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SOME THOUGHTS ON CORPORATE GOVERNANCE (PART 2)

Last month I wrote about how surprised I was to discover that Sean Fitzpatrick was described in the 2007 Anglo Irish Bank annual report as an “independent” member of the board and I finished that opinion piece by saying that I was not sure who is supposed to police issues of that nature.
In the last couple of weeks I have been researching this topic and I would like to use this as an opportunity to report back on my findings.

I discovered that the Australians do things the way I would expect them to be done. I found that the Australian stock exchange publishes an annual report outlining compliance with their corporate governance requirements. (Their corporate governance rules appear to be quite similar to the Combined Code used here.
You can read these requirements and the compliance reports at:
http://www.asx.com.au/about/corporate_governance/monitoring_compliance.htm)

I discovered that the Irish Stock Exchange (ISE) does not do it the same way as the Australians.
As far as I can tell there is no published documentation from the ISE.

What I did discover is that the accountancy firm Grant Thornton published a report “ISEQ Corporate Governance Review 2009”. In that report they looked at all the companies with a listing on the main index of the Irish stock exchange. They did a statistical analysis of compliance with the Combined Code and they gave their own opinions as to where improvements can be made.
As far as I can tell, Grant Thornton has not been hired to do this work and they certainly do not have a formal policing role. In my opinion they appear to have taken on this role in the hope that they might break the dominance of the big four accountancy firms in terms of work done for quoted Irish companies.
Whatever their motivation for doing the work it is good to see somebody going to the trouble because I can find no published evidence that anyone else is doing it in a fully transparent way. (Others may be doing it but they are not publishing their findings. For example the Irish Association of Investment Managers published a report in 2001 and has indicated that they continue to monitor things)

I thought that the ISE would have been delighted that Grant Thornton had gone to the trouble of doing the work that in Australia is done by the stock exchange but it appears that they are not exactly happy with the conclusions reached by Grant Thornton. You can read a full press release from the ISE at:
http://www.ise.ie/index.asp?locID=328&docID=-1 under February 18th but I would like to highlight the following section:

The Grant Thornton Review of Corporate Governance for companies listed on the Irish Stock Exchange is a useful, albeit narrow, contribution to the ongoing debate on Corporate Governance on public markets.

> There would appear to be a disconnect between the detailed findings of the Report and the accompanying commentary. The detailed findings of the Report identify that there is strong compliance with the key components of the Combined Code, whereas the commentary suggests that there is significant divergence away from generally accepted standards. This is regrettable.

Given that the ISE stated that the conclusions reached by Grant Thornton were "regrettable" I hoped that they would have specifically dealt with the issues raised in the Grant Thornton report but as far as I can tell this has not been done (in public anyway).

The Chairman of the ISE, Padraic O'Connor did write an opinion piece for the Irish Times on April 30th and in that piece he appears to agree with one of the main conclusions reached in the Grant Thornton report. He states the following:

There has been much discussion about the composition of boards. There is a clear need for a combination of expertise, independence and objectivity on boards. To my mind, it would be quite a coincidence if the appearance of the same and reciprocal names on the boards of several listed companies delivered these fundamental requisites.

This would appear to agree with the following view expressed in the Grant Thornton report:

there should be a limit to the number of boards of listed or public entities on which individuals can sit.

This makes me believe that there is some common ground between the views of the ISE and Grant Thornton and hopefully the fact that both of them agree that changes need to take place can be embraced in a positive way.

Earlier on I stated that the Australians do things the way that I would expect them to be done but I think that even the Australian way can be improved. I think they could go one step further and publish their findings on each individual company. I am not sure why they decided against doing this.

Unfortunately the Grant Thornton report does exactly the same and does not provide full transparency in the sense that they do not give an analysis of each individual company. I cannot therefore give their specific analysis of Anglo Irish Bank even though they obviously did it. (They do mention specific companies in the executive summary and Anglo Irish Bank does get a couple of mentions.)

