



Executive Compensation Guidebook for Climate Transition

2023 Addendum

(To be read in conjunction with the original guidebook)

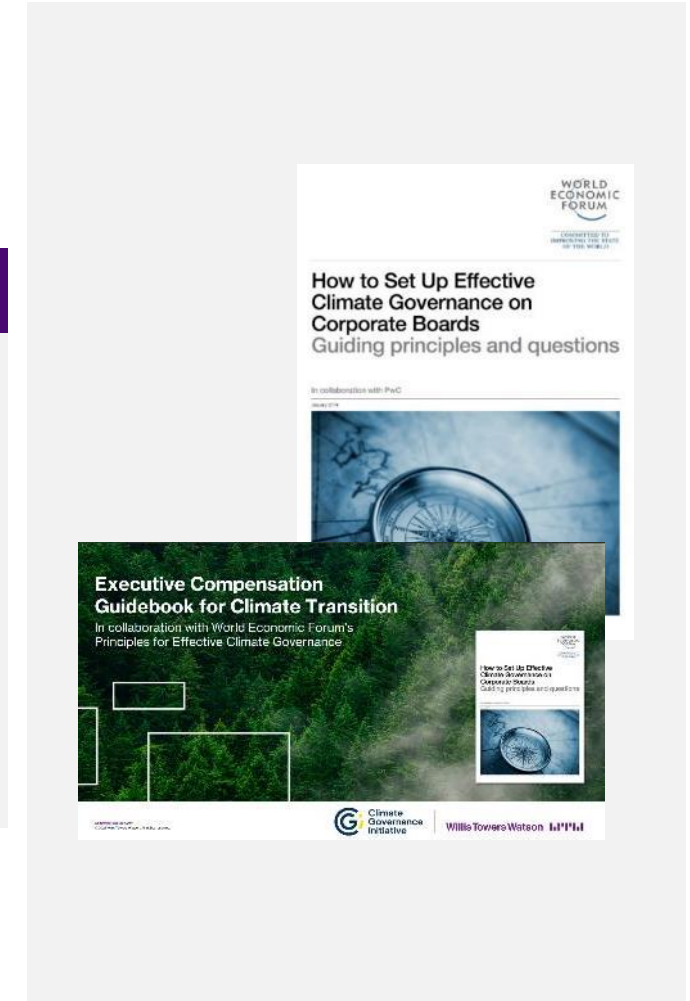
May 2023

Purpose of this addendum

In November 2021, WTW, in partnership with Climate Governance Initiative, published the [Executive Compensation Guidebook for Climate Transition](#) (Guidebook). The Guidebook set out best practices in driving climate transition through executive compensation to propagate the World Economic Forum's Principle 6 – Incentivization under its Principles for Effective Climate Governance. Throughout the 18 months since the Guidebook's publication, broader regulatory and investor context and market practice on the inclusion of climate-related performance metrics in executive incentive plans have evolved. Since the Guidebook's publication, we have observed:

Regulatory and investor context	Incentive plan market practice
<ul style="list-style-type: none">• Regulatory and investor demand for greater disclosure on a company's overall climate strategy including management of climate-related financial risks, plans to reduce emissions and transition to a low-carbon economy• A greater recognition of the need for robust governance, Board oversight and accountability structures, and for Board education and stewardship• More views expressed from institutional investors, especially those in Europe, on climate (and broader ESG) metrics in executive compensation plans, as a widely recognized tangible governance mechanism	<ul style="list-style-type: none">• An increase in the use of environmental (and climate-specific) metrics globally• More companies are putting these metrics in long-term incentive plans• Greater focus on quantitative assessment of progress against these metrics• Greater focus on the strategic alignment and clear disclosure of these metrics

The remainder of this addendum provides more detailed discussions on these observations. While the market and regulatory landscape have evolved, we maintain that the best approach to incorporate Climate metrics into executive incentive plan is to first focus on aligning an organization's climate priorities with its business strategy and to stay sufficiently agile to evolve and learn over time as metrics and goals for the climate transition continue to be refined and scrutinized.



WTW's Global Stewardship Model

Climate governance requires a holistic, cross-company response to preserve long-term value and manage risks — stewardship is at the heart of this

- Effective boards and leaders of successful organizations act as stewards to preserve, protect and increase value over time
- Stewardship encompasses five key elements towards meeting stakeholders' expectations and demands – all of which are key to successfully navigating the global climate transition
- Executive compensation is increasingly recognized as a tangible feature of good climate governance



Source: [WTW Global Stewardship Model](#)

