

When corporate governance reaches a dead end

Now is the time to be more prescriptive and include less contentious criteria for determining independence in listing rules. **BY MAK YUEN TEEN**

IT HAS often been said that corporate governance is a journey, but based on the corporate governance issues raised in the "Q&A on Annual Reports" initiative of the Securities Investors Association (Singapore) (SIAS) and recent corporate governance sagas here, we may have reached a cul-de-sac.

Fifteen years after the first Code of Corporate Governance for listed companies was introduced here, and two revisions later with another one on the way, many companies continue to adopt a box-ticking approach to applying the Code, stretch the interpretation of the guidelines or liberally use the flexibility given by the "comply or explain" approach to depart from even the most basic guidelines.

SIAS's *Q&A on Annual Reports* covers the areas of strategy, financials and corporate governance practices based mainly on the most recent annual reports. As at Dec 31, 2016, 80 out of the first-year target of 200 issuers have been covered, with 18 issuers providing written replies on SGXNET and/or directly to SIAS. I have found the questions to be well researched and insightful.

In terms of corporate governance, independent directors and remuneration are two key areas that have elicited questions from SIAS. In this commentary, I will discuss the issues relating to independent directors. Except for the discussion on Singapore Post (SingPost), they are based on the questions raised by SIAS.

Limit on directorships

Guideline 4.4 of the Code recommends that "the Board should determine the maximum number of listed company board representations which any director may hold, and disclose this in the company's Annual Report". Most companies did not comply with this.

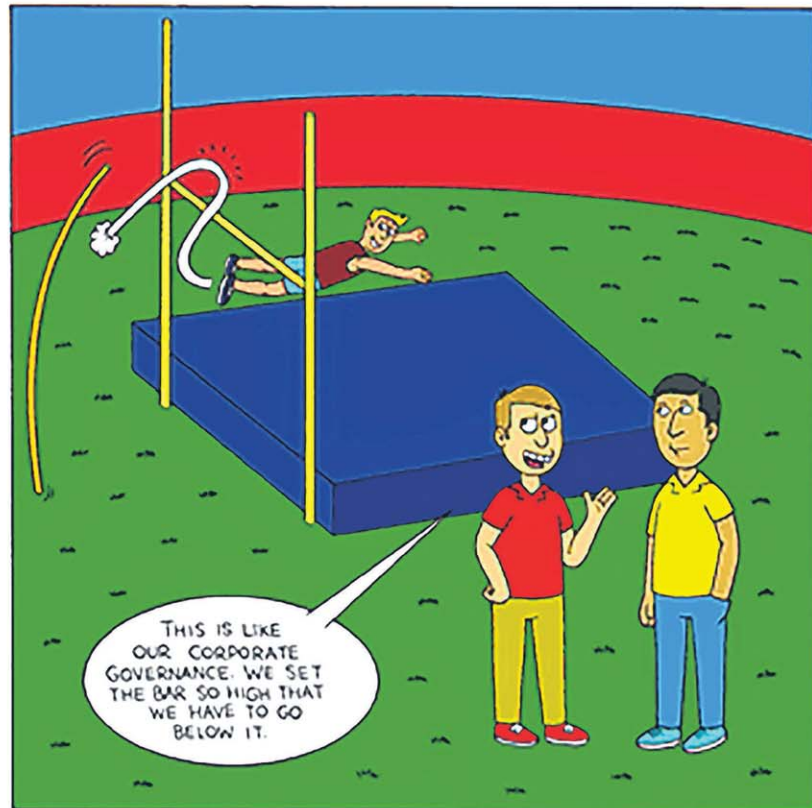
One company that did set a limit was Ellipsiz. This was commendable until one realises that the limit was not adhered to. In its corporate governance report, it stated that "the Board has set guidelines that each director shall not have more than five listed company board representations unless prior consent is obtained from the Chairman of the Board and the Nominating Committee, after considering the principal commitments of the director".

