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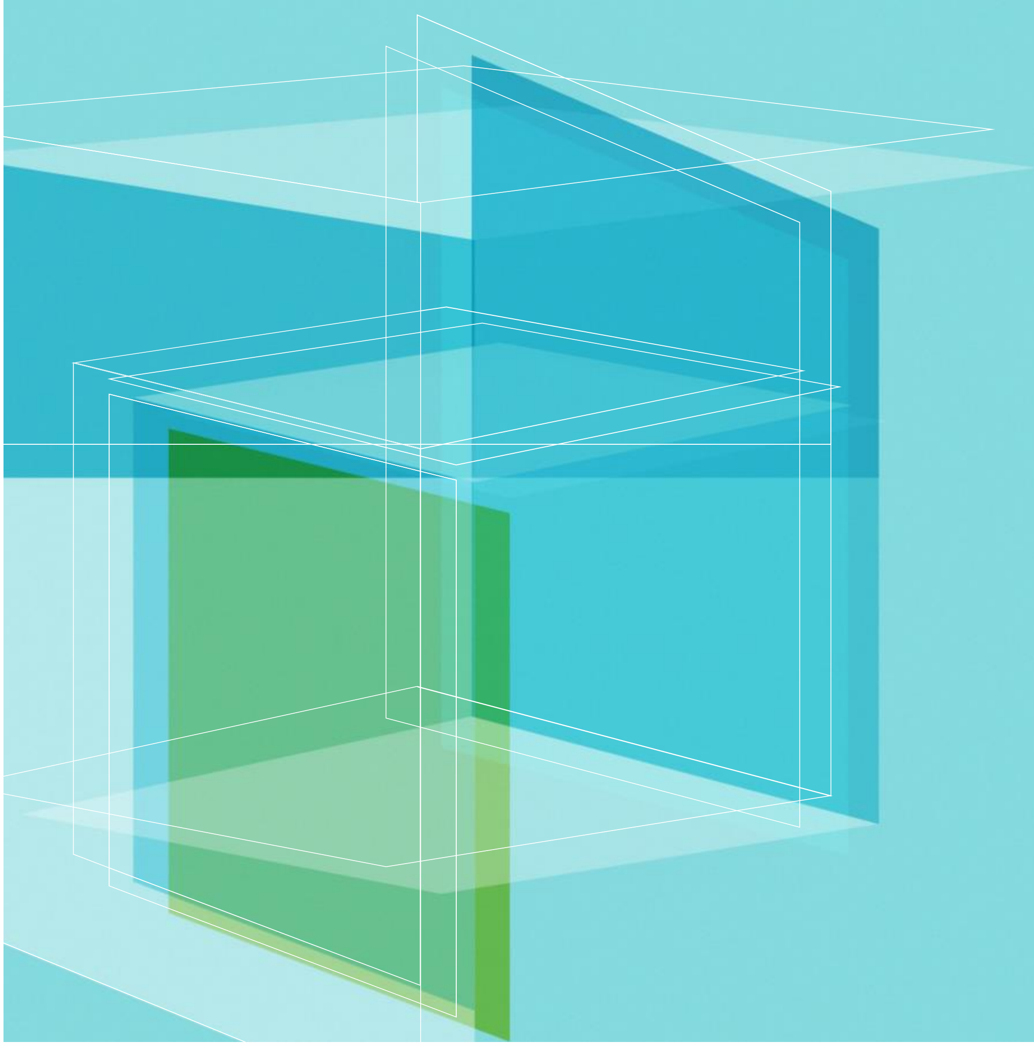
ESG+INCENTIVES

