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SEMLER BROSSY

ESG+INCENTIVES

2024 REPORT

IN THIS ISSUE

SUMMARY OF SAMPLE

S&P 500 COMPANIES

$30B MEDIAN MARKET CAP

INTRODUCTION

Environmental, Social, and Governance (ESG) considerations have been a priority for many corporations over the last half-decade or more. More and more companies have added ESG metrics to their incentive plans in recent years to signal focus and accountability amidst the increased interest in these topics. ESG metric prevalence for executive incentive plans across the S&P 500 rapidly increased from 57% in FY2020 to 70% in FY2021. However, the adoption of ESG metrics in incentives has since plateaued, with prevalence changing from 72% in FY2022 to 74% in FY2023.

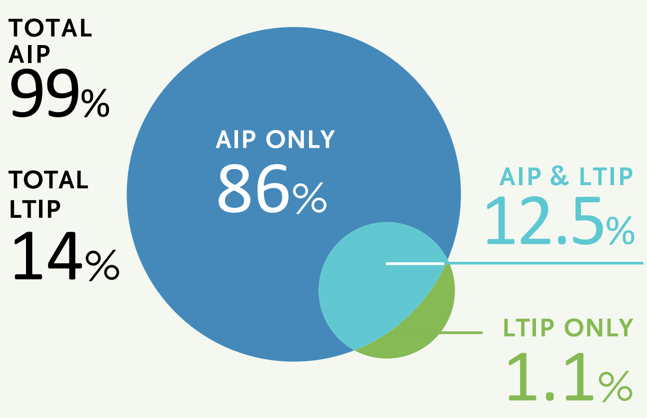
Companies appear to be shifting their focus from adoption to refinement of ESG metrics, with prevalence in annual incentive plans (AIPs) and long-term incentive plans (LTIPs) remaining relatively consistent since FY2021 as companies continue to prioritize the use of short-term ESG goals. However, companies continue to adjust existing plans away from discretionary incentives and towards weighted metrics. In FY2023, 87% of companies with ESG metrics in incentives reported using weighted metrics, up from 72% in FY2021.

Human Capital Management (HCM) metrics continue to be the most prevalent metric category as stakeholder focus on talent management remains strong, and Diversity and Inclusion (D&I) remains the most prevalent metric. Environmental metrics show the largest year-to-year increase and will likely continue to ramp up with the finalization of the SEC's new climate risk disclosure rules.

Recent court rulings on affirmative action and additional political and legal scrutiny towards ESG and D&I may impact the observed trends in the coming years. The data in this report is generally reflective of proxy filings that cover decisions made prior to the majority of these legal decisions and political shifts.

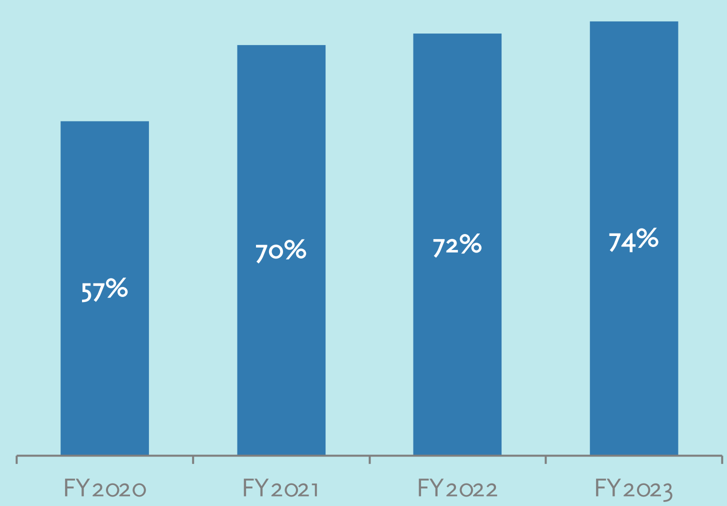
ESG IN INCENTIVE PLANS: AIP VS. LTIP IMPLEMENTATION

(of those with ESG metrics, n=369)



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

ESG IN COMPENSATION PREVALENCE



KEY TAKEAWAYS FROM FISCAL YEAR 2023 DATA

74% of S&P 500 companies incorporate ESG in FY2023 incentive plans (+7 companies from FY2022), which includes all metric types regardless of whether it is formally incorporated in the incentive plan or noted as part of more discretionary assessments, which may be assessments of individual performance. Prevalence is up from 72% in FY2022, 70% in FY2021 (+61 companies from FY2020), and 57% in FY2020. Companies continue to prioritize metric inclusion in AIPs vs. LTIPs which is consistent with prior years. Other key takeaways from FY2023 ESG data include:

- D&I continues to be the most prevalent single metric used at 54% of S&P 500 companies - but adoption of this metric has slowed. Other HCM metrics oriented around talent and retention show larger year-over-year increases in adoption as companies continue to focus on HCM more holistically rather than just on D&I
- 42% of S&P 500 companies use environmental metrics in incentives in FY2023, up from 35% of companies in FY2022. We predict this upward trend to continue as shareholder and SEC focus on environmental disclosures continues to persist
- Companies continue to shift towards formal, weighted structures for including ESG metrics in incentives vs. discretionary structures, as weighted structures are used at 87% of companies that include ESG in incentives in FY2023, up from 81% in 2022
- 34% of companies with ESG metrics disclose some detail on performance goals in FY2023, up from 29% in FY2022. We do not anticipate significant movement towards full disclosure as companies seek to manage social and legal risk, particularly amidst recent court rulings on affirmative action and additional political and legal scrutiny towards ESG and D&I

