SALZBURG GLOBAL SEMINAR

Session 2: Corporate Governance - Driving Accountability: Integrating EESG into Executive Compensation

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Opening Remarks

- There is increasing investor pressure for companies to be better stewards of investor capital and address broader ESG issues
  - Focus on ESG has evolved at an extremely rapid pace – faster than any trend I have seen in over three decades as a compensation consultant
  - There are many driving factors
- In August 2019, the Business Roundtable announced a new statement on the Purpose of the Corporation
  - Signed by 181 CEOs of major US businesses, the statement specified that companies “share a fundamental commitment to all of our stakeholders”
    - Customers, employees, suppliers, communities, shareholders
  - Many commentators stated that smart companies are already embracing the interests of multiple stakeholders
  - But it marked a fundamental shift away from the long-standing view that corporations exist principally to serve shareholders
- In his annual letter to CEOs in 2020, BlackRock CEO Larry Fink named climate change as the single greatest threat facing global business
- Due to the disparate economic and health impact of COVID-19, social justice concerns related to compensation are likely to escalate, perhaps exponentially
  - Increased racial justice concerns may magnify this issue further
  - Recent press coverage of CEO pay disclosures for 2020 already attracting criticism
  - Failed and pressured Say-on-Pay appears to be significantly higher than in past years

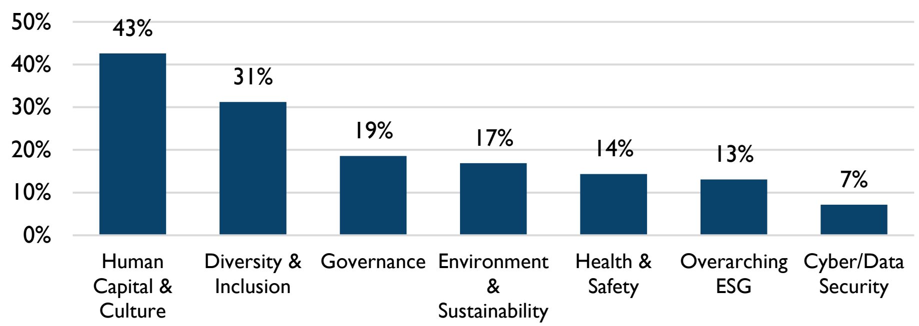
Opening Remarks (Cont'd)

- This proxy season is shaping up to be pivotal for companies and governance professionals as each evaluates performance and pay during a pandemic
- Though "early days," there is ongoing discussions regarding the appropriateness of ESG metrics in compensation plans
  - Which metrics and how best to measure them
  - Defining areas of greatest investor interest
  - Determining what drives sustainable value creation
- Potential for significant unintended consequences – need to move with caution
  - Pressure to disclose and measure objectively creates a potentially unforgiving situation
  - Inclusion and exclusion can "signal" what an organization values most highly, or not
    - Leading to investor, employee and other stakeholder relations issues
  - Failure to achieve goals could be interpreted as cultural or leadership failure (even moral), as opposed to operational underachievement for which there is often external influence
    - Missing a diversity or inclusion goal can be potentially much worse than a profit target
  - Perceived consequences of failure could drive non-ideal corporate behaviors that actually undermine long-term goals

