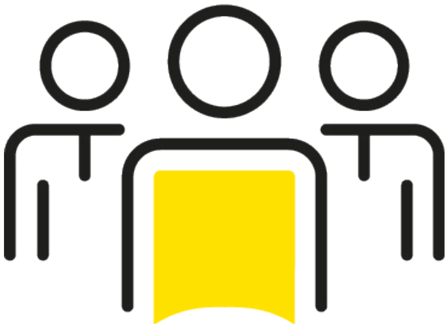
Climate action and remuneration

A pocket guide for remuneration committees

Overview

Aligning executive remuneration with climate considerations is a fundamental aspect of a company's corporate strategy. This requires strong leadership from the board and executive team, leveraging data-driven insights, and establishing clear accountability mechanisms. By building a strong business case, remuneration committees can garner support and commitment to increased climate action. Demonstrating the economic benefits of aligning remuneration with climate goals, engaging stakeholders, and employing bottom-up approaches will generate enthusiasm and build momentum.



As non-executive directors (NEDs), you hold a critical role in ensuring that the organisations you represent align their remuneration strategies with climate action. Meaningfully embedding climate action within executive compensation frameworks can enable an organisation to deliver upon its climate strategy.

This pocket guide draws from conversations and interviews with remuneration committee chairs and members, and industry experts, along with highlighting key principles and steps in the recently updated Executive Compensation Guidebook for Climate Transition, published by WTW in collaboration with the Climate Governance Initiative.

We aim to provide you with valuable principles and actionable steps to navigate the complex landscape of climate-aligned remuneration, enabling you to make informed decisions that contribute to an organisation's climate goals.

Remuneration assessment for NEDs

You can use this useful set of questions to assess your company's approach to remuneration.

1

Climate metrics identification

Has your company:

- disclosed science-based targets – in line with the SBTi, or otherwise scientifically and externally verified short, medium, and long-term climate targets;
- published the company's highest sensitivities to climate performance, based on an externally audited climate scenario analysis;
- identified the most strategic and sensitive climate performance metrics to achieve its climate targets, objectives, and priorities in a risk-prudent and time-bound manner?

2

Climate metrics calibration

Are the company's climate remuneration metrics:

- **Measurable, Significant, and Congruent**
- separate, objective, and quantifiable;
- a significant percentage of variable remuneration, which is commensurate to the scale of the company's climate performance gaps;
- congruent with the company's net zero commitments?

- **Included in the short-term incentive plan (STIP) and the long-term incentive plan (LTIP)**
- included in the STIP and the LTIP, matching the timing between targets, objectives and executive action;
- committing executives for the long term, through restricted stock awards and clawbacks for serious environmental incidents;
- including underpins and climate performance thresholds to cater for performance shortfalls?

3

Climate metric cascade

Are the company's climate metrics cascading throughout the business? They should:

- be set for the company's executive committee, heads of functions and departments, and climate-significant persons;
- be targeted, transparent, and specific to employees' direct influence;
- be quantitative;
- not create conditions for moral hazard against the company's clients?

4

Climate remuneration disclosures

Are the company's climate remuneration disclosures **transparent and prospective**? They should:

- reference clearly, consistently and reliably the company's performance on its short, medium and long-term climate targets, objectives and priorities;
- be easily understood, track periodic climate performance clearly and completely, and enable peer and cross-industry comparability;
- reference a composite list of comparables from peers and climate-leaders from other sectors;
- explain the independent auditing process of the company to validate incentive awards?

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

The Executive Compensation Guidebook for Climate Transition also provides a step-by-step guide for embedding climate in executive incentives.

