NUS National University of Singapore

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Directors' independence, interest alignment remain concerns for listed trusts: governance index

Overall, the average score for all ranked trusts increased this year to 66.0 from 64.1 in 2021, but the recent uptrend is unlikely to continue

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Governance Index For Trusts (GIFT) 2022

RANK	REIT/BT	GOVERNANCE RISK SCORE	BUSINESS RISK SCORE	GIFT 2022
1	NetLink NBN Trust	75	24	**99**
2	Keppel Pacific Oak US Reit	66	21	**87**
3	Cromwell European Reit	65	20	**85**
4	CapitaLand Integrated Commercial Trust	56	24.5	**80.5**
5	Keppel DC Reit	58	20.5	**78.5**
6	Frasers Centrepoint Trust	53.5	23.5	**77**
7	Far East Hospitality Trust	54.5	22	**76.5**
7	Keppel Reit	58.5	18	**76.5**
7	Mapletree Pan Asia Commercial Trust	56.5	20	**76.5**
10	Mapletree US Reit	57	19	**76**

Source: Mak Yuen Teen & Chew Yi Hong

Prof Mak Yuen Teen says Singapore-listed trusts tend to merely tick the boxes on independence when it comes to their independent directors, and this needs to change. PHOTO: MAK YUEN TEEN

THE governance practices of Singapore-listed trusts have begun to improve again after a recent slump; but issues that also dog the rest of the market – such as an ongoing reluctance to actively pursue board renewal and economic recessionary pressures – threaten the sector's long-term performance.

These were among the findings of the Governance Index For Trusts (Gift) 2022, which assessed the corporate governance practices of 43 real estate investment trusts (Reits) and business trusts (BTs) listed on the Singapore Exchange (SGX).

The index, in its sixth edition, was complied by corporate governance advocate and professor of accounting at the NUS Business School, Mak Yuen Teen, and active investor and researcher, Chew Yi Hong.

"We see improvements in the overall governance of trusts. While business risks have crept up given the market conditions, the sound regulatory framework established by the Monetary Authority of Singapore (MAS) has helped ensure that there is no distress in the sector," said Prof Mak.

Overall, the average score for all ranked trusts increased this year to 66.0 from 64.1 in 2021. It had slipped in the two years prior, after increasing between 2017 and 2019.

They are scored in various areas of governance (such as board matters, remuneration, and unitholder communication) which carry a 75 per cent weighting, as well as business risks (such as overall leverage, debt maturity, and foreign currency risks.) which carry a 25 per cent weighting.

However, Prof Mak said the recent uptrend is unlikely to continue, with one reason being that he and Chew intend to raise the bar by reducing the points for the disclosure-type items that should be reported as a matter of course.

"The other is the possibility that some of the business risk factors may deteriorate, such as higher leverage, shorter WALE (weighted average lease expiry) if there is a recession, and more trusts using perpetual securities. With more trusts venturing overseas, they may score less well when they lack management or board experience in overseas markets they venture into."

The top five ranked trusts were, in descending order: NetLink NBN Trust, Keppel Pacific Oak US Reit, Cromwell European Reit, CapitaLand Integrated Commercial Trust and Keppel DC Reit.

NetLink NBN Trust is notable for having been the top-ranked trust in Gift since its debut in 2019. This year, it achieved a new high score of 99, compared to 95 in 2021 and 90 in 2020 and 2019.

Also notable, said the index's authors, was Sabana Reit. It had been under scrutiny from unitholders, market watchers and regulators, and failed in its controversial merger with ESR-Reit in 2020. But it significantly improved its score and ranking in GIFT 2022, moving up to joint 14th place, from 38th last year, as it revamped its board and focused on its core business.

"Activist unitholders, regulators and the trust itself deserve credit for this improvement," Prof Mak said.

Areas where the overall sector did well include allowing unitholders attending annual general meetings remotely to ask questions live; however, the index authors pointed out that the improvement had a lot to do with the changes in rules introduced by SGX.

All trusts also posted their minutes this year, as it is still an SGX requirement. "We hope they will continue to do so, (as there were only) just over 60 per cent of trusts posting their minutes of meeting prior to the pandemic," Prof Mak said.

Trusts also continued to do well in disclosing the exact fees paid to non-executive directors – all but one did so, which is a much higher proportion than in the broader market.

However, one worrying issue for trusts, as it is for the broader market, is that of board renewal. The index authors noted that trusts are still not doing enough to expand the pool of candidates when recruiting independent directors (IDs). For example, only 15 trusts have multi-dimensional diversity in terms of gender, age and ethnicity.

Prof Mak noted that trusts tend to merely tick the boxes on independence when it comes to their IDs, adding: "(Many) have relationships that cause us to redesignate them from independent to non-independent or to impose demerit points.

"We commonly see IDs with relationships with the sponsor or controlling shareholder, IDs being recycled among related trusts, and still very few trusts giving independent unitholders the right to endorse directors. Perhaps MAS should require trusts to put all IDs up for endorsement, not just in situations like Sabana Reit when questions are raised about independence of directors."

Also of concern is the possible misalignment of interest between the directors and managers of trusts and their unitholders, as a result of the remuneration policies and fees earned by managers and related entities.

"Issues such as the independence of directors and the misalignment of interests have a lot to do with the externally managed model. As the sector matures and trusts become bigger, we think the case for internally managed trusts becomes quite compelling and, if the internally managed structure is adopted, it will address some of our major concerns," Prof Mak said.

Tan Boon Gin, chief executive officer of Singapore Exchange Regulation, said in his foreword to the report that the pace of improvements can be accelerated. "Unitholders should have more information on how business performance is linked to remuneration. Boards must continue to engage, and even challenge management to bring about the most optimal outcome for unitholders, thereby ensuring the sustainability of the business. To do this effectively, board renewal and independence are key."

The complete index and report are available on *www.governance-forstakeholders.com*