



# EQUILAR

EXECUTIVE COMPENSATION

# Summit2019

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# Building Shareholder-Focused Incentive Plans for a New Generation of Investor

**Pearl Meyer**

CLEARY GOTTLIB

J.P.Morgan



**OppenheimerFunds**



# Speakers

Aalap H. Shah

Managing Director  
Pearl Meyer

Aniket Shah

Head of Sustainable Investing  
Oppenheimer Funds

Arthur Kohn

Partner  
Cleary Gottlieb Steen & Hamilton

Robert Barbetti

Global Head of  
Executive Compensation and Benefits  
J.P. Morgan

# What is ESG?

ISS Categories

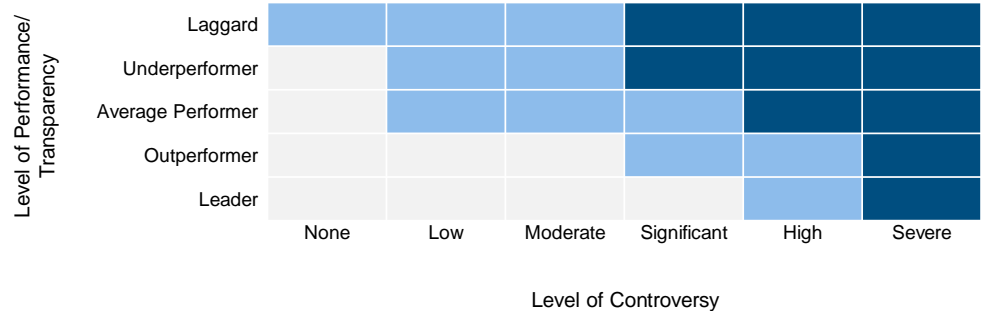
**NEW**

**OLD**

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



Glass Lewis/Sustainalytics Approach



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

# Outside Looking In

- Institutional investors have come to focus on non-financial drivers of long-term value creation

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**

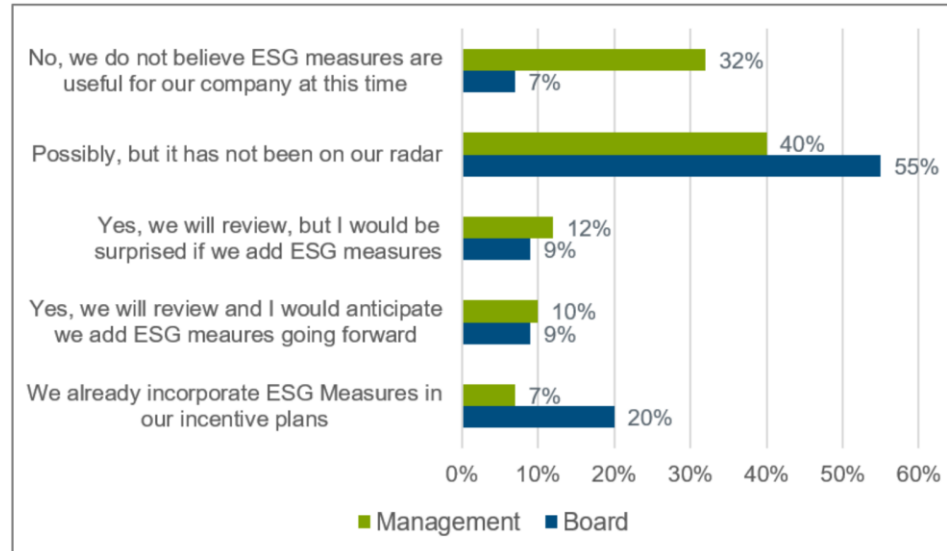
Increasingly a focus of shareholders and customers

# Understood, but...

## 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

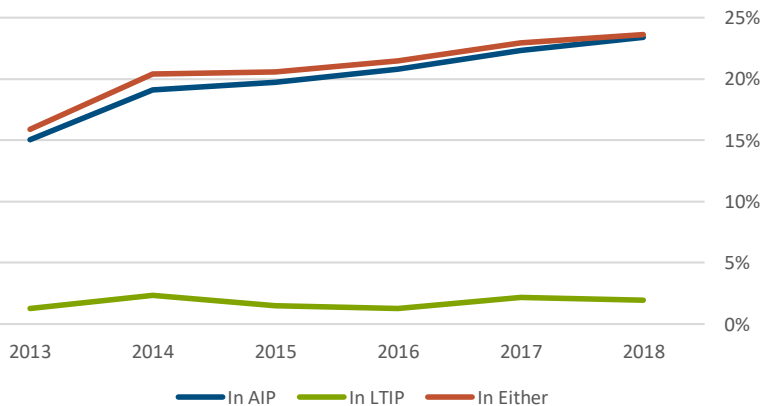


\* Pearl Meyer Quick Poll – August 2018

# ESG by the Numbers...

Interestingly, prevalence of environmental metrics has exhibited a decrease over the past 6 years, while social and governance exhibited a slight increase

