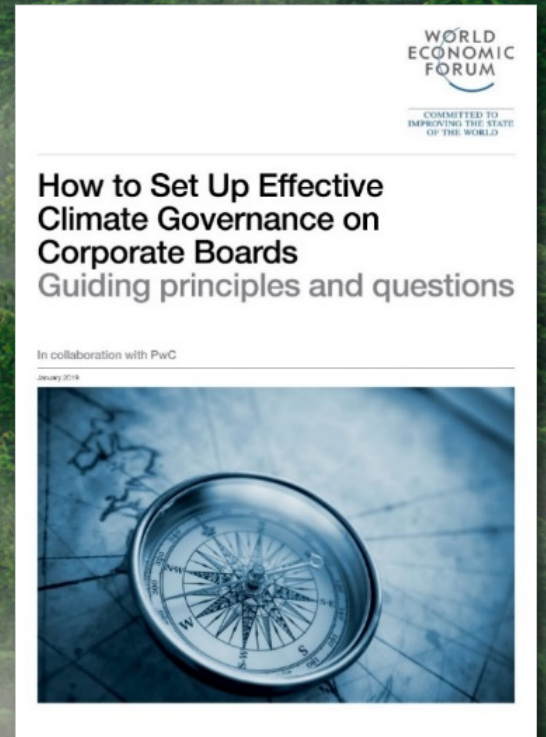


# Executive Compensation Guidebook for Climate Transition

In collaboration with World Economic Forum's  
Principles for Effective Climate Governance



# Supporting chapters

Australian  
Institute of  
**Company  
Directors**



Business, investor and  
regulatory context

Best practices in driving climate  
objectives with executive compensation

Market insights: Climate metrics in  
executive incentive plans

Industry deep-dives



# About this guidebook

As organizations acknowledge the need to transition to a net zero business model, investors expect board members not only to drive the adoption of a credible climate transition strategy, but also to provide clear evidence that its execution has been embedded effectively across all key management processes, including enterprise risk management, strategic planning, innovation, capital investment and human capital.

One critical lever is for management to be held accountable for the delivery of the strategy and, where appropriate, the capturing of opportunities in climate transition.

Willis Towers Watson, partnering with the Climate Governance Initiative, has developed this guidebook to explore how to drive the climate strategy by meaningfully embedding it within executive compensation frameworks. Our work is informed by findings of surveys and interviews with investors and board members from organizations across the globe.

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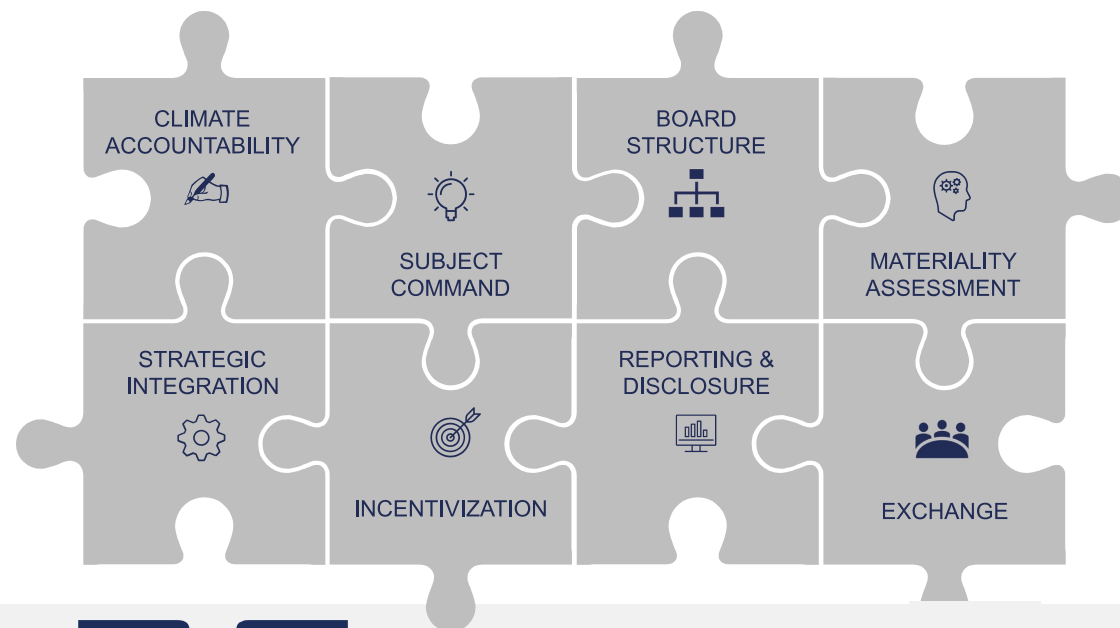
This guidebook is set up as an interactive PDF. Each of the sections may be accessed by clicking on the links below. For example, to jump to our views on “effective executive compensation design,” simply click on the banner at the bottom of the page.

Deep dives on select industries can be accessed at the end of “Market insights” section. Simply click on the industry on page **29**, and this will take you to industry-specific observations on how the industry relates to climate change at a high level, where companies within the industry are in terms of incorporating climate into their executive incentive frameworks, common challenges, as well as leading-company examples.

# The World Economic Forum Principles for Effective Climate Governance

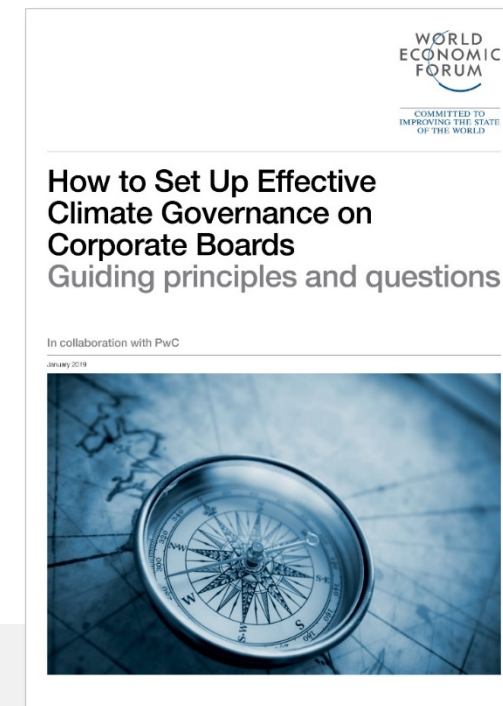
In 2019, the World Economic Forum unveiled the Principles for Effective Climate Governance for non-executive board directors.

These principles set out how well-governed boards should incorporate a climate lens into all relevant aspects of their oversight functions. Of the eight principles, Principle 6 focuses on incentivization.<sup>1</sup> Within this area, executive compensation is identified as one of the key mechanisms that drive the right behaviors and enable the company to deliver on its climate transition strategy.



## Principle 6 – Incentivization

The board should ensure that executive incentives are aligned to promote the long-term prosperity of the company. The board may want to consider including climate-related targets and indicators in their executive incentive schemes, where appropriate. In markets where it is commonplace to extend variable incentives to non-executive directors, a similar approach can be considered.



# Executive summary

Through interviews with board members around the world, review of public disclosures from more than 800 companies and Willis Towers Watson's expertise in executive compensation design, we document our observations on the best practices in how executive compensation can be a powerful tool in driving climate transition and climate risk mitigation.

The merits of linking executive compensation and climate objectives are well established. Emissions reduction and renewable energy adoption are increasingly prevalent metrics in executive incentive plans, especially in Europe and in high-emitting industries such as oil and gas.

There remains much for the business community to learn about the implications of a transition to net zero. Setting consistent and reliable goals and milestones will be challenging. But companies must resist the tendency toward inaction, as climate is widely considered the single-most significant risk to the planet, businesses and the stability of the global financial system.

