A LONG-TERM FOCUS FOR CORPORATE BRITAIN
Call for Evidence Response Form

A copy of the consultation available at: http://www.bis.gov.uk/consultations.

Responses to the Consultation should be received by 14 January 2011.

Completed copies of the response form should be returned:

Via email to: clgconsultations@bis.gsi.gov.uk

Via post to:

Adam Gray
Long-term Focus Consultation
Corporate Law and Governance
Department for Business, Innovation and Skills
1 Victoria Street
London
SW1H 0ET

Name: Ben Mathews, Company Secretary

Organisation (if applicable): Rio Tinto plc

Address: 2 Eastbourne Terrace, W2 6LG

Please tick the box from the following list of options that best describes you:

√	Quoted company
	Other company
	Investor or investment manager
	Business representative organisation
	Investor representative organisation
	Non governmental organisation (NGO)
	Trade Union
	Lawyer or accountant
	Other (e.g. consultant or private individual)

The Board of Directors

Question 1: Do UK boards have a long-term focus – if not, why not?

Comments
Whilst we cannot speak for other UK boards, the nature of Rio Tinto's business necessarily requires the board to make high-end, capital intensive, long-term commitments to the Group's operations and to the people and lands that are impacted by our activities. This commitment also lasts long after a mine has closed. The board of Rio Tinto, in fulfilling its role of providing leadership of the Group, has the ultimate responsibility for the management of the assets of the Group. The focus on large-scale, long life, globally-dispersed assets commences with the exploration and evaluation phases and continues through development, operation and, finally, close-down and restoration of the sites. It can typically take 10 to 20 years from initial exploration through project evaluation to reach the stage of investment approval and operation. Close-down and restoration of mining and downstream operations extends the life cycle of our operations even further. Because of the long-term nature of our activities, any decisions to invest and/or develop taken by the board inevitably has long-term consequences and the board takes these decisions knowing that it has to stand by those decisions for decades.Thus, decisions taken could potentially have an impact on Rio Tinto's reputation many years after the decision in question and this is something the board bears in mind. Therefore, at least so far as Rio Tinto is concerned, the board very much has a long-term focus.

<u>Question 2:</u> Does the legal framework sufficiently allow the boards of listed companies to access full and up-to-date information on the beneficial ownership of company shares?

Comments
A key tenet of good governance is regular shareholder engagement. It is impossible to engage without being able to identify who those shareowners are. In the UK, the statutory process which exists under section 793 of the Companies Act 2006 gives companies the opportunity to identify beneficial shareowners on request by issuers or their agents. The process is typically used to identify larger shareowners so that engagement may take place. The process is subject to delay as a result of the practical difficulties of identifying ownership through the custodial chain. These delays necessarily result in some disclosures being out-of-date by the time they are received. It may not, however , be possible to improve the process without significant systemic changes. In Rio Tinto's case, the ability of the company to identify its beneficial owners is in practice restricted since there are beneficial holders of shares resident outside of the UK and they will not always be capable of identification. Rio Tinto notes that the Stewardship Code aims to enhance the quality of engagement between institutional investors and companies but it does not address increased transparency on the beneficial ownership of company shares.

Shareholders and their role in equity markets

<u>Question 3:</u> What are the implications of the changing nature of UK share ownership for corporate governance and equity markets?

Comments
The changing nature of UK share ownership and the increasingly international nature of our shareholder base (US, UK , Australian, and Asian Sovereign Wealth Funds) has led to many conflicting needs from shareholders who are often from differing jurisdictions. For example, with reference to capital allocation, there are conflicting requirements from shareholders: the Australian contingent expresses a preference for further investment in value adding growth whilst some UK investors are suggesting that share buybacks or a special dividend would be preferable.

Question 4: What are the most effective forms of engagement?

Comments
Face-to-face meetings between major institutional shareholders and the Chairman / CEO / CFO remain the most effective form of engagement. The Annual General Meeting is the best forum to engage with retail shareholders.

Question 5: Is there sufficient dialogue within investment firms between managers with different functions (i.e. corporate governance and investment teams)?

