Investor Group on Climate Change

Climate Action 100+

Incentivising Climate Action with Executive Remuneration in Australia

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About the Investor Group on Climate Change.

We are the leading network for Australian and New Zealand investors to understand and respond to the risks and opportunities of climate change.

Our members include our countries' largest superannuation and retail funds, specialist investors and advisory groups.

They are custodians of the retirement funds and savings for more than 14.8 million Australians and millions more New Zealanders.

Our members manage more than $35 trillion in global assets, and almost $5 trillion locally.

About This Report

This report provides investors with guidance to support their engagement with companies on the integration of climate goals with executive remuneration. It provides a framework to assist investors in evaluating the link between climate incentives and executive remuneration. The framework can also support companies to effectively integrate climate strategy and goals into executive remuneration structures.

Key elements of this report are structured as follows:

- **Key Drivers and Issues Facing Investors and Companies:** A landscape review of the existing executive remuneration landscape in Australia related to climate incentives and an analysis of the key issues facing investors in engaging companies. This section provides insights from stakeholder interviews with investors, proxy advisors, Board members, and senior executives and from an analysis of current climate-linked executive remuneration practices.
- **Guiding Principles:** A set of Guiding Principles developed by Pollination and IGCC for climate-linked remuneration designed to ensure incentives are fit for purpose and outcomes-based (including best practice examples). For each of the six Guiding Principles we have provided a rationale, signposts and illustrative indicators, and an illustrative case study to evidence best practice climate-linked remuneration abroad.
- **Appendices:** An example company evaluation matrix and engagement framework, operationalising the above Guiding Principles, has been provided to aid investors and companies in embedding climate within executive remuneration frameworks.

Acknowledgements

POLLINATION

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01: Executive Summary

There is a growing interest in representing climate-related goals in executive remuneration. Successfully integrating climate-goals into executive remuneration requires consideration of a company's climate strategy and the decarbonisation pathway for its sector and peers. Taking a principled approach (rather than a one-size fits all 'check-box') can help ensure that executive remuneration drives companies to mitigate their unique climate change risks and succeed in their transition strategies.

Remuneration should align outcomes with investor expectations, incentivising action and rewarding management for the achievement of outcomes linked to the action.

On transition and climate, the Board and senior leadership team must consider transition planning in terms of strategy development and evolution as well as disclosures (at increasingly high standards), and addressing issues raised by both customers and the provider of capital. Metrics related to a company's climate change strategy can be incorporated into performance based remuneration for senior executives. For this report, we have described such metrics as incentives for actions to achieve an outcome as opposed to rewards for outcomes, which we note would also be an accurate alternative description.

Effective integration of climate outcomes into remuneration poses unique challenges.

Executives and boards must balance business priorities and climate commitments. The appropriate balance varies with sector and company. Finding the right mix of incentives to reflect this balance (particularly in high-emitting sectors) is the core task of building successful incentives.

Australian companies that integrate climate commitments into executive remuneration take a variety of approaches, but some core 'Guiding Principles' for best practice are clear.

For this report we interviewed investors, proxy advisors, Board members and senior executives, reviewed international company practices and commentary, and analysed the remuneration plans of 14 major ASX-listed companies. These insights established a common view of the considerations, practicalities and best practice approaches for embedding climate incentives within executive remuneration.

We have codified this view into six Guiding Principles (see Figure 1) to support investors and companies evaluate and design effective climate-linked executive remuneration.

The Guiding Principles have been divided into 'Strategic' and 'Incentive' Alignment Principles, which intend to reflect the main takeaways outlined above: (1) a robust climate strategy lays the foundation for effectively linking climate-incentives in executive remuneration, and (2) a principled rather than 'check-box' approach ensures that climate-linked incentives are designed to reflect the unique sector and company-level climate risks and challenges of different companies.

Figure 1: Overview of Guiding Principles for climate-linked incentives

STRATEGIC ALIGNMENT

PURPOSE	PRINCIPLES	
To ensure the effectiveness of remuneration incentives is considered in the context of the company's broader climate transition plan.	*1. Climate-related incentives should reflect, and be directly linked to, progress against a **robust and credible climate transition strategy.***	*2. The company's climate transition plan is **functionally integrated into key business processes and operations,** including through effective governance, capital allocation and reporting frameworks.*

INCENTIVE ALIGNMENT

PURPOSE	PRINCIPLES			
To evaluate whether the design of remuneration incentives is likely to support robust outcomes and drive stronger climate action by the business.	*3. Incentive framework **aligns with, and will not contradict, the commitments and intended outcomes** under the company's climate strategy.*	*4. Climate-related incentives are based on metrics or criteria that **drive increased ambition, are measurable & industry-specific, provide coverage of key issues and will not result in duplication of pay-outs.***	*5. The weighting of climate-related incentives **reflects the materiality of climate change** for the company, having regard to its climate risk exposure, and is **proportionate to other financial and ESG criteria.***	*6. Disclosures relating to climate-related remuneration incentives are **transparent, regular and prospective.***

Fundamentally, remuneration should reinforce the delivery of a robust climate strategy.

Climate-linked incentives are unlikely to drive climate performance in the absence of an effective strategy underpinned by clear targets and a credible transition pathway. As such, the adequacy of a company's climate strategy should be assessed alongside its remuneration framework.

Companies face varied decarbonisation challenges and opportunities, and successful remuneration structures must reflect this variation.

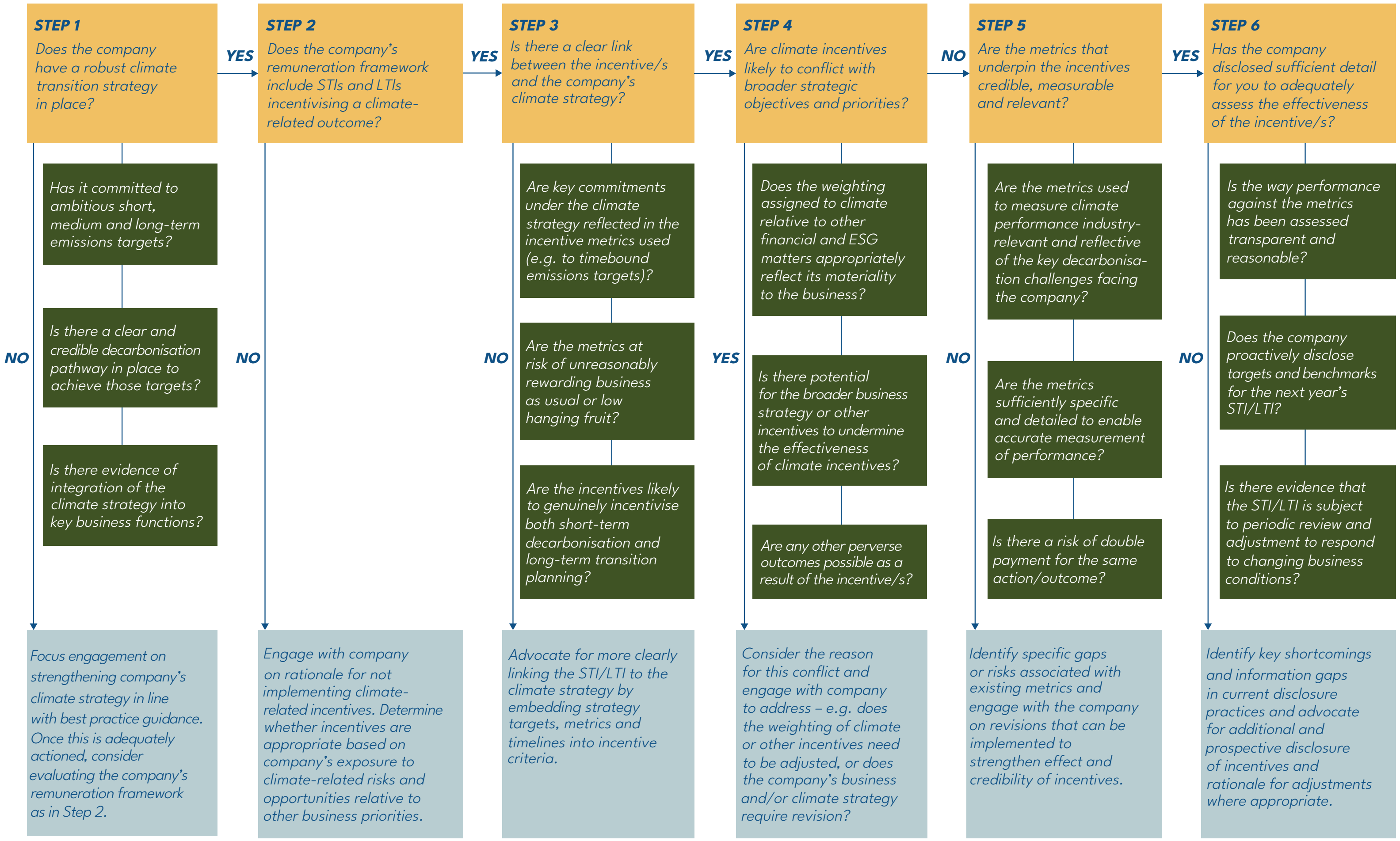
As with remuneration more broadly, climate-related incentives must be tailored to the individual circumstances of a particular company. The incentives should reference and support specific goals and initiatives committed to by the company under its climate strategy. The full suite of executive remuneration incentives should also be complimentary where feasible, driving both business and climate goals and avoiding potential perverse outcomes. While there may be some consistency in the types of incentives that are appropriate at a sector-level and in standard measures such as emissions reduction, investors should recognise that a degree of flexibility and subjectivity is needed in how companies design and implement their incentives.

