ELLASON LLP

FTSE350 ESG trends

A market update

www.ellasonllp.com

Introduction

Welcome to the Ellason ESG trends report for FTSE350 companies

Investor expectations on the integration of ESG-linked metrics in executive incentive plans continue to evolve as ESG grows in prominence. While the incorporation of ESG metrics has become a red-line voting issue for some shareholders in high impact sectors, others want to see ESG metrics incorporated into incentives only where the risks (or opportunities) are material to the business strategy and any targets set can be suitably measured and disclosed. In response, there has been a marked increase in the number of companies incorporating ESG metrics into their incentive plans over the last 12-18 months.

This report explores ESG trends at FTSE350 companies and captures data on companies with financial year-ends to 31 March 2022. The analysis includes both standalone ESG measures and where ESG has been explicitly referenced in personal or strategic objectives.

Highlights include:

- An increase in the use of ESG metrics across the FTSE350, particularly in long-term incentive plans;
- 95% of FTSE100 and 80% of FTSE250 companies now incorporate ESG metrics in at least one incentive plan;
- Social metrics are the most prominent category across the FTSE350. Customer satisfaction and employee measures remain dominant, however there is growing prevalence of diversity & inclusion metrics;
- There is a marked increase in the use of environmental metrics, with just over half of FTSE350 companies using such measures in at least one incentive; and
- ESG measures in the annual bonus are more often discretionary; whereas the majority of ESG measures used in LTIs are linked to quantifiable outputs.

Do not hesitate to share this report with colleagues, and/or contact the Ellason team if you have any questions on this report or have any other remuneration matters you would like to discuss.

In addition to this, the Ellason library also includes pay trends reports for the FTSE350, FTSE SmallCap and AIM 100 – contact one of the team if you would like a copy of these, or other FTSE cuts either by size or by sector (and which can be tailored to your specific request).

email our senior consultants:

peter.smith@ellasonllp.com

ed.mottley@ellasonllp.com

lorna.dodson@ellasonllp.com

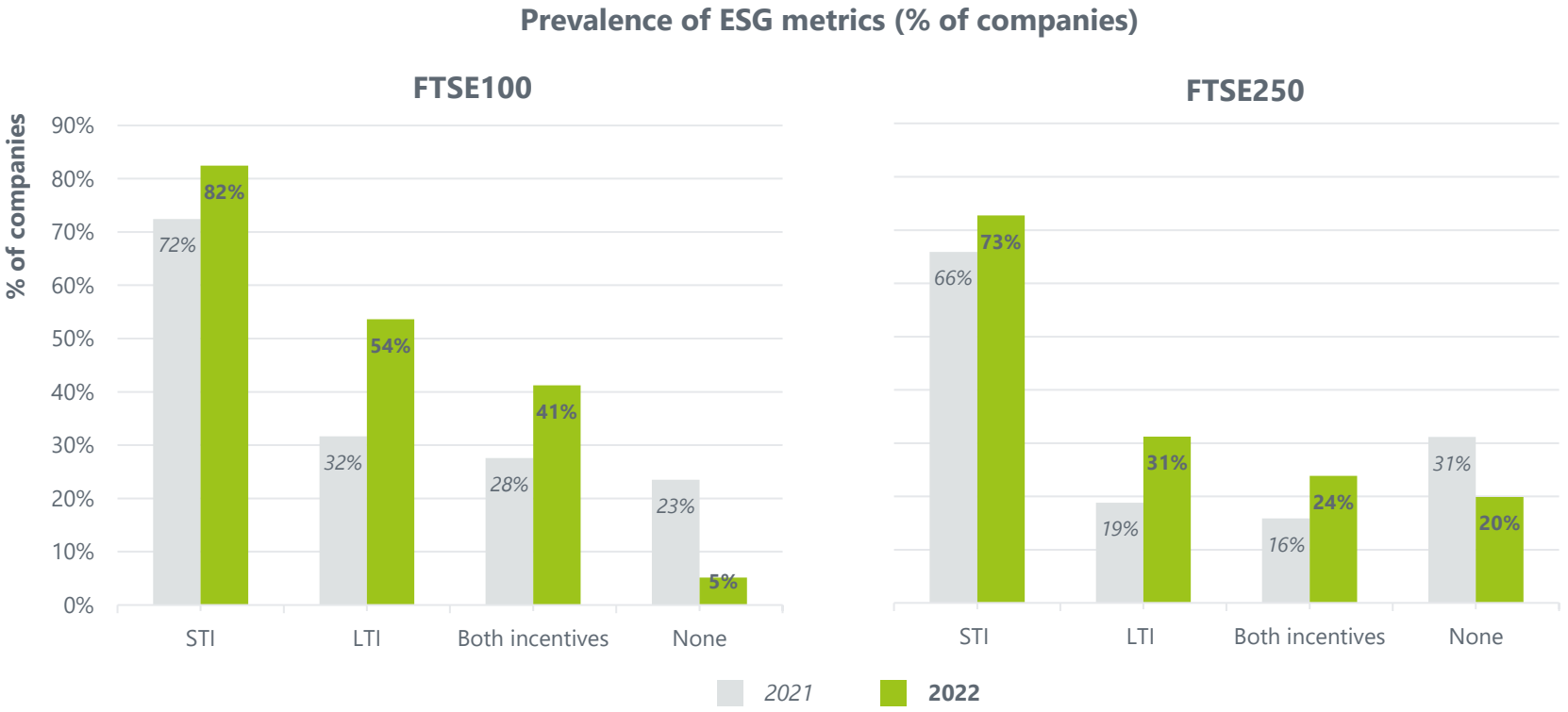
stuart.harrison@ellasonllp.com

jenni.blyton@ellasonllp.com

Prevalence

The majority of the FTSE350 now incorporate ESG into their incentives

95% of FTSE100 companies include an ESG-linked metric in one of their incentive plans, up from 77% in 2021; this compares to 80% of FTSE250 companies (2021: 69%). There has been a marked increase in the use of ESG in long-term plans, particularly in the FTSE100 as companies get more comfortable in setting long-term, quantifiable ESG targets to demonstrate progress on their long-term journey, for example, to a net zero future



