NUS National University of Singapore

Source: *The Business Times*, p21
Date: 6 April 2021

Rebuilding trust in independent directors

Minority shareholders should have greater say in appointing IDs and the independence criteria should be more prescriptive. BY MAK YUEN TEEN

THE concept of independent directors (IDs) was formally introduced to corporate Singapore in the first Code of Corporate Governance in April 2001, which was largely modelled on the then 1998 UK Combined Code.

Each revision of the Code has since seen some adjustments to the criteria for determining director independence. In the last review, employment and family relationships used to determine independence were moved to the listing rules, making them binding. Those relating to business and shareholding relationships are now in the practice guidance and no longer subject to "comply or explain" – although the disclosure of such relationships is still expected.

The proportion of IDs increased from one-third in the 2001 Code, to half IDs where the chairman is not independent in the 2012 Code, and then to a majority IDs where the chairman is not independent in the latest Code.

From Jan 1, 2022, the SGX listing rules also mandate all companies to have at least one-third IDs and a nine-year term limit for IDs. Those serving more than nine years have to be approved by a two-tier vote to continue as IDs. In 2020, 27 companies have already implemented two-tier voting for 34 IDs who have served more than nine years or who will pass nine years during their latest term .

From Jan 1, 2022, the SGX listing rules mandate all companies to have at least one-third independent directors (IDs) and a nine-year term limit for IDs. Those serving more than nine years have to be approved by a two-tier vote to continue as IDs. BT FILE PHOTO

PROCESS OF APPOINTMENT

While progress has been made in strengthening the criteria for determining independence and increasing the proportion of IDs, the appointment and election process for IDs has not changed and is a major contributor to the lack of true independence of IDs. The two-tier vote for IDs after nine years may help but does not address the problems with the appointment and continuing re-election of IDs prior to that.

The Code expects IDs to be independent of substantial shareholders. This is unrealistic when IDs are often effectively appointed by controlling shareholders, who in many cases are also management or related to management. IDs who truly assert their independence would not need to wait nine years to be voted out – by the major shareholders!

Companies often aggravate the perceptions of lack of independence by how they select IDs.

Take the case of Top Glove, which has a primary listing in Malaysia, a secondary listing in Singapore and which has now applied to list in Hong Kong.

In January this year, BlackRock (the world's largest asset manager) and Norges Bank Investment Management (fund manager for the world's largest sovereign wealth fund) voted against the re-election of all six directors at the annual general meeting of Top Glove. BlackRock criticised the company's handling of the coronavirus outbreak. It has also faced criticism for terminating a whistleblower and actions by the US authorities for allegedly using forced labour in its operations.

However, what is less well known is how Top Glove appoints some of its IDs. In 2015 and 2019, when two IDs then aged 87 and 90 years old retired after serving more than 14 and 18 years respectively, their daughters replaced them. These new IDs have entirely different backgrounds from their fathers.

Top Glove may claim enhanced diversity and tick all the boxes on director independence – but they are unlikely to be perceived to be independent. Appointing IDs in such a manner is unlikely to lead to an effective board and makes the company vulnerable to criticism, especially when things go wrong.

One would expect a company like Top Glove – a global company with international investors – to have a robust process for appointing IDs and be mindful of perceptions. It has a large pool of potential directors to select from but appears to choose from a small one. Unfortunately, many companies here, including large companies, are guilty of this.

GLOBAL COMPARISONS

Other countries also grapple with how to better ensure that IDs are truly independent. Many have implemented measures that better empower minority shareholders to appoint IDs or have more robust criteria or approaches for determining independence.

Using data from the *OECD Corporate Governance Factbook 2019*, supplemented by other sources, I compared 51 jurisdictions, including Singapore, in three areas:

- Availability of cumulative voting for directors;
- Minority shareholders' approval for the appointment of independent directors;
- Prescriptiveness of the criteria used for determining independence.

Of the 51 jurisdictions, 30 (including Canada, the US, China, India, Japan, South Korea, the Philippines, Taiwan, Thailand and Vietnam) either allow or require cumulative voting for directors.

Under cumulative voting, each shareholder is typically entitled to one vote per share multiplied by the number of directors to be elected. Individual investors can apply all their votes to one candidate. This makes it easier for minority shareholders to get together and appoint a director of their choice. While cumulative voting remains rare in the many countries that allow it, it is prohibited in Singapore.

Eight out of the 51 jurisdictions have separate minority shareholders' vote or two-tier voting for IDs. These are Brazil, Chile, Israel, Italy, Portugal, Spain, Turkey and the UK.