Investors can use the Guiding Principles to continue and deepen their engagement on climate-linked executive remuneration.

Aligning climate-linked executive remuneration with the Guiding Principles can help ensure that remuneration supports and reinforces company transition needs. We have developed two tools to operationalise these Guiding Principles. The first tool, a Company Evaluation Matrix (see Appendix A), translates the Guiding Principles into a rating system which evaluates alignment of climate incentives against each principle. This matrix has been tested through our own analysis of 14 major ASX-listed companies' remuneration frameworks and is provided as an illustrative rather than prescriptive approach to evaluating against the Guiding Principles.

The second tool, an Engagement Framework set out below in Figure 2 (see Appendix B for further detail), provides a structured approach for investors to test whether a company's incentives are designed in a way that will genuinely incentivise the achievement of transition and climate goals and support the achievement of impactful outcomes.

Figure 2: Engagement Framework



Insights from Company Analysis

To test our approach we evaluated 14 Australian companies against the Guiding Principles which outline what we believe to be best practice (see Appendix A). The companies we assessed operate in high-emitting sectors (transport, energy, resources, consumer goods and industry/manufacturing) and have unique transition requirements. They therefore take various approaches.

The best examples of climate incentives were clearly linked to the company's climate strategy and time horizons, and were ambitious and measurable. They also had weightings reflective of the materiality of the company's climate risks. Other key insights include:

- Climate-related incentives were widely adopted in Short Term Incentives (STIs) but alignment to Guiding Principles was low. In Long Term Incentives (LTIs) climate featured less, but where climate did feature, companies displayed high levels of alignment.
- Most companies only disclosed the metrics used to measure climate performance retrospectively (i.e. rather than prospectively disclosing metrics for the following year/s). This made it challenging to assess ambition on a forward-looking basis.
- All the companies with climate-linked STIs in FY23 reported that the target thresholds for those STIs had been met.
- None of the companies assessed had incentive metrics related to Scope 3 emissions.

Figure 3: Inclusion and weighting of climate metrics in STI/LTI

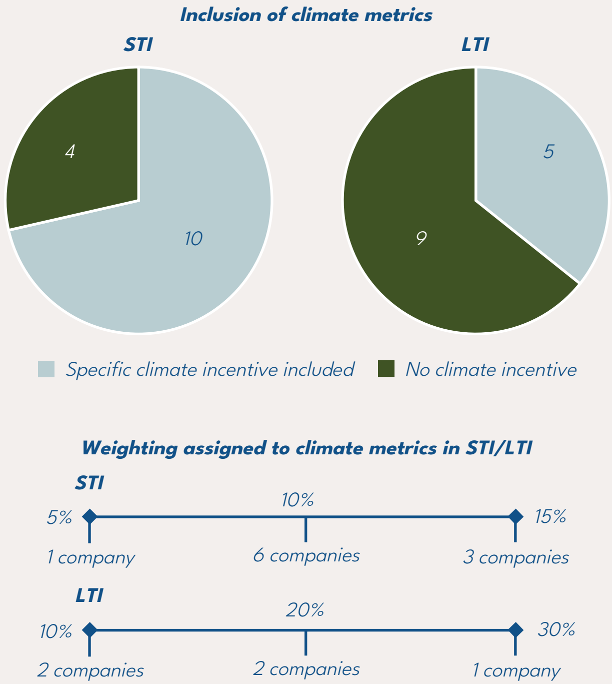
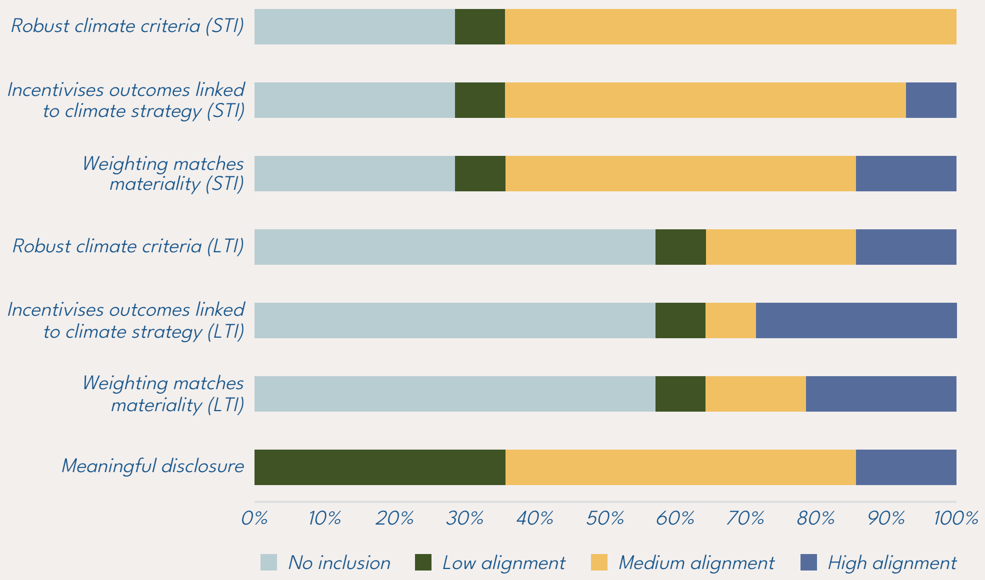


Figure 4: Overview of company assessment against 'Incentive Alignment' Guiding Principles



Notes: Company ratings for the above chart are based on assessment of alignment with the 'Incentive Alignment' Guiding Principles. The detailed evaluation criteria is provided in a Company Evaluation Matrix included in Appendix A.

02: Introduction

The inclusion of climate and transition in executive remuneration has emerged as an important issue for companies, investors, regulators and other stakeholders.

Executive remuneration has been a growing focus for investors working to reduce climate risk and support effective company transition. This reflects a broader recognition that a company's success in managing climate risk and transition is often highly relevant to long-term value creation. Corporate leaders are increasingly tasked with navigating the complexities of climate change while maintaining profitability and competitiveness. Given that executive remuneration incentives are often a powerful tool for driving corporate behaviour, many investors and boards are working to integrate climate strategies and targets into executive remuneration.

The design and introduction of climate-linked executive compensation presents a number of challenges. These include reconciling sometimes short-term financial incentives with climate targets, balancing climate objectives with other business priorities, navigating diverse stakeholder expectations, and selecting appropriate climate metrics. The evolving regulatory landscape and increasing expectations regarding levels of board climate competency introduce further considerations to an already challenging process. There is no one-size-fits-all approach, and the effectiveness of these incentives depends on several company and sector-specific factors.

This report provides guidance for those working to integrate climate performance into executive remuneration frameworks. The Guiding Principles developed here combine insights from interviews with investors, proxy advisors, board members and senior executives, and a review of the current practices of a selection of major, high-emitting Australian companies. These principles can help ensure remuneration appropriately incentivises the delivery of climate-related commitments.