Comments
The level of interaction between managers in different functions differs widely among investment firms. For some, corporate governance and sustainable development are 'back office' functions and play a minor, if any, role in capital allocation decisions; for others, they are integral to the decision making process. Rio Tinto believes that investment decisions which take into account sustainable development and governance criteria are generally more soundly based and are more likely to have taken into consideration a wide array of risks. On this basis, Rio Tinto believes that investment firms which approach financial and other risks in an integrated manner may have a competitive advantage against their peers. If so, the market should drive relative performance in this direction over time.

<u>Question 6</u>: How important is voting as a form of engagement? What are the benefits and costs of institutional shareholders and fund managers disclosing publically how they have voted?

Comments
Voting by shareholders is the ultimate sanction and could therefore be viewed as the final stage in a company's engagement with its shareholders. Rio Tinto believes the voting outcomes in general meeting ultimately reflect the quality of engagement between the company and its shareholders. However, even if an effective engagement programme with key investors is implemented and the Company's strategy is delivered and underlying performance is sound, it does not automatically follow that these same investors will vote all of their shareholding at the general meeting: voting is regrettably considered to be unimportant by some investors particularly when a company is doing well. In addition, a company may experience instances of unhelpful influence, as Rio Tinto has, exerted through neutral voting or abstentions. When a company is performing less well or is failing in the delivery of its strategy, shareholders will be much more inclined to take clear, decisive action. This is ultimately expressed in negative voting for shareholder resolutions. This is entirely democratic and supports the view that investors with wide-ranging portfolios do not always have the time or resource available to them to vote shares at a general meeting of a company the performance of which has been satisfactory. Their attention and resource is justifiably focused on poor performers. Nonetheless, for Rio Tinto, genuine engagement with internal and external stakeholders who are affected by, or have an interest in, what we do is a critical element of successful business practice and, accordingly, Rio Tinto undertakes an ongoing engagement with its investors. The prime benefit is a mutual understanding of objectives. In addition, the risk of surprises in voting outcomes is reduced. Nothing in the Stewardship Code will affect the continuation of Rio Tinto's active engagement policy. With the gradual embracing of the Stewardship Code, investors will, possibly reluctantly, begin to disclose their voting practices publicly. Rio Tinto believes that public disclosure by institutional shareholders and fund managers of how they vote is sound governance. It demonstrates the fulfilment of their duty to their client, the underlying investor, through the exercise of their right to vote. Greater levels of disclosure of voting by institutional investors can encourage increased engagement with companies and may create "peer pressure" on other professional investors to vote and disclose. For the company, as noted above, it is a useful indicator of investor sentiment.

Question 7: Is short-termism in equity markets a problem and, if so, how should it be addressed?

Comments
Market participants have different investment horizons, from seconds to decades. Some commentators argue that short- termism in equity market deflects investor focus from the purpose of investing which is to generate long-term wealth from financing companies. Others argue that short-termism creates equity market volatility and in turn uncertainty, risks which are likely to discourage long-term investors. However, we consider that short-termism is not necessarily a problem. The key question is whether the market makes available capital for new opportunities and provides a liquid and low cost trading platform. There is evidence that it does perform these functions.

Question 8: What action, if any, should be taken to encourage a long-term focus in UK equity investment decisions? What are the benefits and costs of possible actions to encourage longer holding periods?

Comments
Investment firms with different mandates and time horizons should not be incentivised to adjust their holding periods by government intervention; this should be an investment decision. For retail investors, who can suffer disproportionately from charges, it may be worth considering reducing or removing capital gains tax for extended holding periods.

Question 9: Are there agency problems in the investment chain and, if so, how should they be addressed?

Comments
Yes. The investment chain can be complex. Beneficial owners of an investment may include pension fund trustees, mutual and life assurance funds, who in turn represent individual pension fund beneficiaries, unit trust and other policyholders. Custodial chains can make it difficult for the company to identify the investor and the ability of investors to remain hidden is a barrier to shareholder engagement by the company. Problems arising from having large numbers of participants in the ownership chain include differing priorities to voting; lack of transparency and accountability in the voting process, lost votes and a degree of short-termism amongst some investors e.g. hedge funds. These problems may result in

discouraging certain boards from taking a longer term view.

