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Inquiry into Executive Remuneration
Productivity Commission
Locked Bag 2, Collins Street East
**MELBOURNE VIC 8003**

Dear Sir

EXECUTIVE REMUNERATION INQUIRY

The Productivity Commission has been asked to report on the framework and structures of remuneration of directors and executives in Australia. BlueScope Steel closely considers these issues in determining its own remuneration strategies.

It is BlueScope Steel's contention that:

- Remuneration governance standards should articulate principles that can be applied by boards to the competitive circumstances of their companies, and that governance requirements should not attempt to prescribe detailed application of principles;
- It is appropriate to maintain the non-binding status of shareholder votes on remuneration reports. Boards must make a wide range of decisions in the shareholder's interests, and they must be enabled to make these decisions at the required time. Furthermore, directors face shareholders at annual general meetings, are individually accountable at re-election, and boards have responded in circumstances where shareholders have objected to aspects of executive remuneration practice. While the existing requirement for a non-binding remuneration report is supported, the disclosure of an individual executive's details inhibits the negotiating position of the Board in regard to executive remuneration.
- Australia has been largely spared from the examples in some sectors of the U.S. market of gross excesses in executive remuneration practices. This may relate to the prevalence of independent, non-executive board chairmen in Australia (separating the interests of the executive from the board) whereas it is not uncommon for the chairman of a large US corporation to also be the CEO. Also, many Australian companies have established board remuneration committees, chaired by an independent director, other than the board chairman.

This submission is intended to serve as an illustration of the principles adopted by BlueScope to underpin an executive remuneration policy that has been actively reviewed since the listing of BlueScope Steel (formerly BHP Steel) in 2002, which has met the expectations of shareholders and governance bodies.

Yours faithfully

Graham Kraehe
**CHAIRMAN**
**BlueScope Steel Limited**

# EXECUTIVE REMUNERATION POLICY REVIEW

## 1. Principles Underpinning Executive Remuneration in BlueScope

The Company's salaried remuneration framework is designed to:

- Link the reward of executives with the creation of value for the shareholders and the business;
- Recognise and reward individual performance and accountability for key job goals;
- Provide distinguishable remuneration differences between career and performance levels; and
- Maintain a competitive remuneration level relative to the markets in which the Company operates.

The following principles, consistently applied in the context of each country where BlueScope has executives employed, underpin the annual remuneration arrangements for executives.

i) Fixed remuneration (base plus super) to be clearly competitive in the industrial market sector.

ii) Short term cash incentive to be truly variable, and weighted in favour of the underlying financial and operating business performance of the company but also reflecting individual and team achievements on projects that will drive future operating performance. The design must restrict the ability of executives to earn high individual and team based rewards in years when financial results have been unsatisfactory, and the board reserves discretion to reduce bonuses to zero.

iii) Meaningful long term equity incentive to ensure executives feel a similar reward experience as shareholders. Executive Leadership Team members **must build and maintain a personal equity holding** to a value at least equal to their base annual salary, and other executives to at least half their base salary.

iv) The values of the fixed, short and long term grants to be pitched such that a Q3 plus outcome would be achieved for years of outstanding performance (ie stretch performance outcomes for both BlueScope and the executive's personal goals), with outcomes less than the median in years of unsatisfactory performance. The relative weighting between short and long term incentives to take account of competitive market practice, but reflect attributes that may distinguish BlueScope in the market (eg long term focus, cyclical business, cultural and governance priorities etc).

v) Performance hurdles over executive share rights must be directly linked to the shareholder's relative investment experience during the life of the share right, i.e. Total Shareholder Return. Existing share rights must be tested on the basis of an average over the 3 month period immediately prior to a test time, not a single point in time. The same value used for vesting test purposes is used to establish the new base against which new share rights will be tested for future performance hurdles.

## 2. Has Our Approach Been Supported by Shareholders and Executives?

The application of the principles has achieved the objectives sought by Board as discussed below.