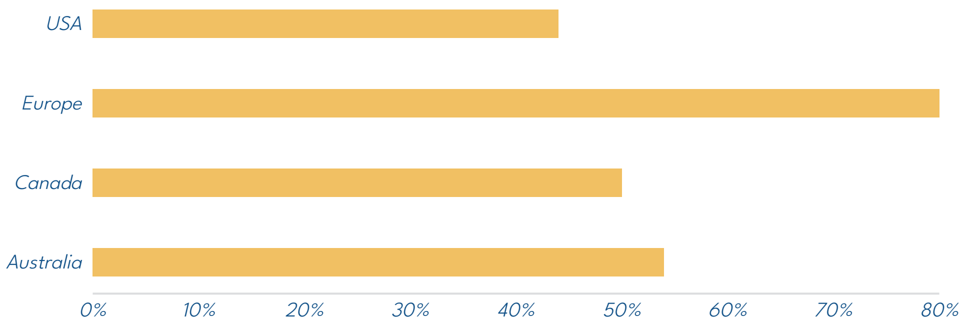
03: Key Issues for Investors & Companies

Our interviews with investors, boards, and advisors identified a number of core challenges and concerns for companies navigating climate linked remuneration today.

3.1 Adoption of Climate-Linked Remuneration Incentives is Increasing – Driven By Regulatory, Strategic and Stakeholder Pressures

There has been a boom in the adoption of environmental and specifically climate-linked incentive metrics across the ASX200. Australian Council of Superannuation Investors' (ACSI) recent report, 'Measuring and rewarding Climate Progress', found that in the proportion of ASX200 entities that had a climate-related incentive in their executive remuneration rose from 10% in FY20 to 54% in FY24.[1] On the broader measure of environmental metrics being included in remuneration frameworks (e.g. waste, water, nature as well as climate), Australian companies are now on par with most developed market peers, as evidenced in Figure 5.

Figure 5: Percentage of companies utilising environmental metrics in remuneration frameworks, 2023[2]



There are several drivers of increased, and more sophisticated, integration of climate into executive remuneration frameworks in Australia. These are:

- **Growing commercial impacts from transition and climate change:** Climate change and transition are becoming increasingly commercially material for various sectors, as both physical climate change and policy change begin to bite. Asking executives to focus on climate issues allows companies to position to navigate transition risks, adapt to physical climate risks and capture commercial opportunities from transition.
- **Development and codification of corporate climate strategy:** As climate considerations become core for many businesses, companies are developing increasingly specific and commercial climate strategies and transition plans. They are also increasingly motivated to integrate these strategies into governance structures including remuneration.
- **Increased regulatory and disclosure obligations:** The Australian Accounting Standards Board is set to significantly impact climate-related disclosures with the release of the first mandatory Australian Sustainability Reporting Standard S2, mandating climate reporting, in the first instance, for large companies. ASRS S2 guidance mandates that companies disclose whether and how climate-related considerations are factored into executive remuneration, including the percentage of executive management remuneration linked to climate-related considerations.
- **Investor focus on climate strategies:** Investors are increasingly engaged in managing the impact of climate change on returns and resilience across various time horizons. In response companies are working to establish governance frameworks that satisfy diverse investor preferences for climate performance and financial performance.
- **Reputation considerations and stakeholder expectations:** Companies face growing pressure from a broader range of stakeholders to demonstrate genuine commitment to climate action. Linking executive pay to climate performance serves as a tangible demonstration of this commitment, enhancing corporate reputation and social license to operate.

1 https://acsi.org.au/wp-content/uploads/2024/06/ACSI-Measuring-and-Rewarding-Climate-Progress-ACSI-briefing-paper.pdf
2 Data for Canadian, European and US companies based on WTW, 2023 Global Report on ESG Metrics in Executive Incentive Plans, 2023. Data for Australian companies based on ACSI, Measuring and Rewarding Climate Progress, 2024.

3.2 Where Investors are Focussing – Key Issues to Solve For

In conducting interviews and in assessing a selection of major, high-emitting Australian companies, several key issues were identified that are challenging the implementation of effective climate-linked incentives.

3.2.1 Short-Termism vs. Long-Term Climate Goals

A comprehensive climate change strategy must consider both short, medium, and long term actions and outcomes, but most incentives are measured over a short to medium timeframe, from three to five years. While certain climate risks may only materialise for a company in the longer-term, companies must take early action in the face of uncertainty, to ensure they are on a trajectory to long-term outcomes like Net Zero by 2050. Setting remuneration with a view to 2050 is a predicament relatively unique to sustainability-linked incentives. Our analysis found that this presents specific challenges:

- **Aligning long-term climate commitments with STI is challenging.** The mismatch in remuneration and climate strategy timeframes leaves significant room for companies to have different approaches to the outcomes rewarded in STIs. Opportunities to significantly or visibly reduce climate risk are not always clear in the short term, so the selection of a metric or metrics that are appropriate for the individuals being remunerated as well as shareholders is difficult.
- **The LTI design, including length of performance period and clawback provisions, does not always provide an imperative for executives to prioritise long-term shareholder value.** The performance periods currently applied to LTIs by many companies (typically three to five years) may not adequately incentivise executives to consider the climate implications of business practices taken today (which are in many cases likely to manifest long after their tenure). Of the companies assessed in this analysis, slightly more than a third had a climate-linked LTI in place, and all of these vested over four years or less.
- **Companies often have little support to include climate in LTI, including among proxies.** This lack of support often stems from a long-term preference for share-price-linked measures in LTI. The low uptake of climate targets in LTI among the sample we reviewed are a testament to this challenge, and presents a further challenge for boards looking to bridge near-term actions with long term ambitions.

3.2.2 Sector Relevance, Simplicity and Measurability

Choosing appropriate metrics and accurately measuring performance against them is also key to ensuring management focusses on necessary actions. Our analysis found that the most effective metrics were sector-relevant, simple and measurable:

- **Sector-relevance:** Effective remuneration incentives ideally reflect the company's specific operating context and climate risks and opportunities. Interviewees acknowledged that this requires a bespoke approach to selecting appropriate incentive metrics, although they should ideally align with incentives that are widely adopted in the relevant company's sector (including consideration of the need for, and viability of, Scope 3 emissions-related metrics). Table 1 sets out some of the key sub-issues which can be considered across different sectors.
- **Measurability:** Metrics underpinning incentives are designed to promote tangible outcomes and do not allow an unreasonable degree of discretion in evaluating performance.
- **Simplicity:** The best metrics incentivised outcomes that are clear and easy to communicate. Most companies reviewed in the analysis did not integrate year-on-year or short-term emissions targets into incentives, despite this being one of the more transparent approaches that demonstrates a clear link to the company's climate strategy.

Table 1: Sector-specific incentive considerations

Industry	Exemplar Considerations
Energy utilities	• How can incentives support a generation portfolio shift to low carbon energy generation and services? • How is the business ensuring a just transition by appropriately managing the business transformation impacts on its workforce and community stakeholders? Can this be reflected in its remuneration incentives?
Oil & gas	• How can incentives balance priorities relating to decarbonisation and business growth? • How can the metrics incentivise investment into existing low carbon solutions as well as R&D? • As above, where workforce transition is required, can this be reflected in remuneration?
Industry & manufacturing	• How can incentives reward progress in rolling out specific decarbonisation initiatives or low emissions solutions in core processes (e.g. electrification projects)? • As above, where workforce transition is required, can this be reflected in remuneration?
Resources	• Does the remuneration framework adequately incentivise executives to increase portfolio exposure to key transition mineral demand?
Consumer goods	• How can incentives address environmental impacts and emissions throughout the company's value chain (which may be the most material emissions relative to those generated from the company's own operations)?

3.2.3 Alignment between Climate and Other Incentive Metrics

Climate-linked incentives are occasionally in direct tension with other incentivised actions (for example, production incentives). The result of this can be that climate incentives are ineffective, or that climate related actions have counterproductive impacts for the broader business which are not considered sufficiently nor negotiated up front. Metric weightings can often amplify this misalignment.