## Do's

- Continuously monitor and evolve measurement of climate goals
- Consider company-specific climate transition strategy and metrics
- Measure short-, medium- and long-term progress towards net zero
- Select metrics and goals that are science-based, clear, ambitious, transparent and consistent
- Tell the story of how executive compensation drives climate transition with robust disclosures

## Don'ts

- Add climate metrics to incentive plans as a "check-the-box" exercise
- Blindly follow market practices and what "leading companies" do
- Set annual goals with no tie-in to the overall net zero vision
- Use judgment-based or ambiguous climate metrics or goals
- Manage annual reports, executive compensation disclosures and ESG/climate reporting in silos



# Business, investor and regulatory context

**Business, investor and regulatory context**

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# The stark reality and business imperative to act

Drawing on the findings of more than 14,000 scientific studies, the Sixth Assessment report<sup>2</sup> from the Intergovernmental Panel on Climate Change (IPCC) warned that unless the world sees a drastic reduction in greenhouse gas (GHG) emissions well beyond the targets already adopted worldwide, average global temperature are expected to surpass the 1.5°C threshold within the next 20 years, causing extreme and irreversible damage to people and the planet.

The IPCC report has sharply raised the pressure on nations to make far more ambitious commitments on climate transition in advance of the UN Climate Change meeting held in November 2021, COP26.

As signatories (now over 190) of the Paris Agreement lay out plans to achieve net zero by 2050 or earlier, attention has also turned to the private sector. As of March 2021, more than one-fifth of the world's largest companies had committed to a net-zero target<sup>3</sup> – a figure that is expected to rise.

Left unchecked, climate change poses the single-greatest risk to global systemic financial stability. Climate risk affects different companies in different ways: Heavy emitters (businesses that either produce or consume large amount of fossil fuels) face the challenge of completely reshaping their business models; and companies with physical assets in areas prone to extreme weather events must identify strategies to mitigate risk and increase resilience. But there are also aspects of climate risk that are systemic and from which no company is immune. In particular, there are different levels of risk associated with different types of transition – from the relatively smooth to the very disorderly transition which will result from inadequate action in the near term.

Climate transition and the new economy, however, also present opportunities for many businesses to innovate and offer zero-carbon alternatives to conventional high-carbon products, thus potentially displacing incumbents with disruptive business models. Consumers are increasingly deciding where they buy, and employees are deciding where they work based on companies' commitments to climate transition. Forward-thinking businesses see these pressure points as opportunities to gain a competitive edge.

# Regulatory actions and net zero plans by geography

While actions vary by region, the direction of travel is clear

## North America

In June 2021, Canada enacted the Canadian Net-Zero Emissions Accountability Act, which lays out a clear path to net zero by 2050.<sup>4</sup> The U.S. president released an executive order to set an interim carbon reduction goal by 2030.<sup>5</sup> Some states have enacted net zero plans by 2050. The House and Senate each passed major legislation on clean energy innovation between 2020 and 2021, pending reconciliation.

## Western Europe and the United Kingdom

The EU has committed to net zero by 2050, with some member states setting earlier targets. The European Parliament reached a provisional agreement on the Climate Law Regulation in April 2021.<sup>7</sup> In the same month, the U.K. set an ambitious carbon reduction goal<sup>8</sup> and continues to be a global leader in climate transition.

## Middle East and Africa

Progress varies. While a number of countries in the region have not ratified the Paris Agreement, some (e.g., Nigeria, Morocco and South Africa) have taken bold actions toward net zero through a carbon tax and significant renewable energy investments,<sup>9</sup> and Saudi Arabia has pledged to reach net zero by 2060.<sup>10</sup>

## Latin America and the Caribbean

All countries have rectified the Paris Agreement, and most have submitted their Nationally Determined Contributions (NDC), their post-2020 climate action plans. Some countries in the region, such as Chile, were among the first countries to submit NDCs.<sup>6</sup>

## Asia Pacific

Progress varies given the mix of developed and developing economies. Most countries have submitted plans toward net zero by 2050 (China, Singapore and Australia in the second half of the century). Some countries have also instituted a carbon tax and invested in renewable energy.



# TCFD's recommendations encourage companies to disclose how metrics and targets are tied to remuneration

The Task Force on Climate-related Financial Disclosures (TCFD) set out a foundational framework for corporate disclosure consisting of governance, strategy, risk management, and targets and metrics.

In particular, TCFD calls on organizations to disclose the metrics they use to assess climate-related risks and opportunities, as well as their performance against such metrics. Recommended disclosures also include scope 1 (direct), 2 (purchased energy) and 3 (suppliers and customers) GHG emissions, as well as how climate risk is embedded in the organization's enterprise risk management process.

Well-measured and disclosed climate metrics and targets are critical to driving climate transition with incentivization and remuneration. Broader adoption of TCFD's recommendations will support this cause.

## TCFD's core elements of recommended climate-related financial disclosures

Governance	Strategy	Risk management	Metrics and targets
Disclose the organization's governance around climate-related risks and opportunities	Disclose the actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning where such information is material	Disclose how the organization identifies, assesses, and manages climate-related risks	Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material

# Investors' perspectives

The investor community sees climate transition as an investment risk and an opportunity. Institutional investors want to ensure that the companies they invest in have viable business models in a low-carbon economy, so that their long-term investments create sustainable value and greater risk-adjusted investment returns.

Institutional investors are also attracted by the apparent “sustainability premium” on ESG assets. Global ESG assets exceed \$40 trillion in 2020 and are expected to rise above \$50 trillion in 2021.<sup>11</sup>

Some investors believe that because ESG and climate commitments ultimately drive long-term value creation, conventional financial and total shareholder return measures might be sufficient to drive the desired attention from management. They believe that there might not be a need for an alignment to incentives.

However, most institutional investors consider incentive compensation to be a powerful tool in accelerating an organization's climate transition. By elevating the importance of the topic in the board room and by holding executives accountable for the company's long-term climate transition targets, investors are pushing to see disclosure of meaningful climate-related targets and how they are incorporated into incentive plans.



**We strongly question the notion that ‘climate strategy is baked into our remuneration plan’ if we do not see disclosure of meaningful targets.”**



**If disclosures are not forthcoming, or if targets are not meaningful enough, then investors will be on it, and may vote against Executive Pay resolutions, or even re-election of Remuneration Committee members.”**



**If you have a 2030 or 2050 plan [on emissions reduction] and it's meaningful for the company, then why shouldn't the plan be broken down into shorter-term targets and anchored into the incentive remuneration plans? Your CEO won't be here in 2050, but they can certainly shape the roadmap to get there.”**



# Investors' expectations on climate metrics

There is strong consensus among investors that companies should select climate metrics that are material to their businesses and that they should be measurable, transparent, and appropriately stretched when linked to executive incentives.

For greenhouse gas (GHG) targets to be meaningful in the context of the global climate crisis, savvy investors look for them to be set not according to a percentage reduction over prior years, but in alignment with the roadmap set by the 2015 Paris Agreement. There are various bodies that certify such approaches, including, most prominently, the Science-Based Targets Initiative (SBTi) which offers specific guidance on types, or scopes, of emissions, depending on the industry and the size of the company.

Beyond GHG emissions, investors also look for evidence of performance metrics tied to significant commercial or industrial milestones as contained in companies' climate transition strategies. These might include percentage of energy from renewable sources or shifting product mix from carbon-intensive to low-carbon or carbon-free alternatives. There is no one-size-fits-all approach, so each company should identify indicators that reflect the specific circumstances of its sector, geography and business model.

