

# Linking ESG to Remuneration

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# Today's agenda

1. **What are Directors thinking about ESG**
2. **Potential ESG metrics – and spotlight on E, S, and G**
3. **How to align ESG and Executive Pay**
4. **Case studies and market trends**
5. **Key takeaways**



# What is ESG?

## ESG is the acronym for Environmental, Social, and Governance

Company-generated quantitative or qualitative information about an organization's performance in areas of interest for “socially responsible investors.”

### Environmental

Operating responsibly in the context of natural resources, global warming, energy usage, pollution



### Social

Operating responsibly in the context of employees, clients, communities



### Governance

Operating responsibly in the context of owners, board, management, competitors, business ethics and structure



Purpose-driven and evolved organizations are adopting ESG investor commitments that promote sustainability and societal impact

<sup>1</sup> <https://corporatefinanceinstitute.com/resources/knowledge/other/esg-environmental-social-governance/>

# What is driving the focus on ESG?



Investors



Regulators



Employees



Consumers

# 1. What are Directors saying about ESG?



# Top ESG focus by region

## North America

Environmental Social Governance

Mature corporate governance. Climate transition expected to be the spotlight in 2021 and beyond. Social issues such as HCG and DEI will likely continue momentum.

## Europe

Environmental Social Governance

More companies have added climate measures to incentive plans. Regulators have taken a tougher stance on emissions. Some companies have removed to instate say-on-climate votes.

## Latin American

Environmental Social Governance

Environmental discussions still in infancy phase and developing. Increasing focus on social issues such as DEI, safety and wellbeing. Governance practices continue to mature, driven by pressure from institutional investors.