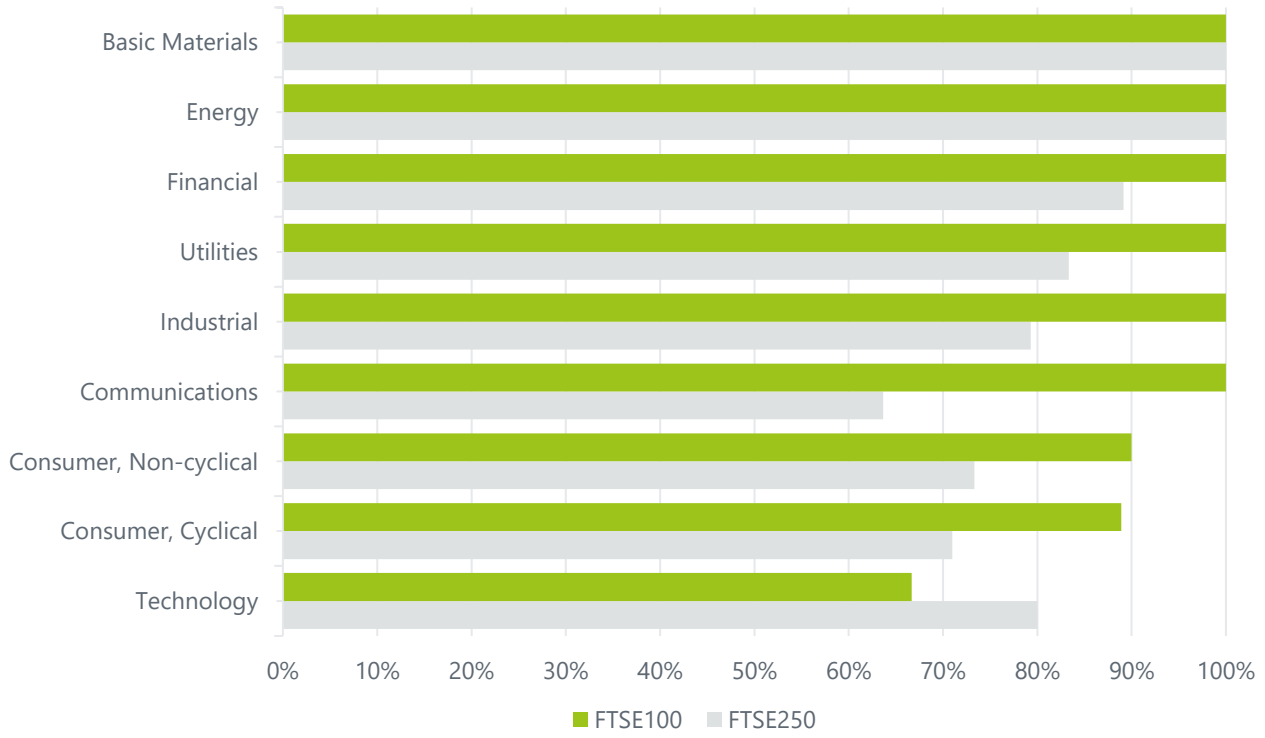
Adds to more than 100%; STI and LTI include those companies with ESG in 'Both incentives'

Prevalence

‘High-impact’ sectors have the highest prevalence of ESG metrics in incentive plans

The prevalence of ESG in incentives varies by sector, driven by external influences and pressures, and the level of importance of ESG in the sector. High-impact sectors such as basic materials (chemical and mining companies) and energy (mainly oil & gas) have the highest prevalence, and consumer-facing sectors (technology and communications) the lowest

Prevalence by sector (% of companies)