While this issue often relates to underweighting of climate risk in a balanced scorecard, overweighting climate-linked incentives or duplication of payouts for the same climate-related outcome are equally problematic. In both scenarios, the required climate action is not commensurate with pay outcomes. Our analysis found:

- **Separate incentives that contradict or make achievement of climate-related outcomes more difficult create conflicting priorities for executives.** This risk is heightened in the oil and gas sector. If a fossil fuel producing company has production growth targets embedded in its remuneration incentives, this indirectly incentivises increased emissions and likely directly contradicts a number of climate-related goals that may also be integrated into executive remuneration. While this is primarily a strategy dilemma, engagement on this misalignment in remuneration may be a catalyst for evolution of a company's strategy. We note that outside the oil and gas sector this issue may be more nuanced, with some investors expressing concern about how the introduction of climate metrics into remuneration frameworks might undermine the pursuit of what they considered to be core financial objectives.
- **Weighting of incentives often does not reflect materiality of climate risk.** Directors are tasked with incentivising management to achieve multiple business objectives focussed on delivering shareholder value. For companies taking climate action, limiting climate change is likely one of many objectives. The relative weighting of climate-linked incentives typically remains materially lower than traditional financial criteria in remuneration structures. In the context of commercial transition risk as well as acute and chronic weather impacts on company operations and assets, investors and companies should test the appropriateness of current weightings. This may not be necessary or appropriate for all companies.
- **There is clear risk of duplicating payouts to executives for achievement of a single climate-related outcome.** Where multiple climate-related metrics are used, these may individually reward an activity or several as well as the outcome from said activity. As one example, incentives for Scope 1 emissions reduction activities as well as a separate incentive for achievement of the Scope 1 emissions reduction target.

3.2.4 Transparency of Disclosures

The companies assessed presented varying levels of transparency in their remuneration disclosures. A minority included detailed explanations of how individual executives were considered to have achieved climate-linked incentive metrics. The majority described achievement with broad, generic language, making assessment more difficult for external stakeholders.

Only two companies were assessed as demonstrating high alignment with the disclosure criteria used in our evaluation. Interviewees indicated that to overcome the above transparency issues, the following disclosures should be considered:

- how performance against climate-linked incentives will be measured and assessed, particularly for metrics that are more qualitative in nature;
- how discretion is applied by the Board, where required, in the determination of executive STI and LTI awards;
- the exact targets or thresholds that proposed STI awards will be assessed against. In our analysis, most companies only disclosed the targets and criteria that underpinned the incentive framework for the prior financial year and did not indicate how future remuneration incentives would be assessed; and
- how the company has ensured the effectiveness of its climate-linked remuneration incentives, particularly where potential conflicts may exist with other incentives or short-term business goals.

04: Guiding Principles for Companies and Investors

While climate-linked incentives inherently require a degree of subjectivity and nuance, several common principles can be applied to their design and implementation.

Some Guiding Principles emerged from our conversations with industry and our company analysis. We believe these Principles (as set out in Figure 6) are applicable to all companies seeking to incentivise climate action.

The principles reflect the insights from our landscape review of stakeholder perspectives and company analysis and were designed to ensure incentives are fit for purpose and outcomes based. They have been divided into 'Strategic' and 'Incentive' Alignment Principles, which intend to reflect that: (1) a robust climate strategy lays the foundation for effectively linking climate-incentives in executive remuneration, and (2) a principled rather than 'check-box' approach ensures that climate-linked incentives are designed to reflect the unique sector and company-level climate risks and challenges of different companies.

For each of the six Guiding Principles, we have provided a rationale for its inclusion, signposts and/or illustrative indicators to guide investor evaluation of climate incentives and, where possible, an illustrative case study to evidence best practice climate-linked remuneration abroad.

Figure 6: Summary of Guiding Principles for climate-linked remuneration incentives

STRATEGIC ALIGNMENT

PURPOSE	PRINCIPLES	
A company's climate strategy is sufficiently credible, ambitious and integrated across its business to enable any related remuneration incentives to be effective.	*1. Executive remuneration should reflect and be directly linked to progress against a* ***robust and credible climate transition strategy.***	*2. The company's climate transition plan is* ***functionally integrated into key business processes and operations,*** *including through effective governance, capital allocation and reporting frameworks.*

INCENTIVE ALIGNMENT

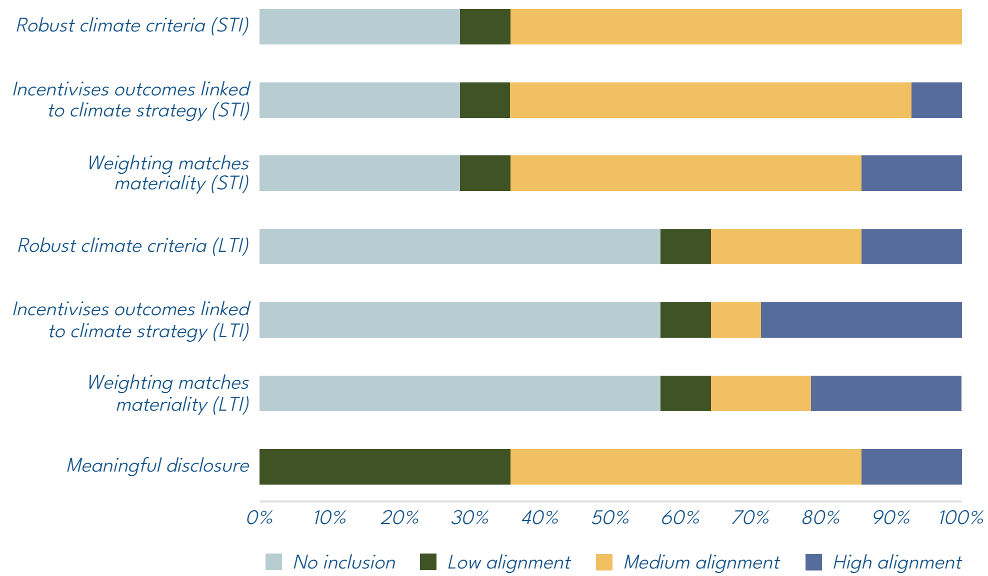
PURPOSE	PRINCIPLES			
The company's climate-linked incentives themselves are designed, assessed and disclosed in a manner which is robust, transparent and likely to drive behaviour change aligned with the company's climate strategy and targets.	*3. All incentive metrics* ***align with, and do not contradict the commitments and intended outcomes under the company's climate strategy.***	*4. Climate-related incentive metrics* ***are measurable & industry-specific, provide coverage of key issues, incentivise out-performance and will not result in duplication of pay-outs.***	*5. The weighting of climate-related incentives* ***reflects the materiality of climate change risks*** *to the company, having regard to its climate risk exposure, and is* ***proportionate to other financial and ESG criteria.***	*6. Disclosures relating to climate-related remuneration incentives are* ***transparent, regular and prospective.***

4.1 Insights From Company Analysis

In developing and testing the framework, we reviewed a selection of ASX200 companies against the Principles (using a bespoke Company Evaluation Matrix provided in Appendix A). The companies we assessed operate in high-emitting sectors (transport, energy, resources, consumer goods and industry/manufacturing), with unique transition requirements and therefore take various approaches to climate-related remuneration.

The best examples of climate incentives were ambitious, measurable, and linked to the company's climate strategy and corresponding time horizons. They also had weightings reflective of the materiality of the company's climate risks. Our insights across each 'Incentive Aligned' Guiding Principle are summarised in Figure 7 below.

Figure 7: Overview of company assessment against 'Incentive Alignment' Guiding Principles



Notes: Company ratings for the above chart are based on assessment of alignment with the 'Incentive Alignment' Guiding Principles. The detailed evaluation criteria is provided in a Company Evaluation Matrix included in Appendix A.

4.2 Strategic Alignment Principles

A robust and credible climate strategy is the bedrock that supports the design of effective climate incentives. The following 'Strategic Alignment' Guiding Principles are designed to first direct investors to undertake a comprehensive evaluation of the company's climate strategy (i.e. evaluate the robustness and credibility of its targets, transition action plan and governance structures).

These two 'Strategic Alignment' Principles are arguably the most important of all six Guiding Principles, but for the sake of this report have been briefly touched upon. This is due to the focus of this report being on how to incentivise climate action in executive remuneration (rather than an evaluation of climate strategies). We have provided some signposts to guide investors and companies in evaluating companies' climate strategies, but recommend referring to best practice and sector-level guidance first. These include SBTi or Climate Action 100+; alignment with IFRS standards; reference to best practice guidance such as IGCC 'Corporate Climate Transition Plans: A Guide to Investor Expectations'.

PRINCIPLE 1:

Executive remuneration should reflect and be directly linked to progress against a robust and credible climate transition strategy.

Executive remuneration incentives are one tool for driving corporate climate action, but they must be underpinned by a comprehensive and credible climate strategy (see the following key signposts for guidance). Without such a strategy, climate-linked remuneration incentives are unlikely to drive meaningful progress.