## Asia Pacific

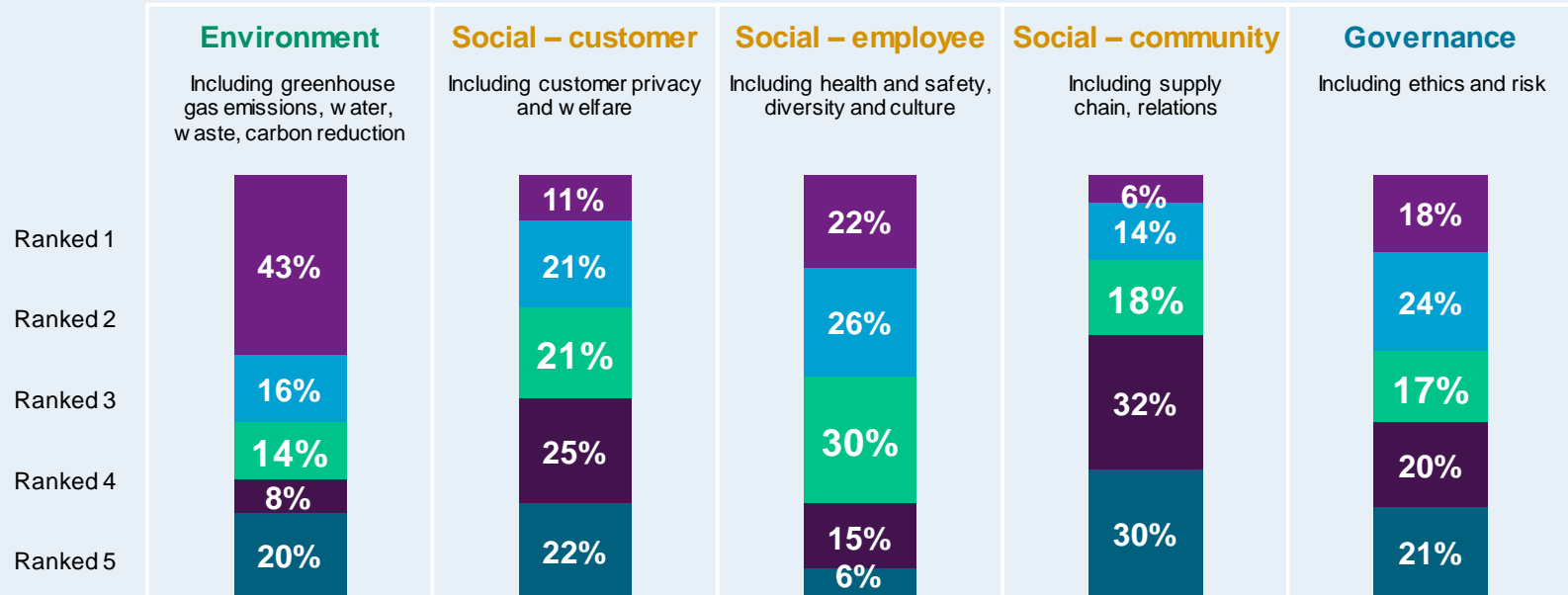
Environmental Social Governance

Wide range of corporate governance maturity levels. Key focuses include: Board diversity, board composition and skills, formal non-executive selection and on-boarding process, and board effectiveness.

# Board's ESG focus

**4 in 5 companies are planning to change ESG measures in executive pay plans over the next 3 years**

What is the relative importance of the following ESG priority areas for your organization in the next three years (rank in order of importance from 1 to 5)?



## 2. Key ESG metrics and spotlight on E,S,G



# Key metrics to consider

- In September 2020, World Economic Forum and International Business Council defined 21 core (and 34 expanded) common metrics for Sustainable Value Creation
- SGX's "Starting with a common set of Core ESG metrics" proposes a list of 27 core metrics for Singapore issuers

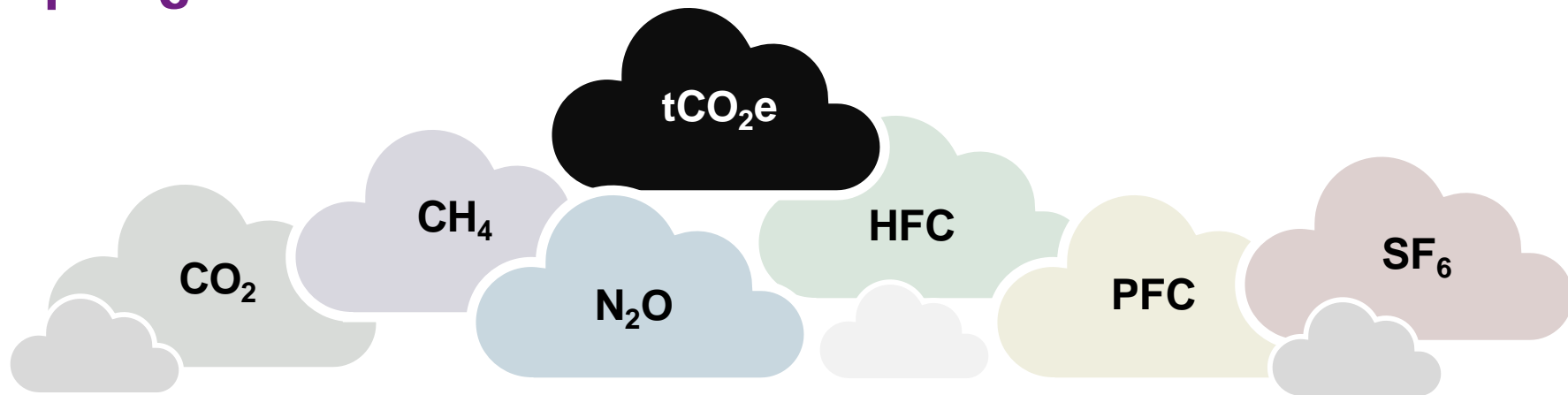
Environmental considerations	Social considerations	Governance considerations
1. Absolute Greenhouse Gas (GHG) emissions	8. Current employees by gender	20. Board independence
2. GHG emission intensity	9. New hires and turnover by gender	21. Women on the board
3. Total energy consumption	10. Current employees by age groups	22. Women in the management team
4. Energy consumption intensity	11. New hires and turnover by age	23. Anti-corruption disclosures
5. Total water consumption	12. Total turnover	24. Anti-corruption training for employees
6. Water consumption intensity	13. Total number of employees	25. List of relevant certifications
7. Total waste generated	14. Average training hours per employee	26. Alignment with frameworks and disclosure practices
	15. Average training hours per employee by gender	27. Assurance of sustainability report
	16. Fatalities	
	17. High-consequence injuries	
	18. Recordable injuries	
	19. Recordable work-related ill health cases	