- Importantly, in years, such as experienced in the current AGM season, of general shareholder hostility toward executive remuneration, BSL shareholders have overwhelmingly endorsed our Remuneration Report and other remuneration related AGM matters.

- In all major acquisitions – Butler Manufacturing (US and China), Smorgon Steel (Aus), Steelscape (US), Varcoe Pruden (US) and ASC (US) – we have been able to translate and convert required executives into our established remuneration arrangements.

- Executive retention has been high.

## 3. Current Governance Expectations

The Remuneration and Organisation Committee of the BlueScope board oversees executive remuneration policy and practice. This committee is comprised of independent directors only, and chaired by an independent director, being a director other than the Chairman of the Board.

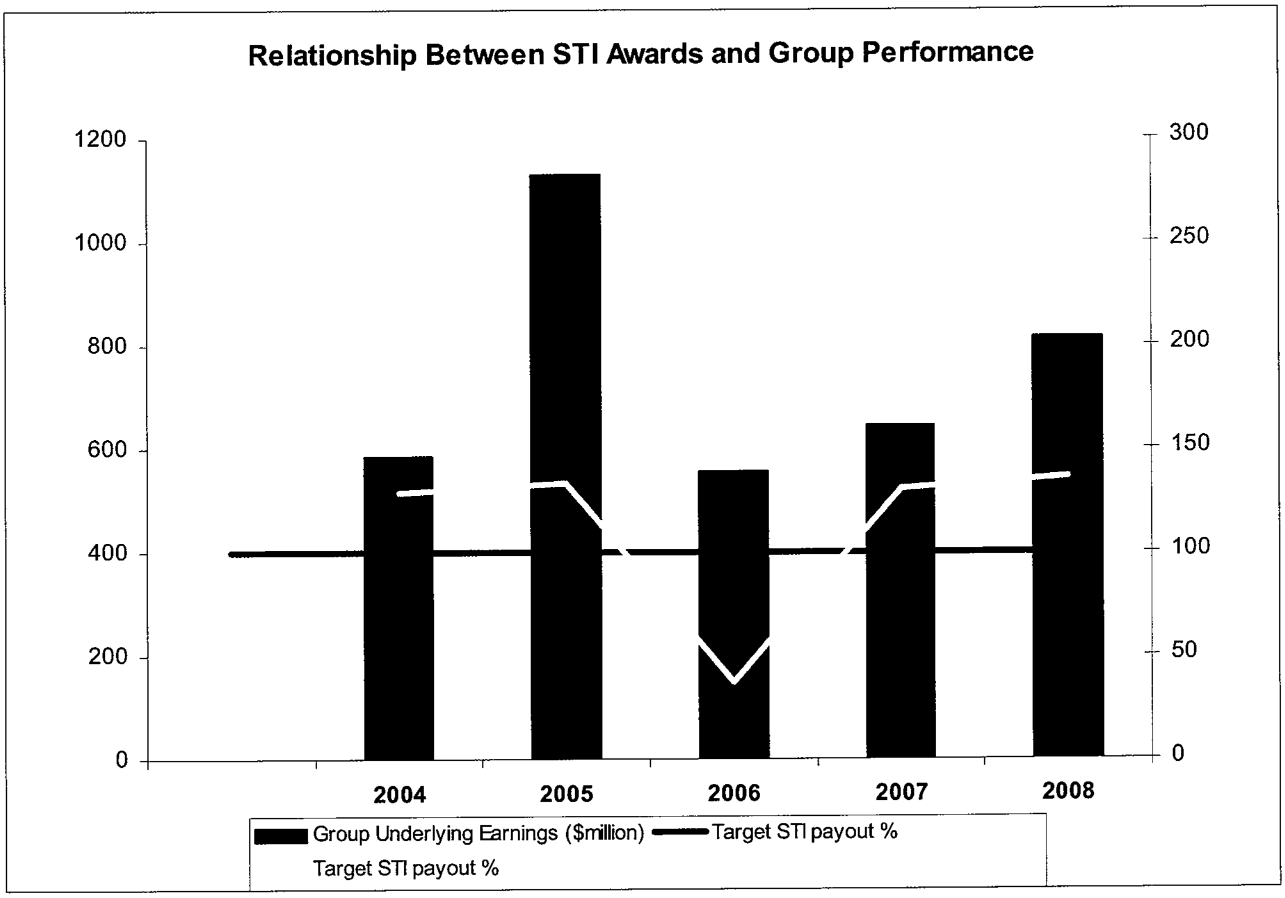
Shareholder acceptance of BlueScope remuneration reports has been consistently above 90%. Shareholders should see a strong alignment between their experience and executive reward for 2008/09 in that bonuses will be significantly down, and the board and executives have frozen fees/salaries in 2009. New share rights issued last year have a base hurdle at a record high hurdle price of $10.57 (compares to current share price in the $2-$3 range), and the existing "pipeline" is well below performance hurdle vesting criteria.

