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Noble should pay heed to its corporate governance

Its practices in picking its board of directors, remuneration policy and degree of disclosure fly in the face of a company that is reportedly working on improving transparency. BY MAK YUEN TEEN

THE third report issued by Iceberg Research and some commentators have touched on the corporate governance of Noble Group, in particular the long tenure of some of its independent directors. However, there has not been an in-depth assessment of its corporate governance. The Governance and Transparency Index (GTI), published by *The Business Times* and the National University of Singapore's Centre for Governance, Institutions and Organisations (CGIO) and sponsored by CPA Australia, provides an indication of the overall quality of Noble's corporate governance and transparency. The 2014 GTI gave it an overall score of 41, placing it in 293rd position in a field of 644 companies covered. This was an unusually low ranking for such a large company. Interestingly, in 2013, Noble was ranked far lower – at 503 – with a score of just 28.

In this commentary, I will discuss in depth two key areas of Noble's corporate governance – its board of directors and its remuneration policy and disclosures.

BOARD OF DIRECTORS

Before its recent annual general meeting (AGM) on April 17, 2015, it had a 13-member board, with an executive chairman, two other executive directors, two non-independent non-executive directors and eight independent directors.

At the recent AGM, the two non-independent non-executive directors did not seek re-election. On May 6, Noble appointed an additional independent director, making it a 12-member board, with three-quarters being independent directors. Perhaps the new appointment was a reaction to shareholders at the AGM, or to recent criticisms about its corporate governance; otherwise, it should have put this new director up for election at the AGM, rather than give shareholders the opportunity to scrutinise and approve his election only at the next AGM.

In my view, Noble's board is still larger than it needs to be, and in its case, more directors do not translate into better diversity. Its board appears over-weighted by independent directors with a banking background. Perhaps it feels it needs a lot of banker-type directors who are able to help it build relationships with banks, given the 41 principal bankers listed in its annual report.

There are also a number of interlocking company and board relationships among the independent directors. The inter-connectedness and lack of diversity among the independent directors is likely related to how Noble appoints directors. In its annual report, it says the appointment of directors is based on the Chairman consulting individually with directors on possible candidates, who are then considered by the nominating committee. This appears to be a classic example of a board which appoints directors through an "old boys' network", purely through recommendations of incumbent directors.

The appointment of the newest independent director, Paul Jeremy Brough, seems to support this. He joined KPMG Hong Kong in 1983, became a partner in 1991 and retired as a senior partner in 2012.

Iain Ferguson Bruce, a current independent director and the audit committee chairman, was also a senior partner of KPMG in Hong Kong, having retired in 1996. Clearly, the pair know each other. Of all the possible independent-director candidates in Hong Kong and elsewhere, Noble appointed one with ties with an incumbent independent director.

The appointment of Mr Brough is particularly surprising, given the public scrutiny Noble is facing. This suggests that it is oblivious to or does not care about public perceptions. Some may argue that this is a sign of hubris.

Mr Brough may have been brought in to ultimately replace Mr Bruce on the board and the audit committee. Mr Bruce sits on the boards of six other listed companies – five listed on the Stock Exchange of Hong Kong and one on New York Stock Exchange – and has other key appointments; he is

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the busiest director in terms of number of listed company directorships on a board stacked with busy individuals based on their directorships and key appointments. He also chairs what is arguably one of Noble's two most critical committees – the audit committee (the other being the risk committee).

Although Mr Bruce is a qualified accountant who had had a distinguished career in KPMG, he retired almost 20 years ago, when financial reporting standards were much different from today's. Given that accounting firms are essentially full-service consulting firms, he may not necessarily have the requisite background to understand the complex financial reporting issues in a global commodities player like Noble.

Similarly, though Mr Brough also had a distinguished career in an accounting firm, it would nevertheless be important for shareholders to assess whether he has the necessary background for a company like Noble when considering whether to support his election at the next AGM.