For Rio Tinto, the issues are more of transparency and engagement.

The Stewardship Code published by the FRC in July 2010 goes some way to addressing such issues by setting standards which require institutional investors to have a clear policy on voting and to disclose voting activity, including regular reporting to their clients or others to whom they are accountable, and requiring them to engage with investee companies. However, the application of the Code is not mandatory and we have yet to see how it is applied.

Question 10: What would be the benefits and costs of more transparency in the role of fund managers, their mandates and their pay?

Comments
The role of fund managers is usually explained clearly enough by investment firms, which market their investment performance, their strategy and the quality of their investment professionals as sources of competitive advantage. However, we consider that there is some benefit to be derived from greater transparency in this area. We believe that if there was greater transparency for investors of the remuneration of portfolio managers, then investors would be in a better position to judge whether they were being rewarded appropriately for meeting those objectives. Fees charged by investment firms and the impact these can have on long run returns should be transparent, particularly for retail investors. Transparency has the collateral benefit of showing how modest, comparatively speaking, the salaries of these in industry actually are.

Directors' Remuneration

Question 11: What are the main reasons for the increase in directors' remuneration? Are these appropriate?

Comments
The incidence of pluralist boards, increasingly global companies and the resulting need for leaders who have the right blend of skills and international experience to drive the delivery of the company's strategy necessitates market-competitive remuneration practices.

The main reasons for increases in directors' remuneration are the increasing calls on their time arising from the need for training, travel and site visits, additional duties imposed by legislation and good practice, greater liability and consequent risk of reputational damage.

Additional factors for Rio Tinto's directors is the structural complexity of the Group and the regulatory compliance obligations associated with its three main stock exchange listings in the UK, Australia and the US, which add further challenges.

Question 12: What would be the effect of widening the membership of the remuneration committee on directors' remuneration?

Comments

Remuneration packages for directors should be designed to attract, retain and motivate directors of the quality required to run the company successfully without paying more than would be necessary to do so.

It is important to have a remuneration committee which comprises individuals who have comprehensive knowledge and understanding of remuneration issues. Rio Tinto in particular believes in the merit of a remuneration committee which consists of diverse and independent non-executive directors who are able to draw on experience outside the Group in order constructively to challenge and help develop proposals submitted by management (which are often heavily influenced by remuneration consultants).

Rio Tinto is not convinced that extending the membership of the remuneration committee to, say, employee-nominated members, would address the issue of influence by remuneration consultants on the remuneration policy of quoted companies, which is more likely to be achieved by a membership of experienced and independent non-executive directors.

Widening the membership of the committee to employee-nominated members may hamper the process of determining the appropriate remuneration package for directors. Whereas committees comprised of independent members enjoy the benefit of impartiality, committees with employee-nominated members may have a narrower focus.

<u>Question 13</u>: Are shareholders effective in holding companies to account over pay? Are there further areas of pay, e.g. golden parachutes, it would be beneficial to subject to shareholder approval?

Comments
We would not welcome further intrusive regulation of executive remuneration. The means exist already for shareholders to be able to hold companies to account over pay via their vote on Directors' Remuneration Reports. Although the vote is not binding, it is highly significant for companies, especially for Rio Tinto which is required to put the Directors' Remuneration Report to shareholder vote both in the UK and in Australia. An adverse vote may result in negative media coverage and growing dissatisfaction of shareholders and institutional investors if the root cause is not seen to be addressed. In addition, the company could face further adverse votes, possibly affecting the re-election of directors, and may ultimately suffer a negative impact on the share price. In addition, Principle D.2.4 of the UK Corporate Governance Code provides that shareholders be invited to approve all new long-term incentive schemes and significant changes to existing incentive arrangements. Rio Tinto enters into formal and early dialogue with its major shareholders on proposed changes to existing remuneration arrangements for executive directors or the introduction of new ones. The consultations are well-received and demonstrate the value of engagement with shareholders. A company cannot offer "golden parachutes" as the Companies Act 2006 prohibits a payment for loss of office to a director unless the payment has been approved by shareholders. Rio Tinto does not believe that obtaining shareholder approval for any other areas of pay such as "golden hellos" or "golden handcuffs" is a workable concept. For example, it would be impractical from a business perspective to recruit an individual and agree a joining bonus / incentive arrangements conditional upon a shareholder vote. Rio Tinto would not support any form of blanket requirement to seek shareholder approval for directors' or key executives' pay. Limiting the proposal of such resolutions to the annual cycle of AGMs would limit the Group's flexibility to hire individuals as required, whilst calling additional general meetings would incur additional expense. Proper and early dialogue with shareholders is the preferred solution.