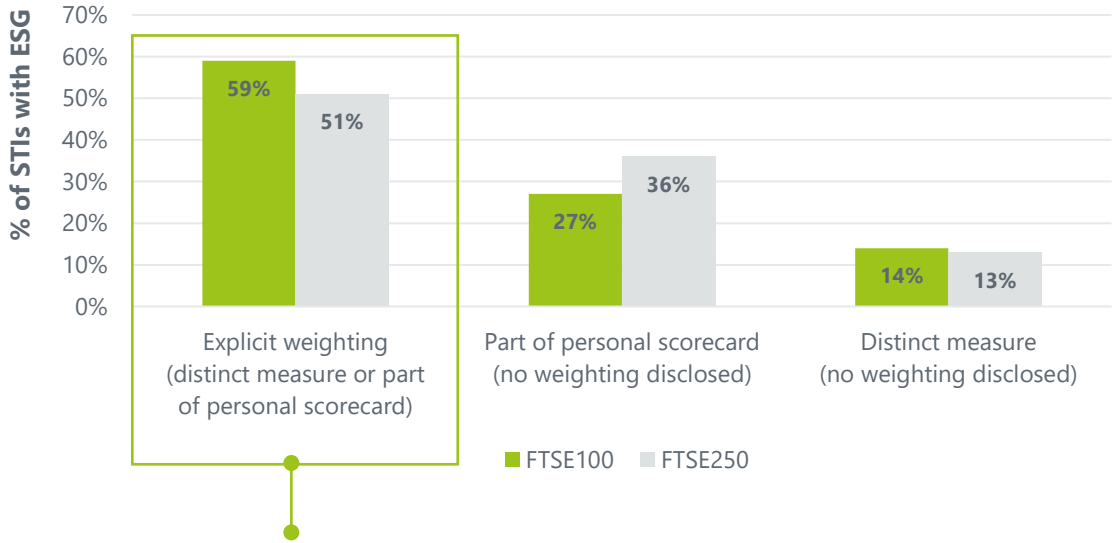


Structure: annual bonus

More companies are ascribing an explicit weighting to ESG in the bonus scorecard

While many companies continue to capture ESG as part of the personal scorecard in the bonus, an increasing number are ascribing an explicit weighting to the ESG component. The typical weighting in the bonus, where disclosed, is around 15-20% of the award

ESG metric type



Typical weighting – explicit ESG metrics[1] (% of award)

	FTSE100	FTSE250
75th percentile	25.0%	20.0%
Median	**20.0%**	**15.0%**
25th percentile	10.0%	10.0%

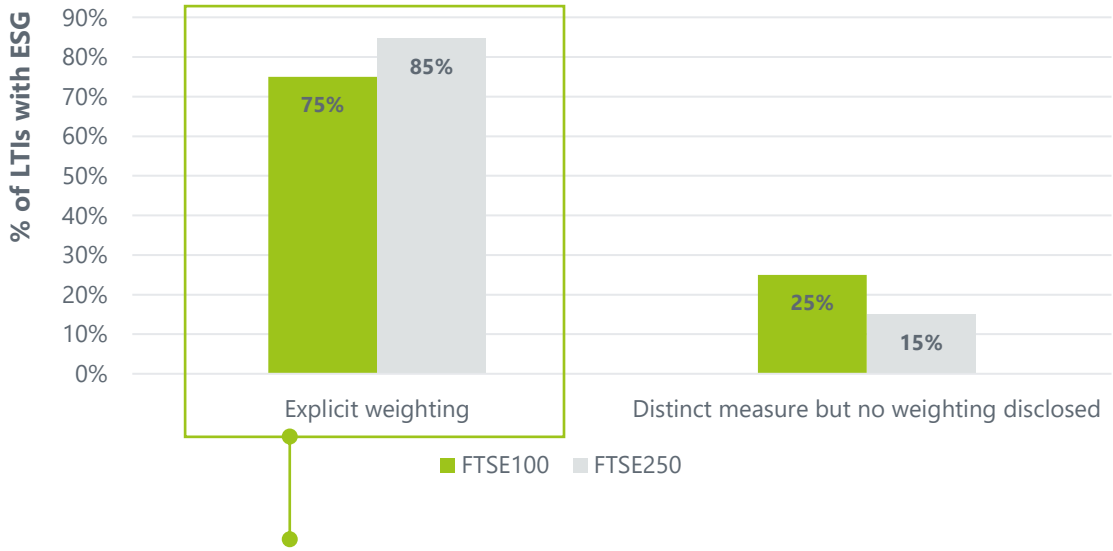
[1] *excludes where ESG objectives are captured as part of the personal scorecard, without a specific weighting identified*

Structure: long-term incentives

The typical weighting for ESG in LTIPs is 15-20% of the total award

Measures in long-term plans are more output-based, typically with quantifiable targets to demonstrate progress on the long-term journey, for example, to a net zero future. The typical LTIP weighting, where disclosed, is 15-20% of the award

ESG metric type



Typical weighting – explicit ESG metrics (% of award)