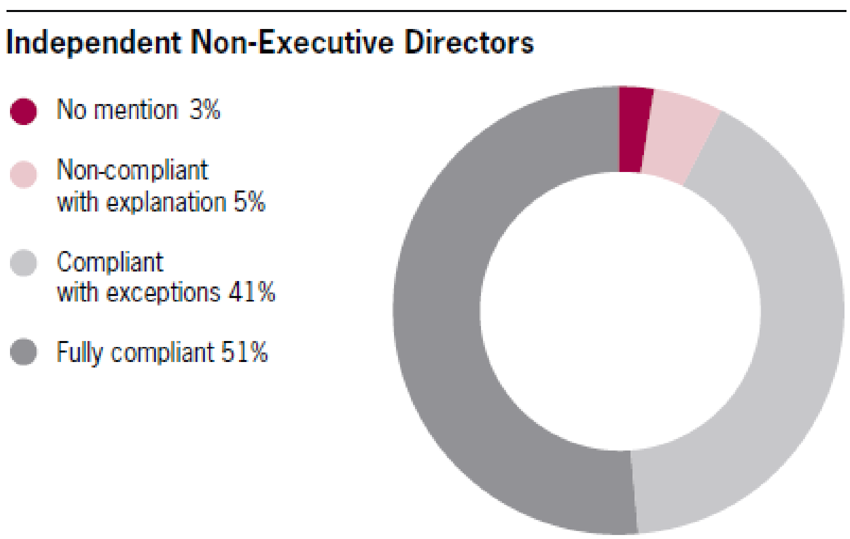
If analysis was provided on an individual company basis it would make it easier for interested parties to look at the issues and allow a more widespread debate. It might even result in greater pressure being exerted to make sure that the spirit of the rules would be enforced.

I believe that Ireland should move to the Australian model and provide an annual report but I would also like to recommend that we go one stage further and publish the detailed results for each company.

It might also be worth considering allowing the author of the report to express an opinion on whether or not the spirit of the rules are being met as well as the letter of the law.

I would now like to return to the issue of director independence, the issue that originally got me looking into corporate governance, the Combined Code and how it is policed.
In last month’s opinion piece I stated that when it comes to corporate governance I believe that the independence of directors is crucial. The Grant Thornton report did look at this issue.
They looked at the number of companies that met the Combined Code requirements (the requirements were included in last month’s opinion piece)

And here is their finding:



I conclude from this chart that Irish companies have plenty of directors that appear to have conflicts that prevent them from being independent but their boards are prepared to explain why they believe that they are. What this does not tell me is whether or not these explanations are adequate. I am worried that if Sean Fitzpatrick was described as independent well then others might be doing the same. I believe that the explanations given should be really detailed and shareholders should be prepared to question any explanations that just say that the people in question are independent thinkers.
The Grant Thornton report does not allow me to reach conclusions about the quality of the explanations given. I have found nothing else to indicate that anyone else is publishing anything in relation to this in an official capacity. I might be missing something but forgive me if I have missed something obvious.
I have therefore reached the conclusion that if policing is going on it is not being done in an open and transparent way.
I believe that there is further interesting work for me to do in this area. I stated earlier that the Grant Thornton report did not look at companies listed on the Irish Enterprise Exchange (IEX).I have started to have a look at some of these companies just to see how they perform relative to the independence aspects of the Combined Code and I have discovered some interesting things. In fact I have seen other aspects of corporate governance that have jumped out at me. I therefore intend to follow up next month with part 3. Watch this space.......lets make things transparent

PERFORMANCE UP TO END JUNE

In my January opinion piece I expressed my disappointment at my 2008 performance. Luckily the first six months of 2009 have been far better and my fund has generated a return of 14.9% (again I have to state that this is my estimate and this figure has not been audited by any third party). The world index rose by 5.9%.

As I stated in January my fund is designed for a world that is not in a major recession and since the markets bottomed in March (when my fund was down over 12%) there has been increasing hope that the world will eventually recover. I hope that this is not a false dawn as my fund continues to be positioned for a world economy that has some growth.

The fund also performed well against other Irish global equity funds:

Global Equity	1 Month	3 Months	YTD	12 Months
AIBIM	0.0	15.3	4.4	-30.4
Aviva Ireland	0.3	16.7	7.6	-26.3
BIAM	0.0	16.7	8.6	-21.4
Eagle Star	-0.2	13.5	5.0	-19.0
Merrion	-0.5	17.4	12.8	-20.7
New Ireland	-0.4	16.5	7.7	-23.7
Setanta	0.4	14.9	8.2	-18.5
Global Equity - Multimanager Funds	**1 Month**	**3 Months**	**YTD**	**12 Months**
AIBIM	1.8	15.2	6.2	-22.3
Irish Life	0.8	15.3	7.3	-19.5
Standard Life	1.2	14.3	7.0	-22.6

If I could keep this up for another few years even Warren Buffett might have to watch out !!!!