Voting for remuneration linked to non-financial KPIs

As impact investors, we want to see ambitious non-financial targets that underpin a company's long-term sustainability strategy, with sufficient weight to influence behaviour, and transparent disclosure to ensure clarity and accountability.

By *Crystal Wong*

Within our Positive Impact Equity Investment Team, we leverage our influence as institutional investors to promote sustainability by advocating for executive remuneration tied to non-financial KPIs. We actively vote on all companies within our impact funds' portfolios, and in particular we vote on remuneration policies at Annual General Meetings, opposing those without substantial links to sustainability. This reflects our commitment to fostering sustainable corporate behaviour among our investees and aligning their business practices with long-term value creation.

Insufficient linkage between remuneration and non-financial KPIs

The misalignment between executive remuneration and sustainability-related non-financial KPIs is a significant challenge. It often leads to missed opportunities in terms of fostering long-term sustainable and financial outcomes. Research confirms that companies that do not embed sustainability targets into executive remuneration strategies struggle to motivate executives to adopt sustainable practices, leading to misalignment with societal expectations and stakeholder interests.

Recognising this issue, an increasing number of companies are integrating sustainability into their commercial strategies to better align with long-term growth objectives. Recent trends show a positive shift towards incorporating non-financial metrics more extensively across industries.

The proportion of companies in the $ 5 billion to $ 9.9 billion revenue range that have adopted ESG metrics as modifiers in executive pay, rose from 10.9% in 2021 to 22.8% in 2023. Moreover, for companies with revenues over $ 50 billion, 19.6% had integrated ESG modifiers by 2023. This reflects a broader movement towards sustainability, with S&P 500 companies more than doubling the inclusion of environmental metrics, from 24.8% in 2021 to 53.6% in 2023, and the adoption of general ESG metrics surging from 25.4% to 44.5% in the same period.

While these trends indicate a growing awareness of sustainability, a more widespread and deep-rooted commitment is essential for sustainability to become a cornerstone of business operations. Despite the progress made, challenges remain regarding the complexity and effectiveness of these non-financial KPIs. Critics argue that without clear guidelines, metrics may serve merely as superficial nods to sustainability (greenwashing), failing to reflect truly material targets for the company and its stakeholders.

To address these concerns, our Impact team advocates for the implementation of transparent, robust, and strategically aligned non-financial metrics. This approach ensures that sustainability initiatives are not only integrated into corporate strategies but are also measurable and impactful, enhancing corporate performance and accountability, and mitigating risks associated with greenwashing.

Why linkage to non-financial KPIs is vital

Integrating non-financial KPIs into executive remuneration is key to driving sustainable

FIGURE 1: NON-FINANCIAL KPIs

Source: UBP

leadership and ensuring long-term business success. How to ensure that remuneration targets are ambitious enough?

- **Materiality assessment:** we advise starting by assessing the non-financial factors most critical to the company and stakeholders. Remuneration should be linked to industry-specific areas where the company can make significant contributions. These factors should also underpin the company's short-, medium-, and long-term strategies, such as the 2030 and 2050 targets.
- **Beyond compliance:** we advise against choosing non-financial metrics solely based on regulatory demands. Instead, companies should focus on a broader range of material factors that truly reflect the company's impact potential.

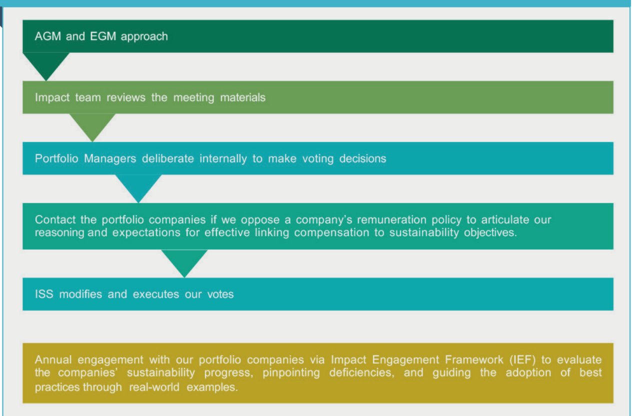
What percentage of sustainability-linked remuneration is considered sufficient or ambitious? How do we balance financial returns with sustainability performance?

- **Meaningful weighting:** we recommend a minimum 20% weighting for non-financial KPIs in remuneration to significantly influence executive behaviour.
- **Progressive integration:** we advise starting with a lower weighting, and increasing it as the company develops more quantifiable and measurable non-financial metrics.
- **Long-term and short-term incentives (LTIs and STIs):** LTIs encourage a long-term perspective, while STIs recognise annual progress. It is crucial that non-financial metrics are incorporated into both to ensure a comprehensive approach.
- **Engagement and direction:** looking beyond the percentages, we value a company's response to engagement and the progress of their metrics. A clear pathway to increasing the weightings of non-financial metrics is essential and well-regarded.

Examples of best-in-class market practices

Schneider Electric[1]
Schneider Electric integrates sustainability directly into its incentive structures, with 20% of the annual variable compensation and 25% of the long-term incentive plan linked to its Sustainability Impact and External Relative Index.

FIGURE 2: STRATEGIC APPROACH - HOW TO ACHIEVE THESE OBJECTIVES



Source: UBP. Notes: ISS is our proxy voting company; the IEF is an annual questionnaire that assesses and monitors the sustainability aspects of companies within our funds, facilitating systematic interaction and evaluation of our influence as investors. For more detailed information, please refer to page 16 of our latest 2023 Impact Report.

Natura[1]
This firm dedicates 30% of short-term incentives and long-term incentives to social engagement, sustainability, and net-zero carbon objectives, showcasing a deep commitment to ESG commitments across its operations.

Through continuous engagement and active voting, we have observed a positive trend: an increasing number of companies in our funds are linking non-financial KPIs with executive remuneration, reflecting a broader shift towards integrated sustainability practices.

Conclusion

As an institutional investor, we are dedicated to advancing sustainable corporate practices and acting as a catalyst for systemic change among listed companies through strategic voting and engagement. We recognise the transformative power of collaboration and actively seek to exchange innovative ideas and strategies with stakeholders committed to integrating non-financial KPIs into executive remuneration. By fostering these initiatives, we aim to drive substantial and measurable impact, contributing to a more sustainable and prosperous future. ■

1 The securities identified above should not be considered as recommended for purchase or sale.

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PHOTO: ARCHIVE UBP

SUMMARY

Strategic Aim: Advocate for portfolio companies to set ambitious, transparent non-financial targets with sufficient weighting in executive pay to drive sustainable behaviour.

Problem: Research shows that companies without sustainability-linked remuneration struggle to motivate executives toward sustainable practices, weakening outcomes and accountability.

Current Trend: Adoption of ESG metrics in pay is rising – but often lacks depth and clear, material targets.
Metric Design: Choose KPIs that are material, measurable, and go beyond mere regulatory compliance to avoid superficial "tick-the-box" exercises.

Recommended Weighting: Set non-financial KPIs at a minimum 20 % of total remuneration to meaningfully influence executive decisions.

Best-Practice Examples: Schneider Electric and Natura integrate strong ESG-linked incentives.
Active Engagement: Leverage voting and direct dialogue (e.g., ISS proxy voting, IEF annual engagement) to push investees toward deeper integration – raising the share of companies in our funds that tie executive pay to sustainability metrics from 55 % in 2021 to 69 % in 2023.