SEMLER BROSSY

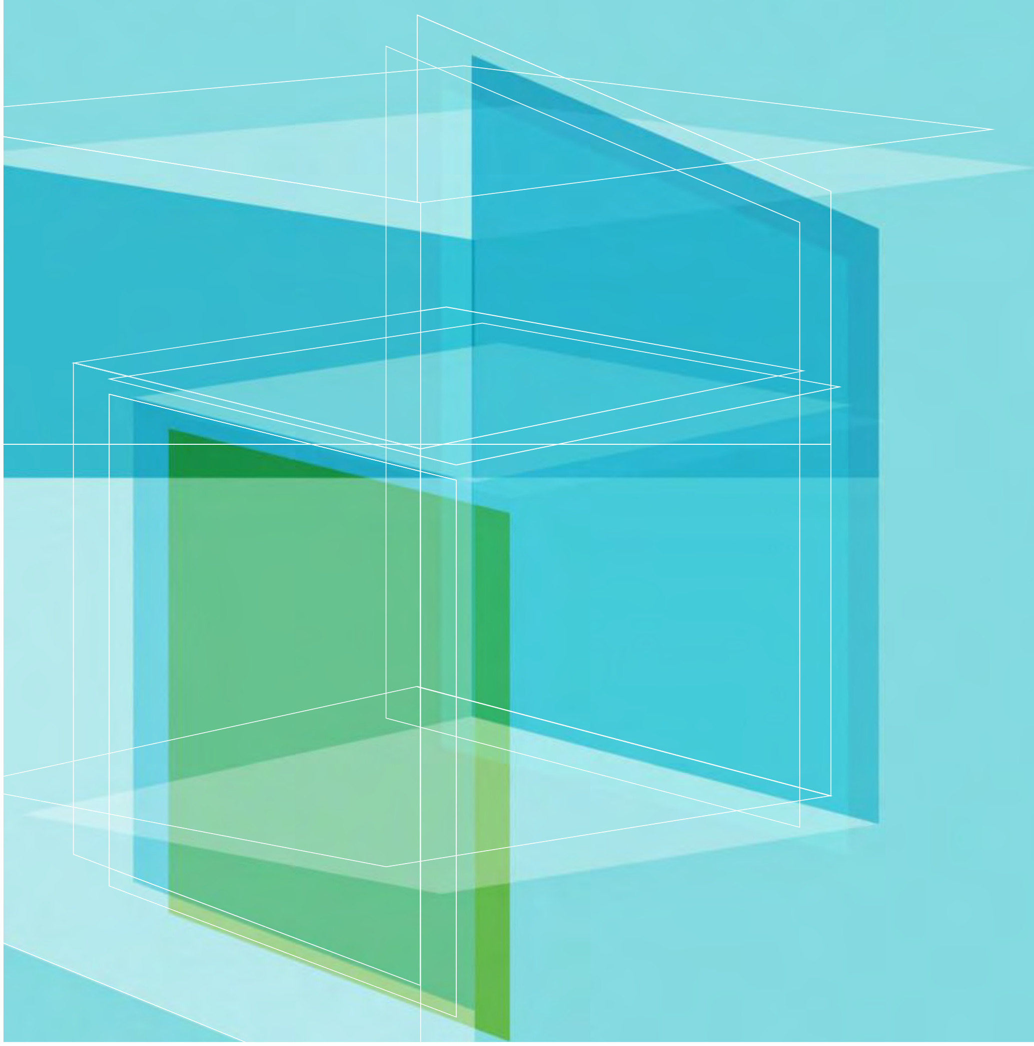
ESG+INCENTIVES

S&P 500

2021 REPORT

IN THIS ISSUE

Types of metric structures	2
Prevalence of structures	3
Examples of sustainability vs. operational structures	4
ESG in long-term incentives	5
Case studies	6



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PLAN DESIGN

ESG is most commonly incorporated as a scorecard (36%) or part of individual components (28%) within the S&P 500. Weighted ESG metrics (20%) and modifiers (16%) are less common

As the use of ESG metrics in incentive plans continues to grow, we see a diverse set of models by which companies incorporate these metrics. As with many 'non-financial' metrics, the use of ESG metrics within a 'scorecard' is a common approach, although this is certainly not the only solution. We anticipate the evolution toward incorporating more weighted and prominent ESG structures into plan design to continue to grow in the coming years.

