COSMOS
Navigate the Compliance Universe

CEP Magazine - November 2021
ESG bonus

By Sally March

Sally March (sjmarch10@gmail.com) is Director, Drummond March & Co, in London, UK.

Sustainability is the watchword for investors and regulators alike. The United Kingdom Financial Reporting Council has long made the connection between ethical culture and sustainable business. It urged and then required boards to take responsibility for the culture of their organizations.

As environmental, social, and governance (ESG) issues move up the agenda in the boardroom, it is not surprising that ESG metrics are being added to executive incentive pay plans. Several recent surveys demonstrate this trend.[1] Axa, a multinational insurance firm, has tied a portion of the CEO's pay to the company's rank in the Dow Jones Sustainability Index since 2016. Major companies like Mastercard and KBR have said they will start pegging some pay to ESG this year. It appears that European companies are moving faster than their US counterparts with 89% already including ESG metrics of some form in their incentive pay plans.[2] Along with reducing carbon emissions and waste reduction, some of the metrics include diversity, human capital, and compliance with applicable laws.

Some investors are skeptical, either remarking on the danger of linking targets to something a company was going to do anyway or questioning the rigor of the targets and metrics. Experience has taught us, however, that doing the right thing is often not a priority until investors or regulators force the issue; for example, after years of efforts to increase gender diversity in boardrooms, the 30% Club reported that the target of 30% women was reached for FTSE 350 companies overall in 2019. (However, 101 companies had still not reached that target.)[3] But doing the right thing is a priority now.[4]

"What gets measured gets managed" has created a challenge for some, but isn't this what ethics and compliance professionals have been thinking about for years: how to measure nonfinancial performance indicators; how to create qualitative measurements? This could be a real opportunity for ethics and compliance to help boards decide what to measure and how it can be done—and a real opportunity for us to help CEOs earn their bonus.

1 John Ellerman, Mike Kesner, and Lane Ringlee, "Inclusion of ESG Metrics in Incentive Plans: Evolution or Revolution?" Pay Governance, March 16, 2021, https://bit.ly/3wFZ8VW; Donald Kalfen, "Meridian Study on Use of ESG Metrics in Incentive Plans," Meridian, May 25, 2021, https://bit.ly/3zWrL2i.
2 John Ellerman, Mike Kesner, and Lane Ringlee, "Do UK and EU Companies Lead US Companies in ESG Measurements in Incentive Compensation Plans?" *Harvard Law School Forum on Corporate Governance*, June 18, 2021, https://bit.ly/38QPJjz.
3 "Global Chair, Ann Cairns, Talks to BBC Radio 4 About Women on Boards and at Senior Executive Level," 30% Club, accessed September 9, 2021, https://bit.ly/3kZyIJu.
4 Larry Fink, "Larry Fink's 2021 letter to CEOs," BlackRock, accessed September 9, 2021, http://bit.ly/3b9z36T.