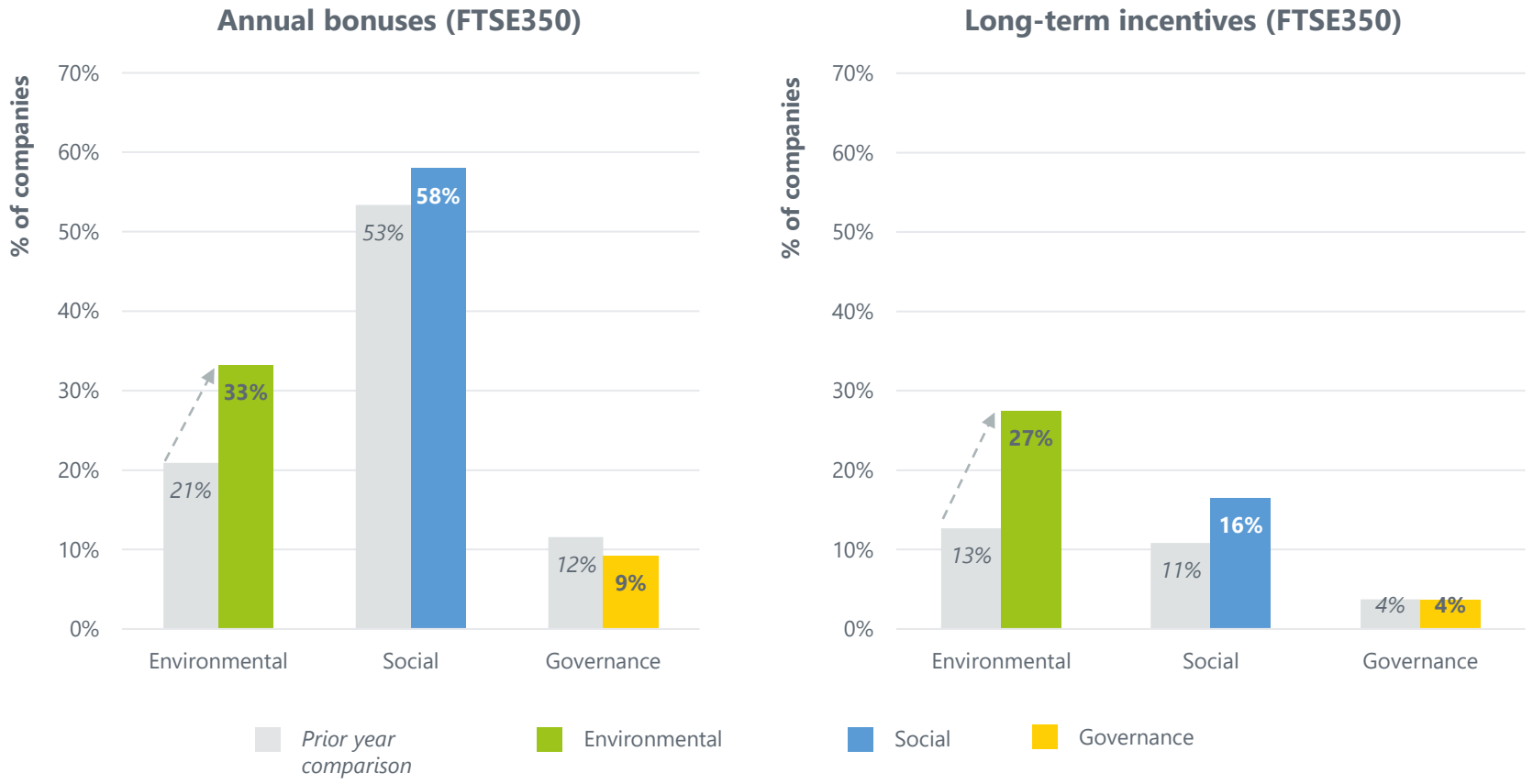
	FTSE100	FTSE250
75th percentile	20.0%	20.0%
Median	**18.3%**	**15.5%**
25th percentile	12.7%	10.0%

Prevalence

There has been a marked increase in the use of environmental metrics in the FTSE350

There has been a sharp increase in the inclusion of environmental metrics in the incentive scorecard, with just over half of FTSE350 companies now using such measures in at least one incentive

Prevalence of ESG metrics



Environmental metrics

Environmental metrics have a higher prevalence in the bonus, but this is rapidly changing as companies progress on their ESG journey

'E' measures in annual bonuses are typically 'input-based' (i.e. focusing on the actions required to deliver the goal), while 'E' measures in LTIPs are more 'output-based' (i.e. a formulaic determination of the actual result achieved). In this regard, companies are using a variety of metrics to measure carbon reduction, e.g. a reduction in Scope 1 and 2 emissions; some companies also include Scope 3, although this is less common. A number of companies also focus on the intensity of emissions, looking at it relative to hours worked per full-time employee or relative to revenue.

