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STRATEGY SPOTLIGHT

Scoring well in the Governance Index For Trusts

There is room for improvement, including in board independence and competencies. BY MAK YUEN TEEN

ON June 29, a new governance index dedicated to real estate investment trusts (Reits) and business trusts (BTs) in Singapore was launched. This index, called Governance Index For Trusts, or GIFT, was developed by Chew Yi Hong, an active investor and corporate governance researcher, and me with the help of a group of NUS accountancy honours students. It is supported by CPA Australia.

The new index has generated much interest among trusts and investors, and many trusts have written to us wanting to understand how they can do better. This article provides more detailed insights into the findings from the inaugural issue of GIFT, especially on the differences between the top 10 and bottom 10.

In the area of board matters, only five out of the 43 trusts scored 75 per cent or more, with three of these in the overall top 10. Trusts often lost points here because they do not have an independent chairman or a high percentage of independent directors (IDs), including in some cases, having directors who they consider independent but we do not because the director has served more than nine years or has significant business or other relationships with the trust, manager or controlling unitholder. Among the top 10, six have an independent chairman, while for the 10 lowest-ranked trusts, only three do, with one having an executive chairman. Trusts will also score more points if they give unitholders the right to endorse directors, and directors who failed to obtain endorsement are required to resign. Only five such trusts gave unitholders that right and two of them are in the top three.

On competencies of the IDs, five of the top 10 trusts have one or more IDs with investment/fund management experience and experience in the industry that the trust operates in, while the other five have IDs with one of these two competencies. For the bottom 10, only two have IDs with both types of experience and another four have IDs with one of these competencies. The other four do not have IDs with either competencies.

The top 10 trusts also do better than the bottom 10 in having recent and relevant accounting or financial management expertise or experience in the audit committee (AC), with all the top 10 having an independent AC chair with such experience and seven having a majority of IDs with such experience. For the bottom 10, eight have an independent AC chair and five have a majority of IDs with such experience.

Remuneration is the weakest area for the trusts, with three trusts getting the highest score of 6.5 out of 10 in the main index. While 33 trusts disclosed the exact remuneration for each non-executive director, with nine of the top 10 and five of the bottom 10 doing so, only seven trusts in total disclosed the fee structure. For remuneration of the CEO and EDs, eight of the top 10 disclosed the remuneration components used and their rationale, while only four of the bottom 10 did so. Five of the top 10 trusts used performance measures to determine the remuneration of EDs that include unitholder return, distribution per unit (DPU) or net asset value per unit that are aligned with unitholders' interests, while only one of the bottom 10 did so. In total, 15 trusts used such performance measures.

In terms of pegging the manager-/trustee-manager's performance fee, five of the top 10 trusts and three of the bottom 10 trusts use unitholder return, DPU or net asset value per unit to determine the performance fee, which results in better alignment with unitholders' interests. Eighteen trusts incurred demerit points because their total fees (excluding non-recurring fees such as acquisition and divestment fees) remained flat or increased over the last two years while DPU decreased.

In the area of external and internal audit, 22 trusts received all 10 points, while 20 received nine points. One trust in the bottom 10 did not receive the points for a clean external audit opinion because of an emphasis-of-matter paragraph.

Trusts generally did well for communication with unitholders, with an average of 10.5 out of 15 points. The top 10 trusts scored an average of 10.7 points while the bottom 10 trusts had an average of 8.8 points. One trust received a perfect 15 points for this section in the main index. However, many trusts can improve their main score and earn merit points in this area by putting their trust deed on their website, avoiding peak periods for holding their annual general meetings, providing longer notice period for unitholder meetings, publishing detailed minutes for unitholder meetings, identifying a specific IR contact with contact details, and specifically inviting unitholders to send in questions ahead of unitholder meetings.

In the section on other governance matters, which covers issues such as experience of senior management, trusts generally do well, with an average of 11.7 out of 15 points. The top 10 trusts scored an average of 12.2 while the bottom 10 an average of 10.7 points. Four trusts scored a perfect 15 points for this section in the main index.

One unique feature of GIFT is a specific section on business risk, covering issues such as leverage, debt maturity and lease expiry. The overall average was 13.2 out of 20 points, with the top 10 trusts having an average of 15.8 points, compared to 10 points for the bottom 10.

One frequently asked question is whether governance is related to performance. We are hesitant about drawing firm conclusions from statistical analyses because of issues such as causality and the appropriate time period for measuring performance. Bearing this caveat in mind, it is comforting that trusts that score higher on GIFT tend to have higher one-year Sharpe ratios and lower volatility of total returns, measured over the last financial year. The relationship is not linear, with the main difference being between the 10 lowest-ranked trusts compared with the other trusts. This provides preliminary evidence that trusts that do poorly on GIFT also tend to perform poorly and have higher risk.

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