Key signposts informing alignment with this principle
The company has a transition strategy or plan in place that is clearly integrated with the company's broader corporate strategy and financial planning.
The strategy includes ambitious short, medium and long-term targets, and the strategy and targets are science-aligned and supported by credible decarbonisation pathway modelling.
The company's climate strategy and targets have been externally assessed and/or validated as being aligned with sector-specific guidance.
The company's strategy outlines how low carbon products and services will contribute to future revenue and sales.

PRINCIPLE 2:

The company's climate transition plan is functionally integrated into key business processes and operations, including through effective governance, capital allocation and reporting frameworks.

Integration of a company's climate strategy into core business operations is essential for climate targets and commitments to be met. The signposts below demonstrate an understanding that climate risks are financially material and addressing them should be a priority. As noted by an investor: "climate is not a standalone metric, as it is a financial risk, it must be connected back to the balance sheet and P&L".

Embedding climate into company operations (e.g. within governance structures, capital allocation frameworks and risk management processes) enables climate priorities to influence all key aspects of the business. This supports climate being factored more strongly into long-term business strategies and growth plans, enabling better responses to climate risks and opportunities and appropriate levels of capital flowing to decarbonisation.

Key signposts informing alignment with this principle
The company's transition strategy and targets are clearly resourced, and their execution is clearly evident and integrated with the company's financial planning and reporting.
Capital expenditures and investment frameworks integrate mechanisms to drive alignment with the climate strategy, and enable capital allocation to decarbonisation activities, R&D and climate solutions which may have longer-term returns than other company investment.
Governance mechanisms are in place to ensure effective oversight, understanding and management of climate risk and opportunity (including at the Board level).
Company sustainability reporting is aligned with IFRS recommendations or other best practice guidance.

4.3 Incentive Alignment Principles

The following four 'Incentive Alignment' Guiding Principles' outline how companies can design executive remuneration frameworks to incentivise meaningful progress against the company's climate targets, commitments and strategy. For each principle, we have provided signposts and illustrative indicators to guide investor evaluation of climate incentives, insights from our company evaluation and an illustrative case study to evidence best practice climate-linked remuneration abroad.

PRINCIPLE 3:

All incentive metrics align with, and do not contradict the commitments and intended outcomes under the company's climate strategy.

The incentive framework should incentivise key outcomes aligned with the climate strategy and reduce climate risk while limiting perverse outcomes for the pursuit of long-term targets. While necessary short-term outcomes should be incentivised, these outcomes must build towards and enable achievement of longer-term commitments as opposed to shifting greater emissions reductions to future decades. The following key signposts provide some direction for what investors should consider when evaluating how incentive metrics align with the climate strategy, and the illustrative indicators outline how this may be done.

Key signposts informing alignment with this principle	
Signpost	**Illustrative indicators**
Climate criteria should link to material physical and transition climate risks as outlined in the company's climate strategy.	• Climate-linked incentives directly relate to the company's most material physical and transition risks (e.g. most significant scope or source of emissions; portfolio resilience in the face of long-term transition risks; adaptation measures to respond to physical climate risks).
Incentives may be linked to specific targets or activities. In both cases, incentives should be outcome-focused.	• Climate metrics are clearly differentiated from other ESG or sustainability metrics. • Incentives directly link to either short, medium or long-term emissions reduction targets, or actions outlined in the company strategy which deliver these targets.

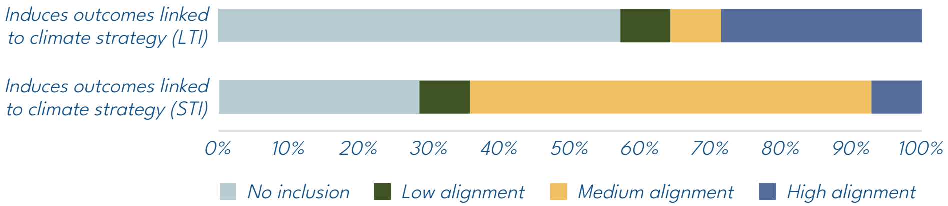
Embedding clear timebound actions or emissions reduction milestones in the climate strategy within the incentive framework is likely to be an effective design choice to drive aligned outcomes.	• Incentive timelines align with time horizons outlined in the company strategy for actions or climate target as much as possible.
	• Where possible companies may consider:
	  ◦ Deferring vesting of STI to align with short and medium-term targets (e.g. ensuring STI encompasses 2025 targets).
	  ◦ LTIs with longer vesting horizons to align incentive and climate target timeframes (e.g. 7-year vesting to align with a 2030 target).
	  ◦ Year-on-year emissions reduction milestones to breakdown climate targets into annual STI timeframes (e.g. see Linde's year-on-year emissions reduction criteria linked to its medium-term target below).

Extension of LTI timeframes to reach further into climate strategy delivery.	• Where jurisdictional norms allow it, LTI vesting may be extended beyond the norm to capture climate strategy delivery on longer time horizons.
Climate incentives do not drive unintended or perverse outcomes.	• Climate incentives are balanced against other incentives and the criteria does not prioritise quick wins, low-hanging fruit or overly prescribed outcomes. • Where incentives are measured against net emissions, there does not appear to be an over-reliance on offsets or use of offsets as a fallback where required action is not taken. • Malus and clawback mechanisms ensure incentives are aligned with long-term climate performance and ethical standards.

Insights for Investors

In our review of companies against this principle (see Figure 8) the best approaches included criteria that were explicitly linked to the company's climate targets or priorities outlined in their climate strategy. In contrast, some companies chose greenhouse gas emissions reduction criteria that were not linked to specific short, medium or long-term climate targets, and so alignment with strategy was not clear.

Figure 8: Company assessment against Guiding Principle 3



Case Study

Global industrial gases and engineering company, Linde's Annual Performance-Based Variable Compensation or STI is made up of Financial (weighted 75%) and Strategic & Non-Financial Factors (weighted 25%). When the GHG metric is combined with the remaining ESG elements in the non-financial component, the result is a 20% weighting of the total payout opportunity for ESG-related measures. The GHG Emissions Reduction criteria is linked to Linde's 2030 emissions reduction targets and year-on-year goals are pre-established to measure performance against this goal. This provides not only a link to Linde's climate strategy but aligns medium-term targets with short-term incentive time horizons.

In its Executive Compensation Matters Report, Linde discloses its performance against this year-on-year goal as well as other climate and sustainability actions taken into consideration by the Board, including positive ESG ratings, establishing a Scope 3 emissions inventory and increased decarbonisation project pipeline and investments.

Figure 9: Linde STI 2023 Thresholds and Payout

Measure	***Threshold Goal***	***Target Goal***	***Maximum Goal***	***Actual***	***Achievement***	***Payout***
GHG Emissions (MM MT)	*43.3*	*39.0*	*35.1*	*38.25*	*118.97%*	*5.9%*

Source: Linde Notice of 2024 Annual General Meeting

PRINCIPLE 4:

Climate-related incentive metrics are measurable & industry-specific, provide coverage of key issues, incentivise out-performance and will not result in duplication of pay-outs.

Metrics must be clear and specific, providing a transparent framework for assessing performance. Using ambiguous or difficult-to-measure metrics in climate-linked remuneration undermines the credibility and effectiveness of these incentives. Ambitious yet achievable targets are essential to driving meaningful change. As one investor noted, "we can't pay executives for business-as-usual, we must encourage stretch."

While quantitative metrics are generally preferable given their objectivity, qualitative metrics can also be appropriate for projects, initiatives or operational changes that address company or industry-specific climate risks and opportunities. However, these incentives should still be outcomes-focussed rather than rewarding activities alone. The following key signposts provide some direction for what investors should consider when evaluating the design of incentive metrics and the illustrative indicators and illustrative examples in Figure 10 provide guidance on how climate-criteria may be designed to be ambitious yet measurable.

