Cooley Comp Talks

Key Takeaways:
Incorporating ESG Metrics into Compensation Programs

At the Comp Talks session on July 21, 2021, **Incorporating ESG Metrics into Compensation Programs**, our panelists – Cooley partners Alessandra Murata, Nyron Persaud, Amy Wood, and Executive Vice President & Head of ESG at Edelman Heidi Dubois, – discussed the considerations and challenges that may arise, and provide advice on designing, implementing and disclosing compensation arrangements that incorporate ESG metrics. Here are some of the key takeaways summarized by Cooley lawyer Benjamin Clark:

Investors care about ESG and believe that most companies have work to do. Investors are increasingly focused on ESG and tying ESG metrics to executive compensation. According to the "2020 Edelman Trust Barometer Special Report: Institutional Investors," 69% of US investors surveyed believe that linking executive compensation to ESG positively impacts the investor's trust in a company a great deal, which is a 17% increase compared to 2019 survey. The 2020 survey revealed that 80% of US investors will not invest in companies that lack enough data on their ESG performance. At the same time,79% of US investors believe that most companies are unprepared to comply with potential ESG disclosure regulations, which the panelists agreed are likely forthcoming.

ESG metrics in executive compensation are prevalent among the S&P 500 and will likely continue to increase among public companies of all sizes. Most companies that utilize ESG metrics include them in annual incentive plans, and the most common method used to evaluate ESG measures is a scorecard approach.

Selecting the right ESG metrics requires work. The presenters stressed the importance of first addressing ESG factors in the business strategy, which involves engaging with shareholders, identifying ESG factors that are material to the company's business, incorporating those factors into the company's long-term business strategy and ensuring organizational alignment on ESG efforts. The foundational work of integrating ESG into the business strategy (or at least understanding how ESG factors can hinder or accelerate a company's long-term strategy) should ideally be completed before including ESG metrics in compensation programs.

This is a marathon and not a sprint. The presenters agreed that incorporating ESG metrics into compensation programs should be viewed as a long-term process. With this in mind, they suggested initially considering ESG metrics with lower weighting, increasing the weighting as confidence builds in using the metrics and, over time, moving from qualitative metrics (which tend to be easier to articulate and to which executives may be more receptive) to quantitative metrics (which allow the company to emphasize progress and accountability in its public disclosures). In addition, they suggested that companies continue to reassess and refine their ESG metrics in response to changes in their businesses, as well as in response to public perception of specific ESG issues.

Communication is critical. While executives receiving incentive, opportunities tied to ESG metrics and investors will be the primary audience, companies need to be aware of the other groups that follow ESG disclosures, including customers, employees, the general public, regulators and rating agencies. It is important to create a strategy for consistent communication to the various audiences – and to be transparent about successes and shortfalls – while maintaining the same level of accuracy as with other public disclosures, which may require implementing new internal controls to avoid liability for false or misleading statements.

Amy Wood
Partner
San Diego

Benjamin Clark
Associate
Washington, D.C

Alessandra Murata
Partner
Palo Alto

Nyron Persaud
Partner
New York, Chicago

Janice Chan
Resource Attorney
New York

Heidi Dubois
Executive Vice President
and Head of ESG at
Edelman