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PHOTO: REUTERS

SGX makes good disclosures, but needs more transparency on share plans

This is in the case of cash-based remuneration, where no shareholder approval is needed and all rests with the remuneration committee and the board having enough information. **BY MAK YUEN TEEN**

On Sept 20, the Singapore Exchange (SGX) held its annual general meeting (AGM), which, according to news reports, was dominated by questions about listed companies suing their own shareholders for defamation.

What appears to have escaped attention is that at the AGM, 42.76 per cent of the shares that voted rejected the proposed restricted share plan (RSP). This is a very high percentage of shares voting against any resolution.

To put this in context, studies of AGMs in 2014, 2015 and 2016 by Chew Yi Hong and me show that the average percentage of shares voting in favour of share and share option schemes is more than 90 per cent. In 2016, out of 190 resolutions for performance or restricted share schemes, only three issuers received less than the support received by SGX for its RSP – with all three not approved by shareholders; another eight received less than 80 per cent support.

The fact that SGX proposed to shareholders for approval for what turned out to be a rather unpopular plan should be a matter for the board and its Remuneration and Staff Development Committee (RSDC) to think about. That being said, eight of the 11 resolutions, including all the resolutions relating to the election or re-election of directors, received more than 99 per cent of votes, and two others relating to the re-appointment of external auditors and general share issue mandate received more than 90 per cent, so there are no indications of a shareholder revolt at SGX. In terms of remuneration disclosures, SGX is one of the best, if not the best, among listed companies here.

PARTICIPATION OF NEDs

Let's look at the RSP, which is to be used as a supplement to the existing performance share plan (PSP) approved by shareholders in 2015. Non-executive directors (NEDs), including independent directors, are eligible to participate in the plan. NEDs may be given restricted shares in lieu of cash fees "or where the Committee deems appropriate, to recognise the contributions made or to be made by such Group Non-Executive Directors to the success of the Group... Grants would not, however, be made to Independent Group Non-Executive Directors to such an extent that their independence may be compromised".

It is unclear what contributions the Board and the RSDC have in mind that may warrant additional grants of shares, since NEDs are already paid additional fees for chairing the Board and Board committees, serving on Board committees, and attendance fees. It is also unclear how the RSDC will assess whether grants are so excessive as to compromise the independence of the independent directors.

The RSDC has to assess contributions, eligibility and

quantum and indirectly determine key parameters of grants that they themselves may be entitled to. Although RSDC members also indirectly influence the cash fees that they themselves receive through establishing fee structures, these involve less subjective decisions by the committee and can be readily benchmarked against comparable companies. I believe SGX should just either require NEDs to use part of their cash fees to buy SGX shares or only grant some shares in lieu of cash fees.

SGX also disclosed that the "current intention" is that awards to NEDs would be in the form of fully paid-up shares, "with no performance conditions attached or vesting periods imposed". It is in line with good practice that share grants to NEDs, if used at all, should not include performance conditions or vesting conditions, but it is unclear why SGX only expressed this as "current intention", suggesting that this may change in the future.

A "retention period" will be imposed. The explanatory notes accompanying the notice for the AGM state that the "current intention" is to impose a one-year moratorium for shares granted in lieu of cash fees. It is unclear how a "one-year moratorium" will help align the interests of NEDs with the long-term interests of shareholders. In general, when NEDs are given shares in lieu of cash fees or are expected to use part of their fees to buy shares, it is considered good practice that they hold the shares at least until they leave the board.

Perhaps SGX envisages a situation whereby the directors have over time accumulated a substantial number of shares and should be allowed to dispose of some. It may be better to just use cash once an NED has accumulated sufficient shares and to require those shares to be held until they leave the board. In any case, a one-year moratorium seems to be a very short holding period to impose on NEDs at the start of the RSP implementation.

GROUP EMPLOYEES

For employees, SGX said that it is intended "to serve as an additional motivational tool to recruit and retain Group Employees whose contributions are essential to the long-term growth and profitability of the Group and to give recognition to outstanding Group Employees who have contributed to the growth of the Group".

There is no requirement for any performance conditions to be set. The RSDC has almost total discretion regarding the grant of shares to employees under the RSP, including inter alia, number of shares, vesting periods, retention period, special provisions relating to vesting and lapsing of awards, and cancellation of awards.

The only limitation is that the total number of new

shares issued under all the share schemes cannot exceed 10 per cent of the total number of outstanding shares. It is therefore possible that employees are given additional shares under the RSP for "retention" reasons, if shares under the PSP do not vest because performance conditions are not met.

The low support for the RSP may indicate that shareholders are not comfortable approving essentially a "blank cheque" plan with no performance criteria for executives, even if they believe that the directors administering the plan are truly independent.

CHANGES IN THE PSP

This leads me to the company's PSP. In April this year, I sent some questions to SGX's Investor Relations (IR) about the company's remuneration disclosures and changes in performance conditions for the PSP. That was before the publication of this year's annual report, where further changes were made. I appreciate the response from its IR.