In this report, we analyze the reported design approach to incorporating ESG metrics into incentives within the S&P 500. For purposes of this analysis, we have categorized these design approaches into four groups:

#	ESG METRIC STRUCTURE	DESCRIPTION/EXAMPLES
1	**Weighted**	ESG is incorporated in incentives through specific metrics, each of which has its own discrete weighting (e.g., 10% of plan based on safety and 5% of plan based on customer satisfaction)
2	**Scorecard**	ESG metrics are formally included in incentives but are not individually weighted and are generally assessed as part of a broader scorecard of ESG or non-financial business priorities (e.g., 30% of the plan tied to strategic initiatives, some of which include ESG)
3	**Modifier**	ESG metric(s) can adjust the overall plan payout by a specified amount (e.g., +/- 10%)
4	**Individual**	ESG is not fully quantified or included as a standalone/weighted component but considered in a broad discretionary assessment, generally in an individual component (e.g., CHRO implemented a company-wide diversity and inclusion training)

ESG METRIC STRUCTURE IN INCENTIVE PLANS

The most common approaches to incorporating ESG metrics in incentive plans are to use them as part of a scorecard of non-financial or strategic objectives or as part of an individual performance assessment that is used to adjust incentive plan performance. Both of these models typically include a degree of subjectivity in assessing performance, especially in the case of individual performance assessments, which are often based on discretionary evaluations. While more formulaic and specifically-weighted metrics or modifiers are also used, these are less common for ESG metrics relative to the typical approach used for financial objectives. This finding is especially true for environmental and social sustainability measures, likely as a result of difficulties in quantifying, setting, and measuring goals and outcomes.

Many companies have historically measured non-financial metrics using a more discretionary framework, which is a trend we expect to continue with ESG metrics as well

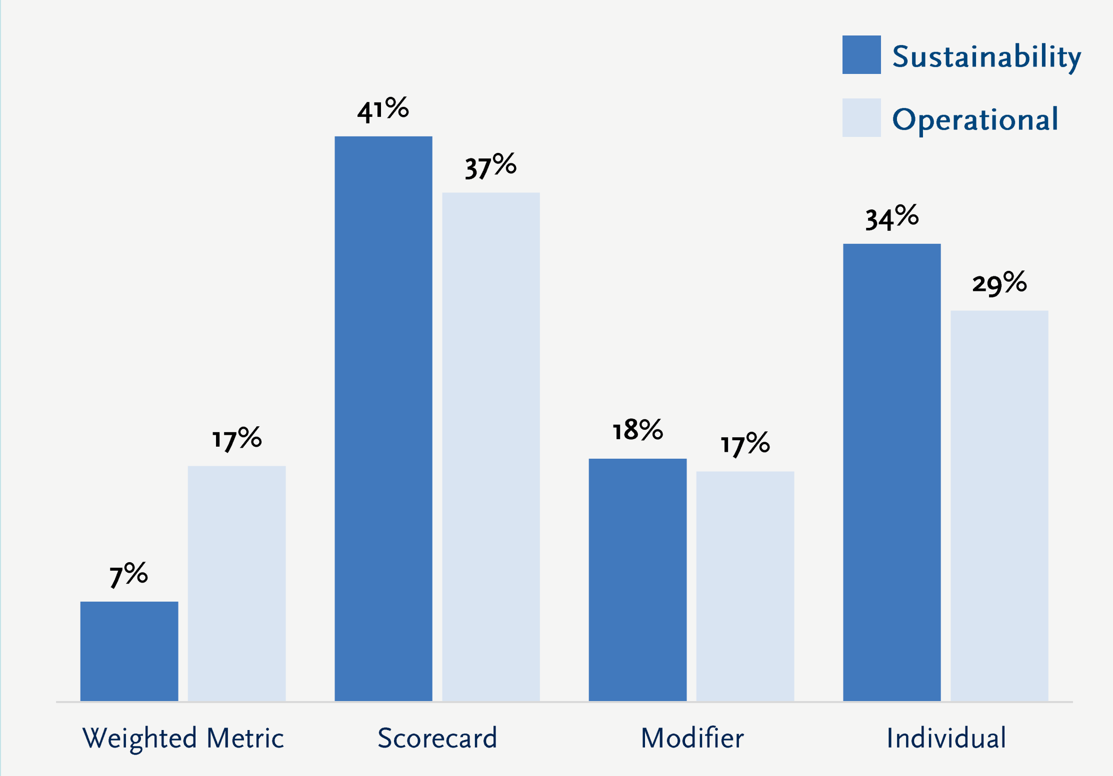
We note that regardless of the approach, metrics of focus in any incentive plan do not need to have a large weighting to be effective. Even a relatively limited impact on inventive payouts can be meaningful by signaling the importance of core principles and objectives of the business.

