

A refined 'Gift' for a changed world

Adjustments made to the index for assessing governance and business risk of Reits and business trusts aim to make the scoring more relevant to investors. **BY MAK YUEN TEEN AND CHEW YI HONG**

THE Governance Index for Trusts (Gift) was launched in 2017 as a dedicated index for assessing the governance and business risk of real estate investment trusts (Reits) and business trusts (BTs). It recognises the unique features which set these trusts apart from other listed issuers which are companies. Most trusts on SGX are externally managed and the managers/trustee-managers have their own P&L considerations. Listed trusts are also subject to different regulations and rules under the Securities and Futures Act (SFA) and Code on Collective Investment Schemes (CCIS) for Reits, and Business Trusts Act (BTA) for BTs – and also have to comply with listing rules and the Code of Corporate Governance.

After years of growth, the Reit and BT sector may be at a crossroads.

There was the debacle with Eagle Hospitality Trust (EHT) which listed in May 2019 and was suspended in March 2020, without a single cent paid out to unitholders. EHT is now going through forensic and regulatory investigations.

At EC World Reit, the Commercial Affairs Department and Monetary Authority of Singapore have launched an investigation into an offence under the SFA, although the investigation is targeted at one of the key management, and not the trust or the manager. Ranked joint 41st out of 46 trusts in 2019, it was initially required to continue with mandatory quarterly reporting due to a modified audit opinion but was spared in May 2020 because it has resolved the material uncertainty relating to going concern in the auditors' report for its latest financial statements following a refinancing exercise in 2019.

Nevertheless, there has been late payment of monthly rents by the sponsor under the existing master lease agreements and waiver of penalty fees for the late payment, although EC World has explained, rather unconvincingly in our view, the waiver of the penalty fees.

With growth somewhat limited, Reits and BTs have turned to consolidation to scale up. Certain trusts have gone through strategic reviews with little tangible outcomes. A substantial unitholder at another trust has gone public with its unhappiness with the way the trust is managed at a critical time when the trust has received an offer for all of its assets.

There have been a number of mergers which, while allowing the managers to diversify their risks and which may provide other benefits such as inclusion in major indices, may nevertheless limit investor choices. More Singapore-based trusts are venturing overseas, and more trusts with wholly foreign assets and foreign sponsors/managers are looking to list here.

More than ever, investors in the sector need to be discerning and pay attention to the governance and business risk of the trusts in their investment decision.

The assessment of trusts for Gift 2020 takes place as the sector is going through change, further impacted by Covid-19.

We have delayed the target date of release of Gift for 2020 tentatively to September in view of the delays caused by Covid-19, but will soon start the voluntary self-assessment which we introduced in 2018. Trusts are provided with a template based on the Gift scorecard for this self-assessment which is then taken into consideration – although our assessment may be different from this self-assessment.

In 2018, 29 out of the 43 trusts – or two-thirds – we invited to do the self-assessment did so, and in 2019, 34 out of 46 – or nearly three-quarters – did. This year, we already have several trusts reaching out to us about the self-assessment. On the whole, trusts appear to recognise the importance of governance and business risks to their investors.

Last year, newly-listed NetLink NBN Trust debuted at the top, with 90 points, comfortably ahead of the next four highest-ranked trusts which all scored 80 points or more. There was a nearly 50-point gap between the lowest-ranked trust and the top-ranked one, and our observation is that the lowly-ranked trusts have generally struggled in performance relative to their peers over the past year.



Developments, such as the discontinuation of mandatory quarterly reporting and the impact of Covid-19 on annual general meetings, have prompted other adjustments to Gift in 2020.

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Certain trusts set a higher bar last year, which meant that trusts which only maintained their standards actually fell down the ranking. But there were areas, such as independence of directors, where some trusts actually slid backwards last year.

In our report last year, we indicated that we plan to make some refinements to Gift. Since then, other developments, such as the discontinuation of mandatory quarterly reporting and the impact of Covid-19 on annual general meetings (AGMs), have prompted us to make other adjustments.