Investor and regulatory developments

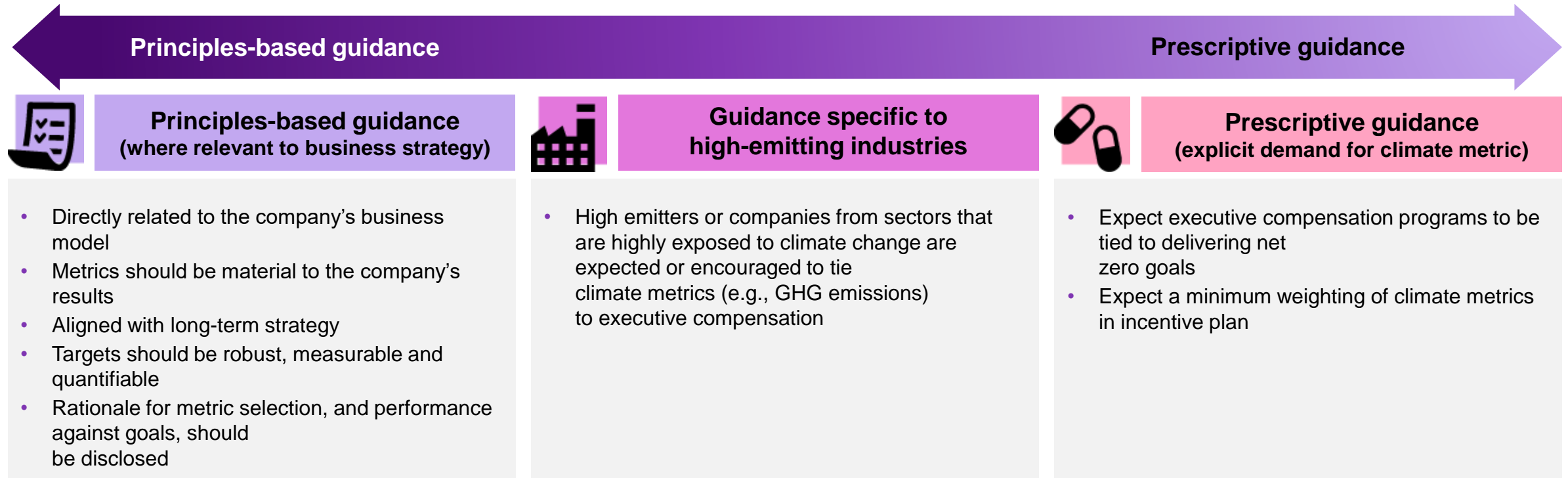
Investor expectations of listed companies and their disclosures are evolving and rising

- Investors are **integrating ESG (including Climate) risks of firms** into their portfolio and risk management processes
- Asset managers who sell products into the EU are subject to the Sustainable Finance Disclosure Regulation (SFDR), which **requires them to be transparent about how they are meeting their scope 3 climate targets**. Many have also signed up to Glasgow Financial Alliance for Net Zero (GFANZ) and other voluntary net-zero initiatives (e.g., Net Zero Asset Managers Initiative)
- This means investors are having to **publish their own TCFD reports, ESG disclosures and make their own net-zero commitments**. They, therefore, need to engage with their portfolio companies **to understand where risks and opportunities lie**, which is **driving increased disclosure requirements**
- Their focus is not just on climate but on **impact on and risk to broader environmental and social issues (ESG)**
- Investors will be evaluating not just what firms are saying they are going to do, but **how well set up they are to deliver**



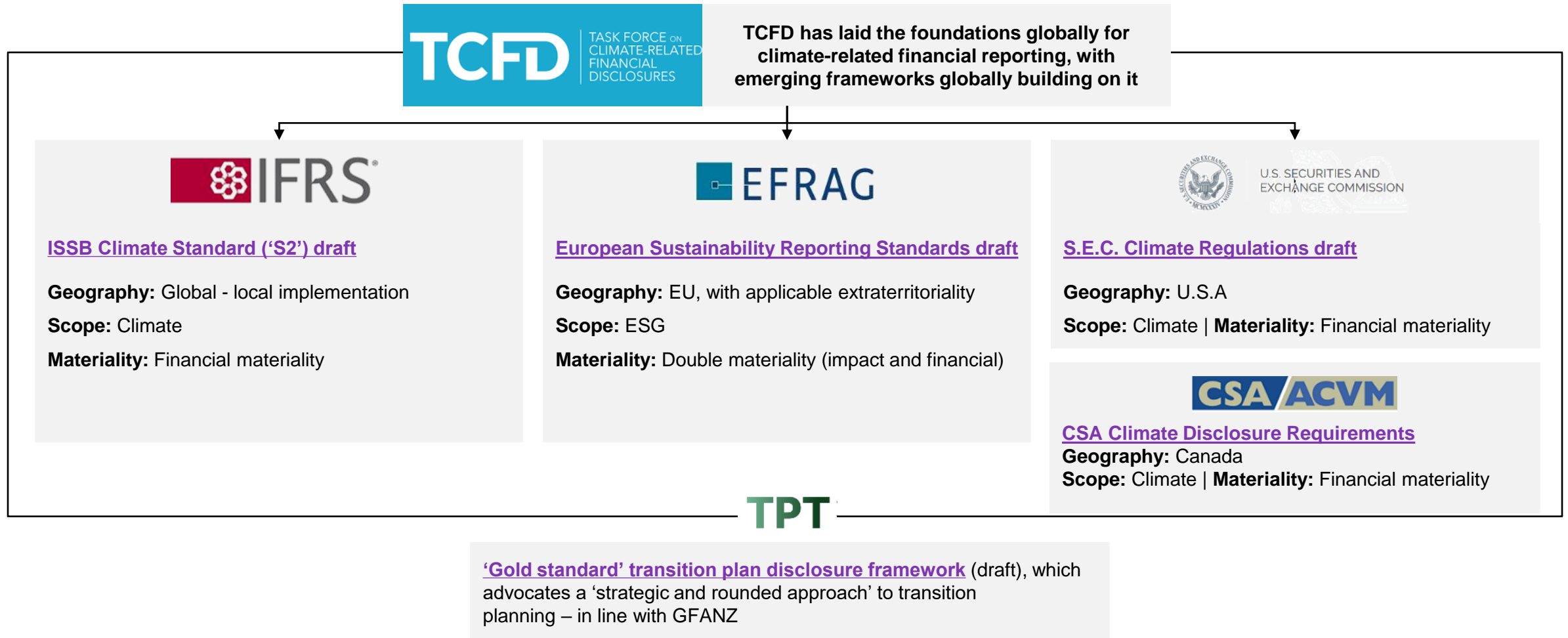
Investor guidance relating to climate-related incentive metrics is also evolving, but generally non-prescriptive so far

