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14 March 2013

Mr David Woods
General Manager
Corporations and Capital Markets Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Mr Woods,

I am pleased to enclose a submission from BHP Billiton in relation to the exposure draft Corporations Legislation Amendment (Remuneration Disclosures and Other Measures) Bill 2012.

I trust you find our submission of assistance in your deliberations.

Yours sincerely,

Jac Nasser AO
Chairman

BHP BILLITON SUBMISSION TO THE TREASURY IN RELATION TO THE EXPOSURE DRAFT *CORPORATIONS LEGISLATION AMENDMENT (REMUNERATION DISCLOSURES AND OTHER MEASURES) BILL 2012*

We welcome the opportunity to participate in this Treasury consultation. We believe this consultation process is a very important one given the significance of the issues addressed in the Bill for the users of the remuneration reporting we provide, including shareholders, investor bodies and other stakeholders.

BHP Billiton has a Dual Listed Company structure, combining an Australian company (BHP Billiton Limited) with a UK company (BHP Billiton Plc). We are therefore subject to the regulatory regimes of both Australia and the UK, and are able to comment on the exposure draft Bill from this perspective.

We have been a participant in the UK Financial Reporting Lab during 2012-13. The Financial Reporting Lab was established by the UK's Financial Reporting Council (a governmental body) to improve the effectiveness of corporate reporting. It brings together investors and companies to find approaches to simplifying corporate disclosure issues, with a focus on the views of investors. In 2012, the UK Government asked the Financial Reporting Lab to undertake a project to ascertain what investors would regard as the most useful type of 'actual pay' disclosure. The disclosure model favoured by investors (as the prime users) in the Financial Reporting Lab project was subsequently adopted by the UK Government in its draft regulations for remuneration reporting. BHP Billiton and a number of other FTSE companies participated in the project to ensure the practical aspects of different types of pay plans and structures were adequately taken into account.

We believe that the UK's investor-endorsed remuneration reporting model has key attributes that, if incorporated into the Australian exposure draft Bill, would better achieve the Australian Government's objective of improving remuneration disclosure for all users of remuneration reports.

Our comments on the Bill are in the following order:

- past, present and future pay
- remuneration governance framework
- clawback
- payments in connection with retirement
- disclosure related to options

Our primary focus is the Bill's proposed addition of 'past, present and future pay' disclosures into remuneration reports.

1. PAST, PRESENT AND FUTURE PAY

BHP Billiton's aspiration is to make simple and relevant pay information accessible to and understandable by all our global shareholders and stakeholders.

We therefore support the Government's aim of improving remuneration disclosure.

We believe the Government's aim will be achieved if the legislation embodies three core remuneration reporting principles:

1) ***Clear and Unambiguous*** – Only one set of pay numbers for each executive, resulting in no confusion for stakeholders.
2) ***Comparability*** – Enable stakeholders to compare pay across companies, both within Australia and across other jurisdictions such as the UK.
3) ***Current Year Performance*** – Report the one set of pay numbers that best reflects current year performance.

Legislation that encompasses these key principles will ensure that pay amounts reported are the most appropriate, useful and transparent for all stakeholders.

We believe the Bill could readily address these three issues if three suggested refinements are made.

1.1 Replace, rather than add to, existing pay disclosures – a single pay number that is clear and unambiguous

The exposure draft Bill adds the 'past, present and future pay' disclosures to the existing section 300A(1)(c) / Corporations Regulation 2M.3.03 disclosures (which appear in the so-called 'statutory table').

Under this approach Australian companies will have to disclose two differently calculated sets of pay numbers for each executive (i.e. the current statutory view and the proposed view which would combine past and present pay to show remuneration received during the year; we assume the intention is that future pay would be shown separately from past and present pay to avoid double-counting, as we discuss below).

This is concerning for several reasons:

- It is likely to be confusing for shareholders and other stakeholders. In simple terms, many will ask "which number is right or most accurate?"