Distribution of Sustainability vs. Operational ESG Structures – S&P 500

(N=287)

SUSTAINABILITY:
metrics focused on longer-term, broad social/environmental goals

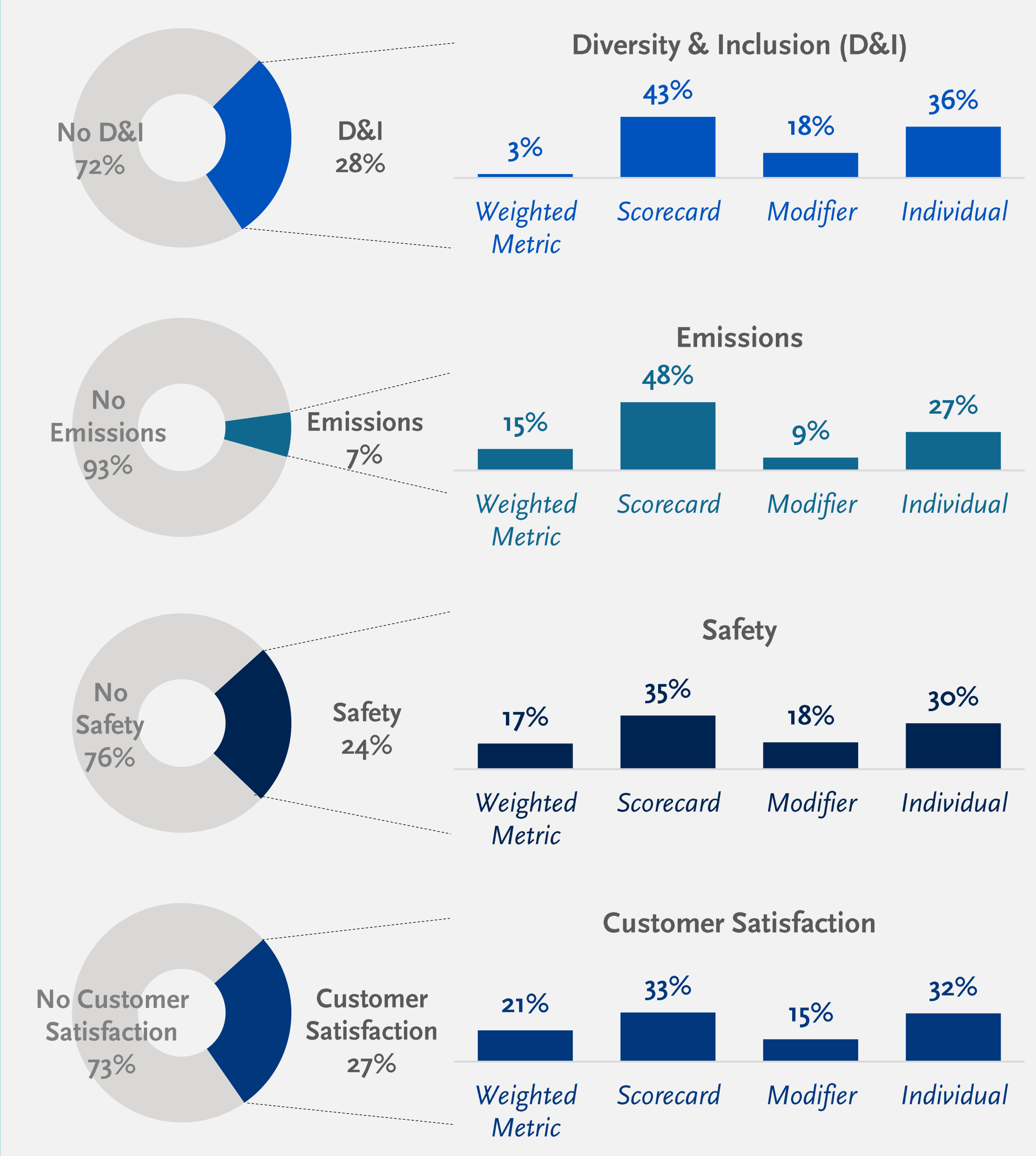
OPERATIONAL:
other stakeholder metrics that are more aligned with day-to-day business results



