# Clean and Clear

## Non-financial ESG-related metrics gain prominence in compensation programs

By Ron Schneider

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Investors are keenly interested in understanding executive compensation programs, especially how these pay programs tie in with and support major elements of a company's business strategy. Pre-set formulaic metrics, where employed, provide a clear window into the behaviors and performance that compensation committees are rewarding.

These metrics traditionally revolve around a range of financial, operational and strategic measures, with TSR improvement (both absolute and relative) either an explicit or implicit objective. Increasingly, many companies are including one or more non-financial metrics in their programs.

Examples of these non-financial metrics include:

- Diversity efforts (board, C-suite and general workforce)
- Employee engagement
- Employee health and safety, and remote work
- Supply chain resilience
- Strategic and revenue diversification efforts

It is anticipated that the impact of COVID-19 on a company's operating and financial performance, employees, supply chains and even its business models is causing companies to focus on improving their resilience to events that once seemed abstract or remote. As a result, many likely will incorporate ESG-related objectives into executive performance metrics, and disclose this heightened focus and new set of priorities to investors.

As reported by Willis Towers Watson in its blog earlier this spring (March 27, 2020): "Just over half (51%) of S&P 500 companies use ESG metrics in their incentive plans, with 50% including it in annual incentive programs (AIPs), … only 4% use ESG metrics for long-term incentive programs (LTIP)."

As companies incorporate additional categories of incentives and metrics into their programs, they will want to disclose these to investors in hard-to-miss, easily digested formats. Typically,

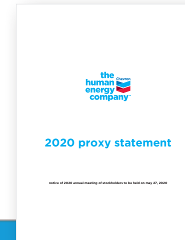



**Figure 1**

Chevron Corporation proxy filed April 7, 2020, page 42. See full proxy statement at ***bit.ly/2RQATRt***.

executive compensation

Specific inputs to the MCC's evaluation are summarized below.

| Category | Weight | Performance measures | | Year-end results vs. Plan highlights "Plan" refers to Board-approved Business Plan | Results(1) | Raw score (0.00 - 2.00) | Weighted score |
|---|---|---|---|---|---|---|---|
| Financials | 40% | Earnings(2) | | $2.9 B, significantly below Plan primarily due to impairments. Normalized earnings below Plan. 5-yr EPS performance versus peers negatively impacted by Upstream weighting amid lower oil prices. | 🔴 | 0.85 - 0.95 | 0.34 - 0.38 |
| | | Cash flow(3) | | $27.3 B, in line with Plan. Normalized for price, better than Plan. | 🟢 | | |
| | | Divestiture proceeds | | $2.8 B, below Plan. On track to deliver proceeds within $5-$10 B program guidance range (2018-20). | 🟢 | | |
| Capital management | 30% | Return on capital employed (4)(5) ("ROCE") | | 2.0%, significantly below Plan primarily due to impairments. Rolling five-year performance vs. peers continues to be adversely impacted by trailing periods—larger Upstream weighting during price decline. | 🔴 | 0.80 - 0.90 | 0.24 - 0.27 |
| | | Organic capital and exploratory expenditures (C&E), including equity in affiliates | | $20.2 B; in line with Plan. | 🟢 | | |
| | | Major milestones | Gorgon | First $CO_2$ injection achieved in 3Q19. | 🔴 | | |
| | | | FGP/WPMP | Core Substation milestone completed in 3Q19. High Pressure Early Oil milestone completed in 4Q19. FGP site productivity improved significantly since 2018, but did not meet objective. Project cost and schedule are likely to exceed original estimates. | | | |
| | | | Permian | Met average unit development cost objective. | | | |
| | | | Asia Petrochemicals | Achieved final investment decision in 1Q19. | | | |
| Operating performance | 15% | Net production, excluding impact of divestments | | Annual growth in middle of 4-7% targeted range. | 🟢 | 0.95 - 1.05 | 0.14 - 0.16 |
| | | Operating expense(6) | | $25.9 B, above Plan. Unit costs higher than plan. | 🟡 | | |
| | | Refining utilization, including joint ventures and affiliates | | Short of Plan by 3.7 percentage points. | 🟡 | | |
| Health, environmental and safety | 15% | Personal safety(4) | | Days Away from Work rate led industry and matched record low. Serious Injury count better than Plan and set new record low. Gaps in fatality prevention. | 🟡 | 1.10 - 1.20 | 0.17 - 0.18 |
| | | Process safety and environmental | | Loss of containment and spill volumes better than Plan. Some gaps in preventing high-severity incidents. | 🟢 | | |
| | | Greenhouse gas management | | On track to achieve flaring and methane intensity reductions. | 🟢 | | |
| | | | | Corporate Performance Rating Range | | | 0.89 - 0.99 |
| | | | | Final Corporate Performance Rating | | | 0.95 |

**Notes:**

(1) Results refer to met / exceeded Plan (green), met Plan with some gaps (yellow), or did not meet Plan (red).