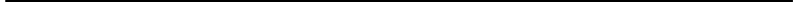
Investors also expect companies to demonstrate the appropriateness and extent of climate metrics through market-leading disclosure. They are cautious not to applaud companies just because they have included a climate metric and are skeptical when disclosure detail is lacking. As with the adoption of any non-financial metric, disclosures should explain how the board and management evaluate the merits of climate metrics versus diluting the impact of financial and operational metrics, striking a balance between short-term financial returns and enabling strategic transformation aimed at delivering long-term sustainable value creation.



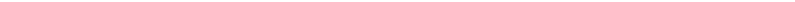
**“If a climate metric is used as an underpin, it must be sufficiently stretched to have any impact on a company’s climate transition plan. Should a bonus pay out at all if you are not achieving your net zero strategy?”**



**“What is long-term in the executive compensation world is short-term in the climate world. Companies should break down their transition strategy into milestones that are aligned with a typical period of a long-term incentive plan.”**



**“Executive compensation cannot be detached from recruitment and having the right leadership team in place. It is important to have the culture and leadership team to deliver the climate strategy.”**





**“We worry many focus on this area as tokenism rather than real change. We hope to make real change.”**



**“It is the board and the CEO that guide the direction. What has become apparent now is that climate needs to be embedded into strategy.”**



**“Most metrics for climate change are yet to be established other than waste/water/emissions. Time is required to ensure that whatever metrics are considered tie to the success of the business.”**

## Climate as an organizational priority

In feedback from 89 board members across 14 countries and multiple industries, we found that a substantial and growing number of global board members think climate change is a significant element of their companies’ overall ESG and strategic priorities.

Many organizations have begun to integrate climate change into their business strategies, but most acknowledge that they are still on a steep learning curve, with management only now developing the skills needed to formulate the right climate strategies. Climate disclosures, especially those relating to how executive pay is linked to an organization’s climate transition agenda, remain in their infancy. This is an area where investors are urging greater transparency.

Board members expect climate priorities and commitments to be cascaded to the broader employee population so that they become engrained in organizational culture, and they specifically look to incentives to help drive that cultural change. Although accountability starts from the top, our research indicates that some directors hold the people function responsible for driving change and ensuring that the entire organization is aligned to new priorities and commitments.

# Best practices in driving climate objectives with executive compensation

Business, investor and regulatory context

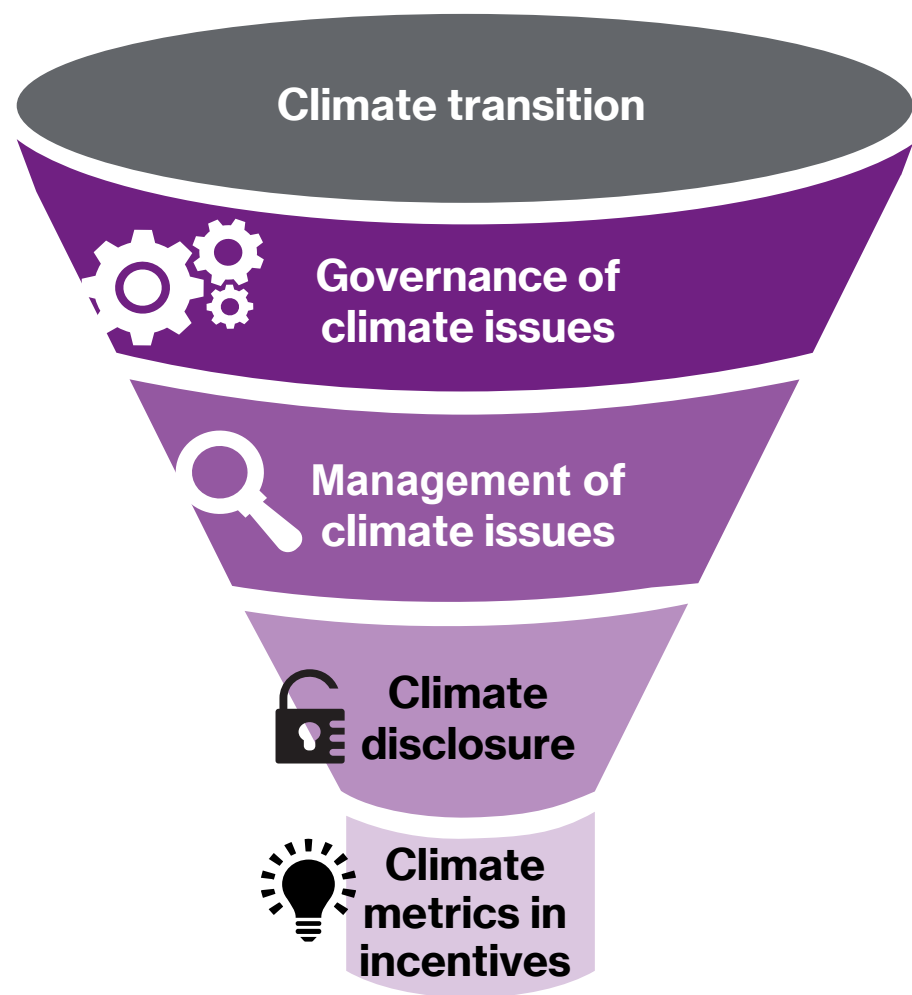
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# A funnel approach<sup>12</sup> to effective climate governance



**Governance of climate issues:** Boards are constantly challenged by the need to prioritize which climate topics are most important, where they should be addressed (i.e., which committee, or the full board), how often to address them and how to provide effective oversight. The range and depth of topics covered by the board should align with areas that pose the most significant risks and opportunities.

**Management of climate issues:** The funnel begins with the whole range of climate issues that the company is addressing; this will always be much broader than what can be summarized for the board. However, the board may direct management to expand, contract or reprioritize the range and depth of climate issues it is handling.

**Climate disclosure:** The next, narrower subset of climate matters is what the company discloses to investors and the public. It is important for management and the board to be in synch about what gets disclosed and how it gets communicated. The board should review and discuss the programs and achievements summarized in public statements.

**Climate factors in executive incentives:** These climate metrics must be consistently measured and tested by management, reviewed and vetted by the board, and shown to be material to the business. They must also be of value to investors and stakeholders. They play a critical role in driving cultural change and individual choices that will deliver the climate and corporate strategy.



## Guiding principles for effective executive compensation governance

These four Principles and Elements of Effective Executive Compensation Design<sup>13</sup> have been repeatedly validated through work with countless organizations and decades of research. This is an important framework when determining how climate metrics can be effectively incorporated into executive incentive plans.

### Purpose

Captures why an organization exists, its mission with constituents, strategy and objectives

### Alignment

Ensures that management acts in the best interest of shareholders and other stakeholders

### Accountability

Connects pay, organizational performance and individual actions

### Engagement

Motivates people, directs behavior, fosters attraction and retention and creates performance differentiation

