



SABMiller plc

**Financial Reporting Council's
Consultation on the Revised UK Corporate Governance Code:
December 2009**

SABMiller plc Response

5 March 2010

SABMiller plc submitted responses to the Financial Reporting Council's Review of the Effectiveness of the Combined Code, and to the FRC's Second Consultation.

Our key submissions were that: the Combined Code largely reflected responsible governance and was working well; if significant changes were to be made to address perceived problems in a particular sector they should not apply to all companies; if changes were to be made to the Combined Code they should be limited to changing "comply or explain" to "apply or explain", to removing the nine year rule and the presumption of non-independence of directors who have served for more than nine years or who represent major shareholders. We also argued against prescription as to the expected time commitment of NEDs and against any introduction of requirements for all companies to have an external evaluation of board, committee and director performance, or to have separate risk committees at board level.

We now welcome the opportunity to comment on the draft revised Code, and set out our comments below. We have also participated in the submission on the draft Code made by the GC 100, and generally support the comments made in that submission.

However, we think that it is worth re-iterating the fundamental and underlying point that there seems to be an unrealistic expectation that more "governance" will guarantee success or, perhaps more pertinently, guarantee no failure. The events of the last 18 months do present an important opportunity to review how robust corporate governance processes are and to learn what might have been done differently. However, every business has to manage risk and judgments about risk must be taken by executives as part of the management by them of the business. If there were governance weaknesses that contributed to the current crisis, it was in the application of the Code rather than a lack of prescription within the Code itself. Adding extra governance requirements is likely to lead to more box ticking and hamper effective scrutiny by non executive directors by occupying time with form rather than looking at substance. Key to the effectiveness of corporate governance is the calibre of the individuals involved, and their clear understanding of their role and responsibilities and the tools necessary to discharge their responsibilities effectively.

In our view, too few of the proponents of so-called best practice in governance matters base their views on factual evidence that their versions of best corporate governance practices actually improve corporate performance. There have been relatively few academic studies which test robustly whether so-called "bad governance practices" result in lower share prices, poor relative performance and excessive executive compensation. When confronted by examples of increased shareholder value, superior performance, and compensation that clearly is merited by performance, advocates of governance "best practice" have too often rejected these examples as "anecdotal" and not worthy of academic consideration.

In October 2007, three leading academics, Professor Sanjai Bhagat of the University of Colorado at Boulder – Department of Finance, Professor Brian Bolton of the University of New Hampshire, Whittemore School of Business & Economics and Professor Roberta Romano of the Yale Law School published a paper in which they reviewed and analyzed most of the then extant studies of the relationship between corporate governance and performance and concluded that they in fact do not

prove the propositions they are cited for. The conclusions of their paper (entitled “The Promise and Peril of Corporate Governance Indices¹”) can best be summarised by quoting the abstract of their study (emphasis added):

“The aim of this paper is twofold, to analyze the performance of corporate governance indices in predicting corporate performance, and to consider the implications for public policy that follow from that assessment. We highlight methodological shortcomings of the extant papers that claim a relation between particular governance measures and corporate performance. Our core conclusion is that there is no consistent relation between governance indices and measures of corporate performance. Namely, there is no one “best” measure of corporate governance: the most effective governance institution appears to depend on context, and on firms’ specific circumstances. It would therefore be difficult for an index, or any one variable, to capture critical nuances for making informed decisions. As a consequence, we conclude that governance indices are highly imperfect instruments for determining how to vote corporate proxies, let alone for portfolio investment decisions, and that investors and policymakers should exercise caution in attempting to draw inferences regarding a firm’s quality or future stock market performance from its ranking on any particular corporate governance measure. Most important, the implication of our analysis is that corporate governance is an area where a regulatory regime of ample flexible variation across firms that eschews governance mandates is particularly desirable, because there is considerable variation in the relation between the indices and measures of corporate performance.”