**Figure 2**
Alcoa Corporation proxy filed March 19, 2020, page 54. See full proxy statement at ***bit.ly/300lmmU***.

***Company IC Plan Metrics***

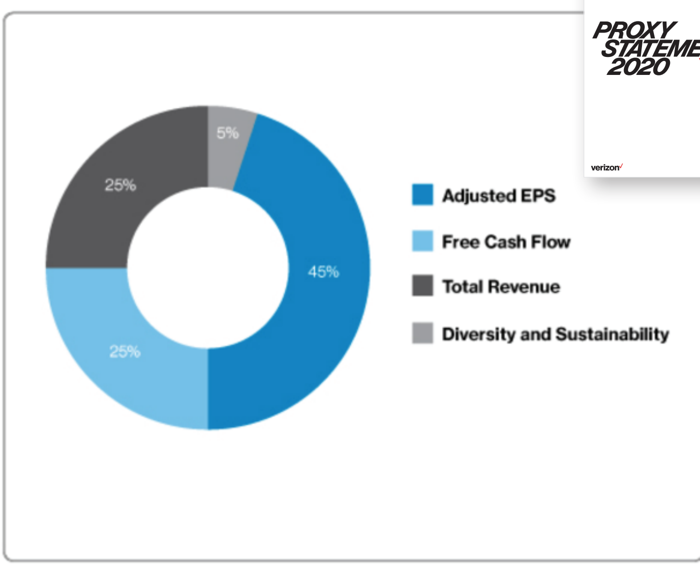
The below chart describes the specific 2019 metrics and results for the 2019 Company IC Plan awards:

| Performance Metrics(1) | Metric Weight | Performance Minimum (0%) | Performance Threshold (50%) | Performance Target (100%) | Performance Maximum (150%) | Performance Super-Maximum (200%) | Performance Results | Achievement % | Weighted Result |
|---|---|---|---|---|---|---|---|---|---|
| **Financial Metrics (70%)** | | | | | | | | | |
| Adjusted EBITDA Excluding Special Items-Not Normalized ($M)(2) | 20.0% | 500 | 1,400 | 2,100 | 2,800 | 3,500 | 1,656 | 68% | **13.7%** |
| Free Cash Flow-Normalized ($M)(2) | 20.0% | 66 | 241 | 416 | 716 | 1,016 | 706 | 148% | **29.7%** |
| Average Attainment on Business Unit Metrics(3) | 30.0% | 0% | 50% | 100% | 150% | 200% | 82% | 82% | **24.6%** |
| **Non-Financial Metrics (30%)** | | | | | | | | | |
| ***Safety and Environmental*** Zero Fatalities (count)(4) | 7.5% | 1 | — | — | — | 0 | 0 | 200% | **15.0%** |
| FSI-Actual (count)(5) | 7.5% | — | 5 | 3 | — | 1 | 3 | 100% | **7.5%** |
| $CO_2$ emission reduction (Kmetric tons) | 5.0% | — | 6.6 | 110.3 | — | 189.3 | -81.6 | 0% | **0.0%** |
| ***Diversity*** Global Women (%)(6) | 10.0% | — | 15.0% | 15.3% | — | 15.7% | 14.9% | 0% | **0.0%** |
| **Total** | 100.0% | | | | | | | | **90.5%** |

(1) The maximum payout for each financial and non-financial metric is 200%.
(2) Adjusted EBITDA Excluding Special Items-Not Normalized and Free Cash Flow-Normalized are Non-GAAP financial measures. Please see "*Attachment A—Additional Information Regarding Financial Measures*" for further discussion regarding how these numbers are calculated from Alcoa's Consolidated Financial Statements, reconciliations to the most directly comparable GAAP measures, and how normalization is applied.

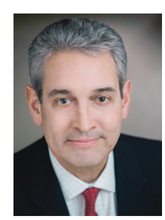
**Figure 3**
Verizon Communications proxy filed March 23, 2020, page 29. See full proxy statement at ***bit.ly/2FXuKk9***.

**2019 Short-Term Plan Performance Measures**


## Why these performance measures?

The Committee selected adjusted earnings per share (EPS), free cash flow and total revenue to reflect Verizon's strategic goals of encouraging profitable operations, efficient use of capital and overall growth. The Committee also selected diversity and sustainability metrics to reflect Verizon's commitments to promoting diversity among our employees and our business partners and to reducing the environmental impact of our operations.



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such metrics are disclosed, in tabular format, in the full discussions of each relevant element of pay in the body of the CD&A.

Given the increasing complexity of compensation programs and a growing desire to summarize programs "at a glance," many companies are supplementing traditional CD&A content with half or full-page "elements of compensation" tables.

In this article are a few examples of how companies are disclosing E&S and other non-financial metrics, along with more traditional financial and operational metrics, in their proxies. These examples and many more can be found in DFIN's "Guide to Effective Proxies." CS

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*For additional examples of how companies are disclosing compensation metrics, as well as a range of other compensation, governance, ESG and related proxy disclosures, please see DFIN's "Guide to Effective Proxies," available **here**.*


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