



The Nominating Committee

And Its Role In Identifying Directors For Renewal And New Appointments*

By Kala Anandarajah
Partner, Rajah & Tann LLP

Overview

In the board renewal process, particularly in public listed companies, an important team of persons responsible for identifying new directors and assessing existing ones to determine if they should continue to act as directors lies in the first instance with the nominating committee ("NC"). The concept of the NC was introduced in Singapore with the introduction of the first Code of Corporate Governance ('Code') in 2001, which took effect in 2003. This short article highlights how the NC is constituted, the essence of the role they perform, and their functions in the assessment of the performance of directors.

Constitution Of Nominating Committee

The Code of Corporate Governance recommends that all companies listed on the Singapore Exchange must establish an NC to make recommendations to the Board on all board appointments.¹ The Code provides that the NC should comprise at least three directors,

a majority of whom, including the chairman, should be independent. The revised Code issued in July 2005 provides specifically that the chairman of the NC must be independent of management, business relationships as well as of substantial shareholders. Specifically, the Code provides that a director will lose his independence if he is accustomed or under an obligation, whether formal or informal, to act in accordance with the direction, instructions or wishes of the substantial shareholder. On whether it is possible to have a truly independent NC, JY Pillay, Chairman of the Singapore Exchange, in an interview for the Singapore Institute of Directors' Bulletin² said as follows:

Where there is a majority shareholder, how independent can the NC be, for example? Yet, this is a matter of evolution. In the larger companies, where there is a greater focus by the media, and a large number of shareholders exist, there tends to be a process whereby the shareholders progressively flex their

muscles and require accountability from the independents and others. In smaller companies, one cannot expect that there will be a substantial degree of independence reflected in the Board.

The Code further recommends that the NC should have written terms of reference that describe the responsibilities of its members, and its membership should be disclosed annually.

Role Of Nominating Committee

Under the Code, the NC is charged with the responsibility of re-nomination having regard to the director's contribution and performance (for example, attendance, preparedness, participation and candour) including, if applicable, as an independent director. The NC should also be tasked with the responsibility of ensuring, in conjunction with the Board as a whole, that the right mix of skills and experience and other such qualities as to enable the Board to function completely and efficiently is found for the board of directors.³ Anecdotal evidence suggests that insufficient time is spent by the Board and the nominating committee in reviewing succession planning within the Board, including the CEO.⁴ As regards the CEO, it has been noted that to ensure that there is proper succession planning, at least the following three elements needed to be reviewed:⁵

- a. **The business strategy:** to identify where the company is going before being able to identify what is required in a leader.
- b. **Management training:** to make sure that the company is developing executives in all areas of the business who will be able to execute that strategy.
- c. **The succession plan itself:** the CEO should identify and develop potential successors for the board to consider.

As a principle of good corporate governance, all directors should be required to submit themselves for re-nomination and re-election at regular intervals and at least once every three years.

The NC is also charged with determining annually whether or not a director is independent, bearing in mind the guidelines on independence and any other salient factors. A director who has one or more of the relationships which could tarnish their independence, on which see Chapter 4, may nonetheless be appointed as an independent director, if the NC determines that such director is in fact independent and the company discloses in the next annual disclosure on corporate

governance, the nature of the director's relationship and the reasons for the NC's determination.

As a matter of interest, with the introduction of the revised Code in July 2005, the Ministry of Finance reinforced the view, contrary to the recommendation of the Council for Corporate Disclosure and Governance, that the NC should go beyond just the technical definition of independence in the Code when assessing whether a director will be able to provide independent views.

When a director has multiple board representations, he must ensure that sufficient time and attention is given to the affairs of each company. The NC should decide whether or not a director is able to and has adequately carried out his duties as a director of the company. On this, the Code recommends that internal guidelines should be adopted that address the competing time commitments that are faced when directors serve on multiple boards.

On the appointment process, the NC is required to provide a description of the process for the election and appointment of new directors to the Board and have this disclosed. This should include disclosure on the search and nomination process. Key information regarding directors, such as academic and professional qualifications, shareholding in the company and its subsidiaries, board committees served on (as a member or chairman), date of first appointment as a director, date of last re-election as a director, directorships or chairmanships both present and those held over the preceding three years in other listed companies and other major appointments, should be disclosed in the annual report.⁶ The names of the directors submitted for election or re-election should also be accompanied by such details and information to enable shareholders to make informed decisions.