Attachment 1 shows the past relationship between executive bonuses and underlying business performance.

Attachment 2 compares BSL against the recently published principles from the UK Financial Services Authority (aimed at reining in excesses in the financial section). BSL's existing practices rate highly against the FSA's standards.

Attachment 3 is a summary of the views of governance bodies on various elements of executive remuneration, and BlueScope's policies in relation to these elements.

## ATTACHMENT 1



## ATTACHMENT 2

**Criteria for good and bad remuneration policies based on the Financial Services Authority letter of 13 October 2008 to CEOs in the UK.**

| Assessment criteria | Poor practices | Good practices | BSL practices |
|---|---|---|---|
| Measurement of performance for the calculation of bonuses | Employee bonuses calculated solely on the basis of financial performance<br>Does not take risk or capital cost into account<br>Calculated on the basis of revenues, without any counterbalancing risk controls | Bonuses awarded take into account appraisal of other performance measures, including risk<br>Management skills, adherence to company values and other behaviours<br>Uses a measure of risk-adjusted return.<br>Measure likely to be based upon economic capital calculation, and should take proper account of a range of risks including liquidity risk<br>Performance assessed on a moving average of results (link to deferred<br>Performance assessed entirely on the results for the current financial year compensation, see below)<br>Calculated on profits, and by reference to other business goals if appropriate | Based on profit and cash flow<br>Inclusion of ROIC for this year<br>Business excellence and strategic provide balance and long term focus<br>Blueprint aligns STI with business planning an performance measurement |
| Composition of the remuneration | Remuneration that has little or no fixed component.<br>Paid wholly in cash<br>No deferral in the bonus element | Fixed component of the remuneration package to be large enough to meet the essential financial commitments of the employee.<br><br>Appropriate mix of cash and components, which are designed to encourage corporate citizenship and alignment of interests between those of | Fixed is a significant proportion without being excessive compared to market<br><br>Significant LTI provides balance in the time horizon for measurement of performance |

| Assessment criteria | Poor practices | Good practices | BSL practices |
|---|---|---|---|
| | | the employee and those of the firm. (For example shares, or appropriately priced share options).<br><br>A major proportion of the bonus element is deferred so that the impact of the performance in one year on the firm/unit's long term profits can be established | |
| Performance adjusted deferred compensation | Payout of the deferred element is not linked to the future performance of business undertaken in previous years.<br>Performance adjusted deferred compensation schemes can be waived/ not enforced despite evidence of poor performance or wrong doing. | A significant proportion of the deferred compensation element to be held in a trust or escrow account, from which funds can only be vested according to rules which take account of the performance of business undertaken in earlier years.<br>Deferred compensation is determined by a performance measure, which is calculated on a moving average over a period of several years.<br><br>Performance adjusted deferred compensation schemes are legally robust and contractually enforced. | Requirement for executives to hold significant amounts of equity equivalent to<br>ELT 1 year's base pay<br>Executives'6 month's base pay<br>Executives are advised of this expectation at the time of each award of rights |
| Governance | No process, or no transparent process for managing conflicts of interest<br>Staff have an ability to influence unduly the valuation of their own positions and hence the Valuations and risk reporting subject to independent verification determination of performance measures. Ability also to front load profit from transactions | Board level remuneration committee with majority of non-executives. Committee has effective control of remuneration policies across the firm and of individual<br>Areas such as HR and Risk have strong and independent role in setting<br>Overall control of the back office vested in operations | Robust target setting and measurement<br>ROC and Board reviews and approval<br>Corporate control with HR and Finance<br>External input applied to both STI financial and LTI target setting |