Figure 10: Illustrative examples of criteria inspired by best practice domestic and international STIs and LTIs

"GHG emissions reduced by [X] tonnes year-on-year in line with climate target"	*"GHG emissions reduced by [X]% in line with climate target"*	*"GHG emissions intensity reduced by [X]% in line with climate target"*	*"Growth ($) of transition business underlying EBITDA"*
"[X]% of revenue uplift from low carbon products"	*"[X]% of renewable energy capacity increased"*	*"[X]% of workforce transitioned to low carbon jobs"*	*"Increase share (%) of portfolio transitioned to commodities critical for a low-carbon future"*

Key signposts informing alignment with this principle	
Signpost	**Illustrative indicators**
Metrics should encourage stretch and be outcomes not activities-based.	• Climate criteria is linked to ambitious and science-based targets. • Where metrics are quantitative, 'threshold' outcomes reflect achievement of the climate target, with target and stretch rewarding over-achievement. • Metrics do not reward business-as-usual outcomes or easy-wins.
Metrics should be quantifiable or clearly defined.	• Quantified metrics (e.g. tonnes of GHG emissions or % of GHG emissions reduced) provide an objective means of assessing performance. • Where metrics are qualitative, they are clearly linked to outcomes under the climate strategy (e.g. final delivery of a decarbonisation project).
Metrics do not allow for executives to receive multiple payments for achievement of the same outcome.	• Climate metrics do not reward the same outcome under different time horizons (e.g. GHG emissions reductions or milestones for the same decarbonisation project under the STI and LTI). • Climate incentives do not duplicate payouts within the same scorecard (e.g. rewarding GHG emissions reductions and completion of decarbonisation activity which led to the reduction). • Gateways or modifiers linked to climate criteria used as an alternative approach to ensure greater prioritisation of climate action (see Dow case study below as an example).[3]
Metrics are responsive and specific to the key decarbonisation challenges facing the sector in which the company operates, noting this should also be reflected in the company's climate strategy.	• Climate metrics prioritise immediate activities to build resilience against physical and transition risks. • Third-party or internally conducted benchmarking of climate criteria and coverage of relevant risks and opportunities to ensure it is in-line with industry peers (domestic and/or international).
Climate incentives have broad senior management coverage, noting that metrics should be relevant and achievable for the individuals to which they are applied.	• Coverage of all C-suite or senior management (beyond the CEO) with direct responsibility for element of climate strategy is best practice. • Individual climate metrics which reflect senior management's accountability for, and ability to influence outcome.

3 Gateways are criteria that must be achieved for any vesting under the incentive plan to occur. Modifiers are a qualitative Board assessment where vesting may be reduced where there has been material underperformance against key ESG objectives.

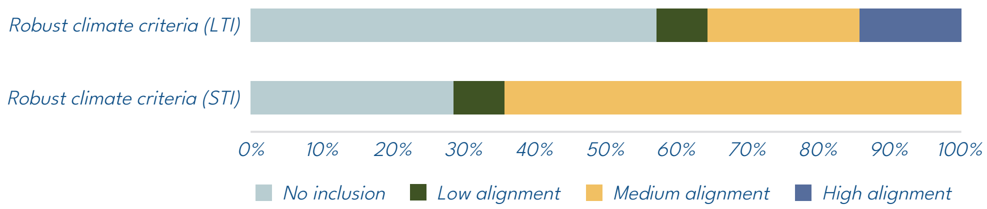
Insights for Investors

In our review of companies, climate metrics took a variety of forms:

- Tonnes of GHG emissions reduced;
- % of absolute GHG emissions or GHG emissions intensity;
- % of renewable energy capacity;
- revenue ($) uplift from low-carbon products and climate solutions; and
- qualitative criteria (KPIs linked to decarbonisation projects; integration of decarbonisation objectives in business strategy; setting of Scope 3 targets and strategy).

Only two companies were evaluated to have climate metrics which were highly aligned with this principle. Most companies would benefit from introducing climate incentives with quantifiable metrics and supporting these with outcome-based qualitative criteria, making sure to not double-up on rewarding the same outcomes.

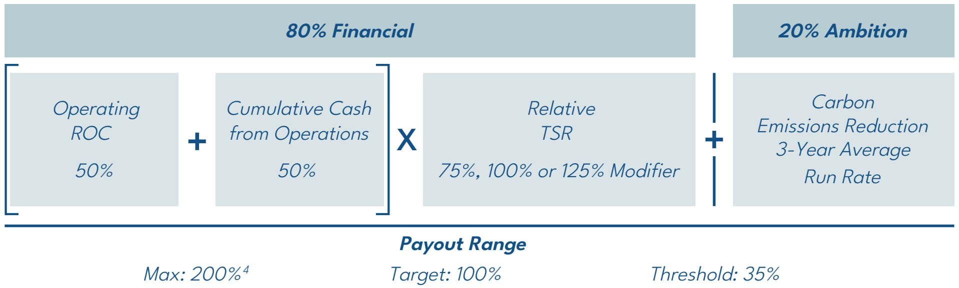
Figure 11: Company assessment against Guiding Principle 4



Case Study

Climate is embedded into Dow's long-term incentive framework, with 80% of the CEO's LTI performance share linked to Financial and 20% linked to Carbon Emissions Reduction, with payouts subject to achievement of threshold, target or maximum outcomes.

Figure 12: Dow LTI Executive Remuneration Framework



Carbon Emissions Reduction metrics include:

- Establish and Define: Establish carbon emissions reduction plan, define Scope 2 carbon emissions baseline; and
- Achieve: Cumulative carbon emissions reduction target.

Interestingly, the payout of the Carbon Emissions Reduction metric is capped at the threshold (35%), if the Establish and Define gateway metrics are not achieved within the timeframe. For entities listed in the United States, Dow comparatively has one of the highest climate weightings in its long-term incentives.[5]

Source: Dow 2024 Proxy Statement

4 Capped at 200% for the combined total of Operating ROC plus Cumulative Cash from Operations, even when considering modification based on Relative TSR, plus Cumulative Carbon Emissions Reduction metrics.
5 https://www.asyousow.org/report-page/2024-pay-for-climate-performance

PRINCIPLE 5:

The weighting of climate-linked incentives reflects the materiality of climate change for the company, having regard to its climate risk exposure, and is proportionate to other financial and ESG criteria.

Executive remuneration should reflect a holistic view of company performance and long-term value creation. Climate risk is one of many risks that company leadership must navigate, and so the inclusion of climate-linked metrics in remuneration should not disproportionately reward or penalise executives.

For emissions-intensive companies, it is reasonable to expect a higher weighting of climate-linked incentives in executive remuneration. These organisations often face material climate-related risks and opportunities, and their strategic decisions regarding climate change can have substantial impacts on their value and the broader environment.

The following key signposts provide some direction for what investors should consider when balancing climate criteria with other financial and ESG criteria, and the illustrative indicators provide guidance on how climate-criteria may be weighted to reflect the materiality of climate risks to the company.

Key signposts informing alignment with this principle

Signpost	Illustrative indicators
Ideally, the weighting assigned to climate-related incentives would be informed by a materiality assessment undertaken and disclosed by the business. Further, it should be weighted against strategic priorities and/or deficiencies that need to be addressed.	
The weighting of specific climate metrics should also reflect that maeriality of the specific climate risk to the company.	• Climate risk is ranked highly in company's materiality assessment or climate change is identified as a key financial risk to the company. • Climate action identified as an immediate priority in company strategy. • Climate weighting matches the company's physical and transition climate risk exposure (e.g. oil and gas and utilities companies, such as Xcel Energy in the case study below, have high transition risk exposure and therefore climate should be afforded a high weighting).
Benchmarking can be a helpful way to assess the comparative weighting of the company's incentive against its industry peers (domestic and international).	• Weighting of climate criteria is in-line with industry peers (domestic and international), illustrative through benchmarking.
The company should be able to balance and articulate a clear rationale for the distribution of weightings across financial and non-financial criteria, as well as across different ESG metrics.	• Financial and non-financial criteria allow for company growth and do no conflict with climate progress (e.g. metrics that reward increased production of emissions-intensive commodities may indicate misalignment).
If the climate criteria is contained within another ESG measure, the specific climate criteria weighting should be called out.	• Companies that have a multitude of criteria under sustainability have granular weightings applied so there is no confusion of weighting between any two individual outcomes.

Insights for Investors

Investors should direct companies to align weighting with the materiality of climate risks and opportunities to the company. Weightings should consider the relevance and impact of climate risks based on industry, geography, and business model.

In our review of companies, STI weightings ranged from 5–15% (with six companies weighting climate at 10%). For LTI, weighting ranged from 10–30%. Higher weighting correlated with emissions-intensive sectors (i.e. oil and gas, utilities and industrial).