2022 REPORT

IN THIS ISSUE

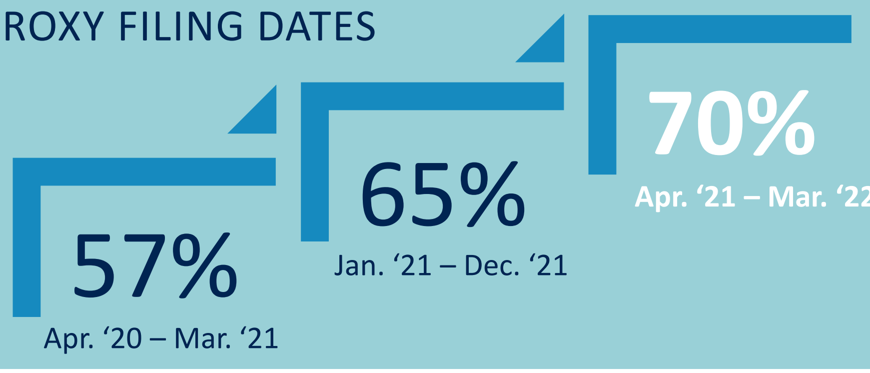


There has been a rapid increase in the adoption of ESG metrics for executive incentive plans across the S&P 500 over the past several years. This has largely been driven by continued shareholder focus on human capital management (HCM) and environmental issues. By adding these ESG metrics to incentive plans, Companies are signaling a heightened sense of commitment to their stated ESG goals.

SUMMARY OF SAMPLE

- S&P 500 COMPANIES
- $29B MEDIAN MARKET CAP

ESG IN COMPENSATION – PREVALENCE BY PROXY FILING DATES



KEY TAKEAWAYS

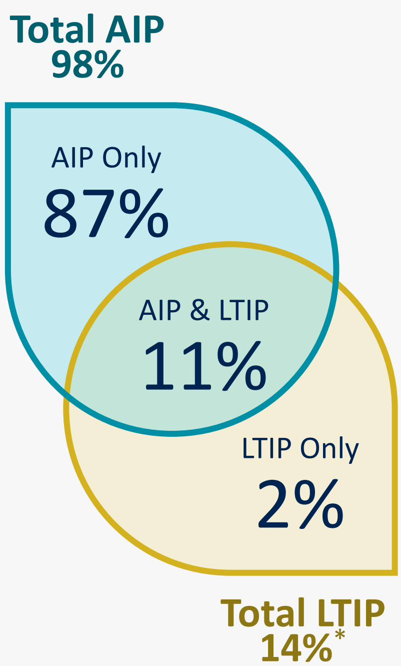
This year, there was a nearly 23% increase in the proportion of S&P 500 companies applying ESG metrics in incentive plans, at 70% prevalence compared to 57% prevalence a year ago. Diversity & Inclusion (D&I) and Carbon Footprint metrics had the largest year-over-year increases.

- Investors are strongly focused on HCM and environmental topics as the most important ESG issues. In this year’s data, we have specifically analyzed the prevalence of metrics within these two categories
- Although D&I continues to lead as the most prevalent metric (46%), companies appear to be taking a holistic approach to HCM in incentives by using other HCM metrics along with D&I
- Environmental metrics remain uncommon in incentive plans. However, prevalence is increasing, with Carbon Footprint emerging as the environmental measure of choice

METHODOLOGY AND S&P 500 DATASET

Semler Brossy has published an annual report series to track the growth of ESG metrics in incentive plans for the past two years. This report examines prevalence of ESG metrics across S&P 500 companies in the past year (proxies filed from April 2021 to March 2022). Future reports will assess differences in ESG prevalence by industry.

ESG IN INCENTIVE PLANS: AIP VS. LTIP IMPLEMENTATION (OF THOSE WITH ESG METRICS, N=348)



* *AIP and LTIP do not add to 100% due to rounding*

STRUCTURE OF ESG IN INCENTIVE PLANS

Of the S&P 500 companies with ESG metrics in incentive plans (348 of the 500), nearly all (98%) incorporate metrics into their annual incentive plans (AIP). Conversely, ESG metrics in long-term incentive plans (LTIP) are still relatively uncommon (14% of the same group) but growing in prevalence. We expect that this dichotomy is primarily because this is a new area of measurement for incentive plans and companies are still learning what works and what doesn't. Equity incentives also have more accounting complexity, and for ESG metrics, many companies shy away from the type of formulaic goals needed to ensure fixed accounting.

The most prevalent structure is to include ESG metrics as part of a scorecard (41%). A scorecard approach allows companies to designate a certain percentage of an incentive plan to a group of two or more metrics, which may include strategic or operational goals in addition to ESG. The scorecard provides Committees more discretion to assess performance and to update goals and priorities each year without adjusting the fundamental incentive plan design.

