

Mr C Hodge
Corporate Governance Unit
Financial Reporting Council
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4 March 2010

Dear Mr Hodge

REVISED UK CORPORATE GOVERNANCE CODE

I write to set out Lonmin's views on the proposed changes to the Combined Code.

We support the approach of breaking the Code into Principles and more detailed provisions. We feel that this will create a clearer focus on matters of true import, rather than creating a mix of principle and detail which inevitably fuels a 'box ticking' culture. We believe that the items in the existing Section E are of significant importance, and welcome the transfer of these to the proposed Stewardship Code.

We do not believe that the corporate governance statement should simply become part of a website. While this has the advantage of not being a static once-only annual report, we suspect this will be outweighed by the perceived 'relegation' from the annual report. Companies are free to communicate governance information online to suit their needs, but should not be exempted from the need to explain to shareholders, in the annual report, how the company is run.

Finally, we welcome the attack on the "fungus of boilerplate". Large swathes of annual reports are filled with formulaic text, unchanging from year to year, which may generate compliance with disclosure rules but certainly does not amount to communication. However, we are concerned that some of the proposed amendments risk simply creating more explanations of the boilerplate type, where the recommendation is so self-evidently appropriate that no explanation is needed. Our own experience of the 'box-ticking' fraternity is that the absence of such explanations is treated as a negative. We would urge the FRC to consider carefully whether these proposals will result in improved governance and communication, or more boilerplate.

Turning to our more detailed comments on the wording of the Code:

Governance and the Code	After citing the Cadbury definition there is a paragraph which we feel undermines the 1992 principles. Corporate governance has two facets – externally-facing and internally-facing. The internal governance of any company (in terms of the control environment, risk assessment, processes, policies and procedures) is of paramount importance in preventing failure and creating the opportunity for success. While "day to day operational management" is also of significant importance, we feel that the Code, as drafted, risks understating the importance of, and value added by, internal corporate governance frameworks.
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Review date	For many companies, their accounting period ending on 31 December 2011 will be the first opportunity to operate and report under the revised Code. We suspect that holding a review after one cycle may be a little premature, and corrode the stability that is badly needed.
Chairman’s preface (para 7)	If the FRC wishes chairmen to report on governance, we suspect the word “hoped” should be replaced by “expected”. However, our concern is that much of this reporting does tend to be unchanged year on year – if the company has robust systems operated diligently by good people, then there will be little need or imperative to re-examine these. While emphasising the importance of the role of the chairman is welcomed, we wonder if this is likely to be a step forward in practice.
Comply or explain (para 2)	Footnote 1 contains a most important point. In our experience, the sound principle of ‘comply or explain’ is often undermined by box ticking analysis by those with insufficient time or experience to be able to assess the company’s reasoned explanation. We would welcome this footnote being incorporated into the body text as a point in its own right. Based on direct experience, we believe strongly that discussions with shareholders and the proxy voting agencies are best undertaken away from the pressure of an AGM, when determining the voting intention is of immediate importance. Engagement and voting are quite different matters – the former is a two-way, often iterative, process while voting is an outcome from that process. Too often, we find that our sole opportunity to engage on governance questions is in the face of an imminent voting deadline.
A.3 Supporting Principle	The proposed requirement that the chairman ensures “that adequate time is available for discussion on strategic issues” strikes us as inexorably leading to new boilerplate reporting. This is such a self-evident requirement that we would be surprised if chairmen routinely fell short of this standard. In reporting, there will need to be a compliance statement which will simply repeat the Code wording verbatim, and be unchanged from one year to the next.
A.4.1	We disagree with the proposed change. While SID has a very useful externally-facing role to play, we do not feel that the case has been made for an internal mandate. It is for the chairman to decide whom to use as a sounding board (and such a role may vary from issue to issue), and requiring that SID be used for this purpose strikes us as overly prescriptive. We also feel that, should internal tensions be such that an intermediary is required, the chairman should rightly have the primary responsibility for addressing these.
B.1 Main Principle	The requirement for knowledge of <i>inter alia</i> “the company” is self-evident, but we wonder how this is to be demonstrated externally, particularly where a number of directors have been appointed to the board in short order. The requirement (which we presume must logically extend to the company’s business and markets, although unstated) is highly likely to fuel more boilerplate reporting.
B.1 Supporting Principles	We would prefer to see the second principle allude to “an <u>appropriate combination</u> of executive and non-executive directors”. We feel that the words “strong presence” are unclear and do not see readily how this can be demonstrated in external reporting, other than through generic statements.
B.1.1	We would like to see the reference to nine years’ service removed. This is an arbitrary measure with no automatic relevance to the determination of a director’s independence, and merely fuels a box ticking mentality which does not serve investors well. At many points within the Code (including the proposed amendments) the need for personal knowledge on the part of directors, for progressive refreshing of the board and of the mechanisms by which board effectiveness can be promoted are all espoused. We feel that the inclusion of what we regard as a discredited principle is, at best, unhelpfully inconsistent.