- Long-term climate commitments are **meaningless without interim goals and targets**, which are key to a credible climate transition plan
- **Executive incentives are recognized as a mechanism** amongst investors and other stakeholders **to create accountability for action** in line with shorter-term goals and supporting targets
- More and more investors are calling this out in their guidance, which ranges from principles-based to prescriptive



*Many institutional investors have not yet issued formal guidance

The main emerging global frameworks largely build upon, and add granularity to, the TCFD framework



European Sustainability Reporting Standards (ESRS)



High-level overview

- The Sustainability Reporting Guidelines (CSRD) came into force at the beginning of 2023, on the basis that companies will have to report on sustainability aspects in accordance with the ESRS in the course of 2025 on the financial year 2024. It **covers ~50,000 companies**
- EFRAG has aligned reporting areas with the TCFD recommendations, but the scope is broader, covering topics **across Environment, Social and Governance (ESG)** and a company's **entire value chain**
- EFRAG includes requirements for companies to publish a transition plan and a non-financial statement including information on how the companies' activities are associated with economic activities that qualify as environmentally sustainable under the EU Taxonomy Regulation



Points to note

- Differs from other frameworks, requiring ESG (not just climate) disclosures **through “double materiality” lens**:
 - Financial: How sustainability matters financially impact the company
 - Impact: How company activities across the value chain impact the environment and society (noting the focus not just on climate)
- Standards would also apply to large subsidiaries on non-EU parents and non-EU companies with a turnover in the EUR > €150m



WTW Commentary

- ESRS standards are **unprecedented in its breadth and granularity**. While its ambition is welcomed, it will have a significant impact on companies from a disclosure perspective and the data requirements for reporting and tracking
- **Board-led governance structures are key** to fully understanding and managing risks and opportunities across the entire value chain, for stakeholder engagement and ensuring accountability for delivery of the strategy

The ESRS standards were drafted by European Financial Reporting Advisory Group (EFRAG) at the end of November 2022 and submitted to the European Commission for consultation

International Sustainability Standards Board (ISSB)



High-level overview

- Final climate-specific requirements ('S2'), which are built on top of general requirements ('S1'), are expected in June 2023. An Exposure Draft was released in mid-2022
- The draft **builds on the TCFD recommendations and four pillars, but adds further granularity**, particularly around transition plans, scenario analysis, metrics and targets, industry classifications and metrics, and specifying reporting of scopes 1 to 3 emissions
- Future work of the ISSB will look at creating or **extending standards for climate-related nature, biodiversity in nature and just transition**
- Will provide a **global standard** but national adoption depends on whether governments/regulators opt to mandate alignment with ISSB*



Points to note

- As the 'other half' of IFRS, ISSB has a **financial materiality/risk focus** (similarly to the TCFD, SEC and CSA). This means it's focused on gathering information that could impact financial performance through the investor lens
- There is not a requirement to disclose beyond reasonable efforts and resource and data available, but there is a requirement to explain what you have – i.e. the quality of the data that you have and therefore the extent to which users can rely on it



WTW Commentary

- **Interoperability of standards globally is key** and has been important in ISSB's work - organizations can use ISSB standards as a baseline and provide additional disclosures to satisfy other (e.g., EU standards) where they apply to them
- We note, however, the **difference between ISSB and EFRAG**, with the former having a financial materiality and climate-specific focus and the latter having a double materiality and ESG-wide focus

ISSB is a standard-setting body established by the IFRS Foundation, whose mandate is to create an international sustainability-related financial reporting standards to meet investors' needs for sustainability reporting, disclosing all significant sustainability-related risks and opportunities to support investors' assessments of enterprise value.