However, Chng Hee Kok, who was appointed to Ellipsiz's board as the independent chairman in September 2015, was listed as holding seven other directorships in listed companies. At the time of his appointment, Mr Chng was managing director at SGX-listed LH Group and audit committee chairman at three other SGX-listed companies, although he ceased to be a director at LH Group in April 2016, remaining as a consultant until September 2016. The company did not explain the deviation from the limit.

Ellipsiz may say that Mr Chng's "principal commitments" still allow him to effectively fulfil his responsibilities but this raises the question as to how seriously the company takes the limit. It remains to be seen if Ellipsiz will lower the bar to allow more directorships or follow others in doing away with a limit altogether.

Independence from key officers

The Code lists certain relationships and circumstances, which if present, would require the board to explain why a director is considered independent if it wishes to classify him as one.



SOURCE: MAK YUEN TEEN AND CHRIS BENNETT, "GUARDIANS OF THE CAPITAL MARKET" (2016); USED BY BT WITH PERMISSION

Guideline 2.3 states that an independent director should have no relationship with "its officers" and 2.3(b) refers to "a director who has an immediate family member who is, or has been in any of the past three financial years, employed by the company or any of its related corporations and whose remuneration is determined by the remuneration committee" as requiring explanation if considered independent.

At Chuan Hup Holdings, Professor Tan Cheng Han has been an independent director since July 2001 and independent chairman since October 2011. Setting aside questions about his independence due to his tenure exceeding nine years – which the company justified with the standard boilerplate explanation of "a particularly rigorous review" being done and "demonstrating strong independence in character and judgment" – the company disclosed the following: "The Board and the Nominating Committee have determined that Prof Tan Cheng Han be considered independent notwithstanding that his spouse, Ms Valerie Tan May Wei, is the Head, Legal and Corporate Secretarial and the Group Company Secretary, as Ms Tan reports to the Chief Executive Officer, and Prof Tan abstains from discussions and decisions relating to her remuneration. In any event, the Board and the Nominating Committee consider Prof Tan to be an Independent Director because he is a strong-minded individual who is able to exercise independent judgment with a view to the best interests of the Company at all times in the discharge of his duties as Director."

Ms Tan has been the company secretary since 1994. As the company secretary, Ms Tan is an officer of the company and is also listed as one of the top five key management personnel (who are not directors or the CEO). The

company's explanation that Ms Tan reports to the CEO is presumably to allay concerns that Prof Tan is directly overseeing Ms Tan. However, in the first place, the company secretary should not be reporting primarily to the CEO – she should be reporting primarily to the board, which Prof Tan chairs. Guideline 6.3 states: "Under the direction of the Chairman, the company secretary's responsibilities include ensuring good information flows within the Board and its board committees and between Management and non-executive directors, advising the Board on all governance matters, as well as facilitating orientation and assisting with professional development as required." Guideline 6.4 states that "the appointment and the removal of the company secretary should be a matter for the Board as a whole".

While the Code does not specifically mention the reporting relationship of the company secretary, the above guidelines certainly recommend that the board and chairman should be directing and overseeing the company secretary.

Guidance issued by the Institute of Chartered Secretaries and Administrators (ICSA) on the reporting lines of the company secretary states that "the company secretary is responsible to the board and should be accountable to the board through the chairman on all matters relating to his duties as an officer of the company" and my own experience with boards and good practice shared by other directors point to the company secretary reporting primarily to the board.

By having the company secretary report to the CEO to avoid a conflict, Chuan Hup has created other governance concerns about the independence of the company secretary from the CEO. Further, I cannot see how having the chairman's spouse report to the CEO who in

turn reports to the board – rather than having her report to the board or to the chairman directly – addresses the concerns about the chairman's independence.

Independence from key officers was also raised by SIAS in the case of Lifebrandz, although the issue here is the relationship between an independent director and a key officer across a number of companies. One of the independent directors of Lifebrandz is Toh Hock Ghim, while the CEO is Chng Weng Wah. Mr Toh and Mr Chng are/were connected through several other companies: at Equation Summit, where Mr Toh is independent chairman and Mr Chng is CEO/executive director; at AGV Group where Mr Toh is an independent director and Mr Chng is non-executive director (and, together with his spouse, owns about 13 per cent of AGV); and at WE Holdings where Mr Toh was independent chairman and Mr Chng was non-executive deputy chairman, before both left in March 2013 following a change in controlling shareholder. Given the "interlocking" relationship between Mr Toh and Mr Chng across the companies, it is reasonable to ask if Mr Toh is really independent from Mr Chng.