- B.2 Supporting Principles We do not like the proposed requirement that selection criteria “do not inappropriately restrict the talent pool”. This is self-evidently correct, but the purpose of any criterion is to exclude some candidates from consideration and this proposed change strikes us as another opportunity for box-tickers to second guess the board. What may seem entirely appropriate and justifiable in the light of information known only to the company may be taken externally as evidence of ‘non-compliance’. We do not wish to see tokenism and positive discrimination on company boards simply to demonstrate good faith. Our preferred form of accountability is for the company to explain why the directors who have been appointed are the right people for the job.
- B.3 Main Principle Firstly, we would ask that the time commitment be clarified. We suspect all directors will have sufficient time to meet their ‘business as usual’ role, but where crises or peak workloads (fuelled by M&A or equity issuance etc) arise, the time requirement can increase exponentially. Requiring directors to plan for the worst will inevitably reduce the number of directorships that each director holds, and therefore effectively reduce the size of the available ‘talent pool’. Secondly, we are concerned that the box ticking fraternity will use the board attendance records as a proxy for this requirement, and give insufficient heed to the company’s explanations of how absences are managed.
- B.4 Supporting Principles We would ask that the term “appropriate knowledge” in the second paragraph be reconsidered. Our concern is that it is challenging to report on this externally in anything but the most generic of terms, and this laudable principle therefore fuels more boilerplate reporting. We believe that this issue could be overcome by including the words “access to its operations and staff” in the preceding paragraph, which would also have the benefit of creating accountability for this recommendation.
- B.4.2 Is it the FRC’s intention that the chairman should become embroiled in internal performance review and development processes for executive directors (other than, where appropriate, the CEO)? We doubt that this is the case, and would suggest that the proposed provision be clarified as applying to non-executive directors only.
- B.6 Main Principle While we have no difficulty with undertaking a “formal and rigorous annual evaluation”, we feel that this could sit at odds with the proposed requirement for external facilitation at least every third year. If the review is suitably rigorous, we are unsure that there is the certainty that further value will be added by external facilitation. We would urge the FRC to consider handling these two items in a single paragraph, whether as a principle or a provision.
- B.6.2 We doubt whether the statement as to the external facilitator’s potential conflicts of interest is of much value to investors. We suspect a more meaningful requirement would be for communication by the company that any issues identified from this process are being addressed in a timely and appropriate manner.
- B.7.1 We support the aim of this section, which is to ensure that the board is accountable to the owners of the company. In our collective experience, institutional investors have a number of opportunities to intervene in any company’s affairs, and are not afraid of so doing where they believe this is warranted. Clearly, direct contact is possible at the levels of the chairman or SID and should lead to the investor’s views being considered, even if no change results. Secondly, there is a vote on each director in every third year. In the final resort, the threshold for requisitioning a shareholder meeting (or a resolution at an existing meeting) is sufficiently low that a small number of institutions could address any issues by seeking a vote (with attendant publicity) should the other routes have failed. If there are cases where institutional investors have not pursued all the avenues available to them, we feel this is a different issue from that being addressed through the proposed amendments.

We feel that the proposals offer an invidious choice:

- We believe it wrong that the chairman acts as a ‘lightning rod’ for the collective actions of the board, and feel this exposes the company to the risk of a loss of leadership when this is most required. There is also a severe risk that the CEO experiences uncertainty of tenure when there is a question over the chairmanship.
- At the same time, we are concerned that the requirement for all directors to seek re-election annually is inconsistent with the need for them to invest time amassing knowledge of the company, particularly non-executives who may not be entitled to a severance payment. Not knowing whether any given director will be on the board for more than twelve months also has an impact on plans for “progressive refreshing” and undermines the whole process of creating board effectiveness.

Overall, we remain to be convinced that there is anything structurally wrong with the status quo, and our preference would be to retain the current three year tenure. Should this be impossible, then we see the entire board seeking re-election annually as by far the less unattractive option.

- C.1.2 While this is self-evidently a useful idea, we wonder whether the UK Governance Code is the right home for this provision. Given the requirements of the Companies Act 2006 in relation to a Business Review, we feel there is a risk of duplication if this is included in the Code. It would be entirely reasonable for the ASB to include this proposed provision in any revision of their RS1 Guidance on the Business Review, which is widely used as primary reference point in this area.
- C.2 Main Principle We would prefer to see this read “The board is responsible for determining and keeping under review the company’s risk appetite and tolerance.” This is not a static exercise, as both appetite and tolerance will vary with *inter alia* trading and credit market conditions. We also feel that defining the terms “risk appetite” and “risk tolerance” would be extremely helpful in managing external interpretation and expectations.
- D.1.3 We are concerned that the proposed wording may be taken as precluding the payment of one-off sums where a director has performed specific services beyond the scope of those expected in their role and would welcome clarity that this is not the case.
- E.1 Supporting Principle We suggest that the first paragraph should read “are aware of” rather than “understand”.
- E.2.2 We, like many companies, take all votes on a poll. As drafted, this provision would not require us to make any announcement, as it is limited to votes on a show of hands only. Conversely, where votes are taken on a poll, the items specified in the provision are overtaken by events as proxy votes will be overridden should the shareholder attend in person, or change their vote. There needs to be greater clarity over what is required, or this provision risks being addressed through breach rather than observance.
- Schedule A para 5 We are very concerned by the proposed changes to this paragraph, and would recommend excluding the proposed additional text. We regard it as unfortunate if the Code requires companies to use “non-financial performance metrics” as these are not necessarily the right measures for some companies to choose. As a compromise, it may be appropriate to ask companies to confirm whether they have considered the use of non-financial performance metrics and, if so, explain their reasons for not using these.

Schedule A
para 5

Secondly, having discussed the question with remuneration consultants, we understand that it is exceedingly challenging to devise a mechanistic and automatic “risk adjustment” overlay system that is equitable and practical, for companies outside the financial services sector. Naturally, we agree that incentives should be compatible with sound risk management and internal controls, but this lies within the normal work of the remuneration committee, who should properly be examining ahead of time whether the pay systems could lead to unwanted behaviour and perverse incentives arising, and then applying discretion to the remuneration outcomes delivered through these mechanisms.

Our fundamental concern is that over-prescription will prove too onerous to deliver in practice.

I would welcome the opportunity to discuss these comments with you, should any of the points made be unclear, or require further elaboration.

Yours sincerely

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