Figure 13: Company assessment against Guiding Principle 5

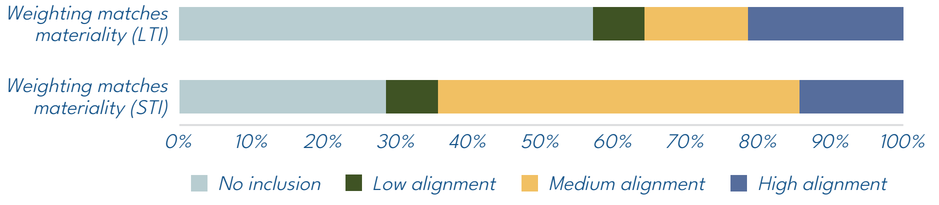
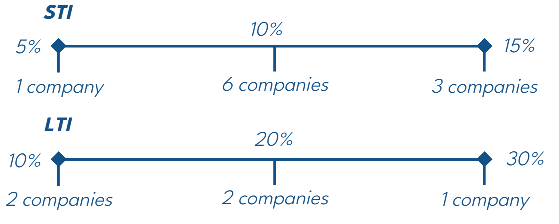


Figure 14: Review of STI and LTI weightings

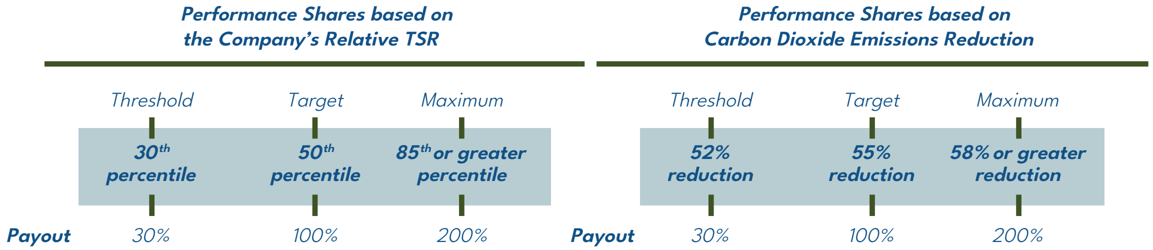


Case Study

Xcel Energy

US utility company, Xcel Energy, has an emissions reduction incentive clearly tied to its CEO compensation through its LTI. From 2021 to 2023, 30% of LTI performance shares were tied to 'the achievement of a specified reduction in carbon dioxide emissions in 2023 below 2005 levels'. The measurability of the targets (threshold, target and maximum) and the high weighting provide clarity on how the CEO will be incentivised to achieve the emissions reduction goal.

Figure 15: Xcel Energy LTI Carbon Dioxide Emissions Reduction Criteria Thresholds



Source: Xcel Energy Notice of Annual Meeting and Proxy Statement (2023)

PRINCIPLE 6:

The disclosure of climate-linked remuneration incentives, and performance against those incentives, is transparent, regular and ideally prospective (rather than retrospective). Incentives should also be subject to regular review and updating to ensure they remain relevant and effective.

Shareholders need timely and transparent information on the design, implementation and outcomes of climate-linked remuneration incentives and remuneration plans in general. Ambiguity in disclosures can raise questions from investors on the way Board discretion is applied. Annual review of climate-linked executive remuneration incentives is also crucial to ensure their continued relevance and effectiveness in driving climate action. The following key signposts provide some direction for what investors should consider when evaluating the disclosure of climate-linked remuneration incentives and the illustrative indicators provide companies can disclose the content, performance and review of these incentives.

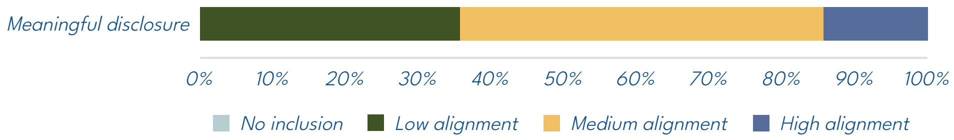
Key signposts informing alignment with this principle

Signpost	Illustrative indicators
Annual disclosure of GHG emissions, performance against targets and value of STI award/s, including detailed information regarding activities that contributed to performance.	• Annual and detailed disclosure indicating where a KPI or criteria is met, including quantification where applicable (e.g. see Enel's prospective disclosure of its 2024–2026 LTI climate-incentive metrics). • Disclosure detailing activities which enabled performance against the KPI (e.g. progress against specific decarbonisation projects).
Prospective (rather than retrospective) disclosure of performance targets that will determine STI award/s for the next financial year.	• Prospective disclosure of the coming year's KPIs or criteria, quantified where possible (e.g. 5% reduction in emissions intensity from 2018 baseline in FY25). • Rationale behind amendments to executive remuneration provided if changes have been made.
Annual disclosure of GHG emissions with third-party verification and executive remuneration report audited by a third-party.	• GHG emissions verified by a third-party. • Executive remuneration report third-party audited *(this is legally required in Australia).*
Clear explanation of how performance against climate-linked incentive metrics is assessed by the Board and rationale as to why they have exercised discretion to award or not award.	• Detailed explanation of how the Board assessed the KPI or criteria. • Rationale as to why the Board have exercised discretion to award or not award performance (e.g. extenuating factors that may have become a barrier or easy-win).

Insights for Investors

In our review of 14 companies, the best disclosures included prospective criteria, provided clear rationale for any amendments, and detailed the decarbonisation activities undertaken to meet the criteria.

Figure 16: Company assessment against Guiding Principle 6



Most companies in the review would benefit from more comprehensive disclosures. This approach not only enhances transparency but also ensures that stakeholders can accurately evaluate the alignment of executive incentives with the company's climate objectives.

Case Study

enel

European utilities company, Enel, links climate to its executive remuneration through its LTI. 15% of Enel's LTI is targeted at reducing GHG scope 1 and 3 emissions intensity related to group integrated power, 'subject to passing the gateway objective concerning GHG scope 2 emissions intensity related to group power generation'. In its remuneration report, Enel prospectively discloses its intensity target 'performance scale' for 2024–2026 (see below, noting performance under the target will result in no incentive awarded) and provides a rationale as for inclusion of the target (i.e. Supporting the achievement of the strategic plan 2024–2026 targets related to climate change mitigation'). While the report disclosed achieved performance against these targets, elevated disclosure would detail the underlying activities which supported performance against the target.

Figure 17: Enel LTI Performance Scale

Gateway objective *Scope 1 emissions intensity of Group Power Generation in 2026*	*Equal to or lower than 125gCO_2/kWh*		
Scope 1 and 3 emissions intensity of Group Integrated Power	*Equal to 135gCO_2/kWh*	*Equal to 132gCO_2/kWh*	*Equal to or lower than 130gCO_2/kWh*
Multiplier	*Target 130%*	*Over I 150%*	*Over II 280%*

Notes: We have provided an abridged version of Enel's LIT Performance Scale. Please refer to Enel's Remuneration Report 2024 for the more detailed version.

Source: Enel Remuneration Report 2024

05: Looking Forward

As we navigate this critical decade for climate change, the evolution and strengthening of climate-linked executive remuneration practices can play a pivotal role in driving the transformational change needed to achieve Australia's net-zero ambitions.

By aligning executive interests with long-term climate goals, companies can position themselves as leaders in the transition to a low-carbon economy, creating sustainable value for shareholders and the broader economy. To realise this vision, Australian companies should continue to improve their climate-linked remuneration practices. This will require ongoing collaboration between investors, boards, executives, and the scientific community. As climate-linked incentives continue to develop over the next decade, a more sophisticated executive remuneration landscape will need to evolve to respond to the following expectations.

Figure 18: Future-looking climate incentive expectations

ALIGN INCENTIVES WITH CLIMATE TARGET TIME HORIZONS	**ENSURE COMPREHENSIVE INCENTIVE COVERAGE OF SENIOR LEADERS**	**ENHANCE TRANSPARENCY & DISCLOSURE**	**INTEGRATE SCOPE 3 EMISSIONS & CLIMATE EXTERNALITIES**	**INTEGRATE REGULAR REVIEW & UPDATES**
Companies will need to increasingly match incentive timelines with climate target time horizons, exploring innovative approaches such as held equity or extended vesting periods.	*Climate-linked remuneration should encompass all senior leaders whose decision-making impacts corporate greenhouse gas emissions. Specific incentives for each senior leader should be linked to their area of control. This broader coverage ensures a company-wide commitment to climate objectives.*	*Executive remuneration reports will need to evolve to provide more detailed disclosures, clearly explaining the activities undertaken and the rationale behind Board discretion in awarding or withholding climate-linked compensation.*	*As companies progress in developing their Scope 3 targets and strategies, incentives will increasingly focus on driving upstream and downstream behavioural changes. Further, executives should consider how it incentivises outcomes to address both transition and physical risks (e.g. resilience and adaptation).*	*Companies will need to implement mechanisms for regular review and adaptation of climate-linked remuneration structures to reflect evolving climate strategy, regulatory landscapes, and stakeholder expectations.*

06: Appendix A. Company Evaluation Matrix

For the company evaluation, we used the following evaluation matrix designed in line with the Guiding Principles set out in Section 5.