EHT was not included in Gift 2019 because it had only been listed for less than three months and had not yet published any annual report when we released our ranking last year. We also considered whether any adjustments to the scoring guidelines were necessary in light of what happened at EHT – although the problems at EHT are rather unique so we were careful not to let it drive the design of the index.

Changes to governance component

We are broadening the desired experience of independent directors to include valuation experience, rather than just investment or fund management experience. We also add multi-dimensional board diversity (including gender and age) and minimum frequency of board and board committee meetings as additional merit items.

For trusts that have overseas assets, we are examining more closely the experience of key management and independent directors in the regions where trusts have overseas assets.

On remuneration, we have incorporated disclosure of how remuneration is aligned with performance and value creation, and disclosure of key performance indicators for long-term remuneration components.

The points for internal and external audit have been reduced from 10 points to five points in the main index. This was done partly by reducing the points for an unmodified external auditor's opinion, while retaining the same range of demerit points for qualified, adverse and disclaimer of opinion. Our view is that while modified opinions do convey concerns about the financial statements, unmodified opinions may not necessarily indicate that all is well.

The five points for audit have been reallocated to the business risk component, which will now carry 25 points instead of 20 points.

With quarterly reporting (QR) having moved to a risk-based approach, none of the trusts are currently required to practise QR – last year, every trust was required to do so. We have included points for trusts that practise voluntary QR or provide quarterly updates, with fewer points for the latter.

Due to Covid-19, SGX granted issuers with financial year-ends on or before March 31, 2020 an extension of 60 days to hold their AGMs. In assessing whether an AGM is held during a peak period this year, we consider the last five business days of April, May, June, July, August, September or October 2020 (and may include other months if SGX further extends the automatic extension). Having looked at the number of meetings for all issuers during the months that have passed, we believe that unitholders will be bet-

ter able to participate in virtual meetings outside of the last five days of those months.

Trusts that held virtual AGMs due to the Covid-19 measures have to post their minutes online, and will automatically get the points for the posting of detailed minutes. Any trust that subsequently stops the practice of posting detailed meeting minutes online will get an additional one-point penalty.

Between 2015 and 2017, we published an annual Singapore Report on Shareholder Meetings. In those reports, we recommended greater use of technology, such as webcasting of meetings and electronic online voting, and detailed meeting minutes be made freely available. The Covid-19 measures have now made detailed minutes freely available for those companies holding virtual AGMs and shareholders now participate virtually in webcast meetings, although these non-interactive, one-way meetings can be improved.

We hope that trusts will continue with these good practices when face-to-face meetings return, and those that do so will be recognised accordingly.

Changes to business risk component

We will assess weighted average lease expiry (WALE) using Gross Rental Income (GRI) instead of Net Lettable Area (NLA). For trusts using perpetual securities, we are also analysing the interest payable for perpetual securities compared to the distributable amount to unitholders.

Changes to scoring methodology

Certain baseline practices are removed from the main index and made into penalties if they are absent. For example, trusts will no longer score points just for having a website but if they do not have an updated website, they will be penalised. The points are allocated to other items. We are also reducing the points awarded for pure disclosure type criteria and focusing more on substance.

For certain items, especially those relating to business risk, we use a more graduated scale for awarding points – eg, rather than say three points or zero points, it is now three points, 1.5 points or zero points. Certain items are dropped because they are difficult to assess on an equitable basis.

For some items, especially those relating to business risk, we will incorporate the latest available interim results. These include, for example, leverage and WALE. However, the main source of information is still the annual report.

Overall, we believe these changes would make the scoring more relevant to investors. Resources permitting, we will update Gift on a quarterly or half-yearly basis.

We look forward to the participation of trusts again in the voluntary self-assessment to continue to improve governance and trust in this sector. The full revised Gift scorecard for 2020 is available for download at governanceforstakeholders.com.

■ Mak Yuen Teen is an associate professor of accounting at the NUS Business School, where he specialises in corporate governance

■ Chew Yi Hong is an active investor and researcher in corporate governance with an MBA with distinction from the London Business School