**The UK, Zimbabwe and Nigeria have indicated adoption; in the UK this will implemented through Sustainability Disclosure Requirements (SDR), superseding TCFD. Japan will likely use as a basis but add to. Australia and Canada have been consulting on ISSB. Recent G7 climate ministers stated its "support for jurisdictions' consideration of the ISSB standards".*

US: SEC's proposed climate disclosure requirements



High-level overview

- Largely following TCFD, proposed regulations (March 2022) require listed companies to disclose
 1. **risks** that are reasonably likely to have **material impact on their business**, results of operations, and
 2. **Scope 1 and 2** GHG emissions and, if material, **Scope 3** emissions
- Disclosure includes
 - a) board and management **governance** over climate issues,
 - b) how the company's **strategy** will accommodate and incorporate these issues,
 - c) how the company **quantifies, prioritizes and mitigates climate-related physical and transition** risks, and
 - d) what **metrics and targets** the company uses and how it is progressing towards those targets
- Subject to final regulations, these rules will be effective fiscal year 2023 for disclosure in 2024 annual reports



Points to note

- All disclosures are subject to company's determination of which climate issues and risks are materials
- SEC acknowledges that disclosure of **Scope 3 emissions are much more difficult** to quantify and **provides both more time to comply and allows for a materiality standard** to determine what must be disclosed; SEC Chair indicated in March 2023 that Scope 3 disclosure could be scaled back
- Regulations are focused on risk management, though acknowledge **opportunities, again if material, may be disclosed**
- If climate commitment has been made, must provide **extensive disclosure on how the company plans to meet** (and progress towards) that target



WTW Commentary

- The proposal would expand Regulation S-K requirements for domestic and foreign private issuers to include climate-related disclosures in annual reports

Canada: CSA's proposed climate disclosure requirements



High-level overview

- Following TCFD recommendations, proposed rules (October 2021) require listed companies to disclose
 1. **risks** that are reasonably likely to have **material impact on their business**, results of operations, and
 2. **scope 1, 2 and 3 GHG emissions** (though exploring alternative approach where only Scope 1 is mandatory)
- Disclosure includes
 - a) board and management **governance** over climate issues,
 - b) how the company's **strategy** will accommodate and incorporate these issues,
 - c) how the company **identifies, assesses and manages climate-related risks** as part of overall enterprise risk management, and
 - d) what **metrics and targets** the company uses to assess and manage these risks and opportunities, where material
- Phased implementation likely in 2024



Points to note

- CSA announced in October 2022 that it was reviewing the ISSB and SEC proposals and how they may impact or further inform the Canadian Climate Disclosure Proposals
 - **Certain features** of the ISSB framework, such as **scenario analysis and the disclosure of Scope 3 GHG emissions, are expected to be optional** on implemented on a phased-in approach under the CSA's requirements
- CSA acknowledges that the rule would need to serve the needs Canadian capital markets while considering international consensus



WTW Commentary

- While the CSA is expected to adopt a **more lenient interpretation of the ISSB framework**, there will be a **net increase in the responsibilities of board members and management** of Canadian issuers to govern climate risks and opportunities

Transition Plan Taskforce (TPT)



High-level overview



Points to note

- Set up to develop a 'gold standard' **disclosure framework for transition plans** (see below)
- Final recommendations expected in Autumn 2023, which directly relate to and **build on ISSB standards** and are expected to be adopted by UK regulators to inform UK listing rules

Principles	Ambition	Action		Accountability	
Planning process	Key stages of transition planning				
Disclosure elements	1. Foundation	2. Implementation strategy	3. Engagement strategy	4. Metrics & Targets	5. Governance
Disclosure sub-elements	1.1 Objectives and priorities	2.1 Business planning and operations	3.1 Engagement with value chain	4.1 Governance business and operational metrics and targets	5.1 Board oversight and reporting
	1.2 Business model implications	2.2 Products and services	3.2 Engagement with industry	4.2 Financial metrics and targets	5.2 Roles, responsibility and accountability
		2.3 Policies and conditions	3.3 Engagement with government, public sector and civil society	4.3 GHG emissions metrics and targets	5.3 Culture
		2.4 Financial planning		4.4 Carbon credits	5.4 Incentives and remuneration
		2.5 Sensitivity analysis			5.5 Skills, competencies and training

- Advocates a '**strategic and rounded**' approach to transition planning, including plans for decarbonization but also responding to risks and opportunities of the transition planning
- This includes an entity's **plans for decarbonization** but also **responding to climate-related financial risks and opportunities** of the transition, and **how it will contribute to economy-wide transition**. This is key for addressing potential unintended consequences of an exclusive focus on net zero targets, such as the "paper decarbonization"
- TPT-aligned transition plans will be a significant step towards satisfying investor and other stakeholder needs to see a credible, strategic plan of how a company will meet their climate objectives and, critically, contribute to the reduction of global emissions and systemic risk



WTW Commentary

- Reinforces **governance as a key element of credible climate transition plans**, including board oversight, roles and accountability, culture, incentives and skills and training
- It is important to use reporting requirements as a **strategic tool to drive stakeholder engagement and cross-company strategy development and planning** - moving away from a compliance mindset

The TPT was set up by the UK Government Treasury, announced at COP26, to make recommendations on 'gold standard' transition plans framework. It is co-chaired by Amanda Blanc, CEO of Aviva and Baroness Penn, UK Treasury Lords Minister, and consists of representatives from private and financial sector, investors, voting agencies, NGOs, public sector and regulators, among others. The TPT works closely with ISSB and other international bodies.