Discrete, weighted metrics, where each metric has a specific goal and a designated weighting, are often the most impactful design elements in incentive plans. This structure is used by 23% of S&P 500 companies with ESG metrics in incentives and is primarily used for metrics that are operationally focused, as opposed to sustainability oriented. We expect that this trend is driven by the longer experience with these metrics and relative ease of goal setting.

#	ESG METRIC STRUCTURE	(N=348)	DESCRIPTION/EXAMPLES
1	Discrete Weighted	23%	ESG is incorporated in incentives through specific metrics, each of which has its own discrete weighting (e.g., 10% of plan based on safety and 5% of plan based on customer satisfaction)
2	Scorecard	41%	ESG metrics are formally included in incentives but are not individually weighted and are generally assessed as part of a broader corporate or individual scorecard of ESG or business priorities (e.g., 30% of the plan tied to strategic initiatives, some of which include ESG)
3	Modifier	8%	ESG metric(s) can adjust the overall plan payout by a specified amount (e.g., +/- 10%)
4	Discretionary	28%	ESG is not fully quantified but rather included as an additional layer of discretionary considerations that may impact final payouts, generally in an individual component (e.g., CHRO implemented a company-wide diversity and inclusion training)

HCM METRICS

– Company Culture
– Diversity & Inclusion (D&I)
– Employee Satisfaction
– Talent Development
– Turnover/ Retention
– Safety

ENVIRONMENTAL METRICS

– Carbon Footprint
– Emissions/ Chemical Containment
– Energy Efficiency
– Sustainable Sourcing
– Waste Reduction
– Water Consumption