- It will add to the complexity of remuneration reports. Whenever there is more than one set of pay figures for an executive there is a need to provide an explanation for what each set of numbers shows, the differences between the sets of numbers, and why the differences exist. The length of remuneration reports will therefore increase, at a time when stakeholders are calling for companies to simplify and shorten the report.

- Confusion and complexity undermines the integrity of the reported information in the minds of users of remuneration information. We believe a goal of remuneration reporting reform in Australian should be to reduce, rather than add to, the complexity of remuneration reports, and thereby decrease if not eliminate the lack of stakeholder trust in reported pay numbers.

In its review of executive pay disclosure rules in 2012, the UK Government addressed exactly this issue of lack of transparency. It identified this issue of multiple disclosures and decided to replace, rather than add to, the existing rules:

> *"The revised regulations will replace the existing disclosure requirements in their entirety rather than adding to what companies are currently required to report on. Therefore, these proposals focus specifically on making as clear and transparent as possible what companies are paying directors and how this supports company performance."* (BIS, Directors' Pay: Consultation on Revised Remuneration Reporting Regulations, June 2012, para 24)

We believe the confusion of two sets of disclosures can be avoided without wholesale repeal of section 300A(1)(c) or Corporations Regulation 2M.3.03. Rather, the Government's policy of requiring 'past present and future pay' disclosure can be achieved through minimal amendments to Corporations Regulation 2M.3.03. The statutory table would remain in place. But, importantly, it would be an improved statutory table giving a clear picture of the 'past' and 'present' pay of the company's executives. Future pay would continue to be shown separately – which is critically important because trying to include future pay in the same table as past and present pay inevitably leads to double-counting (e.g. a share award that is future pay in the year of grant will become past pay in a later year when it vests).

We believe that the suggested amendments to Corporations Regulation 2M.3.03 to achieve this outcome are as follows.

- Present pay: Corporations Regulation 2M.3.03 Items 6, 7, 9 and 10 already require the components of 'present pay' to be disclosed (i.e. salary; bonus relating to the year; monetary and non-monetary benefits; superannuation contributions made by the company; any termination benefits received in the period; and any sign-on payments received in the period). Therefore, no change to the law is required in order to address present pay.

- Future pay: Corporations Regulation 2M.3.03 Item 12 (paragraphs (a), (b), (c), (d), (g), (h)) and Item 15 currently require a significant amount of information about the terms, conditions and value of incentive awards granted during the year that will not vest until a future year. It is therefore not clear that any change to the law is required in order to address future pay. One reform the Government may wish to consider is the disclosure of the 'face' value of awards in addition to 'fair' value. Item 15 currently requires 'fair' value to be disclosed (which we believe is the more appropriate view). However, based on investor preferences, the UK Government has opted for disclosure of future pay based on the face value of awards, rather than fair value, but with the opportunity to describe the fair value of awards in supplementary information (i.e. in a footnote to the table).

- Past pay: The Government's desire to highlight the actual or crystallised value of long term incentives is welcome. This can be achieved through amendments to the current regulations.
  - Currently, Corporations Regulation 2M.3.03 Item 11 (and Accounting Standard AASB 2 Share-based Payment, which must be applied in interpreting Item 11) requires long term incentives that are share-based (which most are) to be valued using an option pricing methodology, with the resulting value being allocated (amortised) over the vesting period.
  - With companies typically granting long term incentives annually, with vesting periods of three to five years, there can be three or four unvested grants at any one time. 'Slices' of the value of each are included in the statutory pay table each year.
  - This in turn means the remuneration report's figure for long term incentives is in fact a mixture of several years' long term incentive awards – and all based on a theoretical valuation derived using the principles of AASB 2. Historically the values derived using the principles of AASB 2 were designed to establish a means of charging the cost of share awards against the income statement of the company, and have been lifted into remuneration reporting in the absence of any other definitions. These charges do not in any way measure performance outcomes, which is what all users of remuneration information want to understand (i.e. the link between pay and performance).
  - This has led to long term incentive disclosures in remuneration reports that are largely meaningless to all readers other than accountants and remuneration specialists – and even for those who do understand their construct they cannot be used in any meaningful way to assess whether remuneration outcomes are linked to performance.
  - In addition, we are not aware of any other jurisdiction that has adopted this complex approach to reporting the value of long term incentives in the remuneration report. In contrast, the global move is towards reporting remuneration on a basis that has clear linkages between pay and performance (or exposes situations where such linkages are not in place).
  - We believe that the Government's objective of reporting 'past' pay could be readily achieved while avoiding confusion for stakeholders, by amending Corporations Regulation 2M.3.03 Item 11 as follows:
    - introduce a requirement to disclose the value at vesting date of long term incentives that vest; and
    - remove the reference to Accounting Standard AASB 2 Share-based Payment and the accompanying requirement to use its valuation methodology.
  - This will ensure readers of remuneration reports are presented with a clear, understandable picture of the true value delivered by long term incentives.