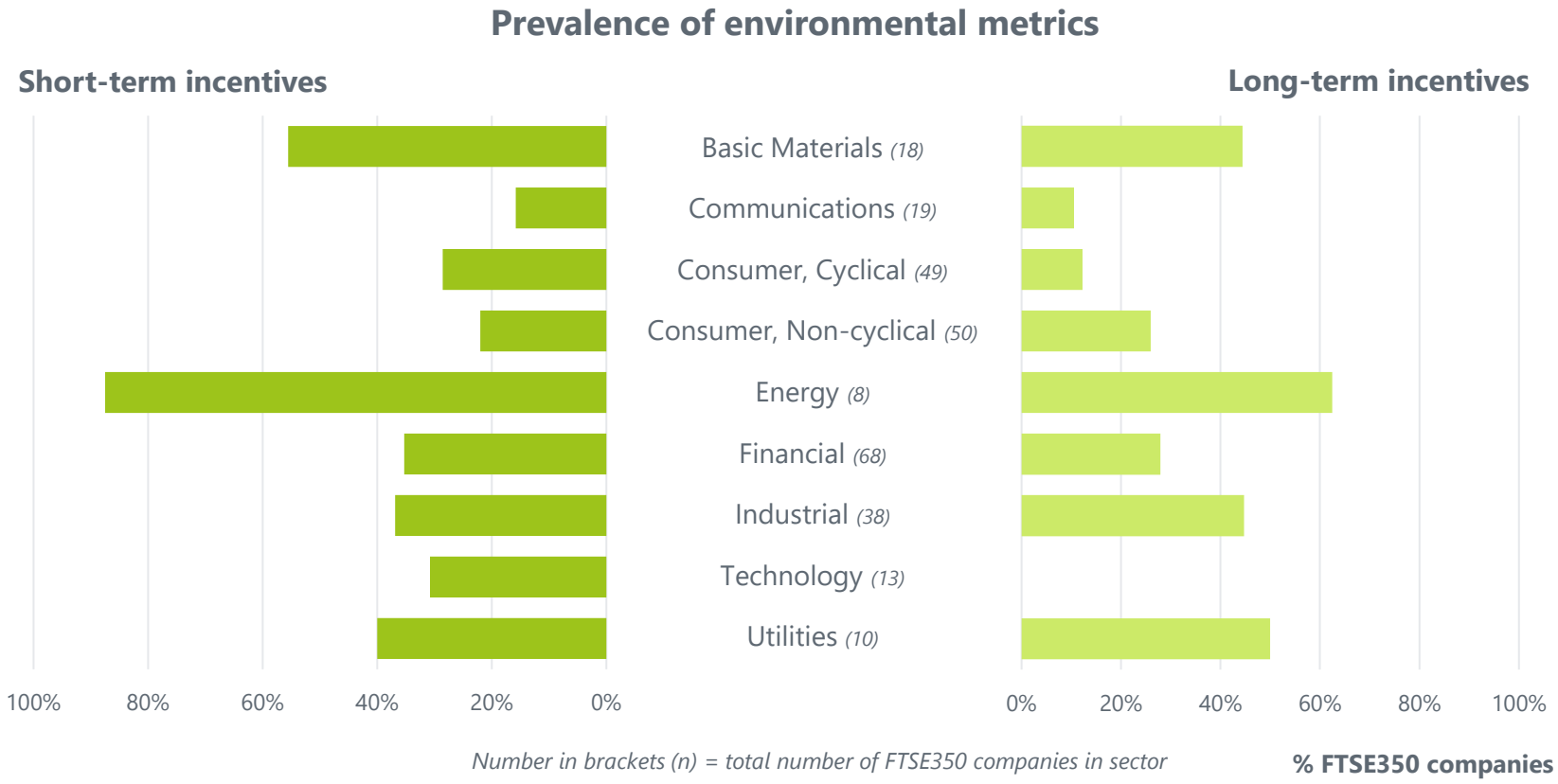
Some companies have set quantifiable environmental targets in the bonus; however, most companies use the bonus to give greater flexibility in how they monitor and assess performance – for example, a discretionary assessment of the implementation of a company's environmental strategy, or making sure there are robust processes in place to gather data and measure progress throughout the organisation

Prevalence (% of companies)	FTSE100		FTSE250	
	In STI	In LTI	In STI	In LTI
Any 'E' measure	**43%**	**40%**	**28%**	**20%**
Decarbonisation / GHG	26%	34%	18%	16%
Energy Efficiency	3%	2%	2%	1%
Waste Reduction	3%	3%	3%	2%
Water Usage	1%	4%	1%	1%
Green Product	2%	6%	3%	3%
General Environmental	14%	3%	9%	3%

Environmental metrics

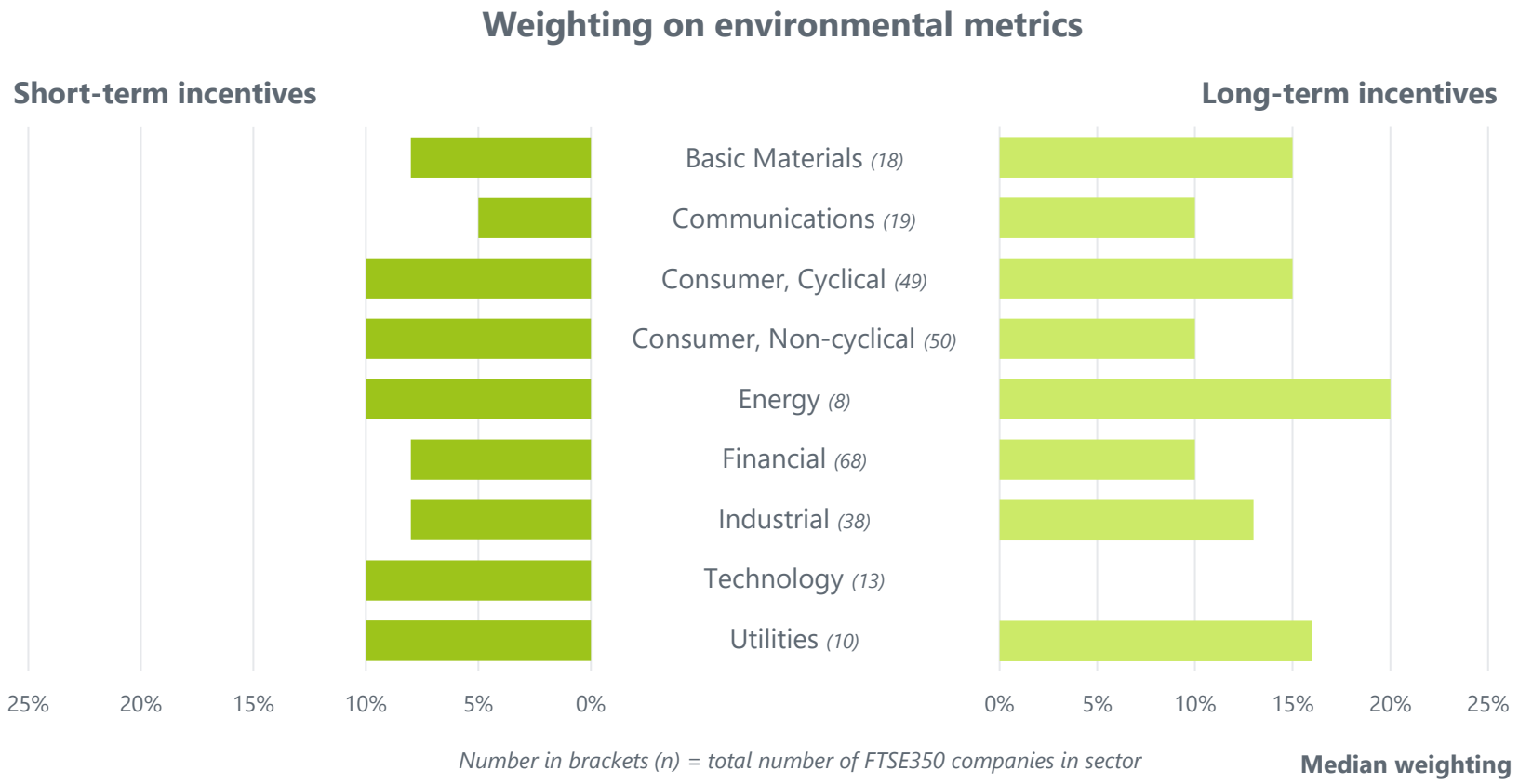
High-impact sectors have the highest prevalence of environmental metrics