# Step-by-step guide to driving net zero ambitions through executive pay





# Design spectrum<sup>14</sup> to incorporate climate metrics into executive compensation

	Incentive Design Description	Pros	Cons	
<p>Lower impact to organization, easier to implement</p> <p>Greater impact to organization, more disruptive</p>	<b>Underpin</b>	Include threshold or basic level of climate performance required for some or all of the payout under other metrics to occur – STI or LTI	<ul style="list-style-type: none"> <li>▪ Appropriate when a company is first introducing climate metrics</li> <li>▪ Threshold climate performance may not be meaningful or material</li> </ul>	
	<b>Individual performance rating modifier</b>	Include a climate modifier under the individual elements of the STI or LTI to modify the payout up/down by a certain percentage	<ul style="list-style-type: none"> <li>▪ Can be tailored to an individual’s role and improve line-of-sight</li> <li>▪ Individual performance assessment tends to be more qualitative and judgment-based</li> </ul>	
	<b>Company performance modifier</b>	Include a climate modifier to overall STI or LTI formula that modifies the payout up/down by a certain percentage for all participants	<ul style="list-style-type: none"> <li>▪ A low-risk approach to introducing a standalone, quantitative climate metric</li> <li>▪ Impact of payout modifier tends to be moderate, and may not highlight the importance of climate</li> </ul>	
	<b>Weighted metric in STI</b>	Include a quantitative climate metric (e.g., carbon emissions) into the STI payout formula	<ul style="list-style-type: none"> <li>▪ Provides a direct measure that reinforces importance of climate</li> <li>▪ Easily communicated</li> </ul>	<ul style="list-style-type: none"> <li>▪ Focus only on annual performance and progress</li> </ul>
	<b>Weighted metric in LTI</b>	Include a quantitative climate metric (e.g., carbon emissions) into the LTI payout formula	<ul style="list-style-type: none"> <li>▪ Appropriate for metrics that need longer time horizons to produce measurable results like Climate</li> </ul>	<ul style="list-style-type: none"> <li>▪ Without frequent interim milestones, participants may lose sight of the path to the long-term goals</li> </ul>
	<b>Incentive funding formula</b>	Incentive pool derived from financial measure adjusted for carbon charge (e.g., carbon cost added to cost of capital in economic profit calculation)	<ul style="list-style-type: none"> <li>▪ Directly links climate objectives with financial performance for the entire organization</li> </ul>	<ul style="list-style-type: none"> <li>▪ Complex formula may be difficult to communicate to participants and investors</li> </ul>
	<b>Standalone incentive plan</b>	Introduce a separate climate incentive plan (e.g., hyper-long term aligned with sustainability strategy, or plan with timeless emissions goals)	<ul style="list-style-type: none"> <li>▪ Encourages participants to take a longer-term view of performance</li> </ul>	<ul style="list-style-type: none"> <li>▪ May be perceived by some as too “dilutive” of financial performance</li> </ul>

# Principles to consider when selecting the right climate metrics

<b>Materiality</b> ✓	<ul style="list-style-type: none"><li>▪ Select metrics that are material to the business; those that contribute to long-term value creation and risk mitigation, and are central to the climate strategy</li><li>▪ They must also be material to the individual participants in order to be effective in incentivizing behavior/action</li></ul>
<b>Measurability</b> ✓	<ul style="list-style-type: none"><li>▪ Use metrics that can be reliably measured, quantified and scaled; potentially also allowing for independent audit of performance achievement</li><li>▪ This also allows for comparison across peers and industries, and to track meaningful progress over time.</li></ul>
<b>Breadth</b> ✓	<ul style="list-style-type: none"><li>▪ Take a broader view of climate performance beyond simply capturing carbon emissions, aligning to company's net zero strategy, such as tying into industrial or commercial milestones</li></ul>
<b>Comparability</b> ✓	<ul style="list-style-type: none"><li>▪ Where possible, metrics should be defined using standard or widely adopted methodologies (e.g., definitions validated by third parties for greater comparability)</li><li>▪ Climate metrics that are captured in ratings and indices published by reputable organizations are a good starting point</li></ul>
<b>Clarity</b> ✓	<ul style="list-style-type: none"><li>▪ Important to provide clarity, transparency and consistency</li><li>▪ Seek independent verification for measurement</li><li>▪ Increasing convergence around core set of Scopes 1, 2 and 3 indicators, as mandatory reporting gains support (e.g., IFRS Foundation mandating sustainability reporting) and leading actors collaborate to develop a common set of metrics</li></ul>



## Measuring carbon emissions

Emissions reduction is by far the most common climate executive incentive metric, but operationalization can be very complex. For example, the Greenhouse Gas Protocol<sup>15</sup> classifies a company's GHG emissions under three scopes, with increasing levels of difficulty in terms of measurement.

**Scope 1:** Direct emissions from owned or controlled sources

**Scope 2:** Indirect emissions from generation of purchased energy

**Scope 3:** All indirect emissions, including company suppliers (upstream), customers and use of sold products (downstream)

As companies set net zero targets, all three scopes should be considered. This includes reducing indirect emissions by influencing or switching supply chain partners and changing the product mix to enable customers to reduce their own emissions. Focusing on all three scopes can yield a competitive advantage over rival products with a lower emissions profile.

On their path toward net zero, some companies also track emissions avoided through product and service enhancements that enable their customers to shrink their GHG footprint. Other tools include carbon offsets, a reduction in emissions achieved through a separate activity, such as forestation, that compensate for their own emissions. However, progressive companies set separate targets for direct and indirect emissions reductions (scopes 1, 2, 3) that exclude carbon offsets.

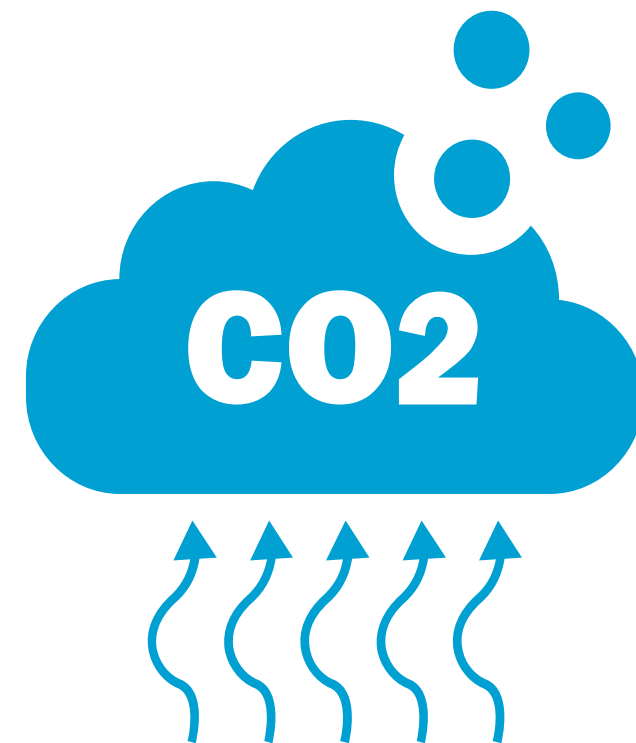
# Carbon emissions as an incentive metric

The most common way of measuring carbon emissions is in tons of carbon dioxide equivalent (tCO<sub>2</sub>e). This metric accounts for all kinds of GHGs through scopes 1 (direct), 2 (purchased energy), 3 (suppliers and customers) emissions, standardized to account for non-CO<sub>2</sub> greenhouse gases. These non-CO<sub>2</sub> GHGs, such as methane, nitrous oxide and other industrial gases, account for one-fifth of total carbon emissions (although this varies enormously by industry).<sup>16</sup>

Carbon emissions goals can be set by scope or at an overall level and may be measured as a percentage reduction or an absolute reduction but in all cases require a reference time period (e.g., reductions relative to the 2012 level). As more companies disclose their carbon emissions goals, benchmarking progress against industry peers may also become possible. However, in absence of a narrative that explains how a given reduction goal fits into a company's pathway to net zero, we expect such a goal to be scrutinized and challenged by investors and stakeholders.

While this is a very new area of activity, lessons are already emerging from companies that have set explicit climate goals in executive incentive plans. These include:

- Set emissions-reduction goals over a longer time horizon (three, five, seven and 10 years) in line with the company's position to deliver on its net zero target. Investors strongly prefer that companies set firm targets for 2050, rather than an "ambition" or "vision".
- Do not be deterred from setting meaningful targets in incentive plans (even before you can set accurate projections of emissions-reductions). Target setting accuracy should evolve over time; until then you can use alternatives such as the average of multi-year annual performance or allow for board discretion. In other words, uncertainty of achievement should not be the reason for not setting meaningful targets.



# Market-leading examples: Illustrating one size does not fit all

## Unilever<sup>17</sup>

Example of climate and broader environmental targets within a scorecard, with a material weight in the LTIP

Unilever committed to net zero emissions in its own operations by 2030 and from all products from sourcing to point of sale by 2039 (among other goals).

