

SHOULD NON-EXECUTIVE DIRECTORS OWN SHARES?

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Should a non-executive director (NED) of a listed company hold shares in that company? This question comes up regularly at Annual General Meetings (AGMs) and the answer is not straightforward.

YES, THEY SHOULD

In Singapore, Guideline 8.3 of the Code of Corporate Governance (Singapore Code) states that the Remuneration Committee should consider implementing schemes to encourage NEDs to hold shares so as to better align their interests with those of other shareholders.

Similarly, SID's *Statement of Good Practice* on Fees Payable to NEDs states that shares can be provided as an alternative to

paying fees in cash, or as an additional grant to recognise particular achievements.

Shareholders themselves in the meantime, typically prefer that their directors or CEO should also own shares.

NO, THEY SHOULD NOT

Directors who do not own shares often attribute this to the difficulties associated with ownership. Strict insider trading rules and share dealing policies for example, mean that shares can be bought or sold only outside blackout periods and only when directors are not in possession of confidential materially price-sensitive information. On top of this, there are stringent disclosure requirements in place for each transaction.

However, whilst these practical constraints do exist, they should not be a big hindrance. After all, one can reasonably argue that officers and directors of listed companies should not be trading in their shares on short-term considerations.

In fact, many NEDs take the view that they can buy, but should not sell, their company's shares while they are directors since selling is tantamount to signalling that the director has lost faith in the company or is aware of negative prospects not yet known by the market.

Therein lies the rub though: some NEDs feel that they are unnecessarily restricted in their investment activities by this "no sale of shares" principle, and therefore prefer to avoid having any shareholding in the first place.

There is also a recent regulatory trend that cautions against going too far with schemes to force the issue of share ownership for the alignment of interests.

Both the UK Corporate Governance Code 2012 (UK Code)

and the Australian ASX Corporate Governance Principles and Recommendations 2014, for example, explicitly discourage the grant of share options or performance-based remuneration to NEDs.

The reason is that such grants or remuneration may lead to bias in the NEDs' decision-making and compromise objectivity.

SID's *Statement of Good Practice* similarly cautions that including NEDs in share option plans, performance share plans, or other equity-related arrangements should only be done after a full consideration of the attendant risks of compromising directors' independence or judgment.

The UK Code goes a step further. If options are granted, shareholders' approval should be sought in advance, and any shares acquired by exercise of the options should be held until at least one year after the NED leaves the board.

BACK TO BASICS

Perhaps the distinction between not approving share options and equity-based remuneration for NEDs versus acceptability of share ownership is best understood with a closer examination of the role of these company officers.

Management is given share-based remuneration to incentivise them to drive the company's performance. In contrast, NEDs, particularly independent directors, play an oversight role. They are there to provide a check and balance on management. It could be argued that they should not be similarly incentivised with share-based remuneration. To do so would put NEDs at the same rank as executives who should be supervised and remunerated by NEDs.

Furthermore with share options, there may not be a close alignment of interests with that of shareholders since option-holders typically do not pay for their options and suffer no real loss if the

share price falls.

On the other hand, a shareholder has something tangible in hand whose value he will first want to protect, and also increase. Allocating a portion of directors' fees payable to NEDs in the form of, or for the acquisition of, shares means that the NEDs will, like other shareholders, have invested their own funds to become shareholders and have a genuine stake in the game.

It goes without saying that, if an NED has a large number of shares in his company, it can also impact his objectivity and judgment. This is why the Singapore Code specifies that holding 10 per cent of a company's shares would be relevant to the determination of the independence of an NED.

Perhaps the short answer to the question we started with is this: NEDs should hold some shares to align themselves with the interests of other shareholders, but should not be holding so many shares, nor should their remuneration be tied to performance, such that their independence or objective judgment is affected. ■