

ESG: Building Shareholder-Focused Incentive Plans for a New Generation of Investors

Compensation Committee Series Webinar
Presented by Pearl Meyer and NACD

September 12, 2019

Meet the Presenters



Richard Goeglein is former chair and director of Pinnacle Entertainment Inc., where he served on both the compliance and compensation committees. Over the course of a career spanning 40 years, Goeglein has held numerous senior executive positions and has served on the boards of more than a dozen organizations, including AST Research Inc., Platinum Software Corp., Boomtown Inc., Holiday Corp., and Aladdin Gaming LLC. In addition to his activities as an NACD Fellow and faculty member for NACD education programs, Goeglein is a trustee and director of Volunteers in Medicine of Southern Nevada, where he chairs the executive committee and serves on the finance committee.



Jessica C. McDougall is vice president of investment stewardship at BlackRock. Her work includes engagement with executives and directors of public companies in which BlackRock is invested on behalf of its clients. These conversations encompass topics such as corporate strategy, governance, environmental and social risk, M&A, and activism. Specifically, she serves as the lead analyst for US and Canadian companies within the industrials and materials sectors. In addition to engagement, Jessica also votes on behalf of BlackRock's clients at these companies' annual and special meetings.



Aalap Shah is a managing director in the New York office of Pearl Meyer. With 20 years of experience, Shah advises public and privately held companies on executive compensation issues, focusing on pay governance, pay-for-performance alignment, and incentive-plan design. Of particular interest to him is the intersection between business strategy, people strategy, and compensation strategy, as he believes alignment of all three is required to design effective programs. Shah advises clients in a variety of industries, including technology, industrial, life sciences/health care, financial services, retail, real estate, and media. He also consults on special compensation programs for IPO and M&A transactions.

Submit a question and receive your answer directly from Pearl Meyer, either during today's webinar or as a follow-up. You will also be opted-in to receive future executive compensation thought leadership from Pearl Meyer.

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- Presentation slides are available today at www.pearlmeyer.com/new-generation-of-investors and within the webinar console.
- The replay will be available early next week at www.NACDOnline.org/webinars and www.pearlmeyer.com/new-generation-of-investors

- Defining ESG
- ESG Metrics in the Wild – What Companies are Adopters
- ESG as an Incentive Metric
- Communicating with Investors

What is ESG

ISS Categories

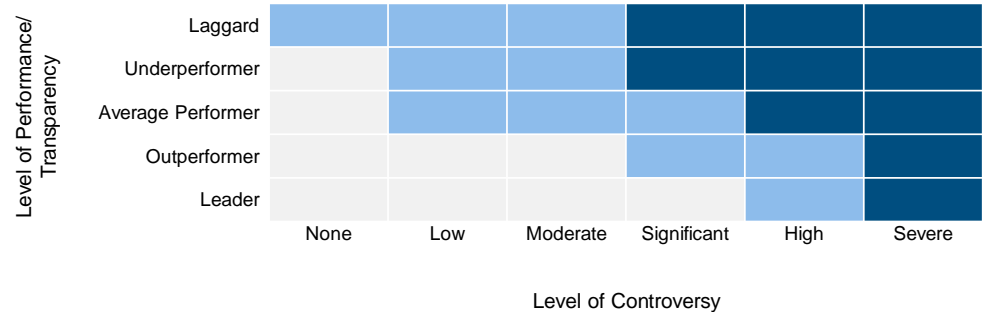
NEW

OLD

Environmental	Social	Governance
<ul style="list-style-type: none"> Environmental risks and opportunities Carbon and climate Natural resources Waste and toxicity Sustainability 12 subcategories total 	<ul style="list-style-type: none"> Human rights Labor, health & safety Stakeholders & society Product safety, quality, brand Customer satisfaction 25 subcategories total 	<ul style="list-style-type: none"> Board structure Compensation Shareholder rights Audit & risk oversight



Glass Lewis/Sustainalytics Approach



For now: It's about transparency and disclosure...not necessarily incentive design...but when should it be?