# Bursa Malaysia's consultation paper has following 'Proposed Common Sustainability Matters'

1. Anti-corruption	2. Community / Society	3. Diversity	4. Energy management	5. Health and safety
<ul style="list-style-type: none"> <li>Percentage of employees that have received training on anti-corruption by employee category</li> <li>Percentage of operations assessed for corruption-related risks</li> <li>Confirmed incidence of corruption and action taken</li> </ul>	<ul style="list-style-type: none"> <li>Total amount invested in the community where the target beneficiaries are external to the listed issuer</li> <li>Total number of beneficiaries of the investment in communities</li> </ul>	<ul style="list-style-type: none"> <li>Percentage of employees by gender, age group, ethnicity and disability, for each employee category</li> <li>Percentage of directors by gender, age group, ethnicity and disability</li> </ul>	<ul style="list-style-type: none"> <li>Total energy consumption</li> </ul>	<ul style="list-style-type: none"> <li>Number of work-related fatalities</li> <li>Lost time incident rate</li> <li>Number of employees trained on health and safety standards</li> </ul>
6. Labor practices and standards	7. Supply chain management	8. Data privacy and security	9. Water	10. Emissions management
<ul style="list-style-type: none"> <li>Total hours of training by employee category</li> <li>Percentage of employees that are contractors or temporary staff</li> <li>Total number of employee turnover by employee category</li> </ul>	<ul style="list-style-type: none"> <li>Proportion of spending on local suppliers</li> </ul>	<ul style="list-style-type: none"> <li>Number of substantiated complaints concerning breaches of customer privacy and losses of customer data</li> </ul>	<ul style="list-style-type: none"> <li>Total volume of water used</li> </ul>	<ul style="list-style-type: none"> <li>Scope 1 emissions in tonnes of CO<sub>2</sub>e</li> <li>Scope 2 emissions in tonnes of CO<sub>2</sub>e</li> <li>Scope 3 emissions in tonnes of CO<sub>2</sub>e (at least on business travel and employee commuting)</li> </ul>