The company has a detailed scorecard weighted 25% of the LTIP called the Sustainability Progress Index, which the committee uses to assess the company's progress against the Unilever Sustainability Living Plan (USLP). This captures targets such as:

- Reduction of carbon dioxide emissions from energy from factories per ton of production vs 2008 baseline (%)
- Purchasing of crude palm oil from physically certified sustainability sources (%)
- Achievement of Leader/A ratings (number) – relating to DJSI, CDP Climate, CDP Water, CDP Forests, GlobeScan rating providers.

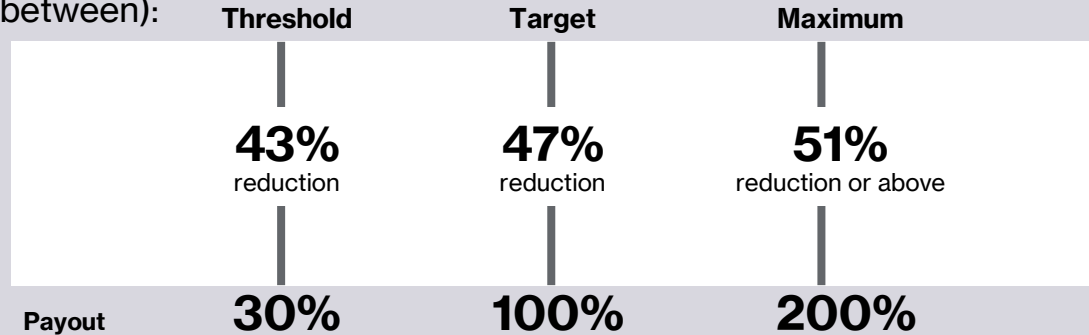
## Xcel energy<sup>18</sup>

Example of a clear and quantifiable emissions reduction metric with a material weight in the LTIP

Xcel Energy is a traditional and renewable energy provider in the U.S. that aims to reduce carbon emissions by 80% (from a 2005 baseline) in the next 10 years. It is the first U.S. utility to commit to 100% carbon-free electricity by 2050.

For several years, the company has had a metric weighted 30% of performance shares based on reduction in carbon dioxide emissions below 2005 levels associated with electric service.

2019-2021 performance is measured at the end of a three-year performance period as follows (straight-line interpolation in between):



Source: Company public disclosures on executive incentive design.

# Acknowledging the downsides

While most companies and investors support incorporating climate metrics in incentive plans, some argue that climate metrics impact many stakeholder groups differently and that companies risk oversimplifying their climate agendas by boiling it down to one or two executive incentive metrics.

There are also concerns about data quality and rigor in goal setting, especially when measuring more indirect climate data over which companies do not have complete control. Without rigor in climate goals, companies may risk being perceived as “greenwashing”.

Achievement of long-term climate goals often requires tradeoffs in short-term gains as businesses invest in transformation and innovation. Some worry that by emphasizing a purely longer-term view of executive compensation that focuses on climate transition they may underplay near-term rewards, which places them at the risk of losing (or failing to attract) the best executive talent.

In lieu of incorporating climate goals in incentive plans, some have proposed mechanisms such as share ownership guidelines, “career shares” (longer-term or post-retirement vesting of equity compensation), or post-retirement lock-up period to establish a stronger link between long-term organizational value and executives’ wealth beyond their tenure at an organization, recognizing that success of climate transition and how it translates into company value has a very long tail.

Importantly, these two approaches are not mutually exclusive. Given the climate emergency, our view is that if deployed effectively, they can be complementary in supporting and accelerating climate transition. Besides, well-designed incentive plans should align with a company’s short, medium and long-term business priorities; and when those goals are achieved then the incentive plans and metrics should be updated.

“

**Some investors lack understanding of how remuneration structures work. Incorporating climate metrics in something already misunderstood and complex can be counterproductive.”**



“

**Shouldn’t executives have climate targets as part of their core job descriptions? Why do they need to be paid more to achieve them?”**





## Anticipated challenges and looking ahead

As organizations learn more about the impact of climate change on their businesses and make strategic decisions about how to drive change, there will be more philosophical debates about how climate goals should be linked to executive remuneration, directly through incentive design or indirectly through longer-term wealth creation.

Some challenges are ubiquitous, such as climate knowledge ramp-up as well as measuring and tracking meaningful data on businesses' climate impact.

The IPCC's Sixth Assessment Report has uncovered more evidence that we need greater commitment for change to avoid an existential crisis. This may prompt a ramp-up in the pace at which highly emitting businesses phase out productive assets. Some businesses have even begun to acquire and decommission polluting assets as a way to compensate for their own emissions.<sup>19</sup>

As climate change risks are incorporated into enterprise risk management frameworks, there will be more interest in quantifying these risks (along with the entire portfolio of ESG risks). Financial performance and climate transition will become more interlinked for many businesses, resulting in new ways of designing creative incentive schemes that drive positive climate outcomes.

We may also begin to see more creative executive remuneration designs, such as:

1. Cash or equity instruments linked to carbon accounting
2. Tokenized compensation vehicles that allow for incentive systems measured across companies

Climate metrics have already begun to extend beyond executives, in particular where wholesale business model transformation requires the active involvement of all staff. Linking remuneration for the broader employee population to the achievement of organizational climate goals highlights the common vision and purpose of the company, driving cultural transformation across the whole of the business and combating climate change for a better tomorrow.



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## Views from boardrooms around the globe

Boards acknowledge that climate metrics and performance systems are not perfect as both they and management are still learning. That said, most recognize the importance of taking the first step, even if that means climate metrics and goals will continue to evolve over time, especially for industries where climate transition poses an existential challenge.

Scope 1 (direct operational) carbon emissions are the most dominant climate metric. However, in the next three years, the market expects greater strategic emphasis on measuring climate-related innovation and business transformation to support organizations' climate transitions and net zero plans. This will likely involve stronger focus and reduction targets for Scope 3 (suppliers, customers and sold products) emissions as well.

As the timeframe for climate transition extends well beyond executives' time in office, boards favor meaningful interim milestones in incentive plans to provide more certainty and stability even during executive team transitions. They consider a combination of short- and long-term climate goals essential.

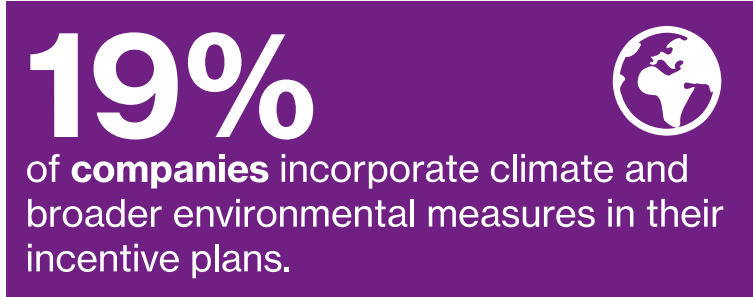
While third-party ratings and rating agencies' scorecards may appeal to some companies as a good way to measure ESG performance for executive incentives, investors caution that ESG ratings are too broad and not generally focused on the specifics of the company's climate transition roadmap.