METHODOLOGY AND S&P 500 DATASET

Semler Brossy has published an annual report series to track the growth of ESG metrics in incentive plans for the past four years. This report examines ESG metrics across S&P 500 companies in the past year (proxies filed from May 2023 to April 2024). Analysis includes all ESG metrics incorporated and mentioned as part of incentive programs in disclosures, regardless of whether the metric is formally included in the program or was noted as part of more discretionary assessments, which may be assessments of individual performance, impacting pay. Data provided by ESGAUGE and Semler Brossy as of April 30, 2024; analysis by Semler Brossy.

YEAR-OVER-YEAR TRENDS IN HCM METRICS

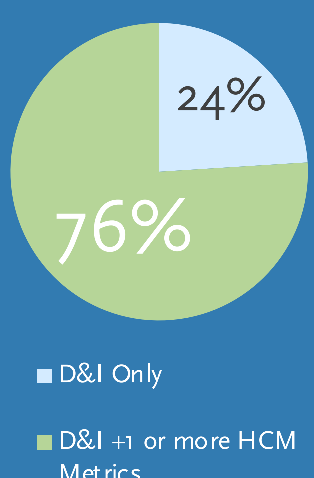
HCM topics remain top-of-mind for investors and government entities, as HCM metrics continue to be the most prevalent category of ESG metric represented in the S&P 500. HCM metrics are generally increasing in prevalence, particularly those related to talent or retention. Employee Satisfaction and Talent Development metrics saw the largest year-over-year increase in HCM metrics at 5% each.

D&I prevalence has also decreased to 54% in FY23 (from 56% in FY22) after years of historically high adoption rates. Additionally, we have begun to see decreases in D&I prevalence among later filers in FY23, which may be driven in part by the June 2023 Supreme Court ruling on affirmative action. The data in this report does not yet completely reflect adjustments made in response to the ruling, but we anticipate D&I prevalence to slow or reverse in the future as companies look to remove D&I metrics, soften D&I metric disclosure in proxies, or rebrand the characterization of D&I metrics to more holistically focus on HCM to avoid politically-motivated scrutiny.

Unlike other HCM metrics, Safety metrics have shown a downward trend as companies move away from COVID-related metrics following the pandemic.

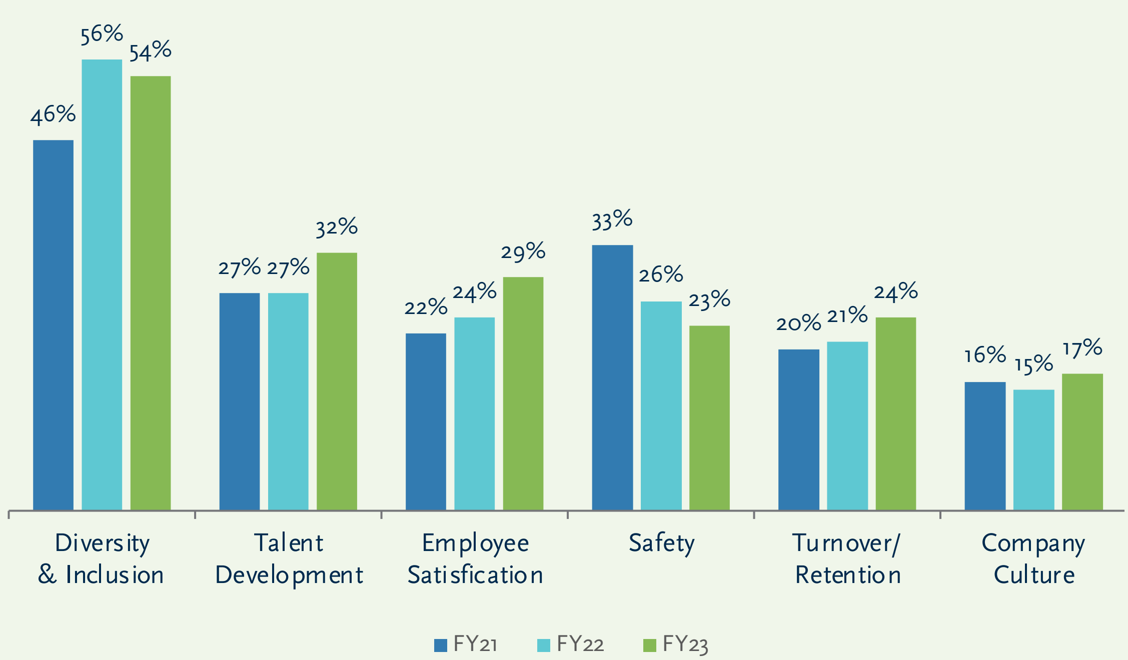
PREVALENCE OF ADDITIONAL HCM METRICS OF COMPANIES WITH D&I

(n=271)



YEAR-OVER-YEAR HCM METRIC S&P 500 PREVALENCE

(% of S&P 500 Companies)

