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Shareholders should back only qualified directors

They need to exercise more informed voting, otherwise the quality of boards and corporate governance is likely to deteriorate. BY MAK YUEN TEEN

RECENTLY, I went to a rather sparsely attended AGM. Before the voting for the election of the directors began, I asked the chairman a number of questions.

The board has four independent directors, three of whom (including the chairman) having served between 10 and 12 years; the board and committees are relatively inactive based on formal meetings; the company pays additional fees for chairs and members of each committee, including for an executive committee that had no formal meetings during the past year; director fees appear on the high side relative to similar-sized companies and based on the number of directors and how active the board and committees are; and it has a wholly non-executive board of directors. I did not have deep concerns about the company but wanted to understand the board's rationale.

The chairman and another independent director were cordial in answering my questions. However, I was not fully convinced that the board was paying sufficient attention to board renewal and did not feel there was sufficient rationale provided for certain resolutions. I voted against some resolutions. To me, it was the company's responsibility to provide sufficient justification for shareholders to support a resolution.

The poll voting results showed that for every resolution, the percentage of shares voting for was at least 99.96 per cent . There were some resolutions where there was (probably) a single block of 100,000 shares that voted against. On a number of resolutions, there were only 1,000 shares voting against, which were not enough for a decimal place so the total votes for the resolutions rounded up to 100 per cent. No prizes for guessing who voted the 1,000 shares against. I caught a glimpse of a director pointing to the screen and talking to another director and I wondered if he had said "I know which idiot voted against that resolution".

This scene of resolutions receiving a very high percentage of "for" votes is repeated in AGMs here and around the world. In the second report on shareholder meetings in Singapore that I co-authored with Chew Yi Hong and released in April, we found that the percentage of shares voting for most resolutions is generally close to 100 per cent. For the 570 shareholder meetings (AGMs and EGMs) held in 2015 that disclosed detailed poll voting results, the average support for the 4,068 resolutions voted was 98.04 per cent .

For director elections or re-elections at AGMs, 367 issuers that disclosed detailed poll voting results had a total of 1,169 resolutions and the average percentage of shares voting in favour was 98.6 per cent. Only three resolutions for director elections or re-elections were not carried and a further 32 resolutions received less than 90 per cent of support.

HOTTER THAN HELLO KITTY

Based on the percentage of "for" votes for directors, they are arguably more popular than every professor, Captain America and limited-edition Hello Kitty plushies. Yet, we often read of complaints about ineffective boards – and even busy directors, extremely long-tenured independent directors and tainted directors often get unanimous or near unanimous support. It's as if director elections are fixed.

Actually, director elections are fixed to some extent. They are generally uncontested – like Donald Trump versus himself for President. However, even if elections are not contested, shareholders can still vote "against" but yet, they almost always vote "for".

I can understand the high level of support if the director selection process is a very robust one. However, quite the contrary, it is in many cases far from robust. There are no particular qualifications, experience or other attributes required to be a director, although being an undischarged bankrupt, of unsound mind or being convicted of offences involving fraud or dishonesty usually disqualifies one from being appointed as a director. It's more a matter of not being disqualified rather than being qualified.

Some directors are appointed to boards with no prior experience and companies then say that they will attend some training or have a company secretary give them a briefing after they are appointed. Imagine your plane lands at JFK airport and the announcement says "Welcome to New York, the co-pilot will now go for his flying lessons".

Directors basically select themselves, each other and who they want to be their fellow directors, although in companies with controlling shareholders, the controlling shareholders will often have the major say.

IMPERFECT SELECTION

With such an imperfect selection process, why are most directors elected with unanimous or near unanimous support? In countries where most companies have controlling shareholders, such as Singapore, one reason is that directors are already endorsed by controlling shareholders before they stand for elections. However, the most important reasons that apply globally have to do with many shareholders supporting resolutions to elect directors without properly assessing their contributions, reliance on proxy advisory firms, and how proxy advisory firms formulate their voting recommendations.

It is a shame that not more shareholders attend AGMs and that some who do, care more about the door gifts and the food. Asking the chairman and other directors questions (not about the door gifts and food) and observing how the board handles them can tell shareholders something about the directors that cannot be gauged by just reading their biographies in the annual report.

The percentage of shareholders attending AGMs is very low. We do not know what the percentage is here because AGM attendance is not disclosed. A report by Computershare shows that only 0.158 per cent of shareholders attended AGMs in Australia in 2015 and has declined by 25 per cent over the last 10 years (in other words, it was still only just over 0.2 per cent 10 years ago). Unlike many other countries, Singapore has the advantage of being small, which means that it is easier to attend AGMs – but of course, the clustering of AGMs is a big problem here.

At an AGM here last year, a director was asked why he should be re-elected but he chose to keep quiet. In the end, other directors had to say something for him. Should shareholders feel confident about the contributions of such a director? How many shareholders had the benefit of learning this about the director?



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Institutional investors who rely more on private meetings than AGMs sometimes find access to the board and especially the independent directors, to be a problem, having to content themselves with speaking to management.

I believe that if more shareholders attend AGMs or have other interactions with the board (such as through private meetings), they may form a rather different view about many boards and how well they are overseeing the company and management.

Many institutional investors rely on the voting recommendations of proxy advisory firms such as Institutional Shareholder Services Inc (ISS) and Glass Lewis & Co – to the extent that corporate leaders such as Jamie Dimon, chairman and CEO of JP Morgan, have called institutional investors "lazy" and "irresponsible".

It is true that institutional investors today rely a lot on proxy advisory firms in making their voting decisions. A study by Stanford University's Rock Center for Corporate Governance reported that many large fund managers agree with ISS more than 95 per cent of the time, when ISS and management disagree about pay practices.