A more recent study in September 2009 by three leading independent researchers, Professors Robert Daines and David Larcker of Stanford University and Ian Gow of the Kellogg School of Management (“Rating the Ratings: How Good Are Commercial Governance Ratings?²”), examined the value and validity of commercial governance ratings, and concluded that “ . . . the level of predictive validity for these ratings is well below the threshold necessary to support the bold claims made for them . . . ”

The abstract of their study reads as follows:

“Proxy advisory and corporate governance rating firms play an increasingly important role in U.S. public markets. Proxy advisory firms provide voting recommendations to shareholders on proxy proposals and sometimes take an active role persuading management to change governance arrangements. Corporate governance rating firms provide indices to evaluate the effectiveness of a firm’s governance and claim to be able to predict future performance, risk, and undesirable outcomes such as accounting restatements and shareholder litigation. We examine these claims for the commercial corporate governance ratings produced for 2005 by Audit Integrity, RiskMetrics (previously Institutional Shareholder Services), GovernanceMetrics International, and The Corporate Library. Our results indicate that the level of predictive validity for these ratings are well below the threshold necessary to support the bold claims made for them by these commercial firms. Moreover, we find no relation between the governance ratings provided by RiskMetrics with either their voting recommendations or the actual votes by shareholders on proxy proposals.”

While both these studies focus on the US equity markets, they provide solid evidence that one-size-fits-all governance practices are of little predictive value, and that companies and boards of directors should embrace governance structures and programs that are appropriate to their specific circumstances, taking into account generally accepted “best practices” as appropriate, but should not go out of their way to satisfy “tick the box” governance scorecards for their own sake.

¹ Bhagat, Sanjai, Bolton, Brian J. and Romano, Roberta, *The Promise and Peril of Corporate Governance Indices* (October 7, 2007). ECGI - Law Working Paper No. 89/2007; Yale Law & Economics Research Paper No. 367. Available at SSRN: <http://ssrn.com/abstract=1019921>.

² Daines, Robert, Gow, Ian D. and Larcker, David F., *Rating the Ratings: How Good are Commercial Governance Ratings?* (September 4, 2009). Stanford Law and Economics Olin Working Paper No. 360; Rock Center for Corporate Governance at Stanford University Working Paper No. 1. Available at SSRN: <http://ssrn.com/abstract=1152093>.

Against this background, our specific comments are in the main directed at reinforcing what we believe is, and should be, the philosophy behind the FRC's approach to the Code, which is that prescription should be avoided and that companies should have the flexibility to design their own governance processes in the light of their own circumstances and their view of the interests of their shareholders as a whole, and not to satisfy governance scorecards.

Chairman's Preface (p.13)

While supporting the inclusion of the Chairman's preface within the Code, we question whether it is appropriate to prescribe where in their annual reports companies should address how the principles relating to the role and effectiveness of the board have been applied.

Comply or explain (p.14)

From our engagements with some representative bodies and investors, we believe that the "comply or explain" regime has led them to take the view that explaining rather than complying is something wrong, and has encouraged a "box-ticking" mindset, which in turn can lead to more defensive reporting by companies. We believe that a change in terminology would be an important step in beginning to change behaviour, and we are therefore very disappointed that the FRC has not taken the opportunity to modify the description of the existing "comply or explain" approach to the more accurate and less pejorative "apply or explain" approach. For the reasons set out in our previous submissions, SABMiller believes that this would be a much welcomed and beneficial change, and we urge the FRC to reconsider its position on this. It is notable that the King Committee on Governance in South Africa (in its "King III" report of 2009) has explicitly adopted "apply or explain", on the basis that this more appropriately conveys the intent of the King code on corporate governance. The Netherlands corporate governance code is similarly worded.

Nevertheless, we welcome the FRC's renewed efforts to encourage investors to judge the case for "complying or explaining", and the reinforcement paragraphs 3 and 4 of the point that non-application is justified if good governance is achieved by other means.

Main Principles Section B: Effectiveness (p.16)

We support the suggestion in the GC 100 submission that the Code should recognise the difference between the board's role and management's role.

However, we do not believe that it is necessary for the Code to be more prescriptive on what "appropriate knowledge" means. Companies differ enormously in complexity and size, and the judgement as to what constitutes appropriate knowledge is best left to individual boards and NEDs.

A.3.1 The Chairman

Given that the third sentence of this provision recognises that in exceptional cases, a chief executive may become chairman (subject to appropriate consultation and explanation etc), should the second sentence of this paragraph not logically include the word "normally" after "not"?

B.1.1. Composition of the board: "Nine year rule"

We strongly believe that the so-called "nine year rule" should be considerably de-emphasised in the context of director independence, especially in light of the focus elsewhere in the revised Code on the importance of directors having a detailed knowledge of the company and its operations. As we have said in our previous two submissions, the nine year cut off in this context is an artificial and arbitrary rule which does not place sufficient weight on experience gained by a director whilst on the board. In our view, this rule reduces the effectiveness of boards, especially where proxy voting services pay minimal or no attention to a company's explanation, however detailed, as to the determination of

independence of directors who have served this long, and automatically recommend a vote against the re-election of any NED who has served more than nine years.

