



Strict regulation and oversight by the Monetary Authority of Singapore has been an important factor for the success of the Reit sector on the Singapore Exchange. BT FILE PHOTOS

# Reinforcing confidence in the governance of trusts

The MAS and SGX should ensure that regulation remains relevant and oversight continues to be strong. **BY MAK YUEN TEEN AND CHEW YI HONG**

**S**INCE CapitaLand Mall Trust became the first Reit to be listed on the Singapore Exchange (SGX) in 2002, the exchange has become the third largest market for Reits in Asia-Pacific. As at July 31, 2021, the total market capitalisation of Reits, business trusts and stapled trusts listed on SGX was S\$125 billion. SGX has been able to continue to attract new listings in the sector, with three new Reits – Elite Commercial Trust, Lendlease Global Commercial Reit and United Hampshire US Reit – included in the latest Governance Index of Trusts (GIFT) report.

These new listings, with predominantly foreign assets, also indicate how the profile of the sector has changed. More foreign Reits have listed here in recent years, and more Singapore Reits are heading offshore in search of further growth.

The growth in the sector has come with growing pains. Over the past few years, some trusts have faced corporate governance (CG) and performance issues. However, none was anything like Eagle Hospitality Trust (EHT) which imploded last year, less than a year after its listing – not long enough for it to be included in GIFT.

Being a foreign Reit, the collapse of EHT risks damaging not only the sector but tainting other foreign Reits. It is therefore comforting that in this year's GIFT, some of the top performers are foreign Reits. The top-ranked trusts in GIFT 2021 are Netlink NBN Trust, Keppel Pacific Oak US Reit, Mapletree North Asia Commercial Trust, Cromwell European Reit and United Hampshire US Reit (with the last two joint fourth).

Nevertheless, trusts with significant foreign assets have some additional risks.

To us, the key lessons from the EHT case include the following:

- all parties involved in a listing must effectively play their roles in undertaking robust due diligence;
- the complex structures inherent in many trusts are difficult for ordinary investors to understand and create governance and business risks;
- the integrity, quality and track record of the sponsors are critical;
- the pervasiveness of conflicts of interest and interested person transactions makes it particularly important for the manager/trustee-manager to have a truly independent board;

■ effective safeguards relating to potential conflicts of interest and interested person transactions, particularly involving sponsors, must be implemented in practice.

It is infeasible to design a scorecard (or for that matter, legislation, listing rules, CG code, etc) that captures all factors, especially those that involve subjective judgements about "integrity" of sponsors, directors and key management; or "quality" of sponsors and assets, although these may manifest in the governance and business risk factors included in the scorecard.

We considered some of these factors especially for trusts that are highly ranked. In some cases, we have reservations particularly about the "quality" of assets and of the sponsor but have avoided making subjective adjustments to the scores.

The following are some areas that we believe warrant more attention which we may consider enhancing in future GIFT assessments.

## TRANSPARENCY ABOUT COMPLEX STRUCTURES

Trusts should help investors better understand why they are structured in a certain way and how different entities within their structure are governed. This is especially so for trusts with foreign assets which generally have more complex structures. For example, what safeguards are in place to ensure that these entities do not enter into transactions with other parties without the knowledge and approval of the board of the manager, especially the independent directors? In the case of EHT, it was alleged that the sponsors were able to procure the master lessors, which were subsidiaries of EHT, to enter into non-disturbance agreements with the master lessees, which the sponsors owned.

Trusts should explain the controls and assurance mechanisms, such as board mandates, limits of authority and internal audits, that help mitigate the risk of unauthorised transactions in related entities that are harmful to unitholders' interests.

## INDEPENDENT BOARDS

The prevalent externally-managed model and the sponsors' multiple roles that apply to most trusts give rise to recurring and pervasive conflicts of interest. This makes having truly independent directors playing key roles particularly important.

In EHT's case, the two co-founders/sponsors held the positions of chairman and deputy chairman of the board, which would compromise the board's oversight role.