% of Firms with an ESG type metric



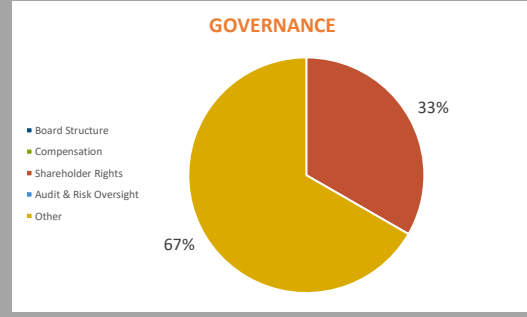
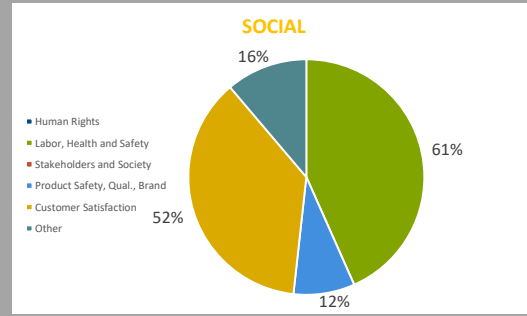
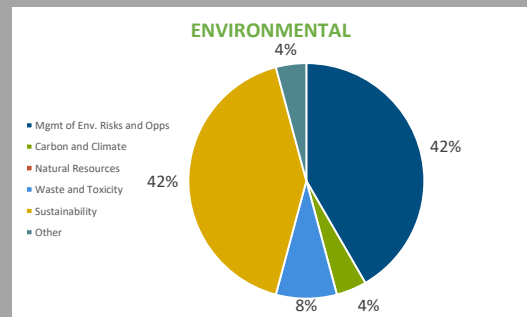
## Prevalence

22%  
Environmental

93%  
Social

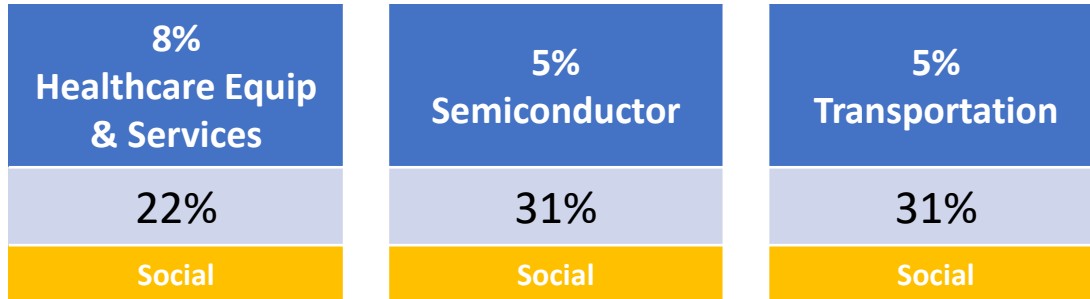
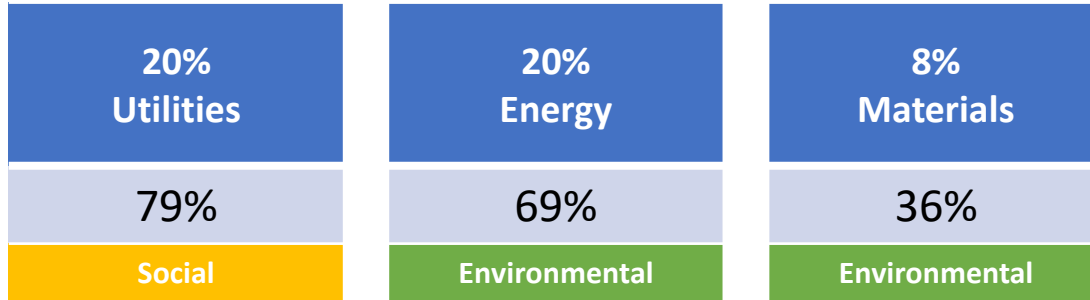
3%  
Governance

## Most Common Sub-Categories



# Who's Doing ESG

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



### These Industries are showing less interest

- Auto & 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%)



# Challenges and Considerations

## 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?



# Challenges and Considerations

## 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

# Q&A

Aalap H. Shah  
([aalap.shah@pearlmeier.com](mailto:aalap.shah@pearlmeier.com))

Aniket Shah  
([aniketashah@gmail.com](mailto:aniketashah@gmail.com))

Arthur Kohn  
([akohn@cgsh.com](mailto:akohn@cgsh.com))

Robert Barbetti  
([robert.barbetti@jpmorgan.com](mailto:robert.barbetti@jpmorgan.com))