“

**Metrics need to remain flexible. It will be a 'crooked road to perfection'. Put something in that is as meaningful as possible but acknowledge it will be imperfect. Don't wait. No one understands it fully. Make a calculated guess. It will likely not be right or enough but that's ok; it can evolve.”**

# Use of climate metrics in executive incentive plans by companies in S&P 500 and major indices in Europe

## All plans



U.S. (n = 317)

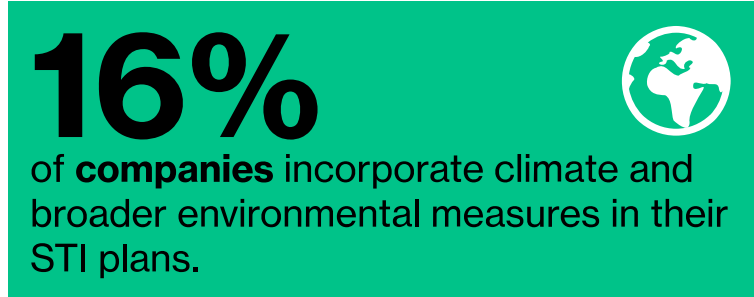


Europe (n=177)



**19%**

## STI plans



U.S. (n = 317)



Europe (n=177)



**16%**

## LTI plans



U.S. (n = 317)



Europe (n=177)



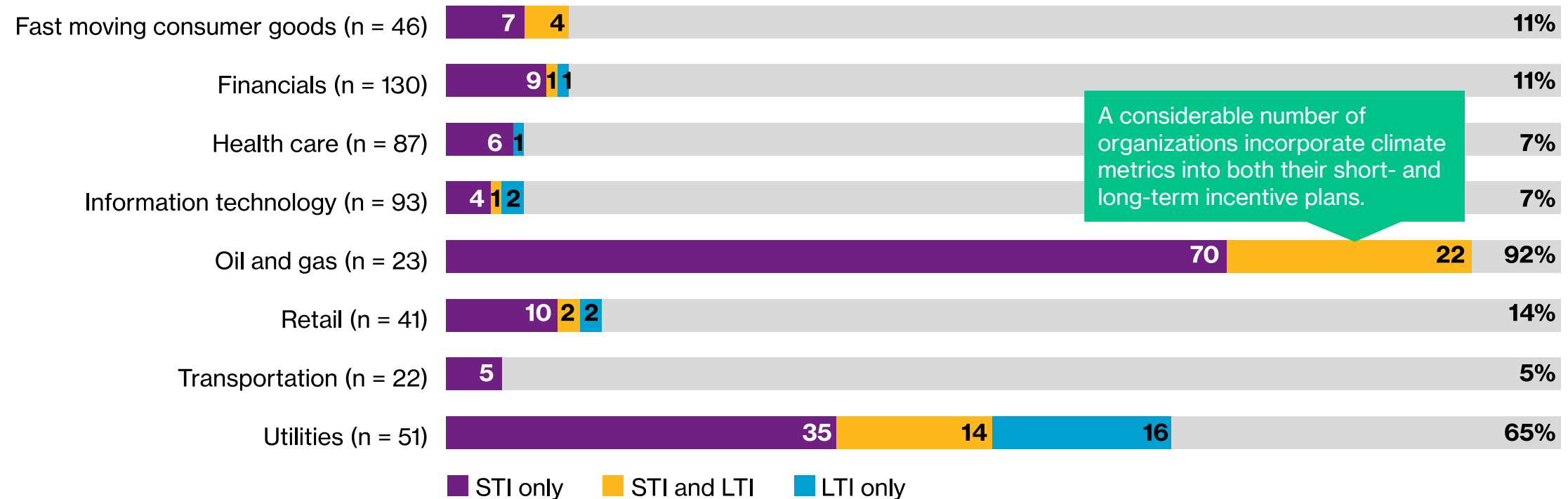
**6%**

- US is based on companies in the S&P 500; Europe is based on companies in the following indices: FTSE 100 (UK), 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)
- Including the following industries: Fast Moving Consumer Goods, Financials, Health Care, Information Technology, Oil & Gas, Retail, Transportation, Utilities
- All analyses are based on FYE between June 2020 – May 2021 (except where latest proxies have not yet been published)

n = number of companies

# Climate metrics are most often incorporated into executive incentive plans of high-carbon emitting industries such as energy and utilities

## All companies (percentage)

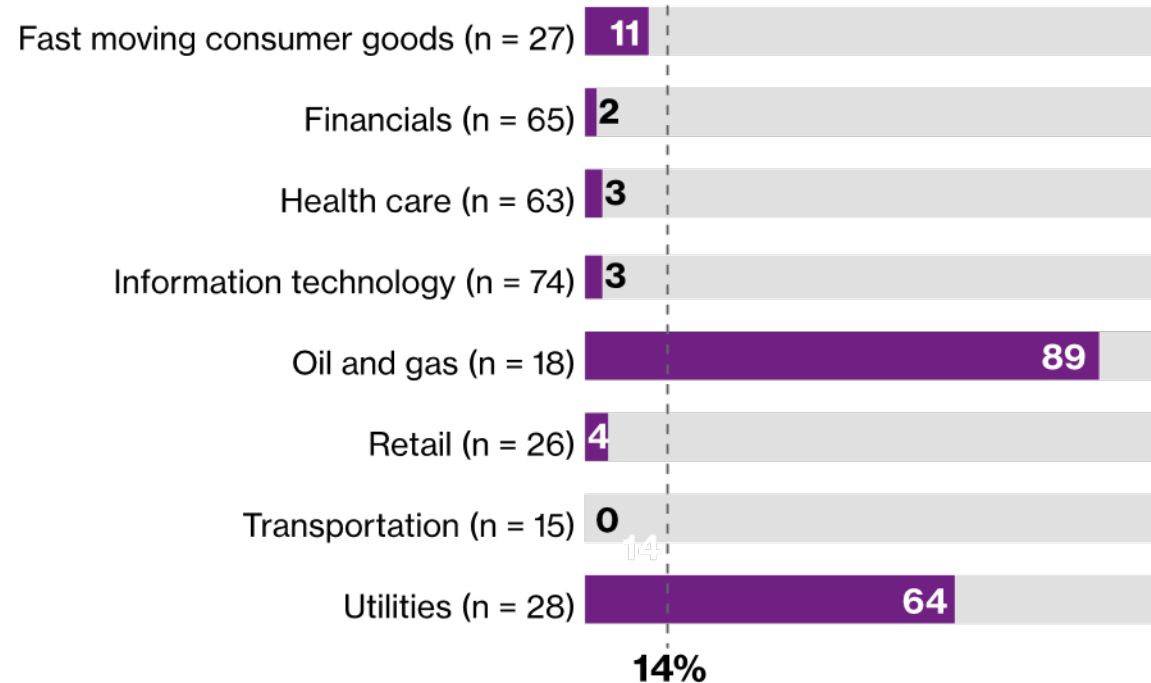


Prevalence for each category includes all companies in the US and Europe groups which include an environmental metric within either the STI or LTI plan, measured as a percentage of the applicable industry group.

Source: U.S. data based on companies in the S&P 500. For Europe and the U.K., companies from the following indices were referenced: FTSE 100 (UK), 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). All analyses are based on FYE between June 2020 – May 2021, subject to availability of disclosure.