OTHER ESG METRICS

– Community Engagement
– Customer Satisfaction
– Cybersecurity
– Product Quality

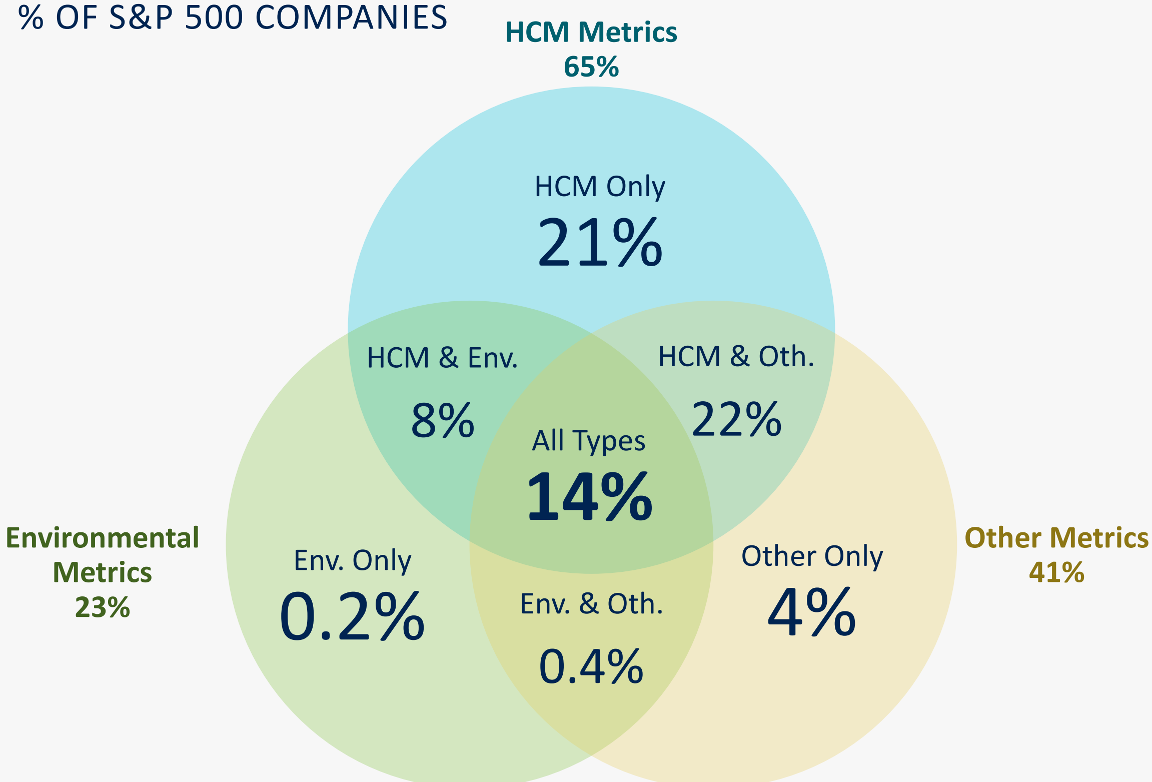
METRIC CATEGORIES

As we've historically discussed, ESG covers a broad spectrum of both operational and sustainability issues. Increasingly, investors are focused primarily on social and environmental sustainability measures. We've grouped the primary ESG measures into three categories to align with how investors and companies generally view ESG dimensions: Human Capital Management (HCM), Environmental, and Other ESG.

We found that 70% of the S&P 500 included ESG metrics in either their annual or long-term incentive plan this year. Moreover, nearly half (45%) of S&P 500 companies include metrics from two or more ESG categories in their incentive design plans.

Also of note, 65% of S&P 500 companies have adopted HCM metrics, which demonstrates that nearly all companies that have included ESG metrics have specifically included HCM metrics.

USE OF ESG METRIC CATEGORIES
% OF S&P 500 COMPANIES



METRIC PREVALENCE

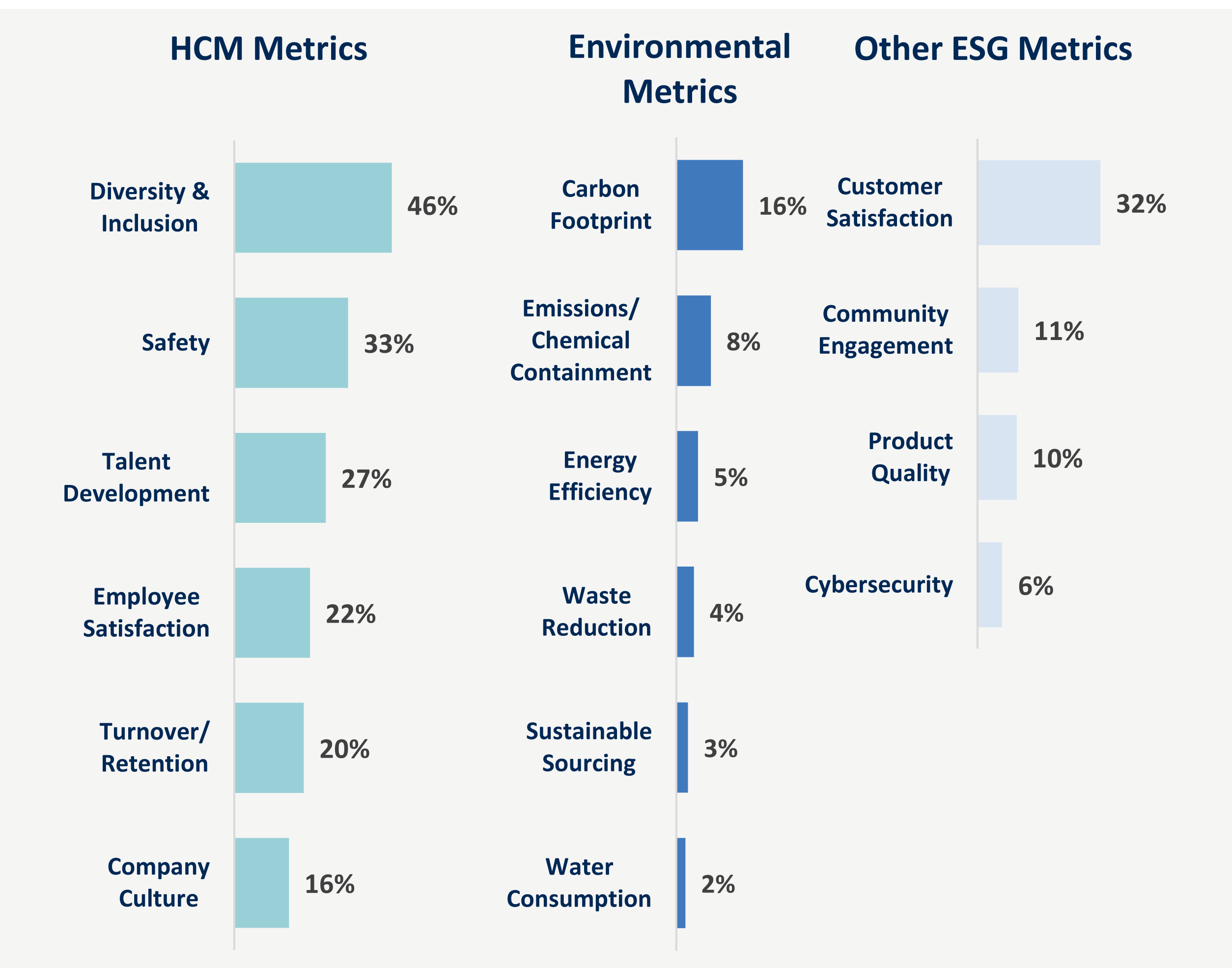
HCM 65% Overall, HCM is the most prominent category of metrics, with 65% of the S&P 500 incorporating these considerations into incentive plans. This aligns with broader market talent-related challenges that many companies are experiencing, including the highly competitive market for talent.