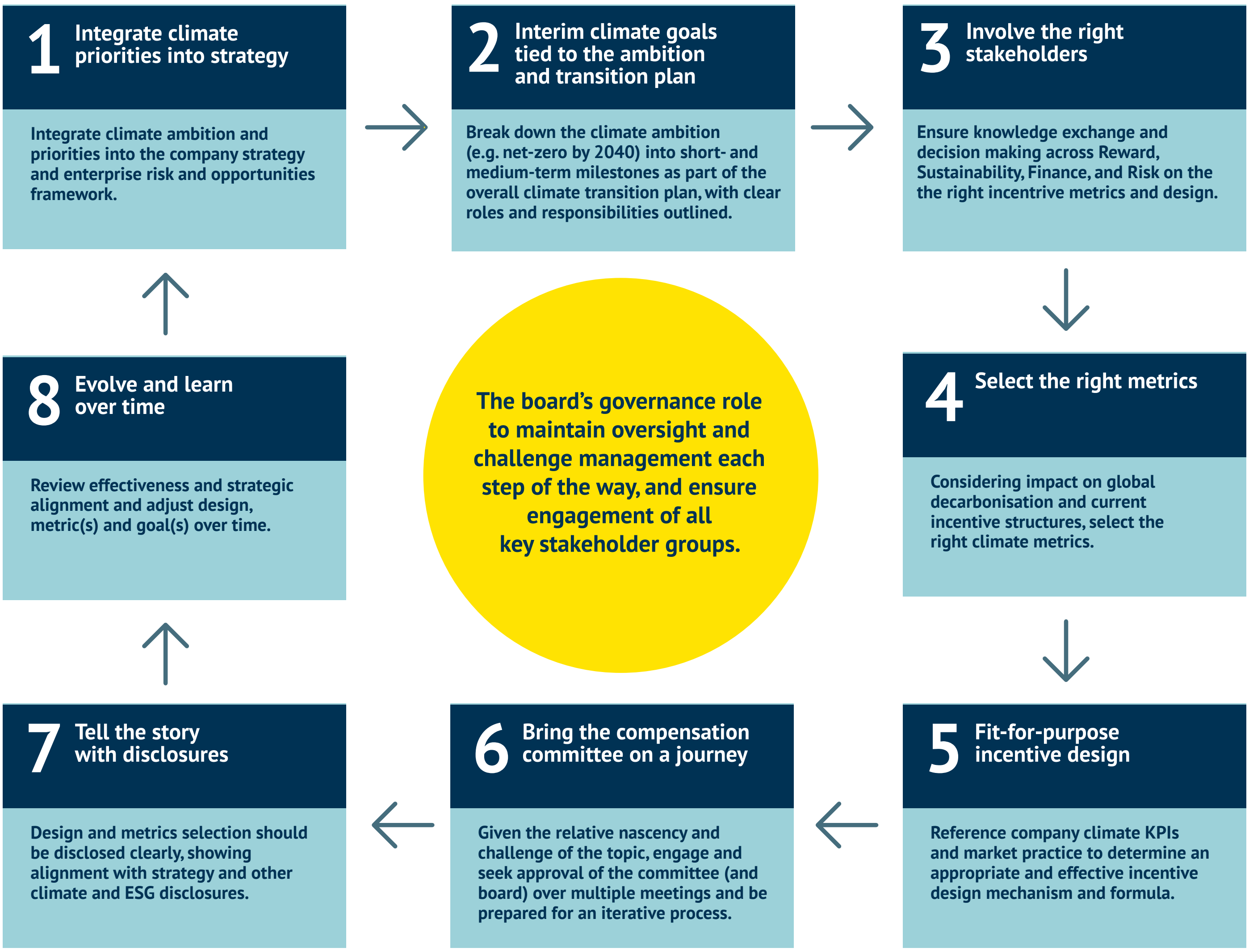


Figure: Step-by-Step guide to embedding climate in executive compensation. Source WTW, Executive Compensation Guidebook for Climate Transition 2023 Addendum

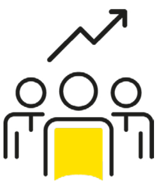
Five guiding principles for climate-related metrics

By embracing these principles, remuneration committees can play a crucial role in leading their organisations toward a future where remuneration practices and climate strategies go hand in hand.

An Addendum to the 2021 Executive Compensation Guidebook, provides an update on climate-related regulatory and investor developments, global market practice on climate metrics in executive incentive plans, as well key considerations for 2023 and beyond relating to metrics and targets and robust climate governance. These valuable considerations should be considered by committees when deciding climate-related metrics.

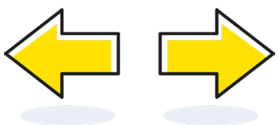
Materiality

- 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 incentivising behaviour/action



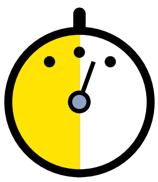
Measurability

- 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 strategic and rounded approach to climate performance and measurement – beyond simply capturing carbon emissions – 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

- 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 organisations are a good starting point

Clarity

- 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

Table: Guiding principles for climate-related metrics. Source WTW, Executive Compensation Guidebook for Climate Transition 2023 Addendum

Insights for remuneration committees

In conversation with chairs and members of remuneration committees, and through interviews with industry experts, we uncovered several key takeaways for remuneration committees to consider.

1

Continuously adapt

In today's dynamic climate landscape, setting targets for remuneration alignment is not a linear process. It requires continuous adaptation and responsiveness to changing circumstances, ensuring that organisations remain on track to achieve meaningful progress. The iterative nature of target setting means committees need to ensure companies remain flexible and agile in the changing environment while ensuring that incentives are quantitative and internally consistent.

2

Link incentives to material impacts and concrete outputs

Incentives should link directly to a company's strategic climate impact to boost executive performance. Remuneration structures must focus on tangible outputs that drive positive impact, rewarding executives for measurable results aligned with the organisation's climate transition plan. For example, applying a material weighting (20% and above) for an emissions reduction metric, linking it to the company's long-term ambition. Through the shift from intentions to concrete outputs, organisations can ensure remuneration practices drive real-world impact.

3

Strike the right balance between ambition and feasibility

When aligning remuneration with climate objectives, consider the maturity of the business. Each organisation is at a different stage of its climate journey, and remuneration strategies should be tailored accordingly. Striking the right balance between ambition and feasibility is key to fostering meaningful change. This is valuable for the executive Short-Term Incentive Plan (STIP) and Long-Term Incentive Plan (LTIP), ensuring alignment with achievable short and medium-term climate targets, while building strong foundations and momentum for the future.

4

Collaborate across the whole board

Collaboration beyond the committee and across the entire board is paramount. Building consensus and alignment between the board and senior management is crucial, requiring active participation and buy-in of all board members and committees. Fostering a shared responsibility for climate action across the board and all committees creates a culture of accountability and commitment throughout the organisation. This can aid a cascading effect into the company's workforce where climate metrics should be considered within the incentive plans for those who have a material impact on the company's climate risk profile and climate performance.

Conclusion

Executive incentives are a powerful and tangible governance mechanism for driving accountability and the remuneration committee's role is essential to getting the design right. However, as the Guidebook Addendum outlines, and Chapter Zero will continue to explore, there are other key aspects of board-level climate governance to consider. WTW's Global Stewardship model is a helpful conceptual framing to help boards to fulfil their duties and meet the demands of multiple stakeholders. This model focuses on five elements (the five Ps) which encompass stewardship: Performance, Purpose, Protection, People and Planet – all of which are key to successfully navigating the climate transition.

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