Outside Looking In



Governance
Brand Value
Workforce Morale and Creativity
Compliance Culture

Determined to have a material impact on long-term value creation

78% of S&P 500

Issued a sustainability report, or some equivalent

26% SRI Assets

Sustainable, Responsible and Impact (SRI) Assets as a % of total US AUM

Management's Attention to Sustainability Issues

Increasingly a focus of shareholders and customers

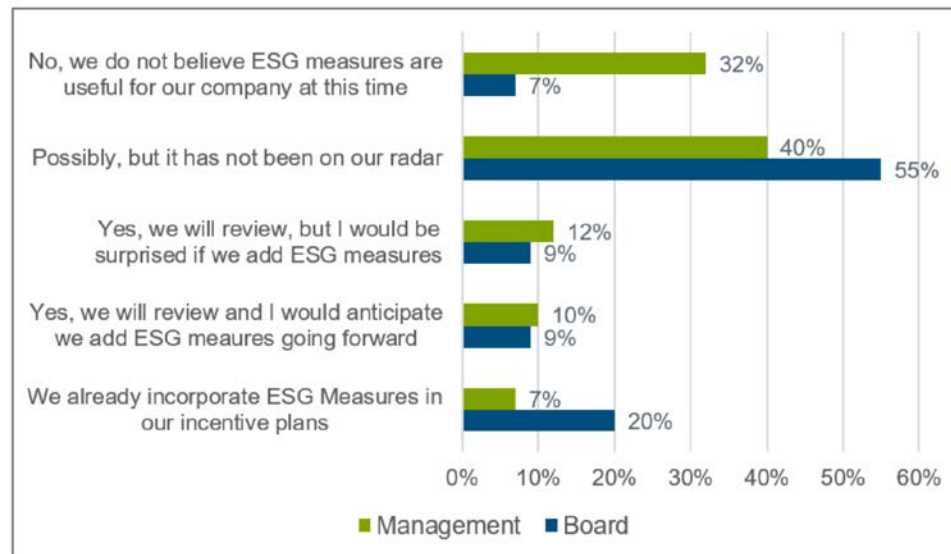
- Institutional investors have come to focus on non-financial drivers of long-term value creation
- BlackRock's Investment Stewardship engagement priorities include:
 - Governance
 - Corporate Strategy and Capital Allocation
 - Compensation that Promotes Long-termism
 - Environmental Risks and Opportunities
 - Human Capital Management

<https://www.blackrock.com/corporate/literature/publication/blk-stewardship-priorities-final.pdf>

* US SIF's 2018 Report on Sustainable, Responsible, and Impact Investing Trends

Will your compensation committee review the appropriateness of ESG metrics for your incentive plan?

Implication: Significant tension between management and board
Context: However, gutting of 162(m) has provided increased flexibility



* Pearl Meyer Quick Poll – August 2018

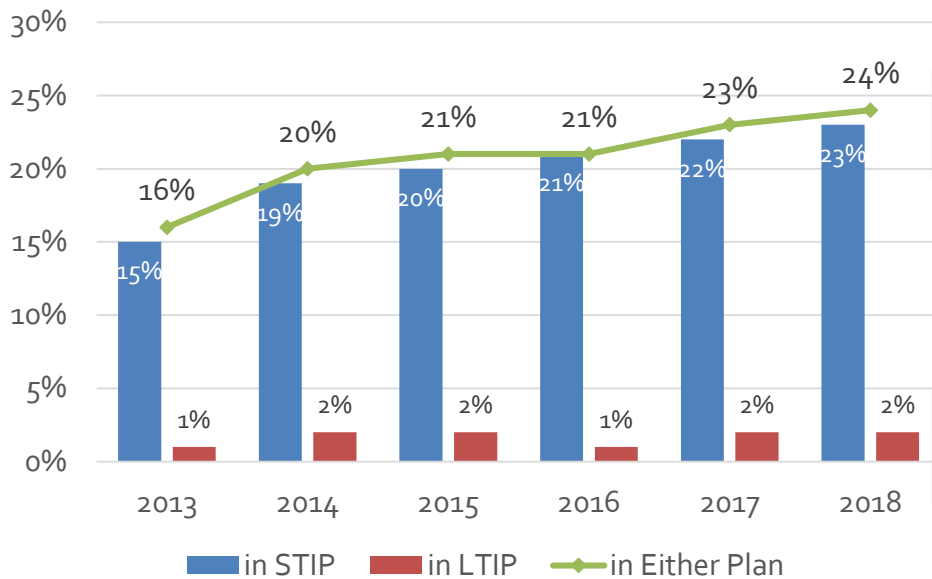
ESG by the Numbers...