EXAMPLES OF SUSTAINABILITY VS. OPERATIONAL METRICS

Looking at the most common ESG metrics in incentive plans in more detail, we see these trends highlighted even more prominently. Diversity & Inclusion (D&I), for example, is rarely a separate and individually weighted metric, and both D&I and Emissions are frequently part of scorecards. Customer Satisfaction, on the other hand, is more often explicitly weighted, likely because it is easier to quantify. That said, scorecards or individual performance assessments are still the most frequently used across measurement types.

Breakdown of Incentive Structure Prevalence for Various Sustainability and Operational Metrics



It is rare for ESG metrics to be included in long-term plans and even more rare for those that are included to be non-weighted components due to the implications of variability accounting

ESG METRIC STRUCTURE IN LONG-TERM INCENTIVES

Currently, it is rare for companies to adopt ESG metrics in long-term plans. With less than 5% of companies in the S&P 500 using ESG in performance shares, the practice is far less common than ESG adoption in annual plans (57%). However, where there are longer-term ESG metrics, the measures tend to be incorporated as stand-alone weighted components or as part of a broader scorecard. The greater prevalence of weighted metrics in long-term vs. annual plans is not surprising, as fixed accounting requires that specific and quantifiable goals for performance shares are set in advance. With the focus on more quantitative goals, it's also no surprise that long-term ESG measures focus mostly on operational metrics, such as Customer Satisfaction, rather than sustainability metrics.

In addition to the accounting complexities and the desire to maintain an element of discretion in the assessment of sustainability objectives, some companies have intentionally selected the annual incentive plan to drive greater accountability for progress toward a longer-term goal. Annual incentives have a degree of 'immediacy' in terms of making progress of ESG goals that may not be as strong as in a long-term plan. That said, we expect the adoption of ESG in performance shares to increase over time as overall shareholder feedback continues to push for ESG within long-term designs.

CONCLUSION

Quantitative measures are one way of defining ESG success, but they are not the only way to successfully incorporate these metrics into incentives. It is not surprising that most ESG incentive metrics today are included as part of a broader scorecard or as part of a more discretionary individual assessment. The adoption and higher prevalence of these structures make sense when considering the recent stakeholder focus on sustainability measures, many of which can be difficult to calculate and quantify. Naturally, the harder it is to quantify a goal or outcome, the more likely companies will lean toward a more discretionary approach. In addition, many companies have always measured non-financial metrics in a more discretionary framework, and this trend will likely continue as more and more companies adopt ESG in pay. At the same time, as companies continue to evaluate the importance of ESG, those that currently use a more discretionary structure might consider whether a more prominent and discrete role for ESG may be appropriate.