Mr Dimon lashed out after 38.1 per cent voted against his pay, 43.8 per cent voted against the board's recommendation that JP Morgan should not be required to disclose when it "clawed back" the pay of senior executives, and 35.9 per cent voted in favour of appointing an independent chairman after Mr Dimon retired, at his company's 2015 AGM.

Over the past few years, some shareholders have tried unsuccessfully to pass a proposal to have Mr Dimon give up his chairman's role and appoint an independent chairman. Frankly, I do not know what Mr Dimon is complaining about as the resolutions were still passed – I guess he is used to near unanimous support for resolutions he favours.

While JP Morgan is still performing well, it has had a series of compliance issues and has paid huge fines to regulators in recent years. Perhaps if investors are more diligent, responsible and independent-minded, more might have voted against the resolutions. Mr Dimon should be careful about what he wishes for.

This leads me to the final issue of how proxy advisory firms formulate their recommendations on director elections. ISS published its latest proxy voting guidelines for Singapore on Dec 18, 2015 for meetings after Feb 1, 2016, and they are available on its website.

Under these guidelines, ISS will generally recommend voting for the election or re-election of an individual director except where there are issues with attendance, overboarding or independence. Competence is not a factor presumably because it is assumed to be present and not easy to objectively assess. This leaves the door open for the appointment of incompetent directors who pass the other criteria.

In the case of independence, ISS may re-classify a director from independent to non-independent based on ISS's own classification of directors. However, as I understand it, it will only recommend voting against the re-classified independent director if the re-classification causes the percentage of independent directors to fall below the one-third of independent directors recommended in our Code of Corporate Governance.

BOILERPLATE REASONS

For director tenure, ISS considers an independent director who has served more than nine years to be non-independent "if the company fails to disclose the reasons why such director should still be considered independent, or where such reasons raise concerns regarding the director's true level of independence". The problem of course is that most companies do give reasons in such cases, often for several such directors, but these reasons are usually boilerplate in nature.

ISS will also generally "not recommend against voting for a CEO, managing director, executive chairman or founder whose removal from the board would be expected to have a material negative impact on shareholder value". This raises an interesting question about its recommendation in the case of unethical behaviour by such an individual, whose removal may adversely affect the performance and value of the company in the short term.

For the audit committee, ISS will generally recommend voting against all members of the committee if the non-audit fees paid to the auditor are excessive or if there is no disclosure of audit and/or non-audit fees. Important factors that affect the effectiveness of an audit committee, such as relevance and recency of experience of members, are not in the guidelines.

ISS policy guidelines also state that, under extraordinary circumstances, they may recommend voting against individual directors, committee members or the entire board for material failures of governance, stewardship, risk oversight or fiduciary responsibilities at the company; failure to replace management as appropriate; and egregious actions related to a director's service on other boards.

PROXY RELIANCE NOT IDEAL

Although the reliance on proxy advisory firms may not be ideal, at least their voting recommendations are based on research and guided by clear voting guidelines that are made public. It is unrealistic to expect many institutional investors invested in hundreds or thousands of different companies to do their own research and formulate their own voting decisions for each of these companies.

From my point of view, voting recommendations of proxy advisory firms are on the conservative side, not infrequently leaning towards supporting resolutions proposed by the company even where the resolutions may be questionable from a corporate governance standpoint (of course, Mr Dimon and company probably think they are often too anti-management).

To be fair, proxy advisory firms need to be seen to be objective and have a firm basis for their recommendations, so I would not necessarily fault them if they sometimes get it arguably "wrong" from a corporate governance perspective. For important investee companies and where there have been adverse public comments about the corporate governance of a company, institutional investors may need to undertake their own additional research and be prepared to depart from the voting recommendations of proxy advisory firms.

A good example of the arguably unsatisfactory state of shareholder voting is the recent case of BP in the UK.

At its April 2016 AGM, 59 per cent of the shares cast voted against the company's non-binding resolution on executive pay. After the meeting, several large shareholders were especially critical of the remuneration committee chairwoman, citing her academic background and lack of commercial experience, with calls for her removal.

While I am not a fan of academics serving on corporate boards (and will leave it to another commentary to discuss why), the criticism is somewhat misplaced. The remuneration committee chair alone cannot be held responsible as the pay packages would have been based on the remuneration policy already approved by BP shareholders and would have been a collective decision of the remuneration committee. (In the UK, remuneration committees have delegated authority for executive remuneration decisions.)

CONSIDER, NOT COMPLAIN

At that same meeting, 98.1 per cent of shareholders had actually voted for her re-election. If the shareholders thought that she was responsible for the executive remuneration packages that they were going to reject and felt that she lacked the necessary experience, why did most of them vote for her re-election at the same meeting?

I believe it is probably because she passed the guidelines for re-election. This is not to say that shareholders should have voted against the re-election of the remuneration committee chairman, but perhaps they should have considered more carefully before casting their votes – rather than complain afterwards.

In my view, shareholders should take a default position that they won't support the election or re-election of a director unless they are convinced of a director's ability to contribute.

They should expect issuers to provide enough information about the qualifications, skills, experience and contributions of a director to support the resolution for his election. Shareholders should also be satisfied that the company has a robust search and nomination process to identify competent and independent directors, and a clear renewal policy and process to ensure continuing relevance of the skills and experience and fresh perspectives.

Where a board has multiple long tenure and busy directors, they should be particularly prepared to vote against the re-election of these directors. If shareholders do not exercise more informed voting, the quality of boards and corporate governance is likely to deteriorate.

The writer is an associate professor at the NUS Business School where he teaches corporate governance and ethics.

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