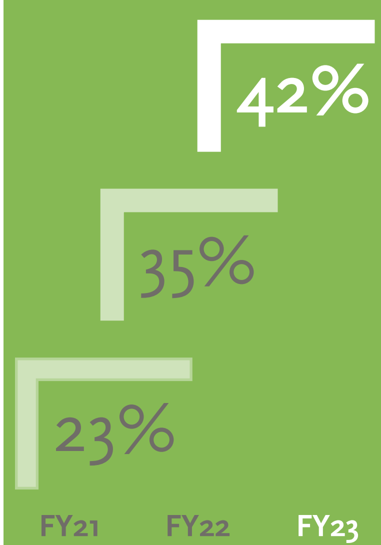


YEAR-OVER-YEAR TRENDS IN ENVIRONMENTAL METRICS

The prevalence of environmental metrics increased (+7%) to 42% of the S&P 500 in FY2023, continuing the trend of notable year-over-year increases. Carbon Footprint continues to have the highest increase in year-over-year prevalence at 30% of companies in the S&P 500 in FY2023, up from 25% of companies in FY2022, while Emissions metrics prevalence decreased one percentage point in FY2023, albeit with a lower rate of decrease than in FY2022 (-2%). Some of this decrease in Emissions goals is likely a recategorization to Carbon Footprint more broadly.

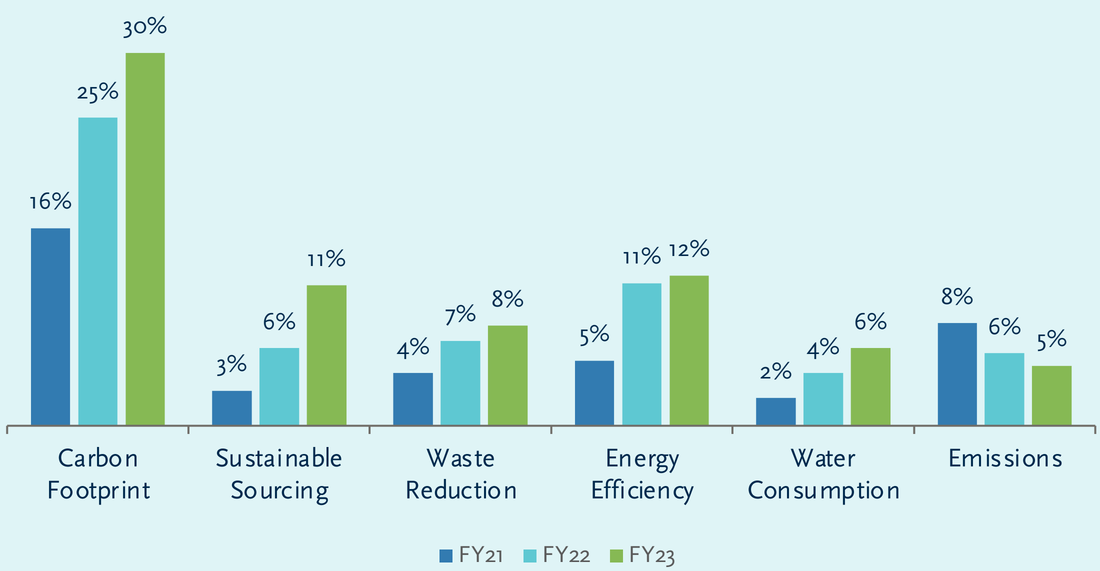
Separately, the SEC has formally adopted climate change disclosure rules in March 2024 that would require companies to measure environmental impacts more closely. These rules are currently under litigation. If implemented, we anticipate these disclosure rules will result in additional increases in environmental metrics in incentive programs in the coming years.

YEAR-OVER-YEAR ENVIRONMENTAL METRIC S&P 500 PREVALENCE



YEAR-OVER-YEAR ENVIRONMENTAL METRIC S&P 500 PREVALENCE

(% of S&P 500 Companies)