In the UK, two-tier voting applies to premium-listed companies with controlling shareholders. Companies that do not pass the two-tier vote have to convene another extraordinary general meeting where single-tier voting applies. India is considering introducing two-tier voting for IDs.

PRESCRIPTIVE CRITERIA

In assessing how prescriptive the criteria for determining independence are, I considered whether these criteria are included primarily in company law, securities regulation, legally binding code, listing rules, or a "comply or explain" code of corporate governance – or their equivalents.

Twenty-four jurisdictions take a prescriptive approach by setting out criteria for determining independence primarily through company law, securities regulation, a legally binding Code, listing rules, or other prescriptive rules. The others rely mainly on a "comply or explain" approach for determining independence based on a corporate governance code, or do not provide any detailed guidance.

Singapore now adopts a hybrid approach, whereby certain criteria are included in the stock exchange rules, but most independence criteria are in the Practice Guidance of the latest Code.

Singapore's approach to determining independence is less prescriptive compared to Canada, the US and most other Asian markets. In Canada and the US, the rules set out a principle-based definition of independence but include a comprehensive list of specific criteria for determining independence. A director is not considered independent if caught by any of these criteria.

In the Asian jurisdictions, independence criteria are usually set out in mandatory rules, such as company law, securities regulations or listing rules. For instance, in Hong Kong and Malaysia, detailed criteria for independence are in the listing rules. In addition, IDs have to confirm their independence to the stock exchange based on these criteria. The listing rules in Hong Kong specifically state that the exchange may question a director's independence if any of the specified relationships exist. In Singapore, IDs are not required to confirm their independence to the stock exchange.

There are other practices around the world that enhance the independence of IDs. For example, while Sweden does not have prescriptive criteria for determining independence, it has a system of external nomination committees tasked with the nomination of directors and assessing their independence. At least one committee member has to be independent of the largest shareholder. Existing directors must constitute only a minority of members, and no more than one current director representing a major shareholder can be on the committee.

This makes the nomination process more arms-length than the prevalent system where a nominating committee made up of existing directors nominates directors and assesses their independence – in effect a self-selection and self-review process.

Taking the three factors together, Singapore is among a small minority of countries where minority shareholders have little influence on directors' appointment and follow a mostly non-prescriptive approach for determining director independence.

ENFORCEMENT

Director independence can also be affected by whether there is robust enforcement against directors for breaches of duties. If directors know that they may be held accountable, they are less likely to let relationships get in the way of discharging their duties.

In this regard, Singapore also fares relatively poorly compared to some other markets. For example, between 2012 and the first six months of 2020, the Australian Securities and Investment Commission (ASIC) has taken 106 enforcement actions against directors, including those in private and public companies. These include criminal, civil and other actions.

In Hong Kong, just in the quarter ended Dec 31, 2020, the Securities and Futures Commission concluded nearly 120 enforcement actions for corporate disclosure and corporate misgovernance issues. In the first six months of 2020 alone, the Hong Kong Exchange imposed disciplinary actions on 43 directors, including 14 IDs.

In Malaysia, Bursa Malaysia publicly reprimanded and fined 23 directors a total of RM8.66 million (S$2.81 million) in 2019 alone, including IDs.

In contrast, public disciplinary actions and statutory enforcement actions are extremely rare in Singapore. Since July 2018, there has only been one public disciplinary action by SGX RegCo, which was taken against a company, and its former executive chairman, former CEO and former CFO.

Building trust in IDs requires more than an occasional tweaking of the criteria for determining independence or increasing the proportion of IDs – which is what Singapore has been doing over the last 20 years.

Having IDs who are effectively appointed by major shareholders, who then opine that the directors are independent of management and the major shareholders who appointed them, is circular logic. It simply cannot lead to trust that the IDs are truly independent.

We have now reached what I consider a reasonable limit in terms of proportion of IDs and there are not many more meaningful criteria we can add to director independence. Future reforms should instead focus on giving minority shareholders greater say in the appointment of IDs, making the criteria for determining independence more prescriptive and the process more robust, and stronger enforcement. One possibility is to allow companies that subject IDs to a two-tier vote on all election of IDs – not just after nine years – to have fewer IDs compared to other companies. However, the votes of controlling shareholders should be excluded from the second-tier vote regardless of whether they are directors, CEO or their associates.

It is better to have fewer IDs on the board that minority investors can trust than have many IDs who are seen as rubber stamps.

The writer is an associate professor of accounting at the NUS Business School where he specialises in corporate governance.
A version of this article first appeared in the Q2 2021 issue of the SID Directors Bulletin published by the Singapore Institute of Directors.