For such a large board with so many independent directors, the lack of any independent directors with strong experience in the commodities industry is rather surprising, and would lead to questions about the ability of the board to challenge management on the company's business model and strategies. Further, while many of the independent directors have international appointments, they are all based in or closely connected, to Hong Kong, though Noble is listed here and operates globally.

The company does not disclose the age of its directors in the annual report. Online searches reveal that at least four out of nine of its independent directors are over 70 years old; the youngest is 58, and the oldest, 85. As a well-known American corporate-governance activist and director once said: "The reason he is so accomplished is because he is old." I have nothing against older directors, but I think Noble can do with some younger blood on its board, who bring current and relevant skills and competencies to the boardroom.

Four of its nine independent directors have served more than nine years. Noble said it has done a "particularly rigorous review" and concluded that they are all still independent; it also said it does not feel it is appropriate to set a limit on number of directorships held by its directors.

If we look at the profiles of its independent directors, busy-ness appears to be a criterion for appointment, rather than a basis for exclusion. The manner in which Noble dealt with the two new guidelines in the 2012 Code of Corporate Governance – those pertaining to degree of independence and setting a limit on maximum number of listed-company directorships – tells us something about its attitude towards corporate governance in general, and its lack of interest in implementing guidelines in the Code (as my discussion of its remuneration policy and disclosures would further confirm).

There are other questionable board and committee practices. For example, the executive chairman is a member of the audit, nominating and remuneration committees, which is not good practice and indicates the pervasive influence that he has in the corporate governance of the company.

In my opinion, stakeholders of Noble should not expect the board to be an independent and effective monitor of management.

REMUNERATION POLICY AND DISCLOSURES

Noble is opaque when it comes to remuneration of directors and senior executives. It discloses the remuneration of its executive directors, top five executives and non-executive directors in bands of S$250,000.

For the three executive directors, it discloses a top band of S$1.5 million and above, together with the percentage mix; for the top five key management executives, it discloses that they were each paid S$1.5 million and up. It does not comply with the Code's recommendation to disclose the total remuneration of the top five key management personnel who are not directors. For the non-executive directors, it provides the rather useless disclosure that they were all paid below S$250,000. As is common, it falls back on the competitiveness of the industry, sensitivity and confidentiality as excuses for opaqueness.

Its other required disclosures give some additional information: Note 6 to the financial statements said that in 2014, the three executive directors were paid a total of US$17 million (with three-quarters being the fair value of share-based payments) and the non-executive directors, US$690,000. In other words, the average remuneration of the three executive directors was well above the starting point of the "S$1.5 million and above" top band.

It should be pointed out that if Noble had listed in HK, such opaqueness would not fly, because the HK listing rules require the disclosure of the exact remuneration of each individual director (including executive director).

Noble is also extremely poor in disclosing its remuneration policy. It vaguely mentions that it links incentive remuneration for senior management to group and divisional earnings and that it may use other role-specific measures (that is, individual performance measures); it does not reveal the fee structure for its non-executive directors.

Noble makes a number of disclosures in the notes related to the assumptions used to value share options, which it uses extensively, but there are no indications that the vesting or exercise of the options is staggered at all. Presumably, this means that all the options granted can be exercised after the minimum period under the listing rules, which is one year for non-discounted options.

This leads to concerns that the options will promote short-termism among the executive directors and senior executives. What is worse is that Noble gives share options to all its independent directors, including those who serve on the audit and risk committees; these options align their incentives closely to management, and may encourage them to promote risk-taking rather than to oversee risk management, and think short-term.

The questionable corporate governance practices I have described will give critics of Noble's accounting practices more ammunition, as board oversight, remuneration practices and financial reporting quality are inextricably linked.

Noble has promised to improve its transparency. It should also take a very hard look at its corporate governance if it wants to regain investors' confidence.

■ The writer is an associate professor at the NUS Business School, where he teaches corporate governance and ethics. He developed the Governance and Transparency Index in 2009 and was involved in the first three issues of the index. He does not own shares in Noble and has no connection to the other critics of Noble