors for determining independence in the HK listing rules are also on the whole considerably stricter than in Singapore. For example, it is common here for partners of law firms to be serving as IDs while their firms provide legal services to the company.

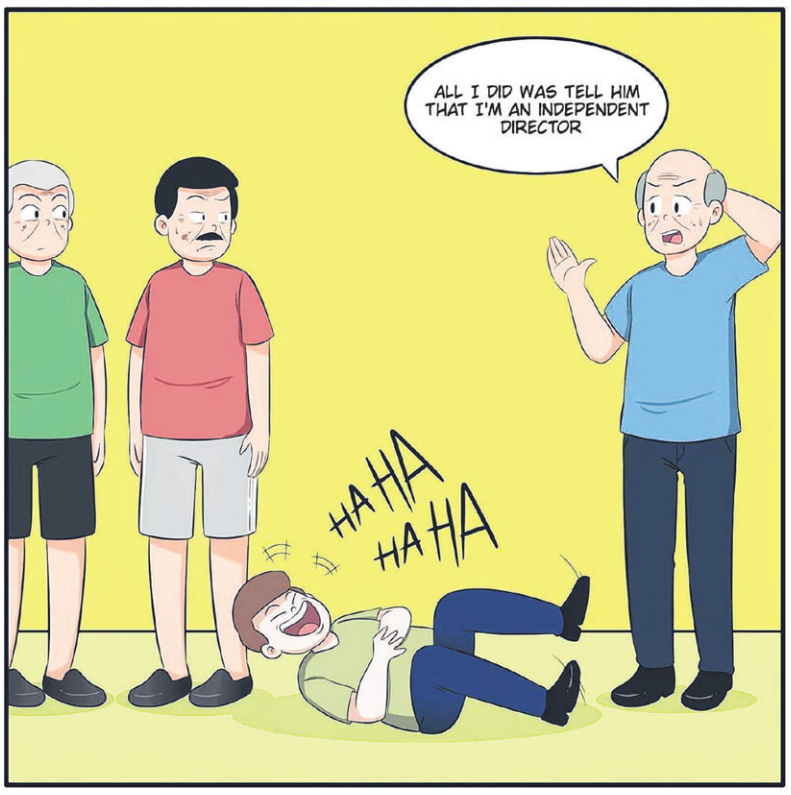
Even if the quantum of fees exceed $200,000 (which is now in the Practice Guidance of the Code), we see cases where the director is still deemed independent. In HK, the provision of services, regardless of quantum, will result in a director to be deemed as non-independent. Directors on HK boards have confirmed with me this strict standard.

Other countries have introduced two-tier voting for IDs, under which such directors are elected by a vote of all shareholders and a vote of only minority shareholders. This applies regardless of the tenure of the IDs. Countries that do so include Israel and UK, with the latter requiring it for premium listings. India is considering adopting a similar practice.

Sweden has a nominating committee whose members are elected by shareholders at the general meeting. Such a committee include non-board members and members who are not associated with controlling shareholders. This makes the nomination process more independent.

Singapore needs to improve the implementation of director independence if it is going to arrest the erosion of trust in independent directors.

The writer is an associate professor of accounting at the NUS Business School, where he specialises in corporate governance. A longer version of this article is available at www.governanceforstakeholders.com



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