Executive incentive plan market practice

Key themes: Executive incentive plan market practice

Prevalence of environmental metrics

Environmental metrics broadly

- Globally, 39% of companies have adopted environmental (“E”) metrics
- Sixty-two percent (62%) of UK and 66% of European companies adopt “E” metrics in their incentive plans
- This is still a minority practice in North America with 25% in the US and 38% in Canada adopting these metrics
- In Asia Pacific, Australia and Japan are the leaders in the region, with 47% and 29%, respectively, adopting “E” metrics
- Companies still tend to incorporate “E” metrics in short-term incentive plans over long-term incentive plans

GHG emissions specifically

- Among these companies, we observe a strong uptick in US companies adopting GHG/carbon emissions metrics at 46% (up from 35% from prior year)
- European and UK companies continue to lead in this area at 67% and 63%, respectively
- More than half of Australian and Japanese countries adopt GHG/carbon emission metrics at 53% and 52%, respectively, with rest of APAC trailing in this area

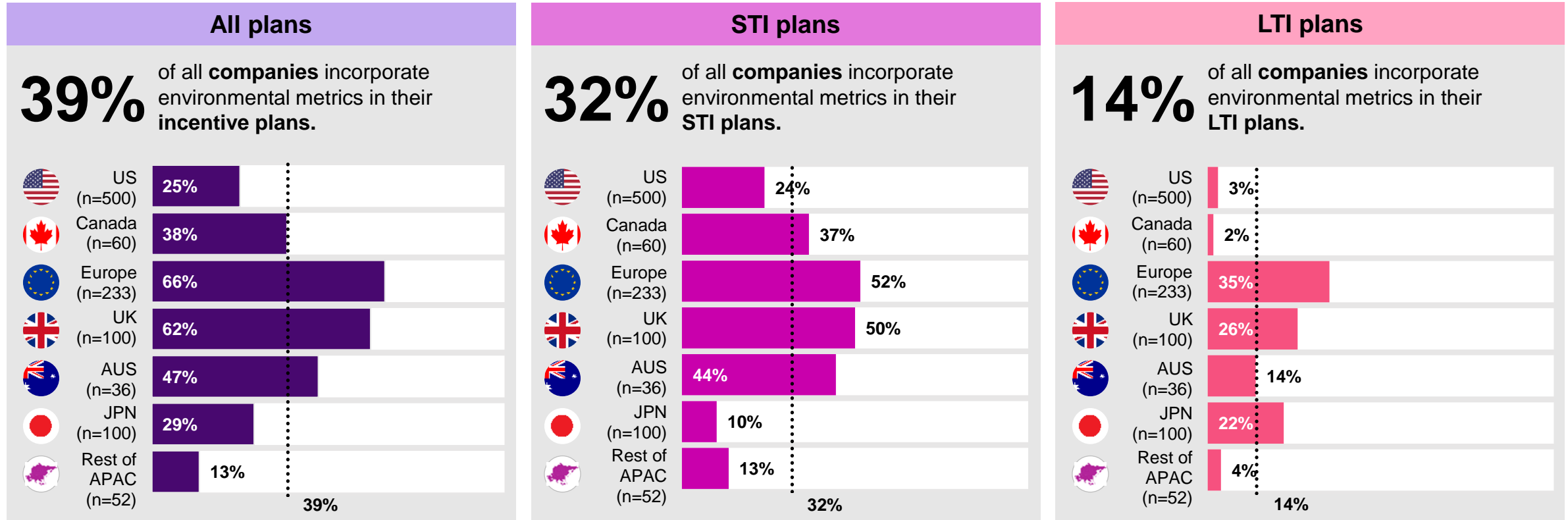
More emphasis on quantitative assessment

How metrics are assessed

- Forty-seven percent (47%) of North American, UK and European companies, assess at least one of the “E” metrics quantitatively
- Where “E” metrics are incorporated into long-term incentive plans, 69% of these companies assess at least one of these metrics quantitatively
- In contrast, only 37% of these companies assess at least one of these metrics quantitatively in short-term incentive plans
- More European and UK companies assess “E” metrics quantitatively than US and Canadian companies
- Among APAC companies, only 34% of companies assess ESG metrics quantitatively, of which only 28% have environmental metrics

See WTW’s research from January 2023 for broader discussion of ESG metrics in incentive plans globally ([link here](#))