High-impact sectors have the highest prevalence of environmental metrics, but companies from low-impact sectors, such as technology and communications, are also starting to embrace 'E' metrics in their incentive plans, particularly in the bonus



Environmental metrics

Where disclosed, the typical weighting on environmental metrics is around 5-10% of bonus potential, compared to around 10-15% in long-term incentives



Social metrics

Metrics linked to employee engagement, customer satisfaction and health & safety have been common in incentive plans for some time

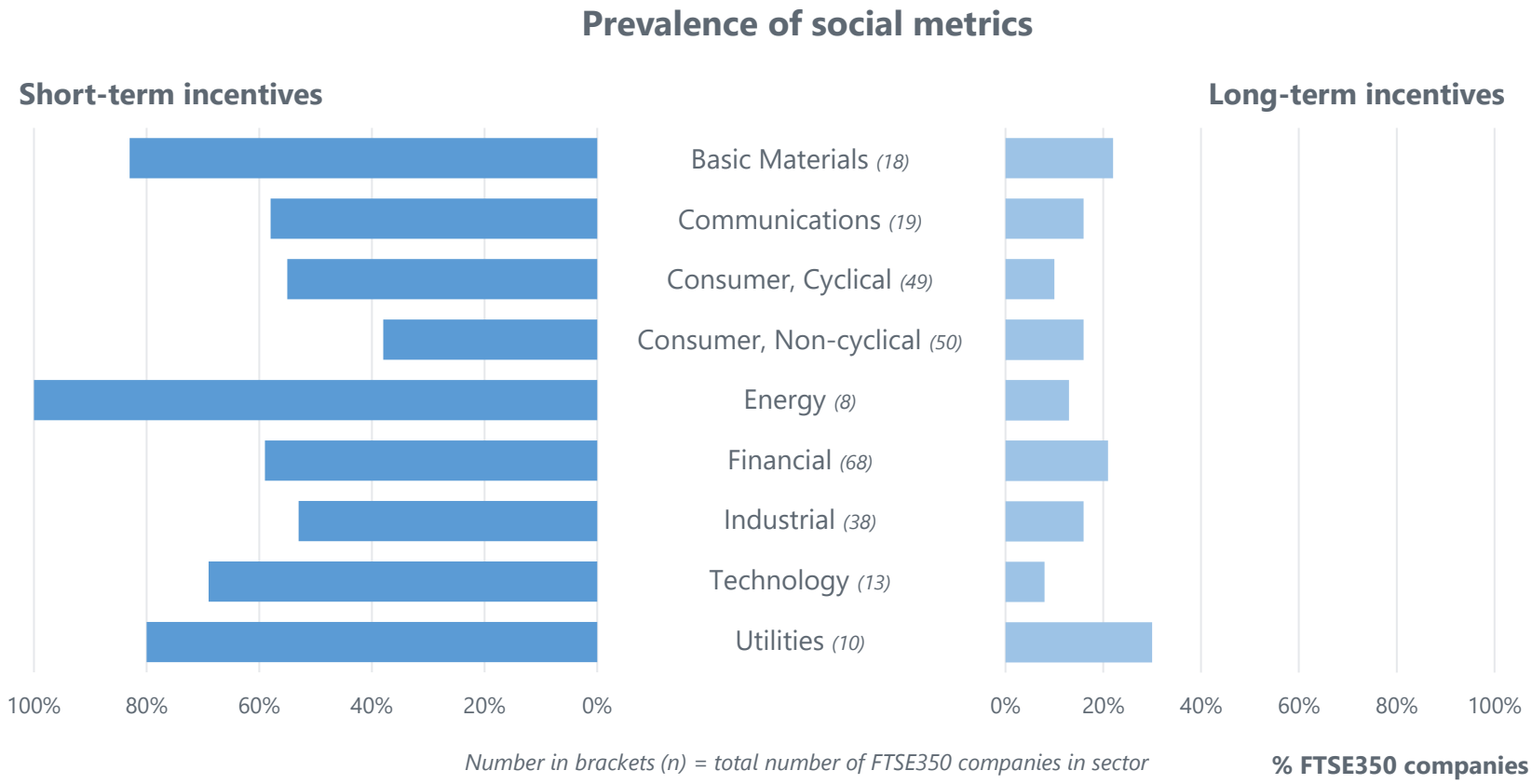
Social metrics are the most prominent ESG metric category across the FTSE350. Customer satisfaction and employee measures remain dominant, however there is growing prevalence of diversity & inclusion metrics and we are starting to see community metrics incorporated into the bonus scorecard in particular, with objectives linked to the wider societal impact of company operations, for example safer gambling and drinking.