To summarise, the current statutory table can, with minimal adjustments to Corporations Regulation 2M.3.03, deliver the Government's objective of a table showing 'past' and 'present' pay, combined. As regards 'future' pay, we see no need for any change to the current law. Corporations Regulation 2M.3.03 already requires companies to make disclosures in relation to future pay that are at least as extensive as those required by the exposure draft Bill. At most, a refinement of the Corporations Regulation 2M.3.03 requirements is all that is needed to achieve the Government's objective in relation to future pay disclosure.

Introducing the 'past, present and future pay' reforms through amendments to Corporations Regulation 2M.3.03, rather than through a new subsection 300A(1)(ca), would ensure the first of the three key principles – clear and unambiguous – is satisfied.

1.2 Comparability: Enable stakeholders to compare pay across different companies

The exposure draft Bill does not include details on how the components of pay are to be measured and reported. In the absence of details there is a high likelihood that different companies will adopt different interpretations. This will in turn lead to stakeholders being unable to make ‘apples for apples’ comparisons across different Australian companies.

The UK Government – informed by its extensive dialogue with investors through the Financial Reporting Lab – recognised that comparability is a key objective of users of remuneration reports. The draft UK regulations therefore prescribe in great detail how each component of pay is to be measured and reported.

We recognise that the Bill’s provisions may have intentionally been drafted in high-level, general, terms. That is, that a ‘principles based’ approach may have been chosen to enable companies to adapt the ‘past, present and future pay’ disclosure requirements to their own specific circumstances.

We believe that the costs of a principles-based approach far outweigh the benefits in the area of remuneration disclosure. The main cost, as discussed, is the accompanying lack of comparability through the inevitable different interpretations.

We recognise that, if the Government adopts the approach we suggest in 1.1 and proceeds by way of amendments to Corporations Regulation 2M.3.03, rather than the introduction of new subsection 300A(1)(ca), the comparability issue is not as significant. This is because Corporations Regulation 2M.3.03, and Accounting Standard AASB 119 Employee Benefits which supports the regulation, *do* include granular details on how each pay component must be measured and reported.

The only area where comparability could be an issue is in relation to share awards, which we turn to now.

1.3 Current year performance

Draft subsection 300A(1)(ca)(i) defines past pay as ‘the total amount of remuneration that was granted to the person before the start of the year and paid to the person during the year’. This suggests that equity incentive awards would be treated as follows:

- Deferred shares earned as part of a short term incentive: The remuneration report will include the value, at vesting date,[1] of deferred shares that vested during the reporting year.

- Long term incentives subject to performance hurdles: The remuneration report will include the value, at vesting date, of long term incentive awards that vested during the reporting year.

This is the methodology the Productivity Commission referred to in its report (Executive Remuneration in Australia, 2009, pages 257-259). It has an internal consistency and is comparatively easy for remuneration report users to understand: past pay is the value of awards that have vested during the reporting year. This is sometimes called the ‘realised in year’ approach.