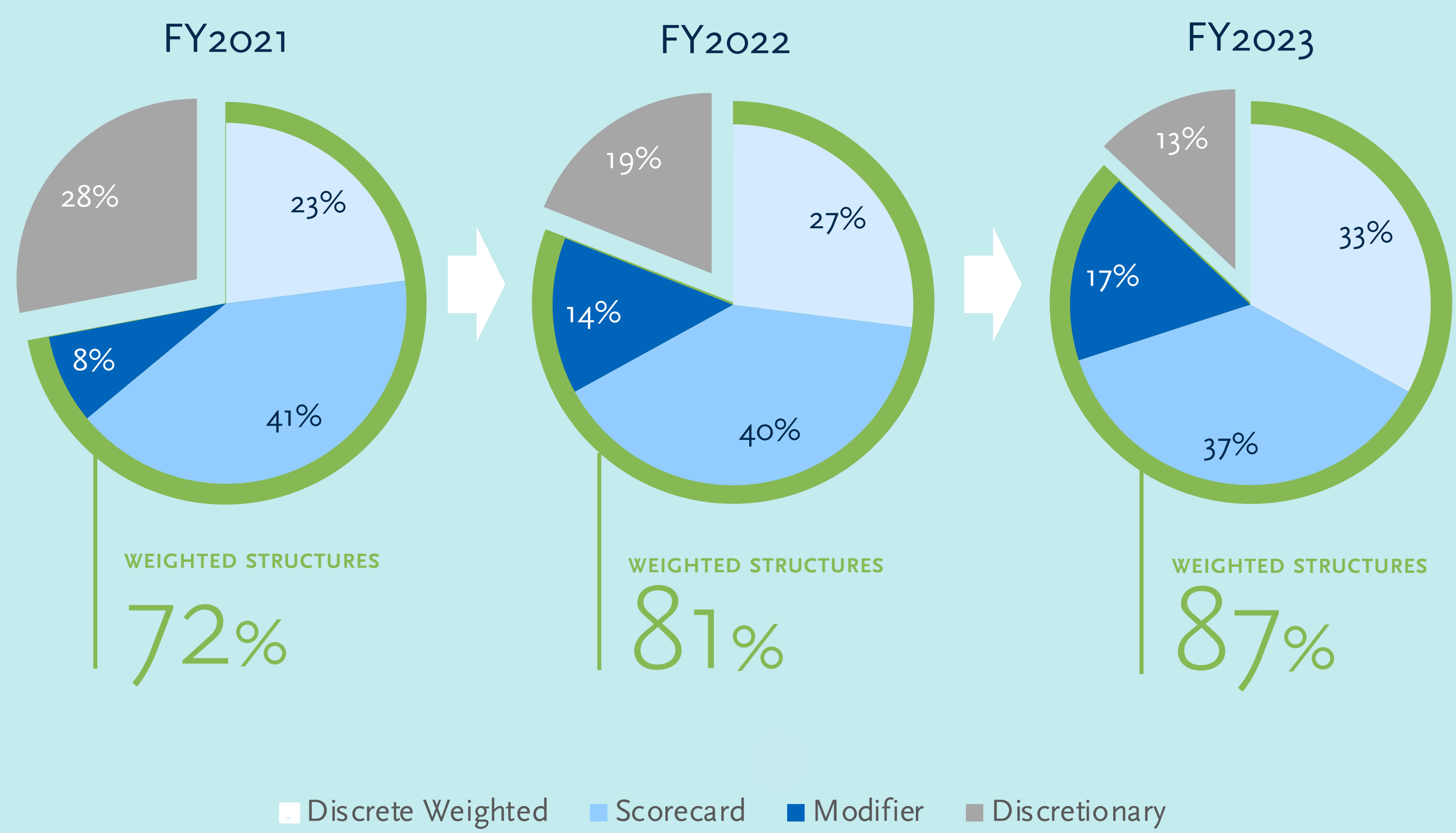
STRUCTURE OF ESG IN INCENTIVE PLANS

Despite the nominal increase in ESG in incentive plans overall, companies continue to shift towards formal, weighted structures (discrete weighted, scorecard, and modifier) for ESG metrics with 87% of companies utilizing these structures vs. 13% using discretionary metric structures.

Most prominent shifts in metric structure were i) discretionary to scorecard (+6 companies year over year) and ii) scorecard to discrete weighted (+17 companies year-over-year), which is the typical path companies take as ESG metrics become more prominent in their programs. 87% of companies with ESG in their incentive plans use discrete weighted metrics in FY2023 compared to 81% in FY2022. The case study found on page eight demonstrates an example of a company that shifted along this path.

YEAR-OVER-YEAR METRIC STRUCTURE – WEIGHTED VS. DISCRETIONARY

(of those with ESG metrics, n=369)