While the majority of FTSE350 companies with a diversity & inclusion metric focus on gender diversity, nearly a fifth of companies include both gender and ethnicity

Prevalence (% of companies)	FTSE100		FTSE250	
	In STI	In LTI	In STI	In LTI
Any 'S' measure	**69%**	**25%**	**52%**	**12%**
Customer measures	29%	10%	23%	2%
Health & Safety	19%	1%	16%	3%
Diversity & Inclusion	28%	12%	15%	4%
Employee measures	27%	8%	27%	4%
Culture measures	2%	0%	3%	1%
Community measures	8%	2%	3%	0%
Supplier measures	2%	0%	0%	0%
Green Product	2%	2%	2%	2%

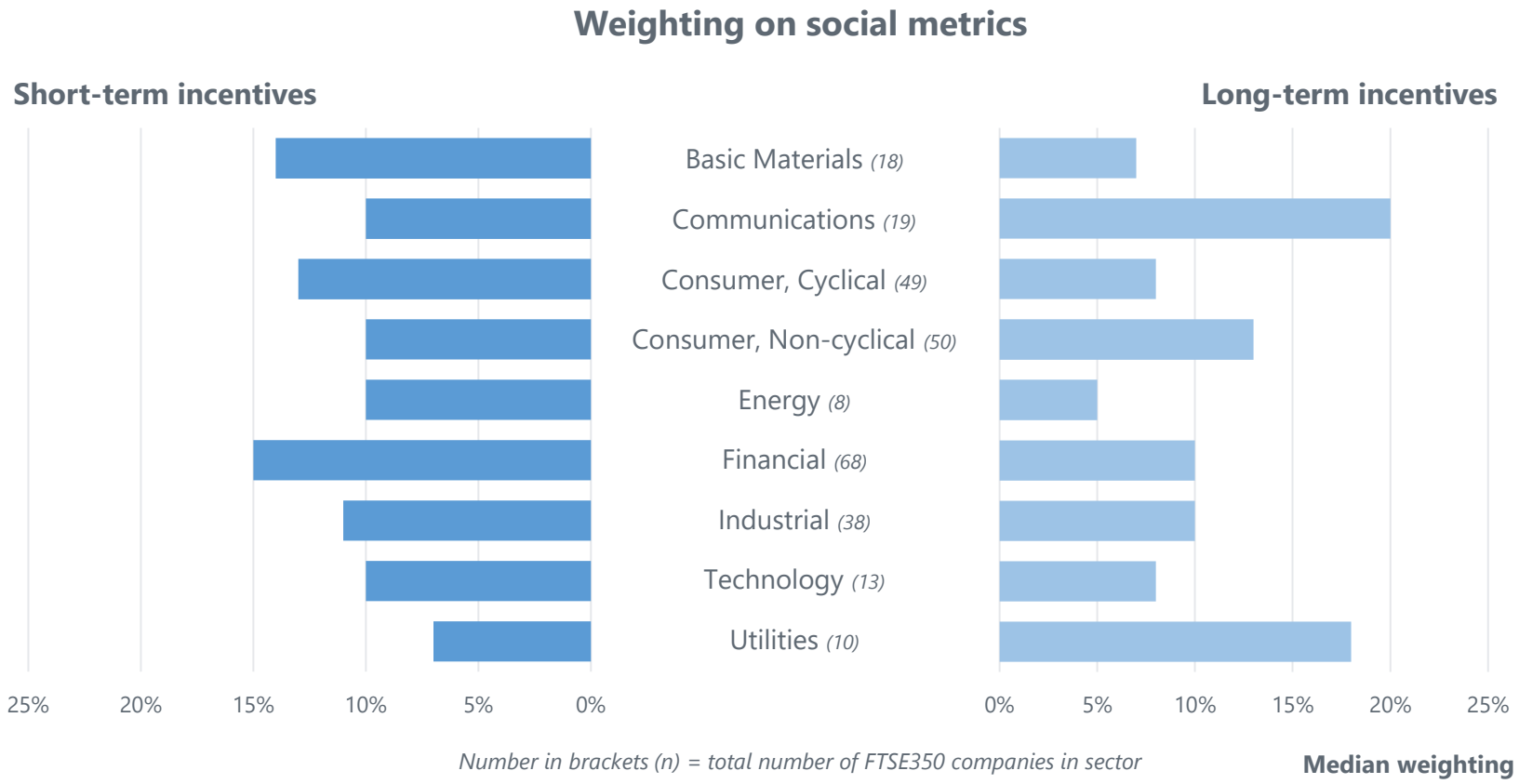
Social metrics

The use of social metrics is fairly equally spread across all sectors



Social metrics

Where disclosed, the typical weighting on social metrics is around 10-15% of bonus potential, compared to around 7.5-15% in long-term incentives