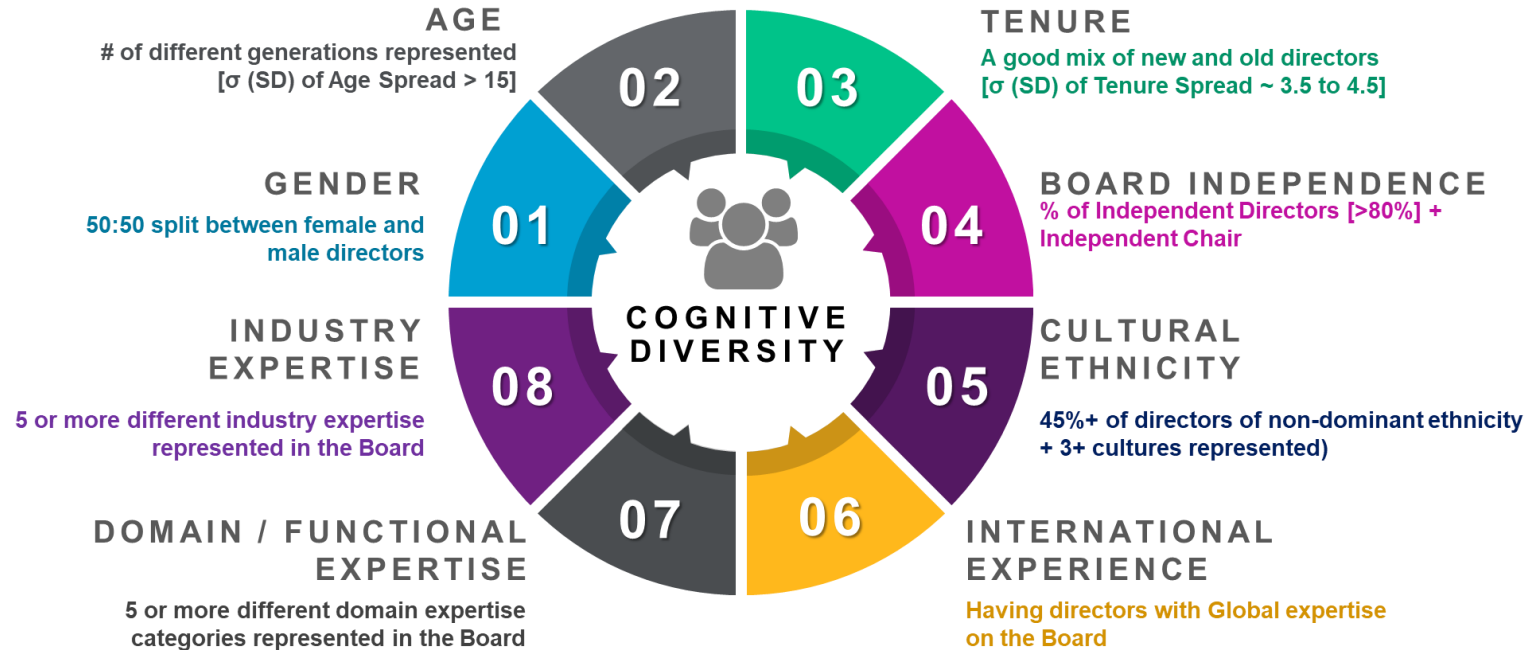
Source: Bursa Malaysia's [consultation paper](#)

# Spotlight on E: Carbon emissions reductions



Scope 1: Direct	Scope 2: Indirect/Energy	Scope 3: Indirect/Supply Chain/Customer
Direct emissions from owned or controlled sources  (e.g. from natural gas boilers used to heat buildings, gases used in refrigeration to cool server rooms, or the fuel burnt in company vehicles.)	Indirect emissions from generation of purchased energy.  (e.g. low for renewable electricity contract, or high if a company opts for a contract which relies on coal power)	All indirect emissions including company's suppliers (upstream) and customers (downstream).

# Spotlight on S: Board Diversity



Source: ICDM and WTW's Malaysian Board Diversity Index

# Governance should be at the top of ESG priorities

Core governance principles for ESG decision-making are purpose and stewardship (risk and opportunities)

## Governance



- **Board's key focus areas for the "G" in ESG**
  - Board Composition and Skills
  - Nomination and Appointment of Directors
  - Board Independence
  - Board Diversity
  - Board Committees and Terms of Reference
  - ESG Board Governance
  - ESG Reporting Standards
  - Training of Directors
  - Risk Assessment and Management
  - Anti-Corruption Programs
  - Board and Executive Compensation
- **Some have set up a separate Board-level Sustainability / ESG Committee**

### 3. ESG and Remuneration





# A practical approach to selecting the appropriate metrics

1. Prioritize the spectrum of issues the company needs to be addressing
2. Determine approach and level of oversight required at the Board vs. Committee level
3. Collaborate with Management on strategy and plan for addressing ESG priorities
4. Educate investors and the public on the issues – why addressing them is key to ensuring sustainability and long-term value creation, and how the company plans to deliver on its goals
5. Demonstrate commitment to initiatives by incorporating metrics that are specific and measurable and goals that are stretch but achievable, and time-bound



# Principles to consider when selecting the right metrics

## Materiality



- Select metrics that are material to the business; those that contribute to long-term value creation and risk mitigation, and are central to the ESG strategy
- They must also be material to the individual participants in order to be effective in incentivizing behavior/action

## Measurability



- 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



- Take a broader view of ESG performance beyond simply capturing carbon emissions, such as tying into industrial or commercial milestones