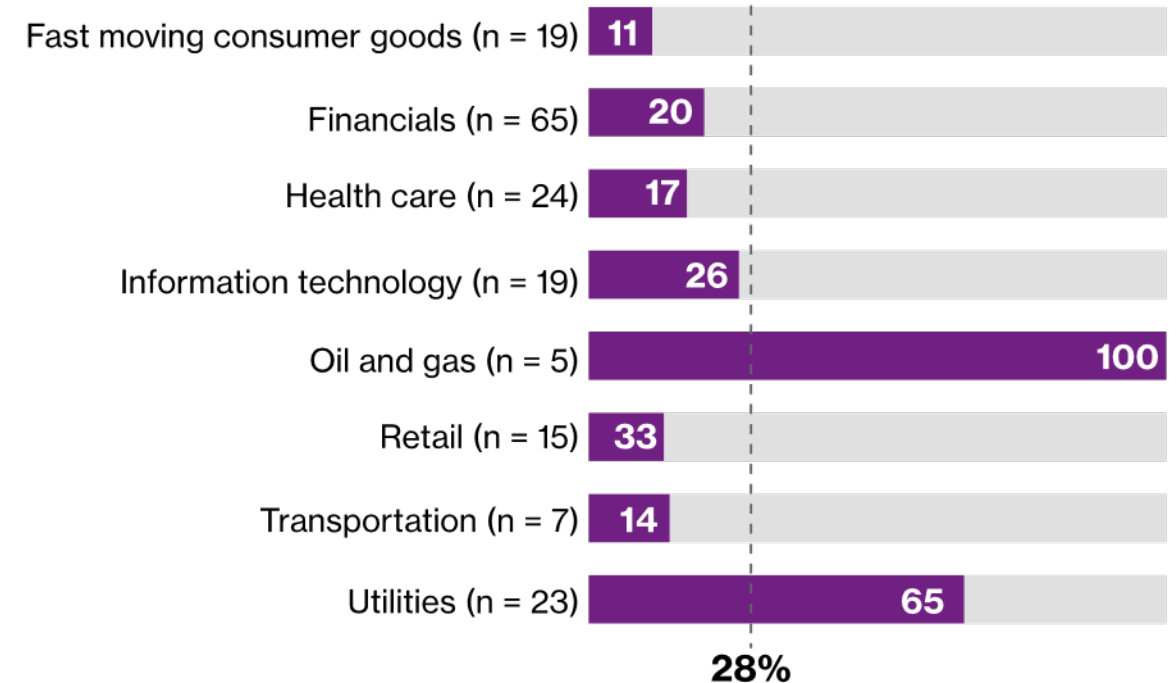
# Use of climate metrics in executive incentive plans is much more prevalent in Europe for most industries

## United States



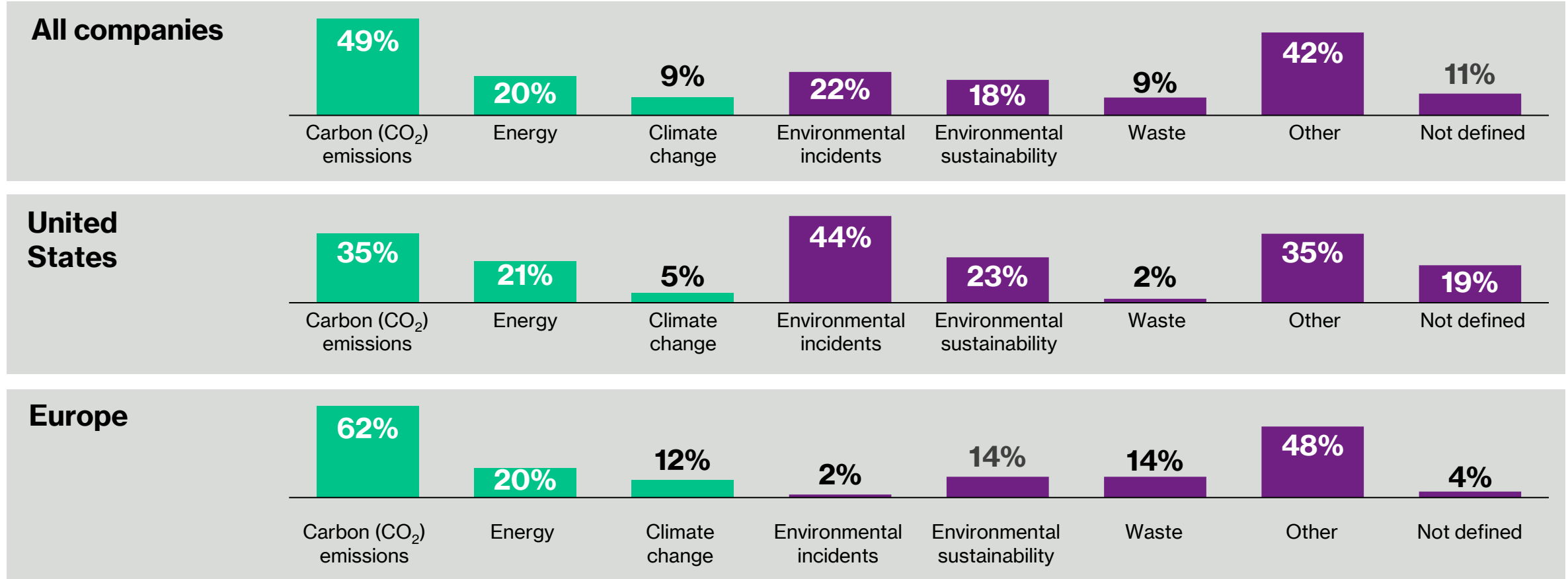
n = number of companies

## Europe



Source: U.S. data based on companies in the S&P 500. For Europe and the U.K., companies from the following indices were referenced: FTSE 100 (UK), 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). All analyses are based on FYE between June 2020 – May 2021, subject to availability of disclosure.

# Carbon emissions is by far the most widely used climate metric in executive incentive plans



Source: U.S. data based on companies in the S&P 500. For Europe and the U.K., companies from the following indices were referenced: FTSE 100 (UK), 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). All analyses are based on FYE between June 2020 – May 2021, subject to availability of disclosure.



# Industry deep-dives

Business, investor and regulatory context

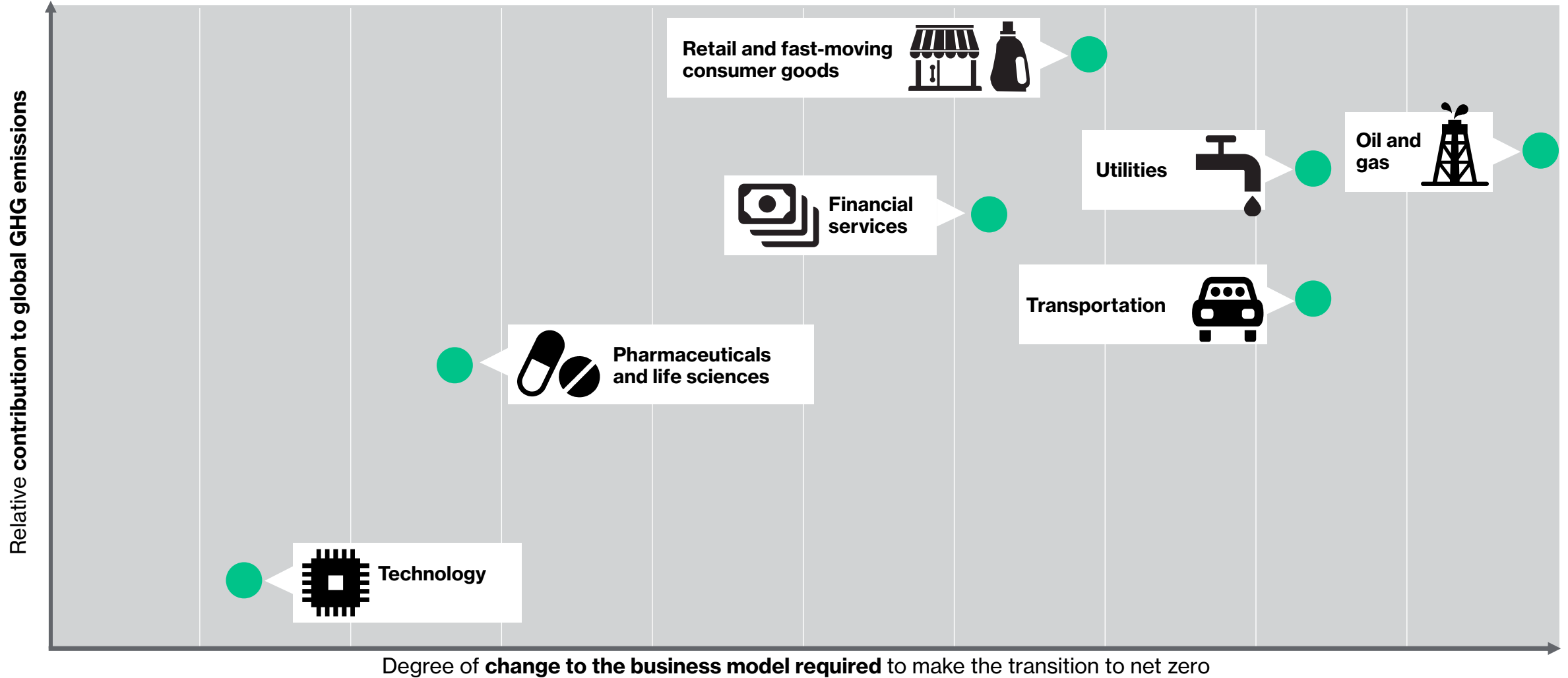
Best practices in driving climate objectives with executive compensation

Market insights: Climate metrics in executive incentive plans

**Industry deep-dives**

# The impact by industry varies notably, but all have a marked role to play

Click on the plus sign to see additional information.