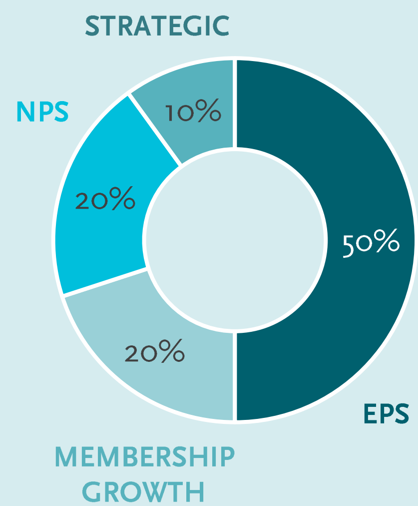
CASE STUDIES: OPERATIONAL METRICS IN ANNUAL PLANS

HUMANA **(NPS weighted metric)**

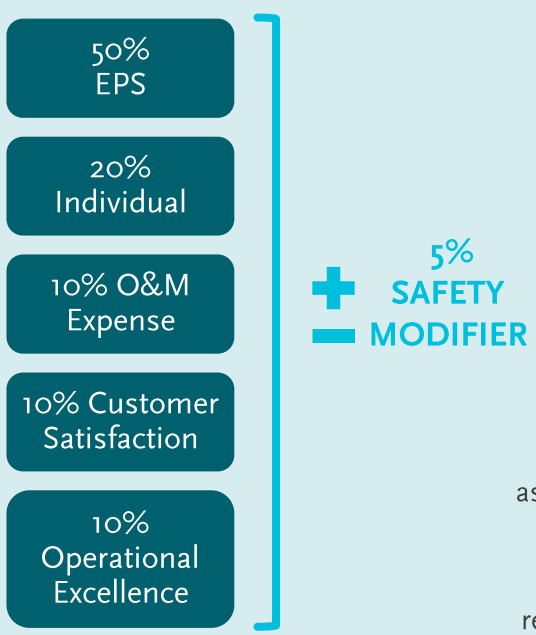
20% of Humana's annual incentive is tied to Net Promoter Score, which aligns with the company's strategy of being a customer-focused business that aims to improve its member experience. Data for this metric is gathered through member surveys by means of interactive voice technology after the completion of an interaction with its call center support teams.

While specific NPS goals for each level of payout are not listed, the company disclosed that the 2020 NPS target represented a 7% increase above 2019 results.

Humana also includes sustainability measures in the strategic portion (weighted at 10%) of its annual incentive that strives for improving member health as well as provider relationships.



DUKE ENERGY **(safety modifier)**



Duke Energy's annual incentive includes a ±5% safety modifier to emphasize the importance of an injury-free workspace. Under the modifier, payouts are adjusted downward (–5%) if there is a significant operational event and upward (5%) if there are no events.

In addition to the safety modifier, the company includes several other ESG metrics as part of the operational excellence scorecard (weighted 10%), customer satisfaction (10%), and individual assessment (20%). The operational excellence scorecard includes a measure of the number of occupational injuries and illnesses per 100 employees as well as measures of environmental events resulting from operations that have an impact on the environment.

CASE STUDIES: SUSTAINABILITY METRICS IN ANNUAL PLANS

T. ROWE PRICE GROUP **(D&I in individual assessment)**

T. Rowe Price Group's annual incentive is largely discretionary, but the company considers financial, strategic, and individual performance when determining payouts. For 2020 the Board approved a set of senior management goals for executives to be evaluated against, select categories for which are shown at right.

Individual achievements for executives highlighted continued progress on D&I strategy (including formation of the Black Leadership Council), strengthening cybersecurity risk oversight, and continued progress in incorporating ESG capabilities into investment decisions.