Governance metrics

Governance is an inherent feature in the structure of incentives

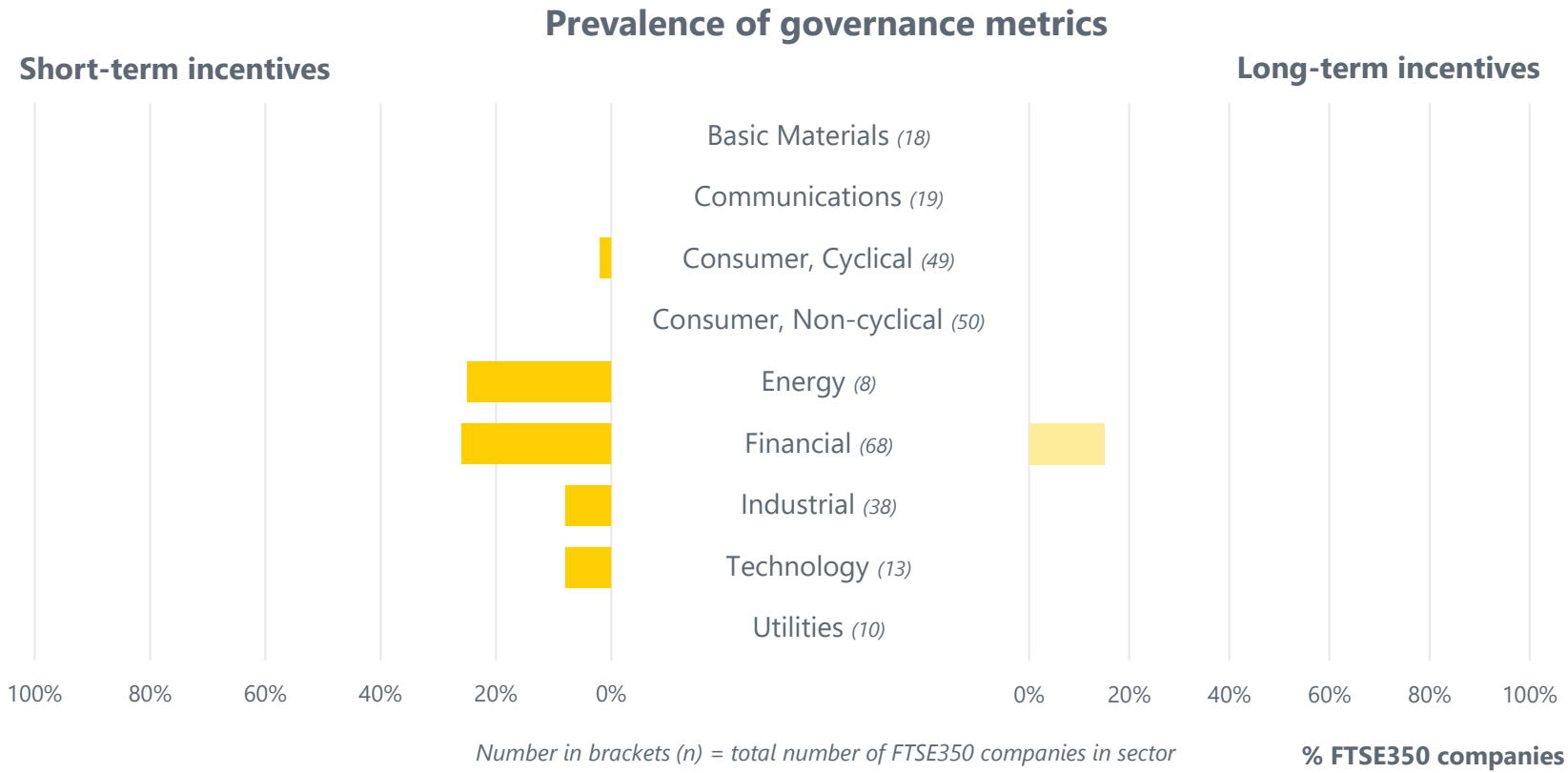
Specific 'governance' measures in incentives include corporate reputation, individual and collective conduct, and data security. While few FTSE350 companies adopt explicit 'governance' measures in their incentives, the prevalence of broader governance features in incentives is widespread, e.g. Committee discretion to override formulaic outturns, malus & clawback, deferral/holding provisions, etc.

Prevalence (% of companies)	FTSE100		FTSE250	
	In STI	In LTI	In STI	In LTI
Any 'G' measure	**9%**	**7%**	**9%**	**2%**
Risk/compliance	8%	7%	8%	2%
Governance	1%	0%	1%	0%
Typical weighting	*5-15%*	*10%*	*Small sample*	*Small sample*

Governance metrics

Governance metrics are typically adopted by companies in financial services

Explicit use of governance metrics in incentive plans is most common in the financial services sector (18 FTSE350 financial services companies), where risk-adjustment plays a major role in incentive outcomes and deferred elements of the bonus are often subject to risk-adjustment over the deferral period. Two companies in the energy sector include a risk metric in their short-term incentive



About Ellason

Ellason provides independent advice and support on all aspects of executive remuneration to Remuneration Committees and senior HR professionals.

Its founders together have over 65 years' experience in advising companies on executive pay strategy, and its client base includes a large number of listed and private companies. Ellason's aim is to be the leading and most trusted advisor to Remuneration Committees, and to do so through a primary focus on the requirements of the Chair and members of the remuneration committee.

Our guiding principle is that advice on remuneration matters should be strategic as well as pragmatic, and always supported by objective and independent analysis.

Our aim is to help companies develop senior executive pay structures which suit the economics of each company. Our starting point is to identify the ideal solution, and then partner with our clients to refine this to ensure that it appropriately balances the perspectives of internal and external stakeholders.

Please do not hesitate contact us if you have any questions relating to this survey or other remuneration-related query.