Interestingly, prevalence of environmental metrics has exhibited a decrease over the past six years, while social and governance exhibited a slight increase

Prevalence

22%
Environmental

Percent of All Companies* with ESG Measures in STI or LTI Plan

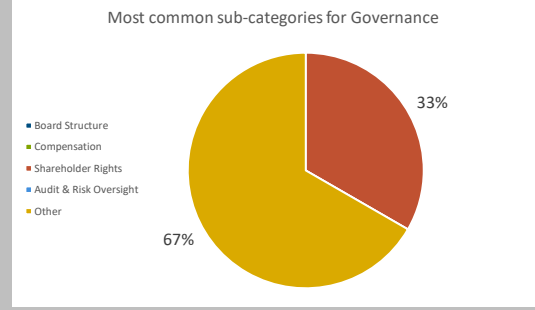
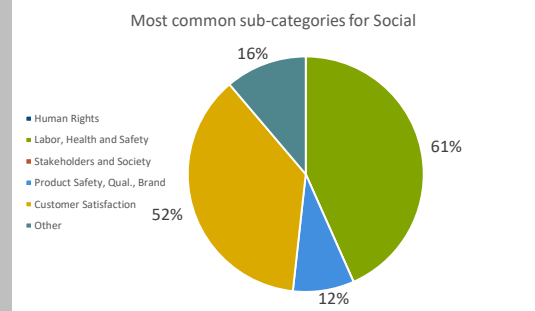
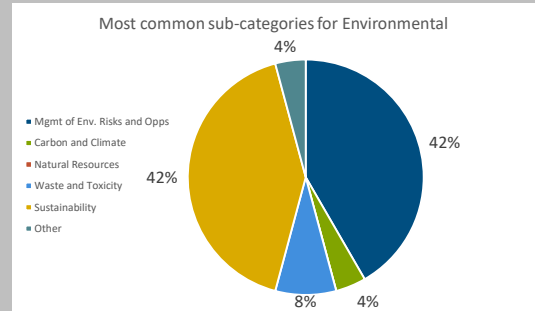