Env. 23% Consistent with prior years, environmental metrics are the least prevalent ESG category considered in only 23% of S&P 500 compensation plans; however, this is a 64% increase from 14% of S&P 500 companies last year.

Other 41% Other ESG metrics consist of operational, consumer-focused, and broader-social measures and represents the second most prominent category, with 41% of the S&P 500 implementing these measures.

Prevalence of Each ESG Metric Among All S&P 500 Companies, Organized by Category

% of S&P 500 companies using each metric (N=500)



"Companies are increasingly dedicating resources to attracting and retaining quality talent, which we hope is not a short-term fix but rather indicative of a more sustainable shift. As such, we expect companies to describe how their approach to human capital management advances their firm's long-term business strategy."
—STATE STREET ADVISORS

HUMAN CAPITAL MANAGEMENT METRICS

HCM is the most prominent category of ESG metrics, with 65% of the S&P 500 considering these metrics in executive incentive plans. All HCM metric categories increase substantially in prevalence year over year. We expect that this increase is driven by stakeholder focus on talent-related issues, intense competition for talent, and the growing knowledge of how to measure and assess HCM performance.

Consistent with last year, D&I is both the most prevalent metric within HCM and overall ESG, and the metric that experienced the second highest year-over-year increase in prevalence (behind Carbon Footprint). D&I is considered in incentive plans at 46% of all S&P 500 companies, which represents a 64% increase when compared to last year's 28% prevalence.

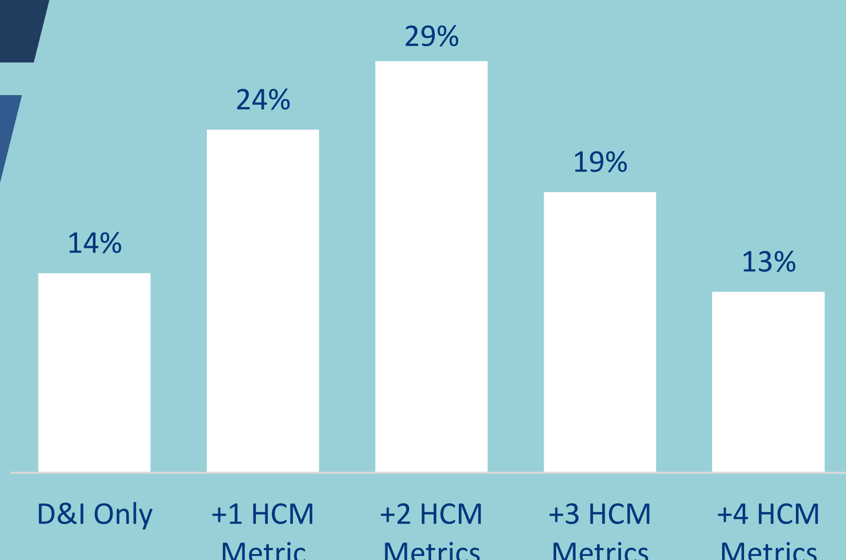
Although D&I is the most common metric, our findings show that companies generally take a more holistic approach to assessing HCM achievements. The exhibit below shows that nearly half of the S&P 500 include a D&I measure in their incentive plans. Of those companies, 86% also include at least one other HCM metric, and over half have at least two additional HCM metrics in their incentive plan designs.

