22

The Nine-Year Rule

David Conner

One of the new provisions in the revised Code of Corporate Governance released in May 2012 is the so called "Nine-Year Rule". This has engendered much discussion and could potentially result in significant movements within the boardrooms of corporate Singapore.

Guideline 2.4 of the Code states that "the independence of any director who has served beyond nine years from the date of his first appointment should be subject to particularly rigorous review. In doing so, the Board should also take into account the need for progressive refreshing of the Board. The Board should also explain why any such director should be considered independent."

DIRECTOR INDEPENDENCE

This apparent link between a director's tenure of service and his independence deserves closer examination.

Few would argue against the Code's prescription that there should be a strong and independent element on each Board. It helps ensure that decisions are properly and objectively made.

Further, the Code exhorts Boards to determine, taking into account the views of the Nominating Committee, whether a director is independent in character and judgement, and whether there are relationships which are likely to affect, or could appear to affect, the director's judgement.

The key to a director's independence therefore seems to be his "character" and "judgement". Yet the Code, through the Nine-Year Rule, obliquely implies that time on the Board could affect a director's character and/or judgement.

It can be said that the basic character of any individual does not really change with time. As a banker of 36 years, I am well acquainted with the basic credit principles represented by the "4 C's of credit" – character, collateral, capacity and cash flow. In my experience, when it comes to repaying a debt, character does not change over time. If so, assuming a director is independent in character on the day he is appointed, he will then continue to be independent in character, even beyond nine years' service on the Board.

As for judgement, it frequently and often improves with time. We are, after all, taught to respect the wisdom of our elders. The Code implies, however, that familiarity with the business or management team could affect a director's judgement. On the other hand, one could argue to the contrary that familiarity with the business and management team is a valuable characteristic which Boards should seek and retain in their directors.

BOARD RENEWAL

While the Code recognises the need for progressive refreshing of the Board, thereby ensuring that fresh perspectives are continually brought onto the Board, the need for Board renewal needs to be balanced with the need for Board continuity.

Familiarity with a business can be very useful when business cycles come into play, particularly long business cycles. Directors, who can remember mistakes of the past first hand by having been there, are more likely to steer the Board and management away from repeating those mistakes. The philosopher George Santayana once said: "Those who cannot remember the past are condemned to repeat it." Although extensive experience with a business should be a quality that is highly valued, the Code suggests that Boards should "penalise" long serving directors when it comes to assessing their independence.

NOT CONFUSING THE TWO ISSUES

It is therefore critical that Boards are made fully aware that the need to refresh their Boards is an issue which is separate and distinct from the issue of assessing the independence of any particular individual director.

At the end of the day, the Code does leave it to the Board's discretion, with the assistance of the Nominating Committee, when assessing the independence of long serving directors, even though this particular issue is "subject to particularly rigorous review". I trust that Boards will, notwithstanding the Nine-Year Rule, have the courage to retain long serving independent directors who are truly independent in character and judgement. ■