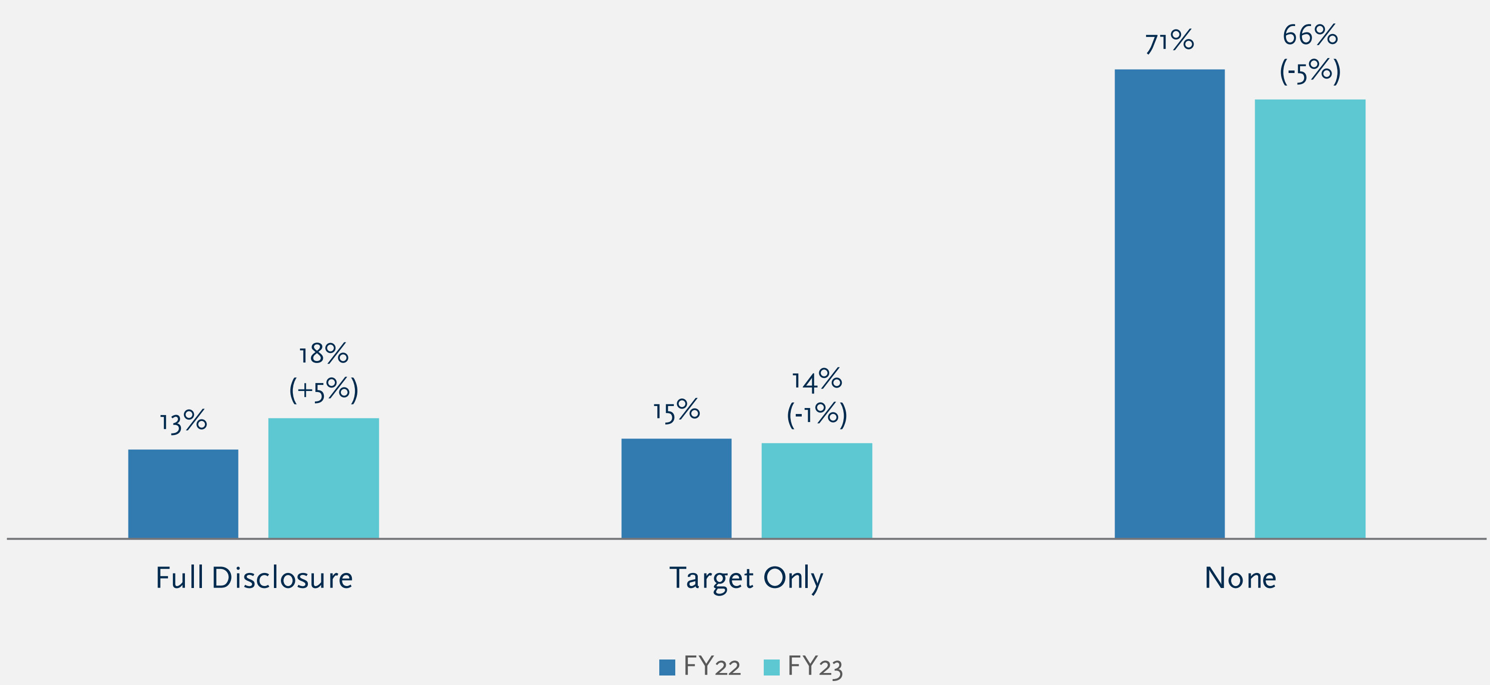
DISCLOSURE OF ESG INCENTIVE GOALS

The vast majority of companies provide only limited disclosure on specific metric goal leverage, despite a slight increase in the amount of disclosure year-to-year seen in the sample. Full disclosure of ESG metric goals (defined as disclosure of threshold, target, and maximum ESG performance goals) increased by 5% from last year (13% to 18%) and is more prominently used in discrete weighted structures than in scorecard, modifier, and discretionary structures. Not shown in the figure below, "Other" disclosures (defined as disclosure of threshold, target, and/or maximum goals alone or in combination) represented 1.4% of disclosures in FY2023, up from 0.8% in FY2022.

We do not anticipate ESG metric goal disclosure to increase as companies seek to manage social and legal risk through limiting disclosure. We anticipate the recent affirmative action ruling, which provides an additional layer of legal scrutiny for companies to navigate, will cause companies to disclose less detail around ESG goals moving forward. Additionally, companies will continue to limit disclosure to maintain flexibility in goal-setting as they build out performance measurement capabilities and look for metric outcomes to become more predictable.

YEAR-OVER-YEAR GOAL LEVERAGE DISCLOSURE PREVALENCE

(of those with ESG metrics, n=369)



CASE STUDY

RTX CORP.

RTX has evolved its use of ESG metrics in incentives from its original inclusion as a scorecard to individual weighted metrics as the prominence of each metric grew. In FY2021, the company introduced its Corporate Responsibility Scorecard (CRS) and at the time did not specify the objectives or their respective weightings. Broadly speaking, the scorecard included People & Culture and Sustainability & Safety, each of which contributed 10% to their annual incentive program.

As time progressed, the company introduced discrete weighted metrics, including Total Representation, Employee Retention Rate, GHG Emissions, and Water Usage in FY2023 as shown below. This shift also represents a move from qualitative measurement to quantitative.

2021 ANNUAL INCENTIVE PROGRAM METRICS	WEIGHT
Earnings	40%
Free Cash Flow	40%
People and Culture	10%
Sustainability and Safety	10%

2023 ANNUAL INCENTIVE PROGRAM METRICS	WEIGHT
Earnings	40%
Free Cash Flow	40%
Total Representation	5%
Employee Retention Rate	5%
GHG Emissions	5%
Water Usage	5%

CASE STUDY

UDR LLC.

UDR provides an example of a company that uses an HCM scorecard to ensure a holistic focus on the well-being of employees across multiple metrics. As a Real Estate Investment Trust, UDR considers these metrics critical to creating a positive "feedback loop" culturally for its employees and residents. Additionally, the company includes a GRESB Percentile ranking as a metric in its annual incentive plan which is a leading global ESG Benchmarking metric for the real estate sector. The company includes an "Overall Health of the Workforce" scorecard made of ten HCM metrics focused on Engagement and DEI.

OVERALL HEALTH OF THE WORKFORCE SCORECARD METRICS (HCM SCORECARD)	
Associate Retention	DEI
Associate Turnover	Engagement Surveys
Compliance to UDR's "Rooney Rule"	Exit Interview Results
Customer Loyalty	Performance Evaluations
Customer Satisfaction	Stay Interview Results

The scorecard is graded on a 5-point scale with 3.5, 3.8, and 4.1 representing threshold, target, and maximum achievement. The scorecard is worth 10% of the annual incentive program for the executive officers shown below:

PERFORMANCE METRIC	CEO WEIGHT	NEO WEIGHT
FFO as Adjusted per Share	30%	30%
Transaction Index	15%	10-40%
Operations Index	35%	10-40%
GRESB Percentile	**10%**	**10%**
HCM Scorecard	**10%**	**10%**