70% of S&P 500 companies have ESG metrics

46% of S&P 500 include a D&I metric

39% of S&P 500 have D&I and 1+ other HCM metric

PREVALENCE OF ADDITIONAL HCM METRICS OF COMPANIES WITH D&I (n=231)



"The world at large is getting hotter, with more pollutants in the air, more violent weather, and our fragile global water supply and broader ecosystem is at risk. Investors, shareholders, and customers increasingly want to ensure their portfolios are aligned with their core values, including their beliefs about the need to support companies working to reduce or eliminate climate change."
— FIDELITY INVESTMENTS

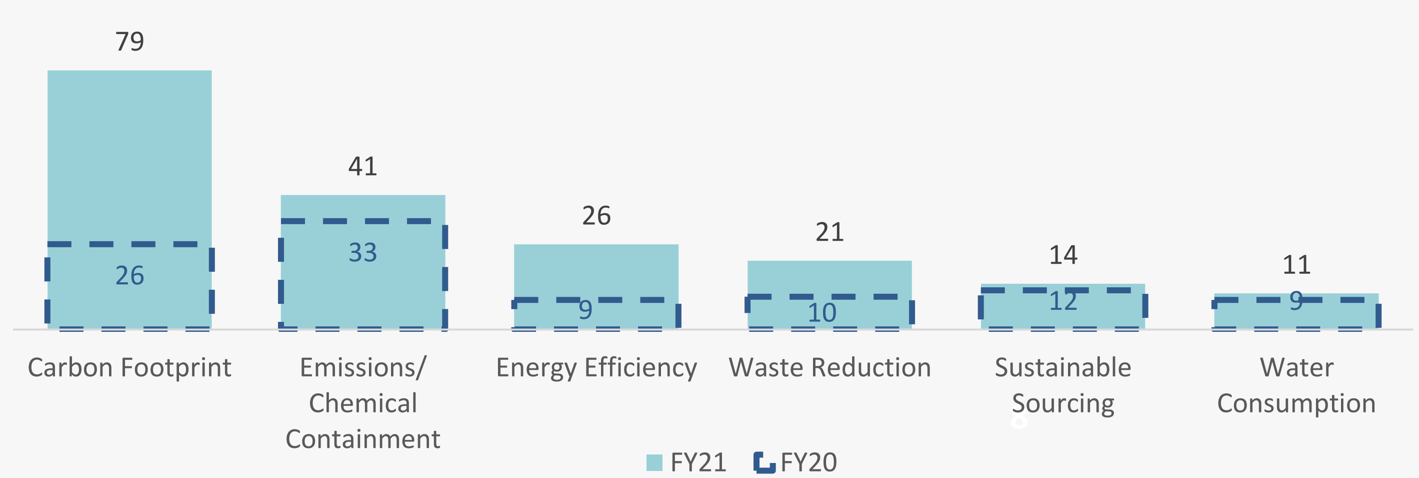
ENVIRONMENTAL METRICS

Although environmental metrics are the least prevalent grouping of ESG metrics in incentives, their prevalence has increased 64% year over year, from 14% to 23%. Carbon footprint metrics have been a key driver of this increase and have emerged as the environmental metric of choice for S&P 500 companies. Carbon footprint metrics experienced an over 300% year-over-year increase in prevalence, from 5% to 16% prevalence across the S&P 500. This was the largest increase among all ESG metrics year over year.

As major institutional investors continue to advocate for companies to consider risks and opportunities associated with climate change, we expect that pressure to add environmental measures will increase. Moreover, with two-thirds of S&P 500 companies having set greenhouse gas emissions reduction targets[1], we believe that carbon footprint metrics will continue to lead prevalence among environmental measures. Additionally, recent SEC guidance on expanded climate-related disclosures may further accelerate this trend.

We hypothesize that challenges associated with goal-setting and measuring achievements in a timely manner have historically deterred many companies from incorporating environmental measures into incentive design plans. We expect that as more companies are disclosing information around how they consider environmental measures in compensation, they are setting the standard and paving a path for more companies to follow suit.