B.4.2: Training and development

We urge the FRC to think again about the new provision in B.4.2. The range of companies and their circumstances, and the experience and skills of each director will vary so widely, that to suggest that the chairman be required to agree with each director a personalised approach to training and development is unnecessarily intrusive, and verging on the patronising.

B.6: Board evaluation

SABMiller recognises that there are occasions when an externally facilitated board evaluation may be of value to a company and its directors, but does not believe this should be prescribed within the Code. We are very concerned that by introducing such prescription, the FRC is creating the need for an unnecessary “industry” of external facilitators, where our own experience with external facilitation has not been satisfactory. The most effective methodology for a board evaluation will depend on the circumstances of the company at the time, and boards should be able to retain their ability to choose when to use external facilitation if they believe it necessary. Against any benefit which it might be alleged might flow from external challenge to the review process, it must be remembered that board evaluation does not occur in a vacuum, and that many directors sit on more than one FTSE 100 board, and can bring their experiences of other companies’ board evaluation processes to bear.

There is also, in our view, a clear conflict between the requirement for an external evaluation every three years with the main principle of the Code section which states that the board should undertake a “rigorous” evaluation of its own performance and that of its directors. If the board does undertake a “rigorous” evaluation every year then why should its evaluation need to be externally facilitated every three years?

We believe that if any new provision is to be added, it should ask boards to explain why, if they have used external facilitation, they believed it to be necessary.

B.7: Re-election of directors

We believe that requiring annual re-election of all directors is pointless and counter-productive, and will have no impact on whatsoever on effective governance. Such a practice could adversely impact board succession and recruitment, especially in turnaround situations, and would encourage short-termism. The logistics of annual director re-election would make the AGM even longer, especially for companies which use electronic handset poll voting on each resolution. The main impact will be longer meetings, individual shareholders will leave before the end of the meeting, and the hot snacks will almost certainly get cold.

We strongly suggest that rather than introducing prescription in this area, flexibility is retained within the Code for companies to determine for themselves the frequency of the re-election of directors and chairmen, with the requirement that issuers explain in their governance report their approach to board re-election.

C.1.2: Accountability

We oppose the inclusion of the new provision C.1.2 in the Code, as a company’s business review (if correctly written) should cover a full explanation of the basis on which the company generates revenues and makes a profit from its operations. As a matter of principle, the Code should not duplicate requirements which are already prescribed in some detail in other mandatory rules.

E.2.2: Constructive use of the AGM

The wording in this provision should read *“For each resolution, where (or if) a vote has been taken on a show of hands, the company should ensure that the following information is given at the meeting...”* An increasing number of companies conduct their AGM voting on a poll for all resolutions, and it should be made clear that the change to this provision is not intended to hinder this development.

Schedule A: Remuneration

The wording in the fifth paragraph of this schedule should be amended to ensure that it is not mis-construed as requiring the use of non-financial criteria for long term incentives. Companies may choose for very legitimate reasons to use non-financial metrics for short term incentives, but not for long term incentives, and it is not for the Code to prescribe which precise metrics are appropriate for individual companies.

We suggest that the sentence in Schedule A should be revised along the following or similar lines:

“Payouts or grants under all incentive schemes, including new grants under existing share option schemes, should be subject to challenging performance criteria including financial and (where the board considers them to be appropriate) non-financial performance metrics.”

We agree with the concern expressed by the GC 100 submission, that it is not clear what the FRC's proposal that the *“criteria for paying bonuses should be risk adjusted”* means in practice.

About SABMiller

SABMiller is one of the world's largest brewers with brewing interests and distribution agreements in over 60 countries across six continents. The group's wide portfolio of brands includes premium international beers such as Grolsch, Miller Genuine Draft, Peroni Nastro Azzurro and Pilsner Urquell, as well as market-leading local brands such as Aguila, Castle, Miller Lite, Snow and Tyskie. SABMiller is also one of the largest bottlers of Coca-Cola products in the world.

In the year ended 31 March 2009, the group reported US\$3,405 million in adjusted pre-tax profit and group revenue of US\$25,302 million. SABMiller is listed on the London and Johannesburg stock exchanges.