

Group Reward & Recognition

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Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee

email: john.kluver@camac.gov.au

Dear John

Please find attached a submission from BHP Billiton in relation to your current review of executive remuneration in Australia.

BHP Billiton welcome the opportunity to provide this submission, and trust you will find our comments of assistance in your deliberations.

Yours sincerely



Richard Doody
Vice President Group Reward & Recognition

Attach.

Submission from BHP Billiton Limited (BHP Billiton) to the Corporations & Markets Advisory Committee (CAMAC) in relation to their review of executive remuneration.

We have a number of comments, as set out below, in regard to the Minister's request to CAMAC to review the disclosure of executive remuneration under s300A of the Corporations Act (and related regulations), particularly in relation to:

- 1) More effectively meeting the needs of shareholders and companies;
- 2) Reducing the complexity of reporting requirements; and
- 3) Simplifying incentive components of remuneration.

1) More effectively meeting the needs of shareholders and companies

The most oft-cited shareholder need not being met by current requirements is disclosure of the amount of actual pay realised by executives. The equivalent for the company is the desire to show remuneration values in the context of the Remuneration Committee's deliberations, that is, what has been provided, why, and what value the company and the recipient ascribe to the benefit at the time that it is provided.

These gaps primarily arise from the focus on the estimated fair value methodology prescribed under accounting standards for including share-based payments within the remuneration analysis. Although the accounting methodology is largely successful in enabling like with like comparisons across different organisations, it also ascribes values to share-based payments which do not relate to the actual benefits experienced by the executives (including to securities that never vest).

The amortisation of amounts across a number of accounting periods is often not simple and transparent to shareholders, and combines a portion of the value of a number of successive years' awards together – clouding the link between actual performance and remuneration outcomes. This does not assist the organisation in expressing the decisions that have led to the setting of remuneration packages for its management team during the current year, and as a result of performance over the financial period which is the focus of the rest of the annual report.

BHP Billiton believes that there is a role for more than one perspective on 'actual remuneration' to be presented and that the requirements for doing so could be reasonably straight forward, as described below.

- a) **Actual remuneration as realised by executives:** The disclosure of actual pay as realised by executives would, in its simplest form, require the adding together of the fixed remuneration components (as already disclosed) with the actual value delivered from awards that have vested during the year (from grants provided in prior years). The value on the vesting date would be a proxy for the actual amounts received by individual executives at the different times that they choose to exercise, or sell, their awards over the post-vesting period – as these events may occur a number of years after vesting, and potentially a significant time after the individual's cessation of employment with the company (when they are out of scope for disclosure).

The current disclosure requirements provide all of the components for this equation – as the number and value of awards that have vested during the year is already required. It

is the addition of these components together, with relevant commentary and explanation, which is not currently a requirement.

- b) **Actual remuneration as provided by the company:** The risk with presenting only the above perspective of actual remuneration is that it would naturally tend to place less weight on those circumstances where awards do not vest (because performance hurdles are not met) or where share price depreciation delivers modest rewards to executives, and rather, focuses the eye on those circumstances where performance and share price combine to deliver rewards significantly in excess of the allocation value.

The range of potential outcomes from the awards is, however, of key consideration to the company in determining the number and nature of equity awards to provide to executives. Disclosure and commentary in regard to the expected future value of the remuneration would, we believe, give the shareholder a valuable perspective on the Remuneration Committee's deliberations and rationale.

Companies use the accounting fair value of the awards (or an equivalent or proxy for it) to determine the appropriate number of securities to provide, in order to deliver a future remuneration value which takes this range of potential outcomes into account. Leaving to one side for present purposes the complexity introduced by amortisation, the current disclosure requirements again provide all of the components for this actual remuneration equation – which would sum the fixed remuneration (already disclosed) with the fair value of the awards that have been provided during the year, or as a result of the year's performance. It is the addition of these components together (without amortisation of equity grants from prior years) which is not currently a requirement.

Reducing the complexity of reporting requirements

Great strides have been taken along this path in recent years, in particular with the consolidation of previously separate requirements under the Australian Accounting Standards and the Corporations Act. This was a significant step forward in simplifying disclosure requirements.

The elimination of reporting for Top 5 executives (as recommended by the Productivity Commission) and restriction of disclosures to Key Management Personnel would be a further significant and welcome improvement in simplifying remuneration reports and providing meaningful disclosure for shareholders.

There is an inherent value in maintaining consistency of requirements across a number of reporting periods, both for shareholders and companies, in terms of the increased level of understanding that comes from familiarity with the disclosures, and enabling the company and the shareholder to make transparent year on year comparisons. BHP Billiton therefore does not advocate change for change's sake, and we have therefore limited our comments to those areas which we feel would most benefit from simplification:

- a) Due to the UK listing of BHP Billiton Plc, BHP Billiton has the benefit of dealing with disclosure requirements in both the Australian and United Kingdom jurisdictions. The UK requirements in regard to disclosure of current shareholdings of each KMP require all holdings as a result of share plan participation to be disclosed, including any activity during the year such as grants, vesting, exercises, and lapses. The Australian legislation also requires disclosure of these activities, but where there is no activity during the year in relation to a particular holding, the holding does not need to be mentioned or listed within the remuneration report. While the UK legislation therefore requires more detail to be provided,

- b) Australian legislation requires the disclosure of “estimates of the *maximum* and *minimum* possible total value of the bonus or grant for subsequent financial years, measured in accordance with applicable accounting standards” for performance bonuses and share-based payments, in addition to the requirement to include the estimated fair value of these payments in remuneration. This additional requirement is often nonsensical, with the minimum potential value being nil (in the event that the employee forfeits the award or a performance hurdle is not achieved) and the maximum value being difficult to calculate (being largely dependent on future share prices of the company) to the point that its best proxy is the estimated fair value already included in remuneration.
- c) In addition to the value of options/rights that form part of remuneration during the year, Australian legislation also requires disclosure of “the percentage values of remuneration that consist of options/rights”. The rationale for this additional requirement and the value that it is intended to provide to shareholders is not clear.

Simplifying incentive components of remuneration

BHP Billiton notes that CAMAC have been requested to “examine where the existing remuneration setting framework could be revised in order to provide advice on simplifying incentive components of executive remuneration arrangements”.

Appropriate incentive arrangements will be particular to the organisation, the time and circumstances, and that “simplification” is neither required or in the interests of shareholders. Rather, such an approach would be more likely to limit the organisation’s ability to drive and reward desired outcomes and behaviours through incentives.

Different organisations will implement different short-term and long-term incentive arrangements, designed to support that organisation’s current business strategy, with the goal of driving sustained shareholder wealth creation. The appropriate incentive arrangements will therefore be those that support the desired corporate behaviours and values, and drive the outcomes that are relevant to that business at that time, reflecting potentially complex business structures, external environments and the needs of multiple stakeholders. Such arrangements will be under constant review to ensure ongoing relevance for the organisation in the prevailing market circumstances.

Mandating, for example, that all organisations have a long-term incentive plan that employs a TSR hurdle, or commences vesting at the median (or above the median) in order to make these arrangements simpler for shareholders to understand will simply produce a ‘sameness’ in arrangements that may not suit some companies, and will not drive the outcomes relevant for that business.

A very significant driver of complicated incentive arrangements in Australia is in fact the current tax structure in relation to employee equity. The impacts for Australian employees vary significantly from those in other major jurisdictions, complicating the equity programs for global companies and, as a result, the related disclosures. Key points of difference, and therefore complication, have been well publicised, but include the taxation upon cessation of employment, tax upon vesting (rather than exercise) for options, and the 75% rule to enable tax deferral for share grants.