<u>Question 14</u>: What would be the impact of greater transparency of directors' pay on the:

- **linkage between pay and meeting corporate objectives**
- **performance criteria for annual bonus schemes**
- **relationship between directors' pay and employees' pay?**

Comments
Rio Tinto believes that remuneration reports, prepared in accordance with the provisions of the UK Corporate Governance Code and applicable remuneration regulations and corporate governance guidelines, already provide sufficient transparency of directors' pay in the areas specified above. This being the case, Rio Tinto does not believe that greater disclosure would be of further benefit.

Takeovers

<u>Question 15</u>: Do boards understand the long-term implications of takeovers, and communicate the long-term implications of bids effectively?

Comments
In Rio Tints's view, boards of listed companies do understand the long-term implications of takeovers, not least because their members are generally intelligent people with broad and relevant business and financial experience. The duty of the board is to act in the company's best interests, the company being, for this purpose, its shareholders, present and future. Generally, a board will have regard to a large number of constituencies (employees, customers, suppliers, relevant governments and regulatory authorities among them) when carrying out its duties. Where the company is on the receiving end of a takeover bid however, while the board will take other factors into account in deciding whether or not to recommend the bid, at the end of the day value will be the overriding consideration and the decision of the board to recommend the bid or not will ultimately come down to value.

<u>Question 16</u>: Should the shareholders of an acquiring company in all cases be invited to vote on takeover bids, and what would be the benefits and costs of this?

Comments
We assume the question is referring to acquiring companies incorporated in the UK only and not those incorporated overseas – it would be inappropriate (and indeed not feasible) for UK law to seek to afford protections extraterritorially to the shareholders of overseas offerors. In relation to UK incorporated offerors, it is Rio Tinto's view that a requirement that the acquiring company's shareholders must give their approval to a takeover bid is unnecessary, at least where the transaction is not significant. It is the function and responsibility of the board to set strategy and direction and to hold management to account. It is not for shareholders to seek to determine strategy or to run the company themselves. There is an argument that, where the transaction concerned is sufficiently significant, shareholders' approval should be sought and this is the approach taken by the FSA (as the UKLA) in relation to companies that have a premium listing in the UK. Such companies are required by Chapter 10 of the Listing Rules to seek shareholder approval before undertaking certain transactions, including a bid for another company if the transaction is, using percentage ratios resulting from the application of the class tests set out in the annex to Chapter 10, over a certain size relative to the acquiring company. Therefore, if the acquiring company has a premium listing in the UK and the Listing Rules so require, the shareholders of the acquiring company will already be asked to vote on the takeover bid. Where the acquiring company has a premium listing but no shareholder approval is required by the Listing Rules, this is because the transaction is not sufficiently significant. We can expect all takeovers, whatever their size, to be given full and careful consideration at board level on an economically rational basis. To require a vote in all circumstances will increase the costs to a company of doing business and this seems to be unnecessary particularly where the transaction concerned is not material.

<u>Question 17:</u> Do you have any further comments on issues related to this consultation?

Comments
This consultation addresses a number of issues which have been covered by other recent consultations and some co-ordination between the different bodies calling for evidence or comments might have led to there being appreciably less overlap. So far as the future is concerned, it may make sense to allow time for the impact of proposals or developments resulting from these consultations to be assessed properly before further consultations are published.