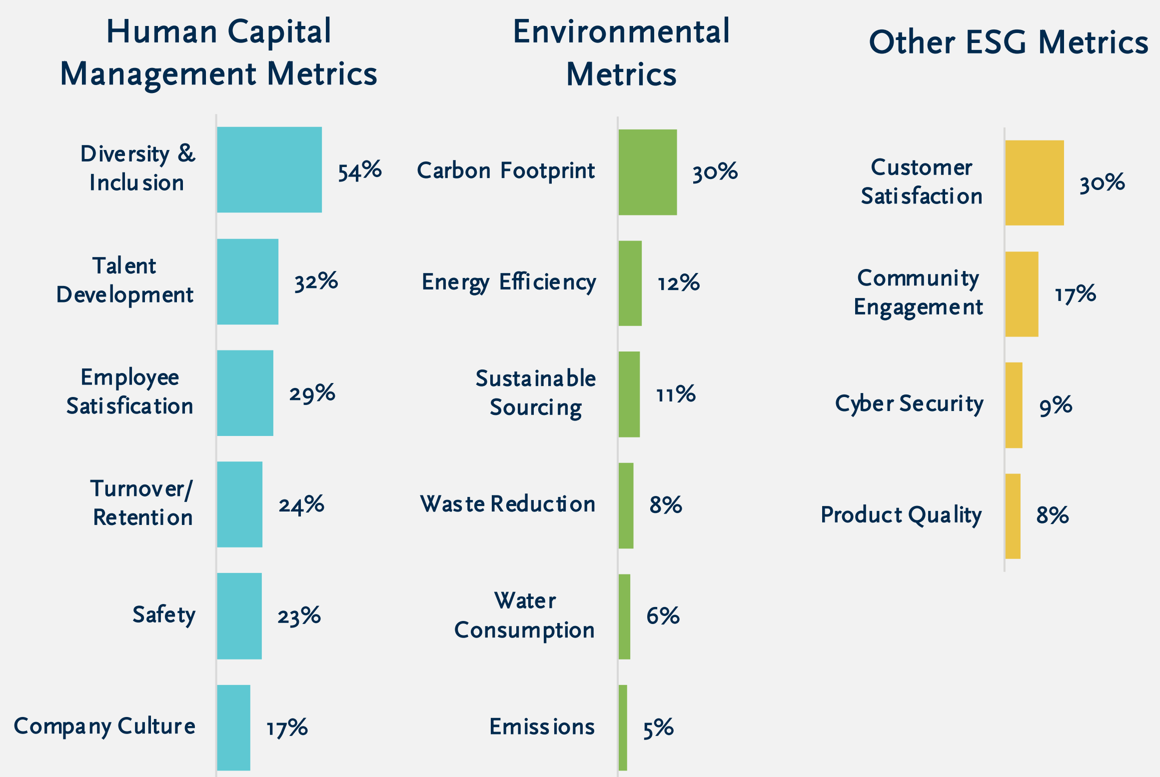
APPENDIX

APPENDIX

DEFINITIONS AND ADDITIONAL DATA

Prevalence of each ESG metric among all S&P 500 companies, organized by category

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



METRIC PREVALENCE

HCM 71%

HCM continues to be the most prominent category of metrics, with 71% of the S&P 500 incorporating these metrics into incentive plans. D&I remains the most prominent metric in this category and in the S&P 500.

Env. 42%

42% of the S&P 500 companies have environmental metrics in compensation plans, and it is the fastest growing category in prevalence. This is a seven-percentage point increase from 35% of S&P 500 companies last year.

Other 42%

Other ESG metrics consist of operational, consumer-focused, and broader-social measures and represent the second most prominent category, with 42% of the S&P 500 implementing these measures, roughly the same amount of companies as last year.