STRATEGIC ALIGNMENT*	STRONG ALIGNMENT	MEDIUM ALIGNMENT	LOW ALIGNMENT
CA100+ Benchmark Target & Strategy Rating	All Climate Action Benchmark Criteria across 1–5 rated 'Yes', covering climate targets and decarbonisation strategy	Mix of Climate Action Benchmark Criteria across 1–5 rated 'Yes', 'Partial' and 'No', covering climate targets and decarbonisation strategy	All Climate Action Benchmark Criteria across 1–5 rated 'No', covering climate targets and decarbonisation strategy
CA100+ Benchmark Climate Integration Rating	All Climate Action Benchmark Criteria across 6, 8 & 10 rated 'Yes', covering governance, capital allocation and TCFD frameworks	Mix of Climate Action Benchmark Criteria across 6, 8 & 10 rated 'Yes', 'Partial' and 'No', covering governance, capital allocation and TCFD frameworks	All Climate Action Benchmark Criteria across 6, 8 & 10 rated 'No', covering governance, capital allocation and TCFD frameworks
INCENTIVE ALIGNMENT**	**STRONG ALIGNMENT**	**MEDIUM ALIGNMENT**	**LOW ALIGNMENT**
Climate criteria induces outcomes linked to climate strategy	• Climate criteria are linked to climate strategy through targets, timebound emissions reduction milestones, and/or clear decarbonisation activities • Incentive timeline matches climate strategy timeline	• Climate criteria are linked to the climate strategy through targets, but no clear decarbonisation activities • Incentives do not match strategy timeline	• No clear connection between the climate criteria and the climate strategy (targets or decarbonisation activities)
Credible climate criteria (measurable, contextual, ambitious, sufficient coverage)	• Considering the industry and company-context, the climate criteria are adequately ambitious • The criteria are quantitatively or qualitatively (outcomes not activities) measurable and have timebound emissions reduction milestones • There is no risk of double-up rewarding the same outcome • Climate-criteria have extensive senior management coverage (including all key decision-makers with emissions-intensive business units)	• Considering the industry and company-context, the climate criteria's ambition are limited • Lack of transparency around how criteria are quantitatively or qualitatively (outcomes not activities) measured • Some risk of double-up rewarding the same outcome • Climate-criteria have some senior management coverage (missing some key decision-makers with emissions-intensive business units)	• Considering the industry and company-context, the climate criteria's does not appear to incentivise ambition • Lack of transparency around how criteria are quantitatively or qualitatively (outcomes not activities) measured • Risk of double-up rewarding the same outcome • Climate-criteria have limited senior management coverage (only CEO)
Weighting matches materiality	• Considering the company's context, sector and compared to its peers, the weighting matches the materiality of transition and physical climate risks • Climate appropriately weighted in the context of other financial and strategy criteria • Climate appropriately weighted in the context of other ESG criteria	• Considering the company's context, sector and compared to its peers, the weighting appears somewhat disproportionate considering the materiality of transition and physical climate risks • Climate not appropriately weighted in the context of other financial and strategy criteria • Climate not appropriately weighted in the context of other ESG criteria	• Considering the company's context, sector and compared to its peers, climate is not appropriately weighted considering the materiality of climate risks to the company
Meaningful disclosure	• Annual disclosure of GHG emissions and value of STIP/LTIP award • Both of the following factors are satisfied: ◦ Prospective disclosure of criteria ◦ Description of decarbonisation activities achieved to satisfy criteria • Annual emissions calculations using GHG Protocol and calculations verified through third-party audit	• Annual disclosure of GHG emissions and value of STIP/LTIP award • One of the following factors are satisfied: ◦ Prospective disclosure of criteria ◦ Description of decarbonisation activities achieved to satisfy criteria • Annual emissions calculations using GHG Protocol and calculations verified through third-party audit	• Annual disclosure of GHG emissions and value of STIP/LTIP award • None of the following factors are satisfied: ◦ Prospective disclosure of criteria ◦ Description of decarbonisation activities achieved to satisfy criteria • Annual emissions calculations using GHG Protocol and calculations verified through third-party audit

*Ratings based on CA100+ Net Zero Company Benchmark referenced company assessments as per August 2024.

**This review considers explicit climate-criteria that has been prospectively disclosed as at July 2024, and does not evaluate retrospective climate activities that may have been assessed as performance against other strategic criteria.

07: Appendix B. Engagement Framework

In alignment with the Guiding Principles, investors can follow this structured approach when engaging with remuneration decision-makers.

Integrating climate-linked incentives into remuneration structures is relatively recent for many companies. When engaging with companies, it is helpful to focus on exploring critical questions with the company to understand the intent behind, and likely effect of, their current remuneration incentives and identify shortcomings and opportunities for improvement. The onus is on companies to demonstrate that their incentives are designed and connected to their climate strategy in a way that will genuinely incentivise the achievement of stretch goals and achieve impactful outcomes. Investors can help guide companies on key considerations in this context but seeking to enforce very prescriptive approaches is unlikely to be productive.

Table 2 provides a framework for investor-company discussions on climate-linked executive remuneration incentives, including high-level suggestions on how to work with companies to address identified gaps. It is recommended that investors sequentially work through the questions set out in the table when engaging in such discussions.

Table 2: Investor engagement strategy

Step	Sub-Questions	If Yes	If No
1. Does the company have a robust climate transition strategy in place?	• Has it committed to ambitious short, medium and long-term emissions targets? • Is there a clear and credible decarbonisation pathway in place to achieve those targets? • Is there evidence of integration of the climate strategy into key business functions?	Proceed to Step 2	Focus engagement on strengthening company's climate strategy in line with best practice guidance. Once this is adequately actioned, consider evaluating the company's remuneration framework as in Step 2.
2. Does the company's remuneration framework include climate-linked STIs and/or LTIs?	N/A	Proceed to Step 3	Engage with company on rationale for not implementing climate-linked incentives. Determine whether incentives are appropriate based on company's exposure to climate-related risks and opportunities relative to other business priorities.
3. Is there a clear link between the incentive/s and the company's climate strategy?	• Are key commitments under the climate strategy reflected in the incentive metrics used (e.g. to timebound emissions targets)? • Are the metrics at risk of unreasonably rewarding business as usual or low hanging fruit? • Are the incentives likely to genuinely incentivise both short-term decarbonisation and long-term transition planning?	Proceed to Step 4	Advocate for more clearly linking the STI/LTI to the climate strategy by embedding strategy targets, metrics and timelines into incentive criteria.

Step	Sub-Questions	If Yes	If No
4. Are climate incentives likely to conflict with broader strategic objectives and priorities?	• Does the weighting assigned to climate relative to other financial and ESG matters appropriately reflect its materiality to the business? • Is there potential for the broader business strategy or other incentives to undermine the effectiveness of climate incentives? • Are any other perverse outcomes possible as a result of the incentive/s?	Consider the reason for this conflict and engage with company to address – e.g. does the weighting of climate or other incentives need to be adjusted, or does the company's business and/or climate strategy require revision?	Proceed to Step 5
5. Are the metrics that underpin the incentives ambitious, measurable and relevant?	• Are the metrics used to measure climate performance industry-relevant and reflective of the key decarbonisation challenges facing the company? • Are the metrics sufficiently specific and detailed to enable accurate measurement of performance? • Is there a risk of double payment for the same action/outcome?	Proceed to Step 6	Identify specific gaps or risks associated with existing metrics and engage with the company on revisions that can be implemented to strengthen effect and credibility of incentives.
6. Do you have sufficient detail to adequately assess the effectiveness of the incentive/s?	Is the way performance against the metrics has been assessed transparent and reasonable? Does the company proactively disclose targets and benchmarks for the next year's STI/LTI? Is there evidence that the STI/LTI is subject to periodic review and adjustment to respond to changing business conditions?	Remuneration incentives are likely to broadly align with the Guiding Principles set out in Section 5. Monitor performance against incentives over time and engage with companies on continuous improvement.	Identify key shortcomings and information gaps in current disclosure practices and advocate for additional and prospective disclosure of incentives and rationale for adjustments where appropriate.

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Investor Group on Climate Change

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