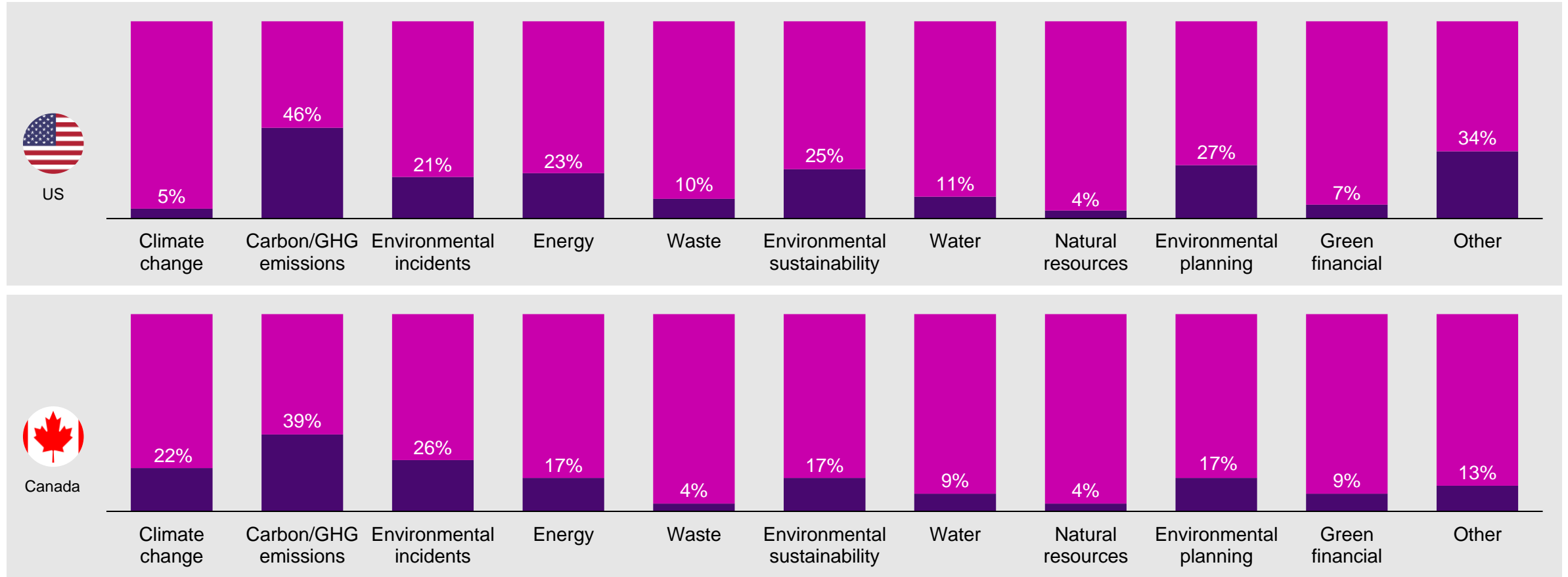
Prevalence of environmental metrics globally



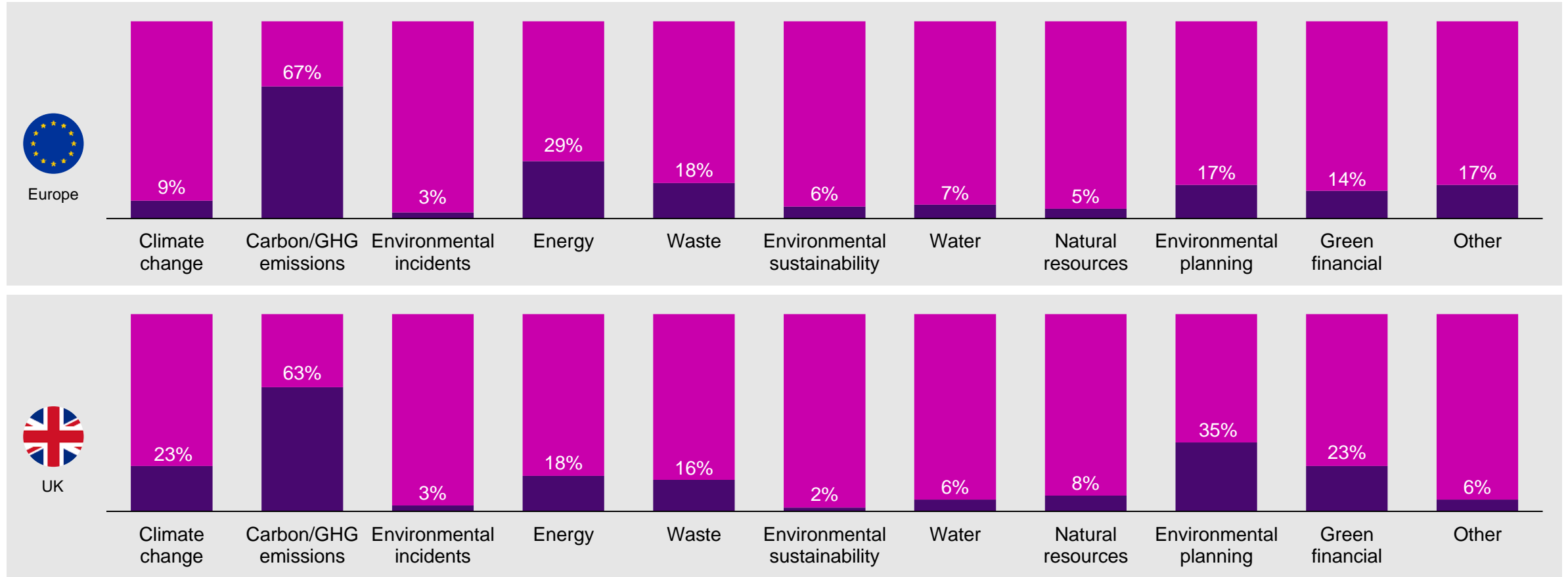
- ESG metrics are incorporated into incentive systems in diverse ways, including weighted KPIs, bundles, underpins or modifiers
- US is based on companies in the S&P 500; Europe is based on companies in the following indices: IBEX 35 (Spain), BEL 20 (Belgium), DAX 30 (Germany), AEX 25 (Netherlands), CAC 40 (France), SMI 20 (Switzerland), ISEQ 20 (Ireland) and MIB 40 (Italy). Canada is based on companies in the TSX 60
- All analyses are based on FYE between June 2021 – May 2022 (except where latest proxies have not yet been published)