APPENDIX

METRIC CATEGORY DEFINITIONS AND ADDITIONAL DATA

HCM METRICS

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

ENVIRONMENTAL METRICS

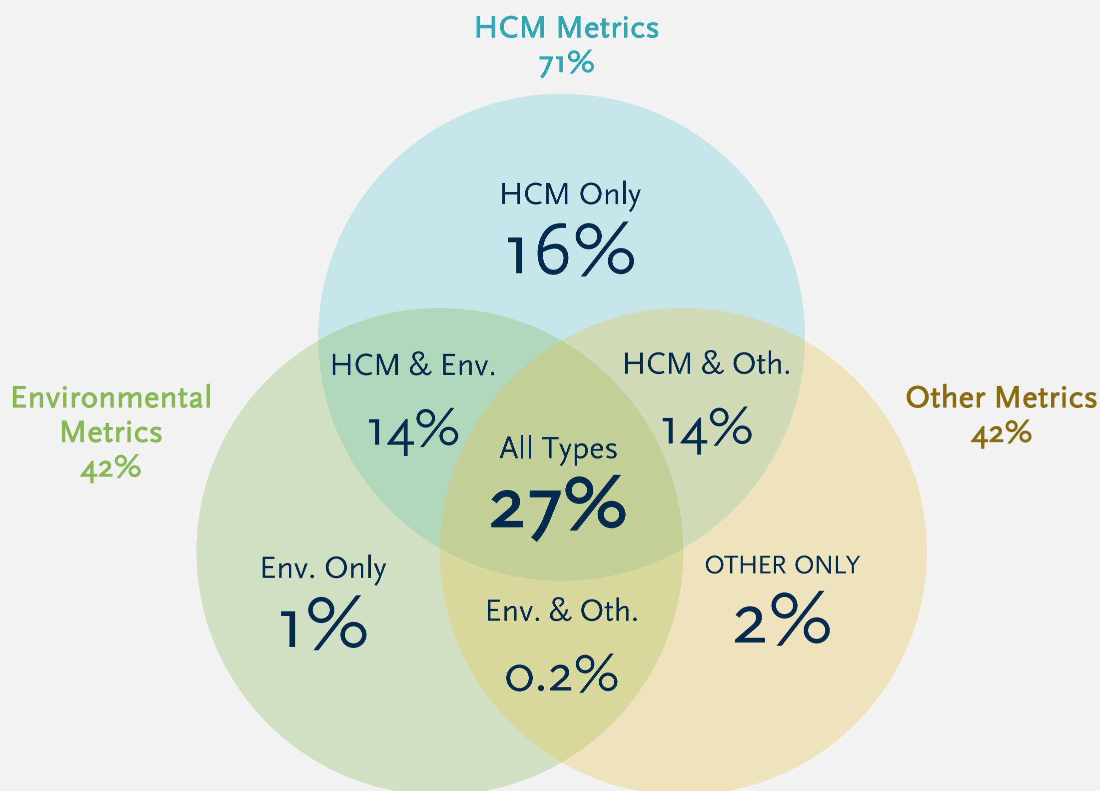
- Carbon Footprint
- Emissions/ Chemical Containment
- Energy Efficiency
- Sustainable Sourcing
- Waste Reduction
- Water Consumption

OTHER ESG METRICS

- Community Engagement
- Customer Satisfaction
- Cybersecurity
- Product Quality

USE OF ESG METRIC CATEGORIES

(% of S&P 500 Companies)



METRIC CATEGORIES

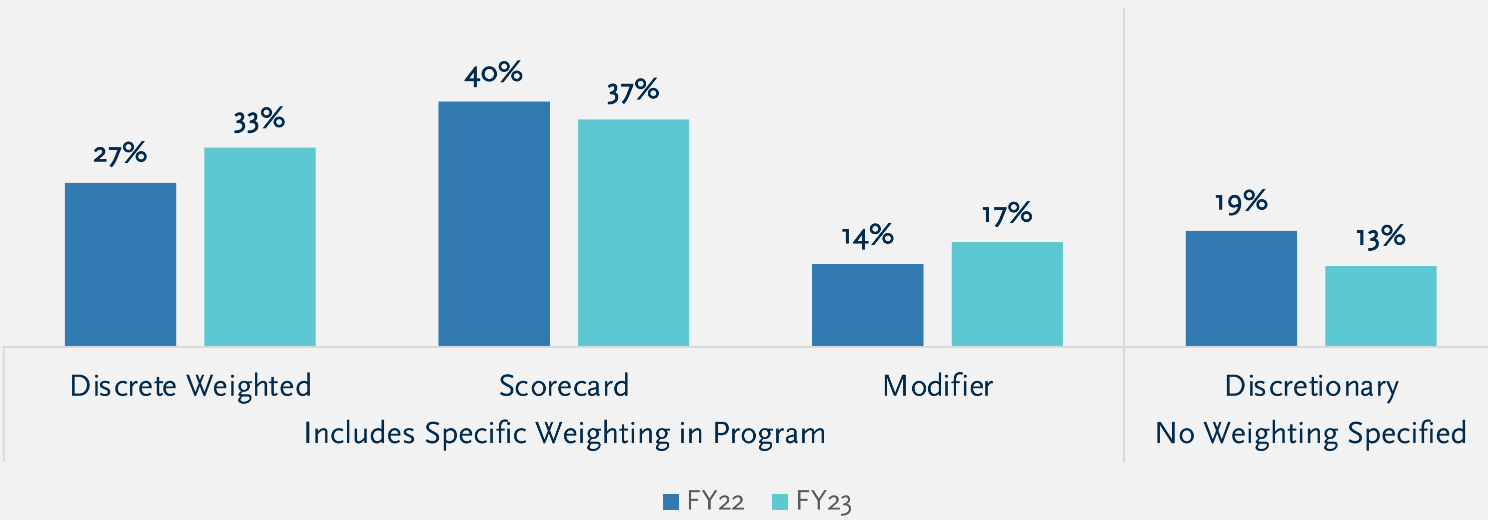
Environmental metrics have experienced significant year-over-year growth while HCM metrics remain the most prominent, with other metrics decreasing in prevalence.

APPENDIX

DEFINITIONS AND ADDITIONAL DATA

PREVALENCE OF ESG METRIC STRUCTURES

(of those with ESG metrics, n=369)



ESG STRUCTURE BREAKDOWN

Year-to-year changes in metric structure are driven by i) a shift to add weighted components to pre-existing discretionary metrics, and ii) the fact that most companies who added metrics did so in a weighted structure.

Scorecard metrics are weighted and assessed as part of a broader scorecard of ESG/business priorities. They remain the dominant ESG structure used by 37% of the sample. This structure allows companies flexibility to focus on a handful of ESG metrics that are important to business strategy while leaving more room for discretion in determining pay outcomes relative to performance against goals. This structure is often used for qualitative goals.

