

Canada Executive Edition

Trends in ESG & Executive Compensation

October 2023



Investors demand sustainable investment funds that incorporate environmental, social and governance (ESG) factors. The growth in assets under management in ESG products/services continues to grow. The investments are driven by new technologies (e.g., AI) that support product innovation. Investors have access to more data for their investing decisions.

Various levels of government continue to play a key role establishing policies, regulations and initiatives to support and encourage long term sustainability. For example;

- The Canadian government in March 2022 introduced its 2030 Emissions Reduction Plan, which provides a detailed roadmap for the Canadian economy to achieve an emissions reduction of 40-45% below 2005 levels, by the year 2030.
- The province of British Columbia is committed to reducing greenhouse gas emissions by 16% below 2007 levels by 2025, 40% by 2030, 60% by 2040 and 80% by 2050. The province is taking actions to reduce pollution and waste while identifying new technologies and opportunities that will help meet the longer-term climate goals.
- Alberta has a many measures and initiatives underway fighting climate change, such as capping oil sand emissions, reducing methane emissions by 45% by 2025, phasing out emissions from coal, implementing Renewable Fuels Standard (RFS) that requires commercial fuel producers and importers to blend renewable products into their fuels.

- The Government of Ontario is building a low-carbon economy with the release of the province's [Climate Change Action Plan](#), which will provide people and businesses with tools and incentives to accelerate the use of clean technology that exists today. Through this plan, the province will continue to reduce greenhouse gas pollution to fight climate change. The plan ensures that proceeds from the province's recently finalized capital and trade program are invested in a transparent and accountable way back into green projects that will help households and businesses reduce greenhouse gas pollution and save on their energy costs.

The transition to a low-carbon environment is creating new risks and opportunities for organizations. In supporting this shift, Boards of directors of Canadian corporations are stressing the importance of ESG considerations as part of their business and processes.

So, how are corporations using executive compensation to foster ESG and reward ESG performance? In this 2023 Executive Edition, we report on the latest developments among the top 120 publicly traded ("TSX120") companies in Canada by market cap.

Overall ESG practice by industry

Our 2023 research indicates that various segments of TSX organizations have similar practices, reflecting that company size is not a determining factor for their ESG priorities.

Exhibit 1: Prevalence of ESG Practice in Incentive

Industry	TSX60	TSX61-120	TSX120
STI or LTI	82%	80%	81%
Short Term Incentive (STI)	78%	80%	79%
Long Term Incentive (LTI)	20%	14%	17%

Exhibit 2: ESG Measure for Short Term Incentive

Industry	# organizations	Prevalence			
		E, S or G	Environmental Measure	Social Measure	Governance Measure
TSX60	60	78%	60%	78%	47%
Financial	11	91%	91%	91%	55%
Energy	9	89%	78%	89%	33%
Materials	9	89%	89%	89%	78%
Industrial	6	83%	50%	67%	33%
Consumer	10	70%	30%	70%	30%
TSX61-120	60	80%	53%	72%	33%
Financial	10	49%	0%	40%	20%
Energy	9	100%	100%	100%	33%
Materials	12	84%	67%	75%	25%
Industrial	10	80%	50%	80%	40%
Consumer	3	67%	0%	67%	33%
TSX120	120	79%	57%	75%	40%
Financial	21	71%	48%	67%	38%
Energy	18	94%	89%	94%	33%
Materials	21	86%	76%	81%	48%
Industrial	16	81%	50%	75%	38%
Consumer	13	69%	23%	69%	31%

As indicated above in Exhibit 2, the following are key observations of ESG practice in STI programs:

- Social measure is the most common ESG component in all 3 TSX segments.
- No financial or consumer organization in the TSX61-120 adopts any environmental measure.
- Energy and materials organizations across all 3 TSX segments have heavily adopted an environmental measure.
- Governance measures are the least practiced across the TSX120 organizations, with only 40% prevalence.

Only 17 of TSX120 organizations have adopted ESG as a corporate performance measure in their long-term incentive (typically share-based incentive programs). Due to limited data, no conclusive observations could be made for long-term incentive.

ESG Application in Short Term Incentive Plans

Corporations find several ways to recognize the importance and priority of ESG within STI, from corporate and/or individual scorecards.

- As seen in Exhibit 3, ESG are either used in the corporate scorecard or both corporate and individual scorecards.
- ESG used in the individual scorecard alone is the least favorable method.
- The prevalence is consistent across all segments of TSX organizations.