## Comparability



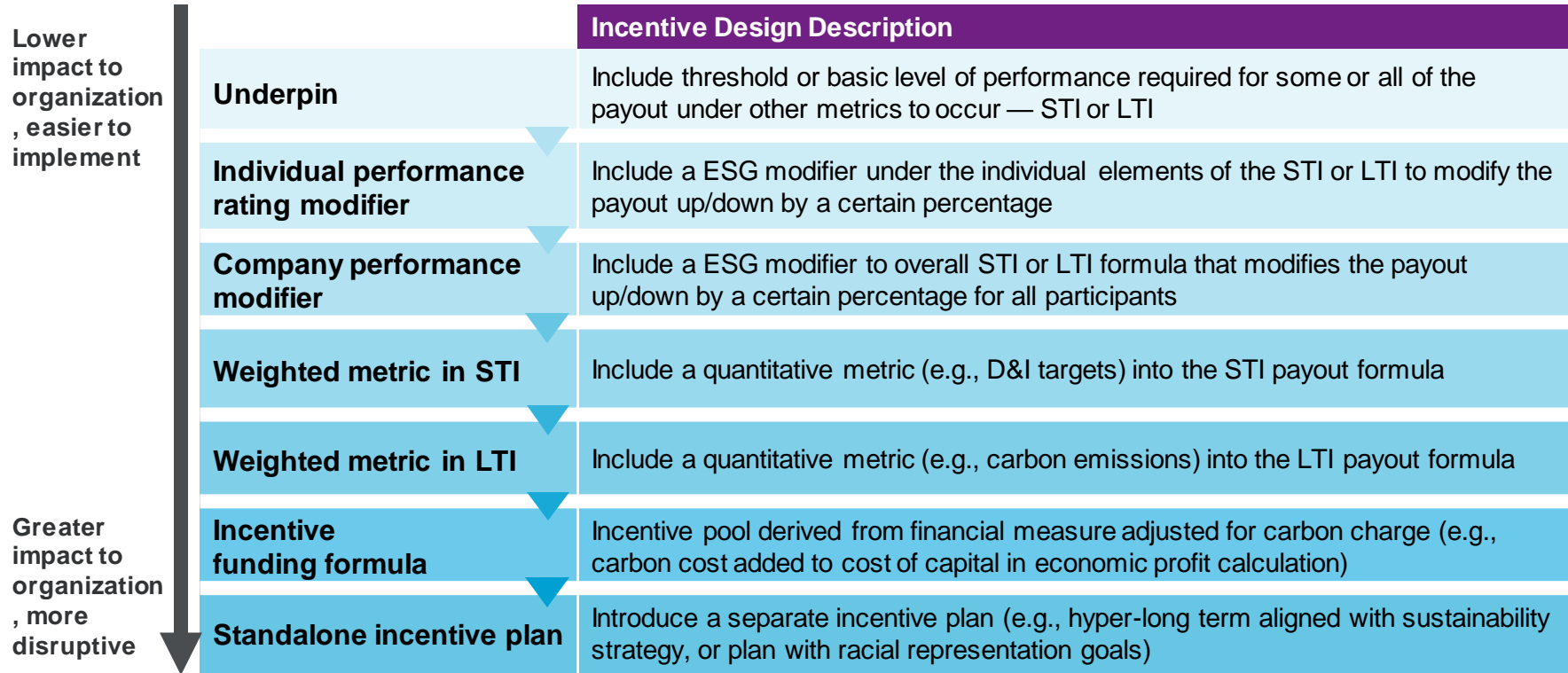
- Where possible, metrics should be defined using standard or widely adopted methodologies (e.g., definitions validated by third parties for greater comparability)
- ESG metrics that are captured in ratings and indices published by reputable organizations are a good starting point

## Clarity



- Important to provide clarity, transparency and consistency
- Seek independent verification for measurement
- Increasing convergence as leading actors collaborate to develop a common set of metrics

# WTW's design spectrum for ESG and incentives



# Lessons learnt in aligning ESG and Compensation

## Do's

Continuously monitor and evolve measurement of goals

Consider company-specific ESG strategy and metrics

Measure short-, medium- and long-term progress towards ESG goals

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 ESG 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 long-term vision