There is, however, an alternative model to which the Productivity Commission’s report did not refer. It is the model adopted in the draft regulations in the UK.

The UK model emerged from the investor-focused workings of the Financial Reporting Lab referred to earlier in this submission. While UK investors were attracted by the simplicity of the ‘realised in year’ approach, investors ultimately supported a different approach which the Lab calls ‘related to current year performance’. Under this approach equity incentive awards would be treated as follows:

[1] Given the absence of details in the Bill, there is scope for different companies to take different approaches to valuation. For example, some may use the closing share price on the date of vesting, while others may use an average share price over the period around the vesting date.

- Deferred shares earned as part of a short term incentive: The remuneration report will include the value, at grant date, of deferred shares that were granted as part of the short term incentive (bonus) for the reporting year. The value to be reported is the full face value (i.e. number of deferred shares x share price on date of grant).

- Long term incentives subject to performance hurdles: The remuneration report will include the value, at vesting date, of long term incentive awards that vest based on performance conditions that end during the reporting year. In most cases, this will be awards that vest shortly after the end of the reporting year, based on a performance period that finishes at year-end.

Investors in the UK prefer this approach to the 'realised in year' approach because they want remuneration reports to become simpler, clearer and shorter rather than more complex and lengthy. The 'related to current year performance' approach will promote simpler, clearer and shorter remuneration reports because:

- Deferred shares: Users of the remuneration report will see a deferred share value that relates to the company's financial and operating performance during the reporting year. In contrast, under the 'realised in year' approach users see a deferred share value that relates to the company's performance from three years in the past. Performance may have been very strong three years ago, justifying a large short term incentive and large deferred shares award. However, if performance has been poor in the reporting year just ended, there is a need to include a potentially lengthy explanation in the remuneration report as to why the figure for deferred shares is so large. The problem with the 'realised in year' approach is the disconnect in time between the year the deferred shares were earned and the year they appear as pay in the remuneration report.

  (Note that UK investors are not concerned about *unvested* deferred shares being included as part of actual pay because the shares have been earned – all performance conditions have been satisfied, and only service conditions remain.)

- Long term incentives: Similarly, under the 'related to current year performance' approach the long term incentive value is at least partly tied to the company's performance during the reporting period. In contrast, under the 'realised in year' approach the performance period for the awards will typically have ended 15 months before the awards appear as a component of 'actual pay' in the remuneration report. This gap could again necessitate detailed explanation.

All users of remuneration information value strongly information which demonstrates the existence – or absence – of a linkage between pay and recent performance. Investors engaged by the Financial Reporting Lab have consistently made the point that direct linkage to the most recent company performance is paramount. They have vocally expressed concerns that to do otherwise will contribute directly to increased levels of doubt and scepticism about remuneration reporting.

Appendix A contains extracts from the UK Financial Reporting Lab's report, relating to the preferred approach, and Appendix B includes a worked example based on BHP Billiton's short and long term incentive plans. The worked example illustrates visually how the proposed Australian approach has an in-built disconnect between the period the awards are earned and the period they are reported.

There will be an additional concern if Australia decides to pursue a different approach to reporting share awards to that adopted in the UK: comparability will be compromised. Australian investors with international portfolios will not be able to make like-for-like comparisons of Australian and UK executives' pay. In an increasingly global investment environment, where the trend has been towards greater comparability (e.g. financial reporting: IFRS), it would be disappointing for investors if Australia pursued a different approach to the UK. The UK embarked on the pay reporting reform process earlier than Australia, and has invested significant resource in ascertaining investor views through its Financial Reporting Lab. Investors (shareholders) are the main category of users of remuneration reports. And, after weighing up the pros and cons of the competing alternatives, the investor community in the UK decided overwhelmingly that "the variable element should reflect the remuneration receivable in relation to current performance" (UK Financial Reporting Lab report, June 2012, page 4).