Discrete weighted are specific metrics that have their own discrete weighting. Its prevalence continues to increase as companies look to implement ESG metrics in a meaningful way into the pay program. These metrics are used for companies that have specific ESG metrics that drive business outcomes. These structures are often used for metrics with quantitative goals.

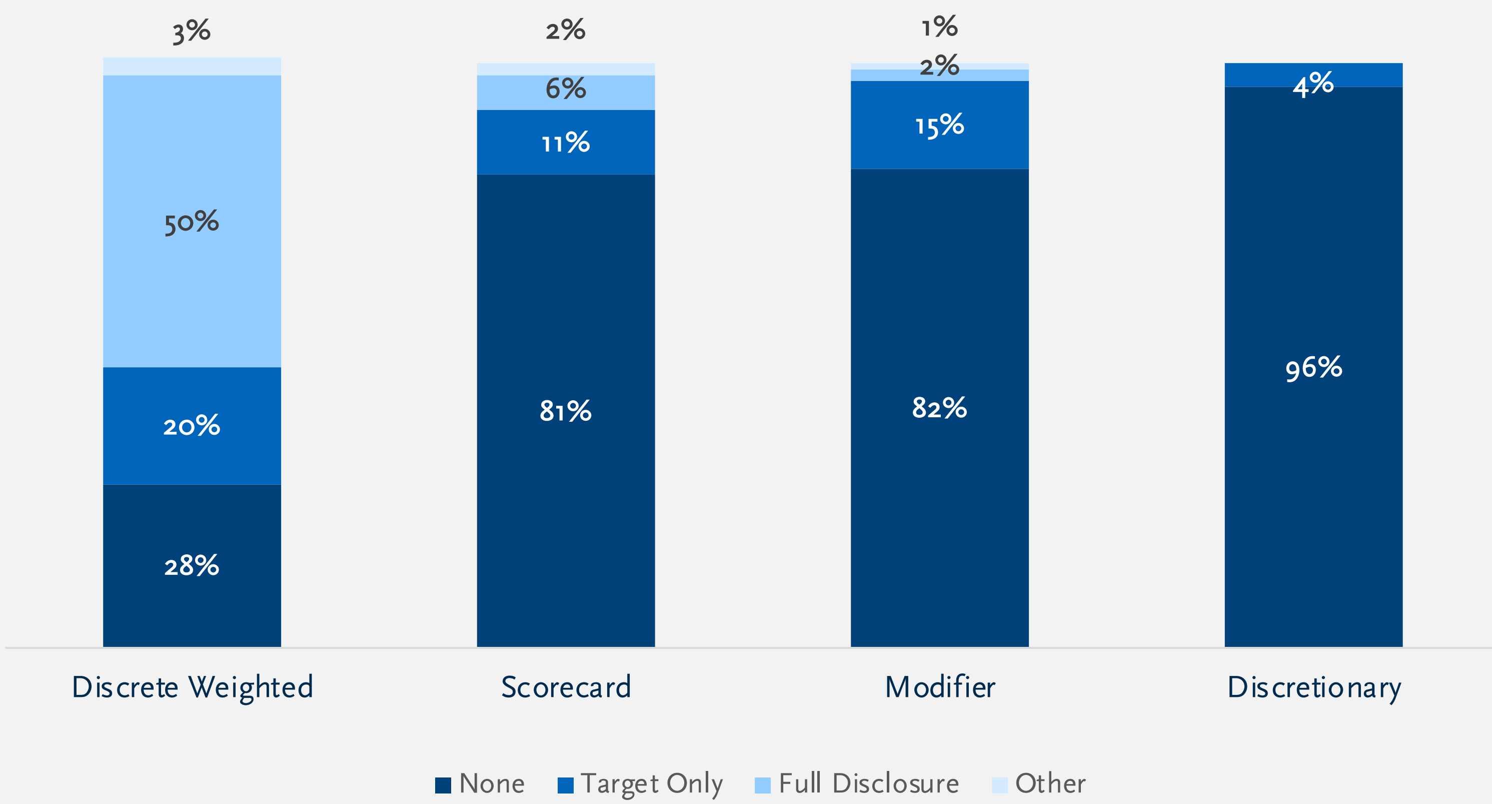
Modifiers allow ESG metrics to affect pay outcomes without holding specific weight within the plan.

Discretionary metrics include ESG with a layer of discretionary considerations, often by individual. While this structure is still used at 13% of companies, companies are continuing to move away from this structure as they look to implement metrics in a more meaningful fashion moving forward.

APPENDIX

DEFINITIONS AND ADDITIONAL DATA

PREVALENCE OF GOAL LEVERAGE DISCLOSURES PER ESG METRIC STRUCTURE



GOAL LEVERAGE DISCLOSURE BREAKDOWN

Full Disclosure of ESG goal leverage occurs when companies disclose threshold, target, and maximum goals for their metrics.

Target Only disclosure of ESG goal leverage occurs when companies only disclose target values and do not include threshold or maximum performance levels.

None or no disclosure of ESG goals means that companies do not disclose any threshold, target, or maximum performance levels.

Other includes companies which disclose either only threshold, only maximum, a combination of target and maximum, or a combination of target and threshold.

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Data provided by ESGAUGE and Semler Brossy as of April 30, 2024; analysis by Semler Brossy. For more information, visit us at **SEMLERBROSSY.COM**