Year-Over-Year Increase in Metric Prevalence:
Number of S&P 500 Companies With Environmental Metrics



[1] Refinitiv Research: https://www.refinitiv.com/perspectives/future-of-investing-trading/are-sp-500-companies-prioritizing-environmental-sustainability/

CASE STUDY Phillips 66

As a petroleum Company, Phillips focuses on its impact on stakeholders through its commitment to its corporate values of safety, environment, diversity, and social responsibility. These values are reinforced in Phillips' annual incentive program which is tied to environmental metrics, including low carbon priorities, and HCM metrics focused on employee safety and culture. Phillips weights operational sustainability objectives, which include ESG and HCM metrics, at 50% of the annual incentive plan, with the remaining 50% dedicated to financial goals (Controllable Costs and EBITDA).

METRIC TYPE	AIP COMPONENT	METRICS	WEIGHT
Operational/ ESG Metrics (50% of Program)	Safety & Operating Excellence	Total Recordable Rate (TRR)	5%
		Lost Workday Case Rate (LWCR)	5%
		Process Safety Event Rate – Tier 1	5%
		Availability	10%
	Environment	Low Carbon Priorities	5%
		GHG Priorities	5%
		Environmental Events	5%
	High Performing Organization	Culture, Capacity, and Performance	10%
Financial Metrics (50% of Program)	Financial Sustainability	Adj. Controllable Costs ($MM)	10%
		Adj. EBITDA ($MM)	40%
		Total	**100%**

CASE STUDY Bristol Myers Squibb Co.

Bristol Myers Squibb Co. is a pharmaceutical giant that places a strong emphasis on retaining and developing critical talent to ensure that its leadership is exemplifying its "BMS Values" of accountability, inclusion, innovation, integrity, passion, and urgency. This is supported through their incorporation of human capital management goals worth 10% of their annual incentive plan based on maintaining high retention and employee engagement levels. These metrics have been maintained at the same weighting in the plan since their inception in 2020. Looking forward into 2022, the annual incentive plan will evolve to incorporate a 10% ESG scorecard in lieu of the HCM goals that will be "aligned to [Bristol Myers Squibb's] commitments on sustainability and social impact."

METRICS	WEIGHT
EPS	30%
Revenues	25%
Product Pipeline	25%
Synergies	10%
HCM	10%

CATEGORY (WEIGHTING)	METRICS	METRIC MEASUREMENT
Human Capital (10%)	Assessment of Voluntary Attrition Management	Measured based on: - Actual trailing attrition levels during 2021 viewed against ranges developed using company's observed attrition levels; and - Management actions to manage and mitigate attrition
	Assessment of Employee Experience/ Engagement	Measured based on: - Employees' observation of employee experience through pulse surveys against baseline results from December 2019. In 2021, surveyed quarterly to (i) measure progress, (ii) aid in the focus of talent and workforce investment decisions, and (iii) address needed management interventions

CASE STUDY Xylem Inc.

As an industrial company focused on water technology, Xylem places a strong emphasis on ESG in its business as exemplified by its inclusion in both its AIP and LTIP. Xylem incorporates ESG in its annual incentive program as part of the individual objectives worth 25% of the program, which include goals on customer success, diversity and inclusion, company culture, talent development, community engagement and sustainability (the remaining 75% of the AIP is weighted evenly between organic revenue, adj. operating income, and free cash flow conversion metrics).

Separately, Xylem offered a special PSU award to its executive team in 2021 focused 100% on key ESG priorities. This award has a 4-year performance period to promote long-term achievement against key ESG goals and is valued approximately at 10% to 15% of total compensation for all NEOs. Additionally, the award represents a 25% incremental increase on top of prior years' target equity grants for the NEOs and is worth 20% of the overall 2021 LTI mix for each NEO.

LTI Mix Breakdown (2021)

SPECIAL ESG PSU AWARD METRICS	WEIGHT	PERFORMANCE TARGET
Women in Leadership	20%	33%
Process Water Recycling *(# of major facilities)*	20%	20
CO_2 Reduction *(million metric tons; cumulative difference)*	20%	1.7
Pollution Prevention *(billion cubic meters; cumulative difference)*	20%	4.2
Non-Revenue Water Reduction *(billion cubic meters; cumulative difference)*	20%	2.4

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