1.4 Summary

In summary, we recommend that the Government:

- Implements the past, present and future pay reforms through minimal amendments to Corporations Regulation 2M.3.03, rather than the introduction of new subsection 300A(1)(ca) to the Corporations Act;
- Includes in the provisions (wherever located) sufficient details around measurement and definition to ensure Australian companies report their executive pay in a comparable fashion; and
- Adopts the ‘related to current year performance’ approach in relation to share awards to be included in the pay table.

2. REMUNERATION GOVERNANCE FRAMEWORK

BHP Billiton has as a matter of good governance described the key features of our remuneration governance framework in our remuneration report in recent years.

We therefore support the Bill’s requirement for the company’s remuneration governance framework to be described in the remuneration report.

3. CLAWBACK

The ability for companies to impose remuneration clawback mechanisms in the event of a material misstatement or omission in the financial statements, upon which previous remuneration was based, is important and clearly in the interests of shareholders and other stakeholders.

We are therefore generally supportive of this provision in the Bill.

However, we note that the Explanatory Memorandum contains several references to *overpayment* whereas the draft subsection does not. For example, the Explanatory Memorandum refers to ‘whether any overpaid remuneration … has been clawed-back’ (para 3.1), and the ‘misstatement or omission leads to a KMP being overpaid’ (para 3.17). The draft provision, on the other hand, does not appear to require that the misstatement / omission has caused an overpayment to a KMP, in order for the clawback disclosure obligation to arise. It would be preferable if the provision could be clarified so that it reflects the scenario described in the Explanatory Memorandum, where there is a causal link between the misstatement / omission and the amount of remuneration received by the KMP.

4. PAYMENTS IN CONNECTION WITH RETIREMENT

We support the Bill’s extension of disclosure requirements relating to retirement / termination related payments.

5. DISCLOSURE RELATED TO OPTIONS

Removing the requirement to disclose the value of lapsed options, and replacing it with a requirement to disclose the number of lapsed options and the year in which they were granted is a sensible reform, for the reasons discussed in the CAMAC report (pages 109-111).

APPENDIX A

EXTRACTS FROM UK FINANCIAL REPORTING LAB REPORT, JUNE 2012

The views expressed by the majority of investors involved in the project, can be summarised in the following principles:

- The single figure of remuneration should be:
  - Comprehensive – that is it should include all types of reward
  - Consistently prepared – both with regard to what components are included and how each component is measured
- Salary should represent amount received; benefits and pension should represent an estimate of the benefit provided to the individual
- The variable element should reflect the remuneration relating to performance in the financial year being reported. Where the performance period for the variable pay is greater than a single year, it should reflect the remuneration where the financial year being reported is the last year of the performance cycle.

Matrix of options of what could be included within a single figure of remuneration

	Salary	Benefits (excluding pension)	Pension	Principle underpinning calculation	Bonus	Long-term incentives
	Cash paid in respect of year.	Cash value of benefits (cash and non-cash) earned in respect of year.	Include only cash values that could be spent, e.g. cash in lieu of pension.	Realised in year	Cash and shares element for immediate settlement relating to current performance year and market value of prior deferred bonus shares that vested in the year.	Awards vested during the current year valued at market value at date of vesting.
ions			Include cash equivalent of contributions: • Cash in lieu • Company contributions to defined contribution plans.	Related to current year performance	Total cash equivalent (if some settled in deferred shares) awarded in relation to the performance year.	Awards that vest in relation to the performance in the year, so paid post year end and either valued at: • At an estimate of market price, if award hasn't vested by AR sign-off date; or • At market value on date of vesting if vested before signing off the AR. If no further performance conditions for LTI, would be treated like deferred bonus upon initial award.

Report available at:
http://www.frc.org.uk/Our-Work/Publications/Financial-Reporting-Lab/A-single-figure-for-remuneration.aspx

APPENDIX B

WORKED EXAMPLE OF 'REALISED IN YEAR' (AUSTRALIAN) AND 'RELATED TO CURRENT YEAR PERFORMANCE' (UK) APPROACHES