Exhibit 3: ESG Used in STIP

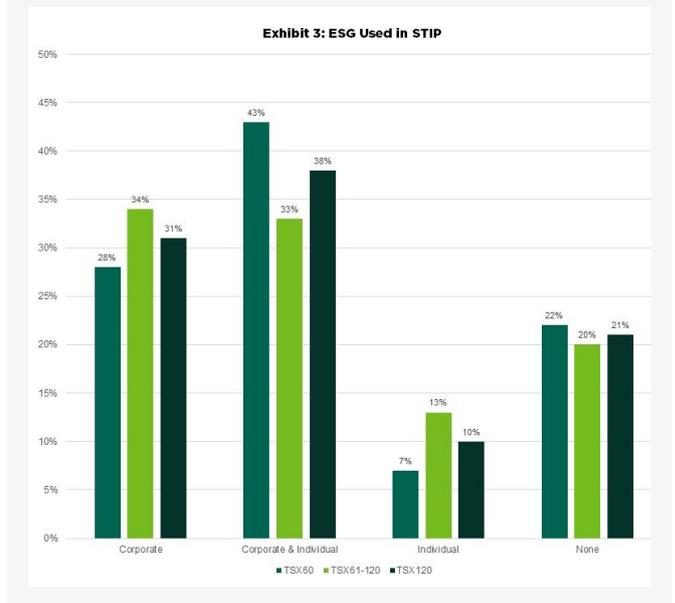


Exhibit 4: ESG Metrics in Short Term Incentive Plan

Category	Measure	Prevalence		
		TSX60	TSX61-120	TSX120
Environment	Carbon Footprint and Emission Reduction	63%	58%	60%
	Energy Efficiency / Renewable Energy	21%	10%	16%
Social	Employee Health & Safety	52%	63%	57%
	Diversity and Inclusion	65%	41%	53%
	Employee Engagement	38%	33%	35%
Governance	Compliance	15%	25%	19%
	Recruitment, Retention and Turnover	13%	25%	20%

- The TSX120 has the strongest emphasis on Carbon Footprint & Emission Reduction, Employee Health & Safety and Diversity & Inclusion are the most common metrics subject to the industry type.
- About 20% of TSX120 use an ESG modifier to adjust the STI payout. This is typically applied to the corporate performance factor, if used.

Regulatory and Shareholders' Advocacy

OSFI's Climate Risk Management Guidelines

In March 2023, the Office of the Superintendent of Financial Institutions (OSFI) published Guideline B-15: Climate Risk Management, which sets out OSFI's expectations for the management of climate-related risks.

This Guideline is OSFI's first prudential framework that is climate sensitive and recognizes the impact of climate change on managing risk in Canada's financial system. The new Guideline B-15 was published after extensive consultations. OSFI received over 4,300 submissions from a wide range of respondents, including Federally Regulated Financial Institutions (FRFIs). Four key themes characterized respondent feedback:

- OSFI's approach to climate-related risks;
- OSFI's expectations related to climate-related financial disclosures;
- The importance of incorporating proportionality and materiality considerations into the guideline; and
- The adequacy of climate-related capital and liquidity requirements.

Proxy Advisors

ISS Canada has a global approach to evaluating social and environmental proposals and generally vote case-by-case, examining whether implementation of the proposal is likely to enhance shareholder value. In addition, they recommend voting case-by-case on management proposals that request shareholders to approve the company's climate transition action plan taking into account the completeness and rigour of the plan.

Similarly, Glass Lewis Canada believes that the Board's role is to ensure management conducts a complete risk analysis of company operations including those that have material environmental and social implications. As such, insufficient oversight of material environmental and social issues can present direct legal, financial, regulatory and reputational risks that could serve to harm shareholder interests and therefore should be carefully monitored and managed. Glass-Lewis recognizes that ESG strategy, targets and their use in incentives should be considered with the company's unique circumstances.

ESG Trends in USA

A recent study undertaken by a third-party indicates the following findings among the largest 250 companies listed in the United States. The US trends are very similar to the practices among

TSX120 companies in Canada.

- 75% of companies have adopted ESG measures in their incentive plans. The prevalence has been relatively stable for the last 2 years.
- ESG measures adopted in short term incentive plans are the most common practice. Only 2% of the companies incorporate ESG in their long-term incentive plans.
- Diversity & Inclusion and Environment & Sustainability are the most common ESG measures used in incentive plans in 2023.
- Performance in Environment & Sustainability and Health & Safety metrics are the focus among Energy, Utilities, and Materials industries.
- Companies are increasingly (38% prevalence) using ESG goals as stand-alone weighted measures and/or stand-alone modifiers.
- Most companies continue to measure ESG performance on a qualitative basis. Only 25% of the companies use quantitative measures as disclosed in their 2023 information circular.

What's next?

Boards of directors have the fiduciary duty to ensure corporate strategy meets the best interests of shareholders and its social obligations, including ESG. These questions might help your development:

- Where are you on this journey?
- Have you defined your ESG strategy and started tracking your base line data?
- Have you started tracking your ESG progress and measuring ESG performance?
- Have you adopted ESG metrics into your incentive plan(s)?
- How deep in the organization are you using ESG metrics? Are you applying them to the entire workforce or only the executives?

Korn Ferry is here to help

Our purpose is to inspire and unleash the potential of your people, teams, and organizations.

Our dedicated, global specialists in North America—spread across 27 offices—are primed and ready to support you throughout all stages of the ESG journey.

We hope that this briefing has equipped you with valuable insights from the market perspective. Should you have any comments or needs, please reach out.

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About Korn Ferry

Korn Ferry is a global organizational consulting firm. We work with our clients to design optimal organization structures, roles, and responsibilities. We help them hire the right people and advise them on how to reward and motivate their workforce while developing professionals as they navigate and advance their careers.

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