Independence from business relationships

Just over a year ago, the Singapore Post saga started to unravel, raising a number of corporate governance issues. At the centre of the saga was Keith Tay, who was the lead independent director, chairman of the nominating committee and member of the executive committee. It will be recalled that Mr Tay is the non-executive chairman and owns more than a third of the corporate advisory firm, Stirling Coleman, which acted as the arranger/financial adviser for three companies which SingPost bought.

Clearly, there was a serious conflict of interest. Throughout the saga, it was never disclosed how much fees were earned by Stirling Coleman, but given that one of the acquisitions, Famous Holdings, had a maximum consideration of up to S\$110 million, the fees for this alone would likely have been very substantial.

However, regardless of the quantum, SingPost was "technically" in compliance with the Code because the fees to Stirling Coleman were paid by the sellers. Guideline 2.3(d) on business relationships only refers to significant payments or material services between an organisation a director is associated with, and the listed issuer or its subsidiaries. Neither were the fees covered by the Singapore Exchange's rules on interested person transactions because they were not paid by the "entity at risk", which broadly covers the listed issuer, its unlisted subsidiaries and unlisted associated companies.

The Code does say that the relationships set out in the Code "are not intended to be exhaustive" and "other salient factors" and "circumstances" can be considered in determining independence, but companies often do not go beyond the specific relationships and circumstances set out in the Code.

Long tenure directors and particularly rigorous reviews

Of the issuers covered by the SIAS initiative so far, there were at least 13 issuers which had at least 28 independent directors who had served more than nine years. These issuers

are expected to undertake a "particularly rigorous review" of the independence of the directors. While the issuers duly stated that they have done so, few gave much details about how the review was conducted. SIAS did not query all these issuers because there were more pressing questions for some, but one issuer they did query stood out. The company was Catalyst-listed GKE Corporation, where Er Kwong Wah has served more than nine years. GKE paid its sponsor RHT Capital S\$3,000 to undertake the "rigorous assessment" of Mr Er's independence.

Given that the sponsor is supposed to supervise the company and ensure that it complies with the listing rules, including the "comply or explain" requirement of the Code in rule 710 of the Catalyst rulebook, one may question whether it is appropriate for the sponsor to undertake this task. Is it not preferable that another independent third party be used, if indeed the company wishes to use such a party? Can a sponsor affirm that an issuer complies with the letter and spirit of the Code when it is paid by the issuer to help it "comply"? Would a S\$3,000 assessment be perceived as being merely a "box ticking" exercise rather than "rigorous"? Where is the line in the sand that the sponsor should not cross in ensuring that it does not undermine its supervisory role?

These are important issues not too dissimilar to questions about what kinds of non-audit services an external auditor can provide to its audit client, especially with sponsors of Catalyst companies often providing other services to their sponsees. However, it is beyond the scope of this article to discuss this in depth.

Other independence issues

Other interesting questions relating to independent directors raised by SIAS include re-designation of directors from non-independent to independent before the "cooling off" periods specified in the Code have passed or who go through multiple re-designations.

Time for a more prescriptive approach

I am sure that the circumstances and relationships related to the determination of independence will be revisited when the Code is reviewed, as is always done. However, rather than simply tweaking the guidelines, it may be time to be more prescriptive and include the less contentious criteria for determining independence in the listing rules. This will establish a clear "floor".

Countries such as the United States, Hong Kong and Malaysia have for a long time been more prescriptive in their rules on director independence because they include detailed criteria for determining independence of directors in their listing rules.

The UK, while remaining less prescriptive over the independence criteria, has strengthened rules on election of independent directors for premium listings.

Both principle-based and rule-based approaches have their advantages and disadvantages. Listing rules should establish a clear "floor" and the Code's principle-based approach should encourage issuers to reach for a higher ceiling.

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