n = number of companies.

Prevalence of environmental subcategories (in % of companies with environmental metrics)

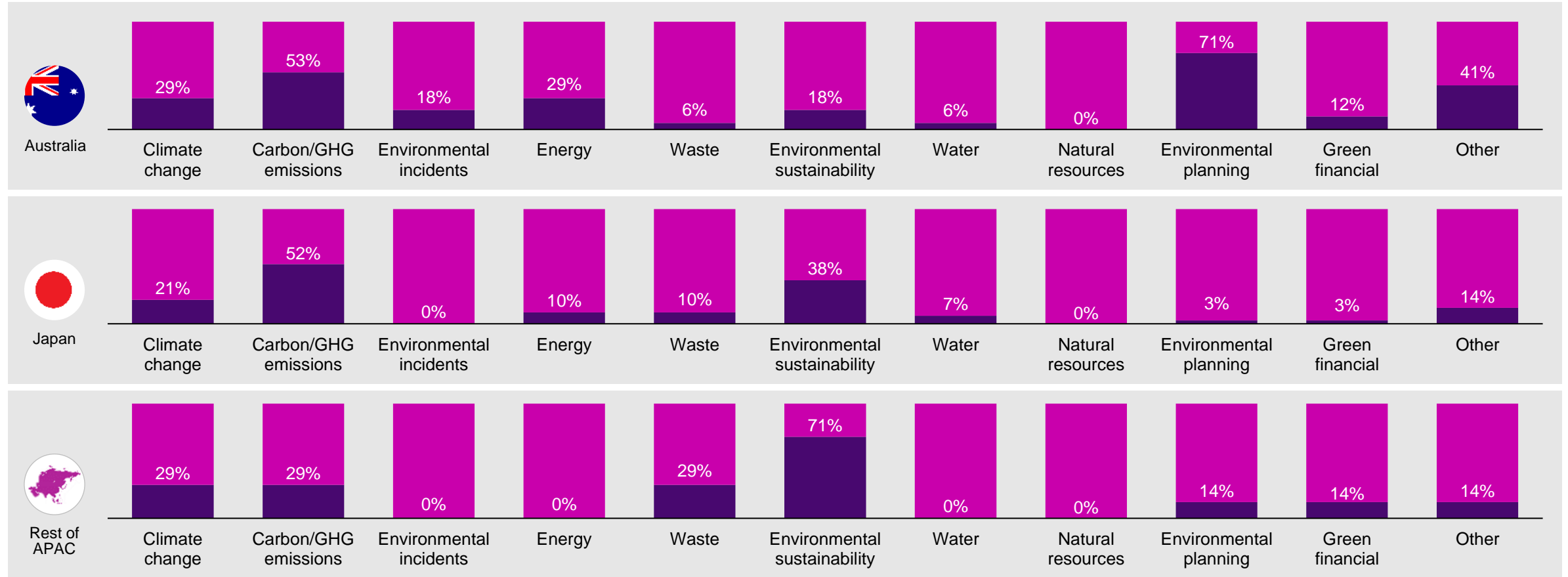


Prevalence of environmental subcategories (in % of companies with environmental metrics)



Prevalence of ESG metrics in executive incentive plans

Prevalence of environmental subcategories (in % of companies with environmental metrics)



n = Number of companies using environmental metrics in their incentive plans

Looking forward — executive compensation and climate governance

Guiding principles for climate-related metrics

Despite evolving regulatory and investor landscape, we maintain that the following principles should be considered when selecting metrics and setting targets on executive incentive plans