Use judgment-based or ambiguous metrics or goals

Manage annual reports, executive compensation disclosures and ESG/climate reporting in silos

## 4. Market practice and case studies



# Prevalence of ESG metrics in executive incentive plans

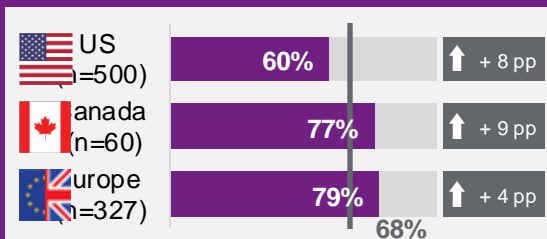
Overall prevalence of ESG metrics in the North America and Europe – a regional comparison

Prevalence is significantly growing and we expect 50% rates in Europe for 2022 (~60% in Ibex-35)

## All plans

# 68%

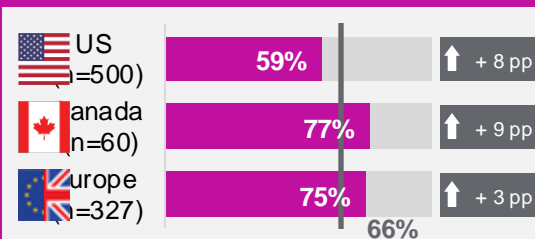
of **companies** incorporate ESG metrics in their incentive plans.



## STI plans

# 66%

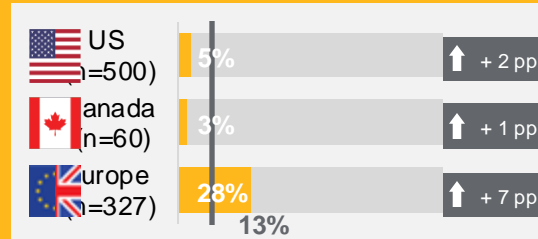
of **companies** incorporate ESG metrics in their STI plans.



## LTI plans

# 13%

of **companies** incorporate ESG metrics in their LTI plans.



- With increasing investor focus, overall use of ESG metrics within incentive plans rose to 68%, up 6 percentage points over the prior year (62%).
  - STI plan usage is up 6 percentage points from 60% in the prior year. Most of the growth relates to an uptick in usage in Canada and the US, where companies have traditionally lagged in prevalence compared to Europe. ESG STI use in Canada now exceeds that of Europe (77% vs. 75%).
  - LTI plan usage is up 3 percentage points from 10% in the prior year. As with adoption and usage of ESG in STI plans, Europe leads the use and growth trend in LTI as well, where ESG metrics are now included in more than one quarter (28%) of all European companies.

n = number of companies

# Prevalence of ESG metrics in executive incentive plans

Which ESG metrics are incorporated into executive incentive plans in the US, Canada and Europe

## All plans



**Social** is comprised of multiple metric categories that encompass Human Capital Management goals, and is ubiquitous among companies with ESG incentive plan metrics. Approximately two-thirds (62%) of companies that use Social metrics do so across multiple categories and this finding is consistent among regions.

# 58%

of companies include

## Human Capital

measurements in their incentive plans



Prevalence of ESG metric categories



# E

# S

# G

All percentages are expressed as % of all companies in the sample

## 5. Key Takeaways



# Understanding the business benefits

For ESG to be sustainable, companies need to look past the moral imperative



## 5 “ESG-isms”



It is not a question of ‘if’, but ‘when’



ESG is not CSR, and not all that glitters is ESG



Think ‘short’, go ‘long’



Do good – do well – do right



Let ‘perfection’ not be the enemy of the ‘good’.



“

**Good thing about incentives is that they  
drive behaviour...**

**Bad thing about incentives is that they  
drive behaviour!”**

# INTERNATIONAL DIRECTORS SUMMIT 2022

The B-Factor: [Bold + Brave] Boards



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