A Calling For More Independent Directors

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Singapore has come a long way in building up its corporate governance standards aimed at promoting investor confidence in companies listed on the Singapore Exchange and putting Singapore on the global map as a trusted international financial hub.

The Code of Corporate Governance ("Code") was first introduced in 2001 and has been recently revised.

The motivation for the changes can partly be attributed to the corporate scandals which have dogged Singapore's corporate environment leading investors to call for greater corporate governance.

The recent changes were the result of a review undertaken by the Corporate Governance Council (comprising representatives from the business community and stakeholder groups) set up in February 2010 by the Monetary Authority of Singapore ("MAS") to look into enhancing corporate governance practices in view of changing investor environment and market developments.

The new Code is meant to address the need to tighten the rules on corporate governance, especially in terms of checking the power of the Chairman/ CEO of the company, and the need for a strong and independent element on the board of directors.

Enhanced Corporate Governance?

Corporate governance advocates have generally reacted favourably to the new Code. Some of the key changes to the Code relate to the areas of director independence, board composition, remuneration practices and disclosure and risk management. The new revisions do appear to address the key concerns of investors and regulators surrounding corporate governance issues

It now remains to be seen how effectively these measures will be implemented in practice.

This article looks at the following particular changes:

- The tightening of the concept of "independence" and in particular the introduction of the relationship with a 10% shareholder and relationship with external organisations through provision of material services in the determination of independence; and
- "The 9 year rule".

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Tightening Of Concept Of Independence

In recognition of the need for a strong element of independence on the board, instead of a general requirement that one-third of the board be independent, the Code now requires independent directors to make up half of the board where the chairman and CEO is the same person, or are immediate family members, or are part of the same management team, or if the chairman is not independent.

10% Shareholding

Some of the factors to be taken into account in the determination of independence now include a situation where the director is or related to a 10% shareholder or has a direct association (emphasis added) with a 10% shareholder.

In the Code, a "10% shareholder" refers to a person holding not less than 10% of the voting shares of a company. The introduction of this concept of a director's relationship with a 10% shareholder is in recognition of the fact that the interests of a shareholder appointing a director may not necessarily be aligned with the interests of the other shareholders as a whole and potential conflicts arising from such relationship may affect a director's ability to exercise independent judgment.

MAS felt that the 10% threshold was more appropriate than the 5% threshold recommended by the Council which is the basis for determining substantial shareholding under the Companies Act and the Securities & Futures Act.

The Code also elaborates on what amounts to "direct association" with a 10% shareholder. This essentially is premised on the director being accustomed or under an obligation to take instructions from or to act in accordance with the directions or wishes of the 10% shareholder in relation to the corporate affairs of the company. The fact that the director is nominated by the 10% shareholder in itself does not negate his independence.

While this is theoretically clear, it may not be so easy to demonstrate in practice. Often there would not be any formal understanding. Every case will need to be assessed on its own facts.

Ultimately, this will need to involve a 2 step process:

- The director nominated will himself need to assess his ability to exercise independent judgement; and
- The Nominating Committee will need to scrutinize the relationship including the reasons for the nomination, past dealings between the 10% shareholder and the nominee. This is particularly where the director is of the view that he is independent notwithstanding any relationship with the 10% shareholder. The Nominating Committee may well think of setting down certain categories of relationships where the director will not be considered independent regardless of such director's view taking into account the Code's guidelines.

Provision Of Material Services

Under the Code, a director who in the current or immediate past financial year is or was a 10% shareholder, partner, executive officer, or director of any organization to which the company or any of its subsidiaries made, or received payments or material services in the current or immediate past financial year is unlikely to be considered independent.

The 10% shareholding concept has already been discussed above.

This change formally sets out parameters which companies have often used to scrutinize candidates for independent directorships.

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However the Code does not elaborate on what amounts to "material services" and requires again a judgement call for the board.

In practice, often professionals sit as independent directors and bring to the board their relevant expertise in their professional fields which is often invaluable. If the company then engages the services of the firm in which the independent director is a partner, executive or director, under the Code, it is now likely to bring into question whether the director ceases to be independent solely as a result of the firm being involved.

It is not unreasonable to take a view that the mere involvement of the professional firm ought not affect the directors independence as a whole. However, going forward, prior to the appointment of the professional firm, the board should consider whether the proposed matter for which the firm is being engaged is of such a nature where a potential conflict of interest may arise. If there is any concern that there may be potential for conflict, the board ought to err on the side of prudence and take the view that the independence has been affected. Factors which the board may wish to consider in its determination include (i) the nature of the services to be provided (ii) the value of the services and (iii) the duration of the services.

The 9 Year Rule

The Code now provides that a director who has served on the board of a company for more than 9 years should be subject to particularly rigorous review in his re-appointment as independent director.

Again this is a logical change which addresses the concern that after a long period of service a director may have developed close ties with management which may well compromise on independence. This is weighed against the benefit of having an independent director who would have gained valuable understanding of the business of the company which may be crucial for an independent director to discharge his role effectively.

The Code however does not go on to discuss what would amount to particularly rigorous review. Again this requires the Nominating Committee to develop the parameters for review of the re-appointment of long-serving independent directors.

The new Code is likely to call for more qualified persons to step up as independent directors. If an analysis is made of independent directors of listed companies in Singapore, it will not come as a surprise that there are some names which crop up more often. This then begs the question whether there is a reluctance to serve as independent directors. While this in itself is not an indication of shortage, it is clear that to give proper effect to the revisions, the greater the pool of candidates, the better.

Conclusion

The new Code is likely to call for more qualified persons to step up as independent directors. If an analysis is made of independent directors of listed companies in Singapore, it will not come as a surprise that there are some names which crop up more often. This then begs the question whether there is a reluctance to serve as independent directors. While this in itself is not an indication of shortage, it is clear that to give proper effect to the revisions, the greater the pool of candidates, the better.

Additionally, the Code requires a director who has multiple directorships to ensure that sufficient time and attention is given to the affairs of each company he represents. The Code recommends that the board of a company should determine the maximum number of directorships any director should hold and disclose this in the annual report.

This is meant to discourage a director from holding too many directorships and may add to a crunch in the number of directors who may be immediately available to serve on boards as independent director.

However, this is likely to be a perceived shortage as there are many qualified candidates out there who have probably not been tapped.

With the new changes, the time is ripe for more candidates to come forward and uphold the standards promoted in the Code.