Review Of Board Performance

The Code recommends a formal assessment of the effectiveness of the Board as a whole and the contribution made by each director to the effectiveness of the Board.⁷ The exact evaluation process is left to the Board to implement, and in particular, the NC. The process of review must be disclosed in the annual report. As a measure of the Board's performance, a range of performance measurement tools is spelt out in the guidelines to the Code. The criteria that has been suggested should be used by every company is an evaluation of the company's share price performance over a five-year period vis-à-vis the Singapore Straits Time Index and a benchmark index of its industry peers. Other

performance criteria that may be used include Return on Assets ("ROA"), Return on Equity ("ROE"), Return on Investment ("ROI"), and Economic Value Added ("EVA") over a longer term period.

Any performance criteria put together must be objective. Such performance criteria, that allow comparison with its industry peers, must be approved by the Board and address how the Board has enhanced long-term shareholders' value. These performance criteria should not be changed from year to year, and where circumstances deem it necessary for any of the criteria to be changed, the onus should be on the Board to justify this decision.

Individual evaluation should aim to assess whether each director continues to contribute effectively and demonstrate commitment to the role (including commitment of time for board and committee

meetings, and any other duties). The chairman should act on the results of the performance evaluation, and where appropriate, propose new members be appointed to the Board or seek the resignation of directors, in consultation with the NC.

The suggestion that the NC be the group which spells out the guidelines for evaluation appears somewhat incestuous at first flush. A group of directors is called upon to set out the criteria to decide how the Board's performance as a whole, of which they are also members, is to be assessed. The criterion suggested is peer review, with the aim of increased shareholder value. Can such an approach really yield an independent and objective set of criteria? Perhaps the criteria for evaluation could be set out by the Code itself or by an independent body such as the Institute of Directors. ■

**Adapted from a book by the writer titled Corporate Governance – Issues & Practice, published in December 2009 by the Academy Law Publishing.*

1) The Singapore Board of Directors Survey 2000 (the first survey that was undertaken by the Singapore Institute of Directors in conjunction with others) notes that in 1999, in 69% of appointments to the Board, the chairman was instrumental in identifying the candidates. In 68% of appointments, the chairman had exerted a major influence in making the final selection and ultimate appointment. It would be interesting to see how the introduction of NCs will impact on the existing approach. The Singapore Board of Directors Survey 2008/9, which is the most recent survey, provides that almost all companies identify potential non-executive directors through personal contacts, other board members or the nominating committee. Only 5% in fact use search firms; although this is noticeable since none used search firms previously.

2) The Directors' Bulletin (Singapore Institute of Directors, Issue 3 of 2009).

3) The Singapore Board of Directors Survey 2000 notes that having experience as a senior company manager or partner in a relevant professional firm and having knowledge of finance or law were seen as being very important selection criteria. The 2002 Survey mirrors these findings and also identifies business and management and strategic planning experiences as key factors. The Singapore Board of Directors Survey 2008/9, which is the most recent survey, takes a different stance and provides that 85% of the companies assess the suitability of directors formally prior to their appointment, with the nominating committee in 47% of the companies conducting interviews to assess the suitability of the directors.

4) Corporate Board Member's "What Directors Think" Survey (2006) notes that 43% of the 1,330 respondents were dissatisfied with the planning of their company's management succession.

5) Corporate Board Member, "The Wrong Way to Pick a Chief Executive" (May/June 2007) at 44.

6) See the Singapore Institute of Directors Board Survey 2008/9.

7) Assessment of boards as a whole or all of the individual directors has not caught on as much amongst companies in Singapore. What has grown, however, is the evaluation of the CEO. The Singapore Board of Directors Survey 2008/9, provides that 78% of the companies evaluate the CEO's performance on a periodic basis, of which 40% conduct it formally with discussions on pre-planned agenda, analysis, follow-up actions and documentation. CEO performance is assessed by the remuneration committee in 53% of the companies, the Board as a whole in 36% of the companies and the nominating committee in 24% of the companies.