Business, investor and regulatory context

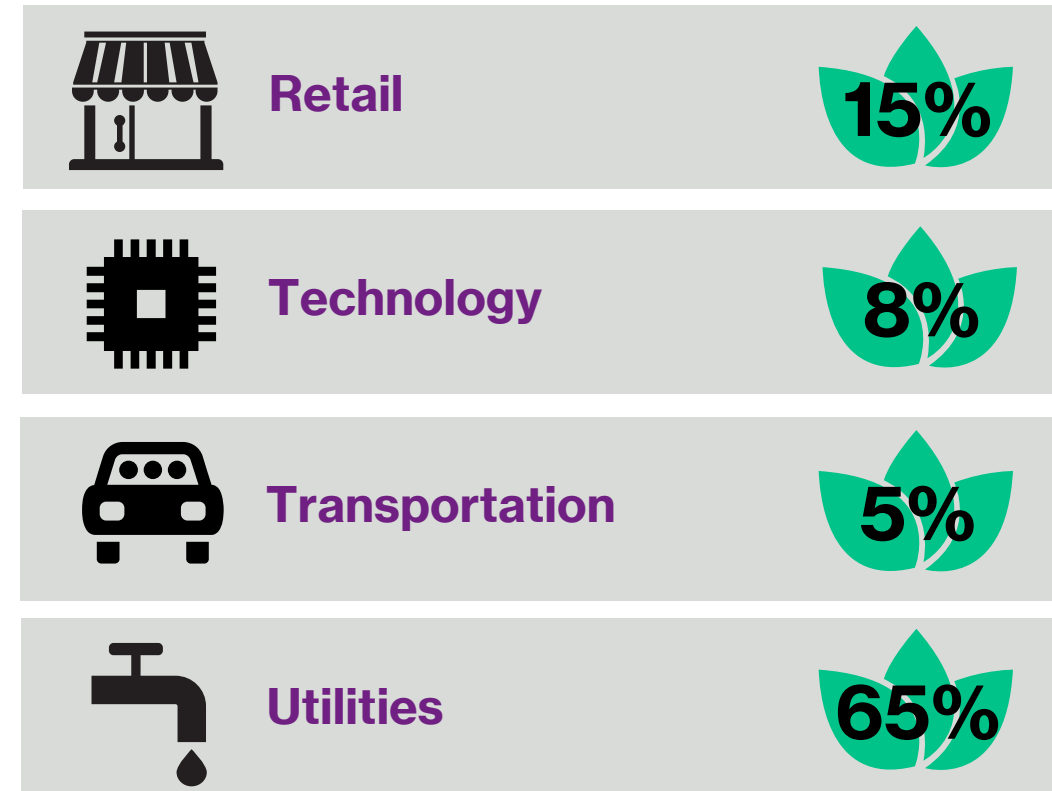
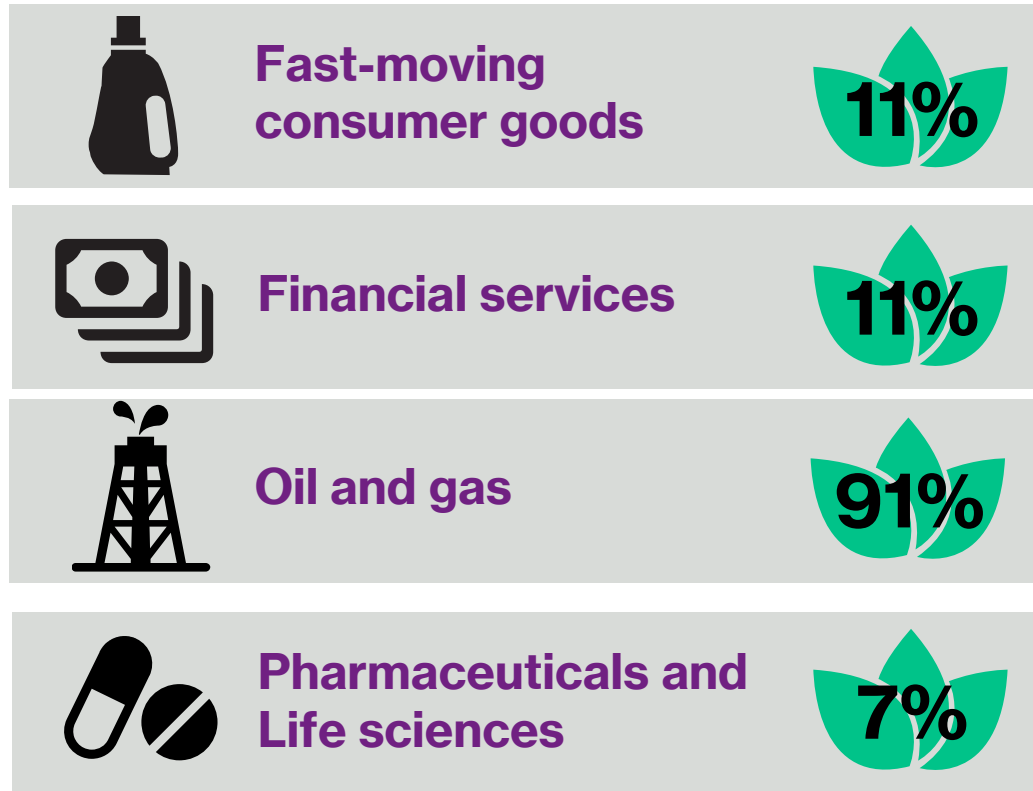
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Industry deep-dives

# Industry deep dive: driving action against climate change through incentives

Click on the industry of interest below for a summary of the industry as it relates to climate change more broadly and for observations about where the industry is in terms of driving action against climate change through executive compensation.



**Note:** Percentages show prevalence of US S&P 500 and top 350 European companies (FTSE 100 (UK), 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)) within that industry, that include an environmental metric within either the STI or LTI plan, measured as a percentage of the applicable industry group. All analyses are based on FYE between June 2020 – May 2021, subject to availability of disclosure.



# Endnotes

1. [http://www3.weforum.org/docs/WEF\\_Creating\\_effective\\_climate\\_governance\\_on\\_corporate\\_boards.pdf](http://www3.weforum.org/docs/WEF_Creating_effective_climate_governance_on_corporate_boards.pdf)
2. <https://www.ipcc.ch/report/ar6/wg1/>
3. <https://eciu.net/news-and-events/press-releases/2021/report-fifth-of-worlds-largest-companies-now-have-net-zero-target>
4. <https://www.canada.ca/en/environment-climate-change/news/2021/06/government-of-canada-legislates-climate-accountability-with-first-net-zero-emissions-law.html>
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