From the FY2018 annual report, we can see the changes in performance measures, performance targets and peer companies used for comparison for its PSPs. For the previous PSP used during the tenure of the late CEO Magnus Bocker, return-on-equity (ROE), absolute total shareholder return (TSR) and relative TSR compared to peers – measured over a three-year period starting from the grant year – were used in determining the vesting of shares. The peers were those in the FTSE/MV Exchanges Index which consists of listed global exchanges.

That PSP expired in 2015, the year that the current CEO, Loh Boon Chye, joined. A new PSP, called SGX PSP 2015, was approved by shareholders at the September 2015 AGM. The initial performance measures under this new PSP were earnings per share (EPS) growth and relative TSR "against selected peers" also measured over a three-year period, with each being equally weighted.

The new performance measures are, in my view, inferior to the earlier performance measures. I generally consider ROE (or other accounting return type measure) to be better than EPS measures because it takes into account the investment required to generate earnings – even though admittedly, there is no perfect measure. Dropping absolute TSR also means that SGX can have negative TSR, but shares will still vest on the TSR criterion as long it performs relatively better than its peers. Relative TSR certainly has its merits but is arguably better used in combination with absolute TSR (since a negative absolute TSR means SGX's shares have lost value). Further, unlike the FTSE/MV Exchanges Index used previously where the identity of the exchanges included is determinable, it is unclear what "se-

lected peers" means. This is not to say that a weaker group of peers is necessarily being used for comparison under new PSP, but just that there is now less transparency regarding who the peers are. One positive change, however, was that the vesting period was extended from three to four years.

There may be good reasons for the differences in performance measures and peers, but more information about the rationale for the changes and whether the peers are the same would have been welcome.

Between FY2016 and FY2017, there were no changes in performance measures and "selected peers" continued to be used – although we have no idea whether the selected peers were the same over the two years. The three-year average EPS growth targets for vesting of shares were in fact raised in FY2017, perhaps reflecting the fact that the new CEO has been on board for some time and should now be expected to deliver better performance.

However, in FY2018, the performance measures were once again changed, as were apparently the peer companies. Now, the performance measures are strategic and non-financial priorities (with 40 per cent weighting), EPS (30 per cent), relative TSR against selected peer exchanges (15 per cent) and relative TSR against selected Straits Times Index companies (15 per cent).

Again, SGX did not explain the rationale for the changes or provide details about the "strategic and non-financial priorities" that are now the single most important vesting criterion, nor did it list the "selected peer exchanges" and "selected Straits Times Index companies". There may be good reasons to include non-quantitative "strategic and non-financial priorities" for vesting of shares and for determining the annual cash bonus – especially if they include measures such as liquidity and valuations on our market and regulatory key-performance indicators – although they are obviously more subjective in nature.

However, what really caught my attention the most was the change from EPS growth to absolute EPS and a loosening of the EPS target. In FY2017, the average three-year EPS growth rate that was required for 100 per cent payout of the shares under this criterion was at least 6.2 per cent. Average EPS growth rate of at least 9.9 per cent would result in 150 per cent payout, while a growth rate of 3.1 per cent – the minimum rate resulting in a payout under this criterion – would result in a 50 per cent payout.

In FY2018, an EPS of 34 cents would result in a 100 per cent payout under this measure, while a minimum of 37 cents EPS would result in a 150 per cent payout. The "threshold" EPS resulting in a 50 per cent payout is 32 cents. SGX's diluted EPS for FY2018 stood at 33.8 cents, just 0.2 cents below the EPS target that would result in a 100 per cent payout.

What this means is that even if EPS for SGX remains relatively flat over the next three years, there will be a 100 per cent payout under this criterion. Is this an indication that the board (and RSDC) is expecting tough times ahead and has lowered the expectations for the CEO? Or perhaps some of the "strategic priorities" may dampen earnings in the next few years?

Investors may wonder about the rationale for changes in performance measures, performance targets and peer groups over the years.

It is only because SGX has excellent disclosures for its share plans, especially the PSP, that one can see the changes that have been made and question them. For many other companies, disclosures about share plans at the time of adoption and as grants are made leave much to be desired. Shareholders may approve a plan with vague performance conditions or with certain specified performance conditions that may then be changed without further approval from them and without their knowledge.

Notwithstanding this, at least share and share option plans require shareholder approval on adoption. The same cannot be said about cash-based remuneration, including cash bonuses, where no shareholder approval is required and everything is in the hands of the remuneration committee and the board.

It is critically important for boards and remuneration committees to have truly independent directors who are knowledgeable about remuneration matters to reduce the risks of expropriation of minority investors through remuneration. Since remuneration consultants do not owe fiduciary duties to the company and shareholders, they can only be relied on to give truly independent advice if overseen by truly independent directors.

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