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Nine-year rule for IDs: A necessary but small step

Mandatory tenure limit for independent directors is but a blunt tool; many other areas of governance need to be strengthened to achieve the ultimate goal – improved board effectiveness. BY MAK YUEN TEEN

THE introduction of a mandatory nine-year tenure limit for independent directors (IDs) by the Singapore Exchange (SGX) adds the Republic to the list of markets with a mandatory limit.

In Malaysia, a mandatory 12-year limit comes into effect in June this year, with IDs who have served 12 years or more having to resign or be re-designated by Jun 1, 2023. An annual two-tier vote remains in place under the Malaysian Code on Corporate Governance 2021, for IDs who have served more than nine years and less than 12 years. Clearly, Malaysia, which introduced two-tier vote for IDs before Singapore, has – like Singapore – decided that the two-tier vote is not sufficient for improving board independence and renewal. SGX will revoke the two-tier vote immediately.

Singapore has a longstanding issue with IDs who simply would not leave. A 2015 study by me and Chew Yi Hong found that the longest tenure for an ID was 45 years, followed by two who had served for 33 and 32 years. One ID had served a cumulative tenure of 96 years on his four boards, and another served 80 years on four boards.

The *Singapore Directorship Report 2021* (*SDR 2021*) found that for firms that have been listed for at least nine years, 5 per cent of IDs have been with the same issuer for more than 20 years. Further, although there has been an overall decline in long-serving IDs in recent years, the percentage of firms which have been listed for at least nine years and which have at least one ID who has served more than nine years actually increased from 55.3 per cent to 59.2 per cent between 2018 and 2021 – although firms with three or more such IDs declined from 14.3 per cent to 9.8 per cent.

Some other markets which have imposed mandatory limits for IDs include China (six years), Philippines (nine years), Indonesia (10 years), India (10 years), Vietnam (10 years) and France (12 years). The number of years is generally a multiple of the usual term of service for directors in a market.

The European Commission recommends that member countries limit service on the supervisory board as a non-executive or supervisory director to no more than three terms or alternatively 12 years (two-tier boards with a supervisory board and an executive board are common in Europe).

Less prescriptive approaches

Some markets continue to use less prescriptive approaches to address ID tenure. For example, the Hong Kong Code recommends a separate shareholder's vote on re-appointment of IDs after nine years (all shareholders can vote on this separate resolution). Where all the IDs of an issuer have served more than nine years on the board, the issuer should appoint a new ID.

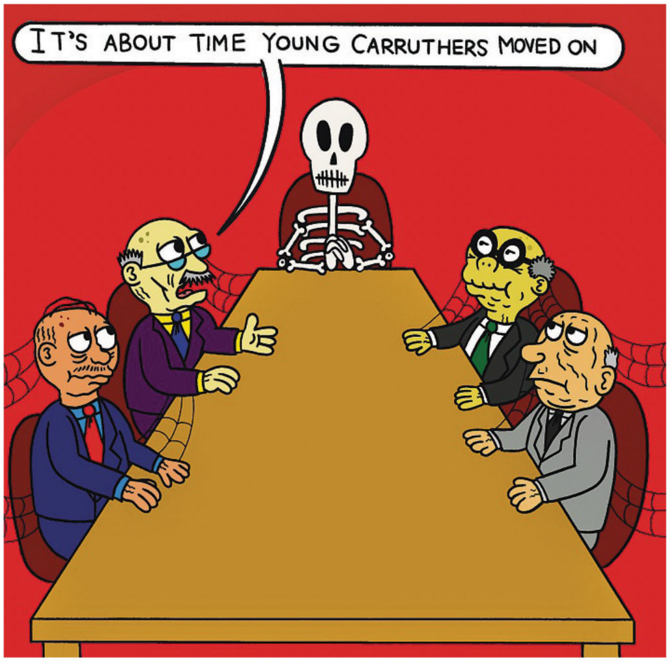
The Australian Code states that boards should regularly assess independence of a director after 10 years. In the United Kingdom, the board should explain why a director is still independent after nine years.

Rules in the United States and Canada do not specifically address this issue.

However, there are differences in rules and institutional environments in other markets that may support a less prescriptive approach to tenure of IDs.

Other measures

In Hong Kong, the criteria for independence are stricter and all are in the listing rules, giving them more bite. IDs in HK also have to confirm their independence to the stock exchange based on the independence criteria in the listing rules and promptly inform the exchange if there is any subsequent change in circumstances which may affect their independence.



A 2015 study found that the longest tenure for an ID in Singapore was 45 years, followed by two who had served for 33 and 32 years. ILLUSTRATION: MAK YUEN TEEN AND CHRIS BENNETT, DIRECTORS DAZE, 2014

That said, these may not address issues such as familiarity risk compromising independence, and lack of renewal. With institutional investors and proxy advisory firms increasingly leaning towards tenure limits and listed companies on stock exchanges in mainland China having a six-year tenure limit for IDs, perhaps Hong Kong will eventually adopt a mandatory limit too.