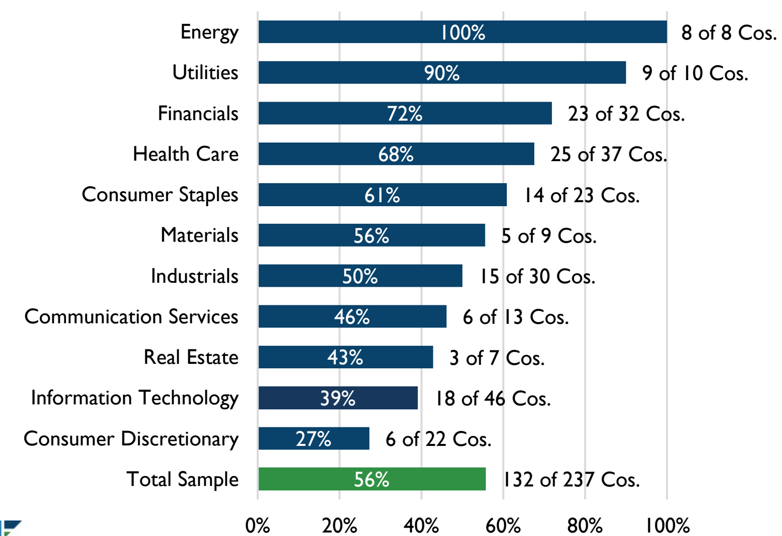
ESG Movement
Trends

- A 2020 FW Cook study of 237 of the largest U.S. companies found that 56% included an environmental, social, or governance (ESG) metric within their annual or long-term incentive plan design
  - ESG metric usage has been trending upwards as shareholders place greater pressure on companies to address societal issues
  - The most common ESG metrics in compensation plans include those related to human capital and culture, diversity and inclusion, and governance

Prevalence of ESG Measures by Category



Prevalence of ESG Measures in Incentive Plans by GICS Sector



ESG Category	Examples of Goals
Human Capital & Culture	Automation goals, culture survey results, employee engagement survey results, health of workforce score, high performance retention rates
Diversity & Inclusion	Improvement in female and minority representation rates in employee population and at management levels, inclusion survey results
Governance	Stakeholder engagement targets, compliance achievements, continuity plan completion
Environmental & Sustainability	Annual progress towards long-term emissions goals, reduce carbon intensity, reduce greenhouse gas emissions
Health & Safety	Lost time injury rate (LITR), safety audit goals, reduce workplace incidents, total recordable incident rates (TRIR)
Overarching ESG	Implement overall ESG strategy, recognition for ESG initiatives, ESG scores from external ratings agencies
Cyber/Data Security	Fraud prevention, data governance, mean time to identify risk, mean time to resolve

** Includes use of ESG metrics as a discrete metric, as a modifier, as an individual goal, or in a broader (weighted) category without having an individual weight assigned to the specific metric*

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Human Capital Disclosure Requirements

Annual reports filed by companies after November 8, 2020 are subject to new disclosure requirements regarding human capital resources

- New rules state that "where material to an understanding of the registrant's business," disclosure of any human capital resources (including total number of employees), and any "human capital measures or objectives" that it uses in managing the business should be disclosed
  - Disclosure requirements are "principles-based" meaning they should be customized to each company's unique circumstances
- While there are numerous metrics and objectives that an HR department focuses on (commentators have listed more than 30), the question is which measures are so significant that an investor might conclude that the measure is material to an understanding of the business
  - Stating a company intends to comply with all U.S. discrimination laws is likely immaterial; investors assume this
  - A statement that the company believes low employee turnover is critical and the HR department strives for a turnover rate of X% or less might be material, depending on the particular company
  - If an HR head is told that her/his job performance should be focused on a few specific metrics, they might warrant examination as possible material measures

Human Capital Disclosure Requirements (Cont'd)

As companies have filed annual reports after November 8, patterns of disclosure are emerging, as was the case when companies began making proxy statement disclosures with respect to compensation risk assessments

- Such disclosure may be influenced by shareholders, many of which have urged companies to disclose additional information about human capital management
- A preliminary review of the first 50 filings for companies with market caps in excess of $1 billion indicated:
  - Significant differences in the lengths of the new disclosures with some companies expanding on past practice and others either repeating past disclosures or cross-referencing other documents, such as the proxy statement or Corporate Responsibility Statement
  - Topics considered "material" differ by company, with the most common topics reflecting expanded headcount, diversity and inclusion, and employee training and development
    - Other less commonly discussed topics include employee benefits and company culture, values, and ethics