| Assessment criteria | Poor practices | Good practices | BSL practices |
| --- | --- | --- | --- |
| | Business areas can determine the compensation of staff in risk and compliance Compensation for staff in risk and compliance is determined independently of the business areas<br>Incomplete separation of duties between front and back office: ability of the front office to influence back office procedures. (See also SYSC 5.1.6R to 5.1.11G on the segregation of functions) | | |

**Attachment 3**

## Australian Governance Advisory Bodies - Summary of opinions on Executive Remuneration 2007 AGMs

| Issue | ACSI | RiskMetrics | CGI | BlueScope |
|---|---|---|---|---|
| **Key areas of focus** | STI disclosure<br>Termination payments<br>Disclosing rationale for changes to exec rem | Termination payments<br>Disclosing rationale for changes to exec rem | Appropriateness of performance hurdles<br>Disclosure of remuneration should be "user friendly"<br>STI disclosure | Rigorous governance in setting and measuring targets<br>Targets for both STI and LTI use external inputs<br>STI process disclosed |
| **Consultation** | Strongly support engaging with companies | Engaging more with companies<br>Will contact company to clarify issue where likely to recommend "no vote" | Will consult with companies but only if they are corporate subscribers to their service | Open door to consultation requests |
| **Performance hurdles** | Preference for dual hurdles with weighting towards relative hurdles<br>Companies using only absolute hurdles must have stretch targets<br>Preference for progressive vesting over cliff | TSR may not be appropriate in all cases.<br>Absolute TSR- must be greater than 10% per annum<br>EPS- hurdle should be consistent with market expectations. Base line EPS should be disclosed Will accept accounting based measures but concern they can be manipulated | No preferences per se. Hurdles should be tailored to each company's specific business and shareholders must be told why they are appropriate. | Relative TSR against ASX 100 meets expectations of relative market based hurdles. Absolute internal hurdles may be commercially confidential and prevent full disclosure to shareholders, so not adopted. |
| **Retesting** | Assess on a case by base basis<br>Maximum of 4 retests | Case by case assessment. Maximum four retests (6 monthly over two years). | Not in favour but will not vote against on this issue alone | Established due to industry volatility<br>Modest approach with a |

| Issue | ACSI | RiskMetrics | CGI | BlueScope |
|---|---|---|---|---|
| | | | | limit of 4 retests |
| **Hedging** | Not on unvested equity | Not on unvested equity | Not on unvested equity; all hedging must be disclosed | Not on unvested equity |
| **Change in control** | Vesting of equity on change of control must be pro-rated | Did not discuss | Board discretion | Conservative as requires performance hurdle to be achieved and pro rating vesting of equity on change of control |
| **STI plans** | Must disclose rationale for increases in STI and link to performance | Must explain rationale for increase in STI maximum.<br>Expect actual payments to increase in boom periods but not maximum opportunity | Clear explanation of relevance of hurdles and why payouts are appropriate | Full disclosure of the basis of STI setting and measurement together with KMP outcomes<br>Disclosure exceeds statutory requirements |
| **Remuneration reports** | Will vote "no" if they vote against another resolution on rem | Overall vote is generally an on-balance thing | Push to simplify | Remuneration report provides excellent disclosure<br>All remuneration policies have been approved by shareholders in prior years |
| **Fixed pay movements** | Movements higher than CPI need to be justified | Did not discuss | None | Market based reviews country by country |