While few US companies have term limits, they often have mandatory retirement ages for directors. According to the Spencer Stuart US Board Index 2022, 70 per cent of S&P 500 boards have a mandatory retirement age, with 53 per cent setting it at 75 or older. A 2014 survey of investors by the Institutional Shareholder Services, which included two-thirds of US respondents, nevertheless found that 74 per cent felt that long director tenure was problematic.

It is rare for Singapore companies to have a mandatory retirement age for directors. IDs I have spoken to here prefer a mandatory tenure limit to a mandatory retirement age.

Institutional investor activism

The ownership structure of companies is also a relevant consideration. In countries such as Australia, Canada, UK and US, most listed companies have dispersed ownership and the majority of the shares are usually held by institutional investors. These investors have a greater ability to block the re-appointment of long-serving or ineffective IDs.

In the UK, it is rare for IDs to serve beyond nine years because of pressure from institutional investors. Similarly, in Australia, an article in 2014 noted that many organisations were adopting a limit of 10 years, even though there is no hard limit.

Pressure from institutional investors have resulted in changes in some of these markets which have increased the ability of public shareholders to appoint or remove directors or hold directors accountable, such as through widespread adoption of proxy access provisions allowing significant long-term shareholders to nominate director candidates, and annual election of all directors.

In companies with dominant shareholders, which is the case for many companies here, IDs are essentially appointed by these shareholders and easily entrenched. Without stronger regulatory intervention, the problem of long tenure of IDs is likely to persist in Singapore.

Ineffectiveness of other approaches

Singapore has tried other approaches, first through a guideline in the 2012 Code that a "particularly rigorous review" of independence of a director be done after nine years.

This became a box-ticking ritual in many companies, with long-serving IDs reviewing the independence of other long-serving IDs, or management (who may be on the nominating committee in Singapore) doing so. The *SDR 2016* found that for firms listed before 2007, the percentage that have at least one ID who has served more than nine years actually increased to 64.3 per cent, from 57.5 per cent in 2014.

While two-tier voting could have made a difference, it is likely to result in glacial change at best and there are implementation challenges. Without a hard limit, some long-serving IDs may still want to hang on, hoping that they will pass the two-tier vote.

Early experience with two-tier voting also shows that very few shares are often voted for the second-tier vote, and the outcome can sometimes be based on fine margins. Scrutineers must ensure that those who are supposed to abstain from the second-tier vote indeed did so.

Some respondents to the SGX consultation highlighted the challenges faced in finding suitable ID candidates, citing the limited talent pool and low director fees as reasons. More than 20 years after we started our corporate governance journey, it is time we slay the myth that there is a limited talent pool in Singapore. If low fees are a problem, then issuers should be prepared to raise them. Perhaps controlling shareholders who are management should just pay themselves less. We need to push issuers to cast the net wide and to also not simply recycle the usual suspects.

Not a panacea

Even supporters will concede that a mandatory tenure limit is a blunt instrument. There will be cases where an ID should justifiably stay on for a little longer, such as a newly appointed independent chairperson who will have a relatively short runway, or if there is senior management transition in progress. Companies in such exceptional situations can retain an ID beyond nine years and re-designate them as non-independent.

We should also guard against unintended consequences.

Some IDs may simply move from one board to another when their nine years is up, or are rotated among related companies and deemed to be still technically independent. Some may even agree to swap boards with each other. Swapping ineffective IDs will just spread the misery around.

Nine years should also not simply become the standard tenure for IDs, as shorter tenures may be justified in some cases. With a fixed tenure limit, it is even more important that boards plan for succession. If all IDs are appointed at the same time, such as when the company lists, they should generally not retire together as that could be disruptive.

Some IDs are not independent from day one. A tenure limit is not a substitute for robust criteria and processes for assessing independence.

What next?

There are many other areas that need to be strengthened if we truly want to improve board effectiveness, which is the ultimate goal.

Robust search and nomination processes, underpinned by proper board skills matrices that reflect the most important skills and experience needed and are sufficiently granular to assess the nature and depth of each skill and experience, are necessary. Fit and proper policies, high-quality and relevant professional development programmes, and proper board and director evaluations, are just some of the other areas which need attention and improvement.

Having finally addressed the issue of long-serving IDs, perhaps we should now turn our attention again to the issue of busy directors. Although a somewhat dying breed, they are nevertheless a continuing problem.

Many countries which have adopted mandatory term limits have also adopted limits on number of directorships, and proxy advisory firms have highlighted this gap in Singapore. Why allow a small handful of busy directors – who are often associated with problematic companies – to hold us back? There is no Superman who lives among us.

The writer is professor (practice) of accounting at National University of Singapore's Business School. He is a member of the Monetary Authority of Singapore's corporate governance advisory committee. The views in this article are his personal views.