Having an independent chairman and a majority of independent directors is important. However, purely technical approaches based on minimum compliance with the rules are often used to determine director independence. Independent directors sometimes have relationships with related parties or entities which may compromise their independence, but which are not strictly captured by the rules. When directors fail to meet specific independence criteria in the rules, trusts sometimes use the flexibility in these rules to deem such directors as independent even though they are unlikely to be perceived as independent.

Trusts almost never disclose the search process for independent directors even though the appointment template for directors requires disclosure of the "search and nomination process".

Independent unitholders should also be given the opportunity to at least endorse the appointment of independent directors.

## OTHER SAFEGUARDS

The prospectuses of trusts generally disclose safeguards for dealing with conflicts of interest and interested person transactions. For example, one prospectus states that "any nominees appointed by the sponsor and/or its subsidiaries to the Reit manager board to represent its interests will abstain from deliberations and voting on such matters". Most trusts also state that the audit committee has a policy of reviewing interested person transactions. We believe trusts should provide positive assurance that the safeguards are applied in practice.

The audit committee should provide more information on its process for arriving at its opinion that acquisitions and divestments to interested persons are based on normal commercial terms and are not prejudicial to the interests of the trust and minority unitholders. Audit committees generally merely cite the opinion of the independent financial adviser. This may raise questions about the value-add of independent directors on the committee, and the robustness of the process in reviewing such transactions.

## VALUATIONS

Independent valuers play a particularly important role in the context of trusts, both prior to the IPO where two independent valuers are typically appointed to value the assets acquired by the trust for the listing, and on a continuing basis as the trust acquires additional assets or divests existing assets.

Even though valuations are based on international valuation standards, valuers are not subject to stringent regulation and regulatory oversight. SGX has enhanced its rules relating to valuation and engaged with the valuation profession to improve standards and transparency. Nevertheless, we believe there is room for improvement. Self-regulation by a profession is rarely sufficient.

Para 5.1(d) in Appendix 6 of the Code on Collective Investment Schemes (CCIS) states that a property fund "may acquire assets from or sell assets to interested parties, if... each of those assets is acquired from the interested parties at a price not more than the higher of the two assessed values, or sold to interested parties at a price not less than the lower of the two assessed values".

In the case of EHT, two valuers were used to value the 18 properties that were acquired. One valuer assigned a higher valuation to 16 out of the 18 properties and its valuations became the adopted valuation against which the purchase consideration for each property was compared. This resulted in a higher discount from valuation for 16 out of the 18 properties, than if the valuations of the other valuer were adopted.

Similarly, at newly-listed Elite Commercial Trust (which is ranked joint 6th in GIFT 2021), the valuations of one of the valuers were used to determine the purchase consideration for all the properties acquired by the trust from the sponsor just before the IPO.

The valuations of the adopted valuer were higher in most cases, often substantially so, and the purchase consideration for every property was then based on the valuation of this valuer.

In these and other cases of multiple asset acquisitions prior to the IPO, trusts adopt the valuations of the valuer providing more of the higher valuations, with the valuations of the other valuer disregarded.

This is in line with the CCIS. We believe that the CCIS guideline on using the higher of the two assessed values in the case of asset acquisitions, and the lower of the two assessed values for asset sales, should be reconsidered.

## NO ROOM FOR COMPLACENCY

Strict regulation and oversight by the Monetary Authority of Singapore (MAS) has been an important factor for the success of the Reit sector on SGX. However, EHT is a wakeup call and MAS and SGX should ensure that regulation remains relevant and oversight continues to be strong.

The increasing use of hybrid securities, continuing growth in foreign assets, and reliance on short-term financing and currency mismatch between loans and assets in some trusts, are areas that should be monitored.

As the sector matures and trusts consolidate, the trade-offs between the internally managed model and external managed model may also change and the case for the former may strengthen.

The philosophy of strict regulation and oversight should also guide the thinking of MAS and SGX as they look to other opportunities for growth on our market, such as the listing of special-purpose acquisition companies (SPACs).

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