2020 SELECT COMPANY GOALS
Investment Performance and Capabilities: grow investment management talent
Net Flows and Distribution Capabilities: enhance sales, client service and marketing
Enterprise Strategy, Governance and Financial: ensure right strategy and allocation of resources
Product Capabilities: maintain and support a strong product range
Shared Services and Talent: attract, develop, and retain a diverse workforce

VALERO ENERGY **(ESG scorecard)**

One-third of Valero Energy's Operational Performance objectives in the annual incentive plan is tied to 16 health, safety, and environmental metrics. In addition, 20% of the plan is also based on Strategic Execution, which includes a qualitative assessment of various initiatives, some of which include ESG.

METRIC	WEIGHT
Financial (EPS)	40%
Operational Performance	40%
Strategic Execution	20%

OPERATIONAL PERFORMANCE	
13.33%	Health, Safety, and Environmental
13.33%	Mechanical Availability
13.34%	Refining Cash Operating Expense Management

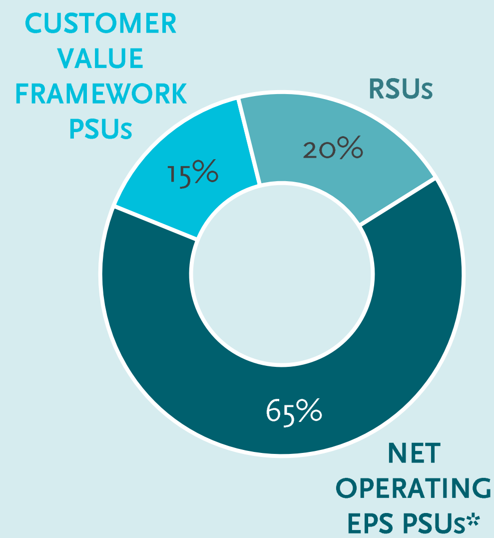
STRATEGIC EXECUTION
Return to stockholders, operational excellence, disciplined use of capital, etc.
Environmental stewardship, sustainability, D&I, compliance, corp. citizenship/community

CASE STUDIES: OPERATIONAL AND SUSTAINABILITY METRICS IN LONG-TERM PLANS

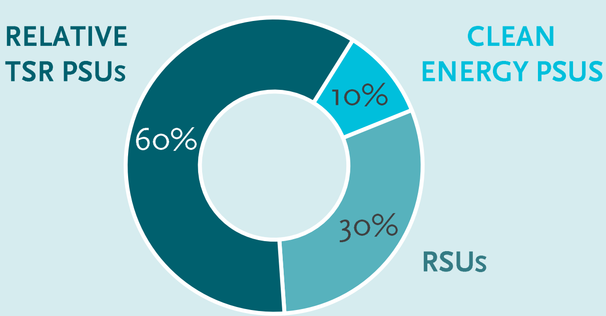
NISOURCE **(ESG scorecard)**

20% of NiSource's PSUs (15% of total equity) are tied to a "Customer Value Framework" scorecard. The 2020 framework included the following metrics:

- **Safety** determined by the National Safety Council Barometer Survey ranking
- **Customer care** measured by the JD Power Studies results
- **Organizational culture improvement** based on "Culture Index" results of yearly employee engagement surveys across four categories: engagement, inclusive culture, leadership and continuous improvement
- **Environmental impact** measured by a greenhouse gas emissions reduction



*Include a ±25% modifier tied to relative TSR



CLEAN ENERGY TRANSITION GOAL		
	Performance	Payout
Max	1,038 MW	200%
Target	738 MW	100%
Threshold	438 MW	50%

AMEREN **(environmental weighted metric)**

10% of Ameren's long-term incentive is tied to a clean energy transition goal. This goal is measured quantitatively based on renewable generation (e.g., energy storage additions associated with new wind, solar, biomass, and landfill gas) and energy storage over a three-year period. Performance payouts between threshold, target, and max are linearly interpolated.

Starting in 2021, the clean energy transition goal is being enhanced to include megawatts associated with the retirement of Ameren's coal-fired energy centers over the three-year performance period.

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