93%
Social

3%
Governance

* Pearl Meyer Study of S&P 500 companies

Most Common Sub-Categories



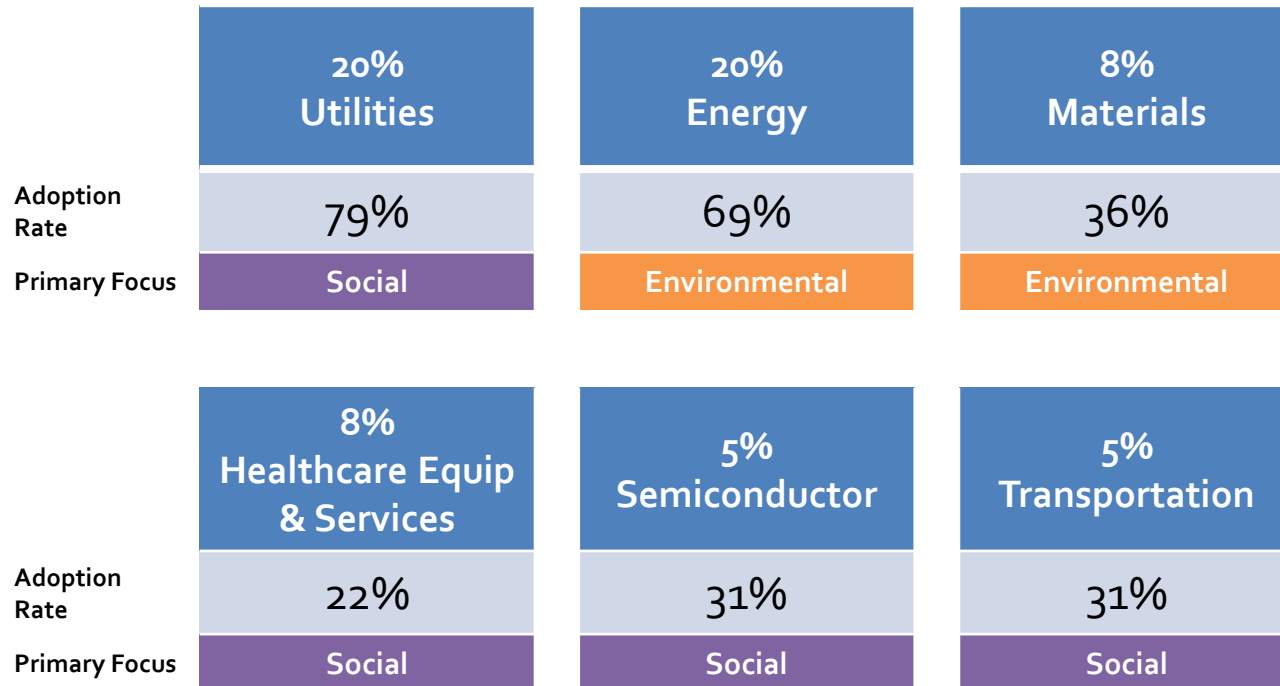
Poll Question 1

What ESG category is most aligned with the company's long-term value creation?

1. *Environmental*
2. *Social*
3. *Governance*
4. *Other non-financial metrics better align with long-term value creation*

Who's Doing ESG

ESG metrics are catching on with these industries....



These industries are showing less interest

- Auto and Components (0%)
- Commercial and Prof. Svcs (1%)
- Consumer Durables/Apparel (1%)
- Consumer Svcs (1%)
- Food/Staple Retailing (1%)
- Household/Personal Product (1%)
- Insurance (1%)
- Media and Entertainment (1%)

* Pearl Meyer Study of S&P 500 companies

Buy-In and Integration with Corporate Strategy

The implementation of compensation program designs using non-financial metrics requires buy-in from the board and management

- Sustainability, in this context, is NOT about environmental outcomes. Rather, it is about whether overall corporate strategy adequately takes into account the non-financial factors that enable long-term value creation. For example, farmers know that optimizing the long-term value of their land frequently means not pushing its productivity to the limit in the short-term.

Materiality and Significance

Which non-financial metrics are material to the company's business and strategy for long-term value creation?

Which metrics are significant for investors and other stakeholders?

- “Sustainability” refers to corporate activities that maintain or enhance the ability of the company to create value over the long term.
 - **Operational excellence**—companies should perform at the highest standards in order to mitigate risks, leverage opportunities, and generate on-going, long-term financial returns
 - **Materiality**—focus on ESG issues that are relevant to a company’s business and potential drivers of long-term financial performance
 - Quantifying efforts in a tangible, trackable measure
 - Articulating integration in overall long-term strategy
 - SASB framework as starting point
 - **Industry relativity**—comparing company performance to that of peers engaging in similar economic activity

Poll Question 2

If you were to include an ESG-related metrics into the incentive program, what % weighting should it have?

1. *No weighting, but a modifier on plan payout*
2. *<10%*
3. *10% to <=15%*
4. *>15% to <=20%*
5. *>20%*

Use of Metrics

Will non-financial metrics be used in a short-term incentive plan or will they be integrated into long-term incentive plans?

- Will they be objective or subjective measures? How much visibility does the company have to enable the setting of appropriate targets? Will the metric be used as a performance modifier or as a standalone measure?

Engagement

Companies integrating non-financial metrics into their compensation plans should be prepared to explain the relevance of the chosen metrics to overall corporate strategy

- Investors are interested in understanding the value proposition of sustainability efforts that position the company for long-term success
 - Articulated in standardized reporting to show integration in overall strategy
 - Aligned with identified key impacts, risk, and opportunities for the business
 - Raw materials, environmental compliance, health and safety
 - Goal setting and progress tracking
 - Financial impact in the form of:
 - Cost savings, efficiencies, waste reduction, recyclability, risk mitigation tactics, market capture, etc.

- Not every ESG metric is for every company – materiality is key
- Monitoring ESG-related metrics is here to stay
 - Many are already demonstrating incremental improvement, but not disclosing
- Incorporating within incentive programs should be considered on a case-by-case basis and does not have to be a “zero-sum game”
 - Metrics should have proven connection to risk-mitigation and long-term value creation
 - Both quantifiable and subjective metrics should be considered
 - If metrics are not adopted within incentive program – will need to consider how progress will be communicated to shareholders/stakeholders

Q&A

You can submit a question in the top-right corner of your webinar console.

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Meghan Metzbower, Senior Manager, Fellowship

Phone: (571) 367-3638

Email: Fellowship@NACDonline.org

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