Materiality	<ul style="list-style-type: none"> • Select metrics that are material to the business - those that contribute to long-term value creation and systemic risk mitigation, and that are central to the climate strategy and transition plan • They must also be material to the individual participants in order to be effective in incentivizing behavior/action
Measurability	<ul style="list-style-type: none"> • Use metrics that can be reliably measured, quantified and scaled; potentially also allowing for independent audit of performance achievement • This also allows for comparison across peers and industries, and to track meaningful progress over time
Breadth	<ul style="list-style-type: none"> • Take a strategic and rounded approach to climate performance and measurement - beyond simply capturing carbon emission - aligning to company's transition strategy and in support of the economy-wide transition • This could be measures tied to industrial or commercial milestones, investment or innovation goals to support climate solutions or engagement measures to steward counterparties with their transition
Comparability	<ul style="list-style-type: none"> • Where possible and relevant to do so, metrics should be defined using standard or widely adopted methodologies (e.g., definitions validated by third parties for greater comparability), these might be industry specific • Climate metrics that are captured in ratings and indices published by reputable organizations are a good starting point
Clarity	<ul style="list-style-type: none"> • Important to provide clarity, transparency and consistency – with prospective disclosure of targets • Seek independent verification/review for measurement • Increasing convergence around core set of Scopes 1, 2 and 3 indicators, as mandatory reporting gains support (e.g., IFRS Foundation mandating sustainability reporting - ISSB) and leading actors collaborate to develop a common set of metrics

Step-by-step guide to embedding climate in executive compensation

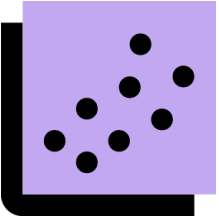


Examples of different design approaches to incentive practice



Material weighting (20% and above) of emissions reduction metric in long-term incentive plan with clear linkage to company's long-term ambition

Example: Total Energies - 15% weight on Scope 1 and 2 emissions metrics and 15% on Scope 3 in Europe; for a total weighting of 30%



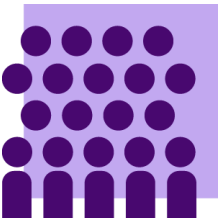
Use of both short- and long-term incentive plans to address specific areas of climate transition plan including interim milestones that support overall long-term ambition

Example: Standard Chartered - 4% weighting in STI tied to progress against net zero by 2050, and 15% weighting in LTI tied to (a) sustainable financial revenues, (b) contribution to advancement of sustainable ecosystem and (c) implementing roadmap to achieve net zero by 2050



Balance of climate metric with related ESG objectives that are material to the company's strategy

Example: Unilever - using a "Sustainability Progress Index" weighted 25% of the LTI, used to assess the company's progress against its sustainability program (ESG-wide scorecard approach)



Extending climate incentives to broader employee population to engage workforce and drive behavior against common goals

Example: Mastercard - extending ESG and climate metrics to annual corporate scorecard, which factors into all employees' bonus calculations globally

What's to come in executive incentives in 2023 and beyond

Developments will vary by region while common themes will emerge



We expect focus of companies across Europe will be on **refining the metrics** and their strategic alignment and materiality as climate transition plans are developed, as well as **calibration and independent verification** of goals relative to their progress to date.



As US and Canadian companies **grapple with the disclosure** of climate transition metrics and goals that are material to their business, more companies will **adopt climate metrics** in their incentive plans where they have a significant impact on the business's overall strategy.



Australian and Japanese companies will continue to **adopt climate metrics**, while other countries in APAC will confront broader regulatory challenges in **enhancing and standardizing climate-related disclosures**.



To address investor expectations that climate metrics be measurable and quantifiable, we expect to see **higher** prevalence of companies **using quantitative metrics** across regions, and **more robust disclosure of rationale in metric selection** and **progress** against targets. In some markets, we expect to see more focus on **aligning targets with emerging benchmarks** in response to calls for greater standardization and comparability.



While GHG emissions reduction continues to be an important metric, companies across the economy will likely adopt **a broader set of climate metrics with greater linkages to other ESG factors** to assess how effectively management is **transitioning the business to a low-carbon economy and managing the risks**. This will depend on a company's sector and impact on global emissions. Future regulation relating to **carbon trading schemes** may also have implications for carbon metrics in executive incentive plans.



Key actions for boards to consider for robust climate governance



Climate awareness, education and skills and access to expert advice. Ensure you are regularly informed



Ensure disclosures are meeting expectations, and include a transparent engagement and stewardship plan



Clear ownership of climate risk (physical, transition and liability) identification and evaluation in management



Engage with external communications to ensure they are accurate and not exposed to greenwashing claims



Ensure transition plan to 2050 is in place with transparent interim targets, assumptions and dependencies



Understand and be able to articulate how climate action plan aligns with fiduciary / director duties



Sub-committees to translate long-term strategy into clear decision-making processes relevant to each



Align executive compensation with the key objectives of the climate strategy and transition plan