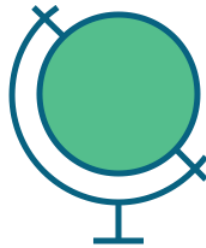




REWARD VALUE



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ESTABLISHING UNIFORMITY & TRANSPARENCY IN SUSTAINABILITY METRICS

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The importance of a sustainable society has become clear to most people. Businesses are incorporating ESG measures into their policies and procedures, asset managers are establishing criteria for responsible investing in accordance with the UNPRI guidelines and asset owners are influencing companies to incorporate the SDGs as established by the UN Global Compact. A multitude of initiatives have been started to structure sustainability metrics and reporting. Long-term sustainable performance is addressing companies at their heart of existence and is impacting companies' purpose to serve all stakeholders at large. Clarity on the meaning and evaluation of sustainable performance is therefore detrimental in securing the needed change in how companies add value to society. To arrive at the needed transparency and uniformity of metrics, global standards are to be established that clearly describe what is measured, how it is measured and how it is reported. This allows for auditable performance evaluation and monitoring progress towards defined goals.

Reward Value's mission is to promote the development of remuneration policies that contribute to long-term sustainable and inclusive value creation. The effective integration of sustainability performance in the financial performance and incorporating the integrated measure in the (executive) remuneration policies will stimulate organizations towards a sustainable long-term value creation for society at large.

Reward Value is a non-profit research initiative. Reward Value can be reached by email (contact@rewardvalue.org) or by phone (+31646100970).

1. Introduction

In order to achieve a better and more sustainable future for society and our planet, the Sustainable Development Goals (SDGs) aim to promote changes in the way we produce, consume and live. Continuing in the way we currently use our resources, deal with waste and address societal issues like inequality, will seriously harm societies and the planet in the long term. There is very little doubt about that.

Large companies have a crucial part to play in this transition. Currently however, there is little common understanding in how we define clear targets for corporate behavior, or track progress and measure success for that matter. This requires a global harmonization of how the different elements of sustainability and corporate responsibility are measured and reported. Uniformity allows for comparison between companies and creates transparency allowing share- and stakeholders to hold companies accountable for their actions.

As Reward Value, we believe that global standards for targets and measurement of corporate social behavior and transparent performance assessment can be included in executive compensation design, in order to incentivize and accelerate the dearly needed progress towards a sustainable planet.

2. Existing initiatives

Over the past two decades, many different organizations have developed frameworks and disclosure guidance on ESG (like Climate Disclosure Standards Board Framework, GRI Sustainability Reporting Standards, SASB Accounting Standards, Taskforce on Climate-related Financial Disclosures and many others). In addition, data providers like MSCI, S&P and Sustainalytics have collected a wide range of ESG related data and rate companies on their sustainability performance. The interpretation of the collected data often differs between the data providers and as a result, businesses are rated differently for the same performance. Furthermore, asset managers have created their own sets of metrics to use in their sustainable investment products.

The UN Global Compact is the leading platform that introduced the 17 SDGs. It has joined forces with GRI to establish guidelines on the integration of SDGs into Corporate Reporting. Such initiatives are also recently presented at the World Economic Forum in Davos with the presentation of the Consultation Draft “Toward

Common Metrics and Consistent Reporting of Sustainable Value Creation”. These initiatives are relevant to move towards integrated reporting in support of reaching the set Sustainable Development Goals.

3. What is missing?

To really be able to measure progress, uniformity of definitions and metrics is needed. Unlike financial data, sustainability data does not have structured commonly agreed upon principles.

The International Accounting Standards (like IFRS and USGAAP) clearly defines the key metrics and describes how these metrics are measured. Taken together with reporting guidelines, this means that stakeholders are able to analyze business performance and compare it to other businesses and sectors.

Such analysis based on common definitions and metrics is not yet possible for sustainability performance. Achieving uniformity in measuring and reporting sustainability performance will make it possible to audit and enforce global goals. Competing reporting standards on ESG however, dilute clarity on sustainability risks and hinder steps towards a more sustainable society.

4. The challenge

To arrive at uniform standards, the common interests of the different stakeholders are to be addressed. Commercial interests of asset owners, managers and issuers may differ from each other, as well as from the interest of society in general. Realigning these interests requires a uniform yardstick. An independent body needs to be established to develop and monitor the implementation of uniform metrics and reporting standards.

Two important criteria are to be fulfilled. First of all, reporting needs to be compulsory for all companies. A strict mandatory regime should be installed in line with current financial reporting obligations. Second, uniform standards are to be established which will become applicable globally. These criteria can be established in mutual cooperation between governments, regulators, auditors and companies under the central coordination of a global institute like the IASB. The defined criteria are then subsequently to be ratified by the local governments of subscribing nations.

Strict adherence to these harmonized global reporting standards can be strengthened by the additional

support from asset owners and asset managers. Some asset managers are against mandatory standardized reporting and are favoring a “comply or explain” approach. Such an approach will, however, not lead to the desired level of global adherence and comparability of sustainable performance. Uniform standards offer clarity and make sure that companies and their executives know that they will be held accountable on a level playing field.

5. How do we get there?

We observe a need for a governance framework similar to IFRS. Standards are set by an international, independent body through a collaborative, iterative process involving a diverse range of stakeholders. Those standards must be subsequently ratified by lawmakers, like is currently the case with IFRS.

To this end, a secretariat needs to be established to coordinate efforts and to act as a steering group/board. An organization like IASB/IFRS would be a natural candidate for this. This secretariat would engage with current initiatives such as those identified above to identify commonalities in current frameworks, as well as with industry experts from accounting firms (e.g. the Big-4), data providers (e.g. KLD, Vigeo-Eiris, S&P RobecoSAM, Sustainalytics and Asset 4), and business organizations (e.g. Business Roundtable) to leverage key expertise and to ensure the feasibility of the harmonized framework. Lawmakers and civil society organizations need to be included as well to make sure the societal perspective and law-making point of view are accurately reflected. Stakeholders from the investment community like institutional investors must be included as well so that the harmonized framework accurately reflects their needs too.

Arriving at a harmonized framework will not be easy. Practically it may be fruitful to start with a ‘pilot’ to both develop processes and to generate tangible gains from the get-go. CO2 emissions measurement and reporting are a natural candidate given the urgency of the climate change problem and the widespread concern about this.

About Reward Value

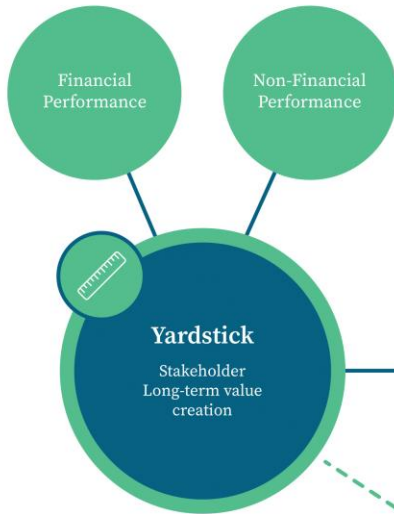
Better executive remuneration policies lead to better outcomes for both shareholders and other stakeholders (customers, employees and society at large).

Reward Value is building the foundation for new, stakeholder aligned, remuneration policies through a research agenda (see figure enclosed) that serves to answer four questions:

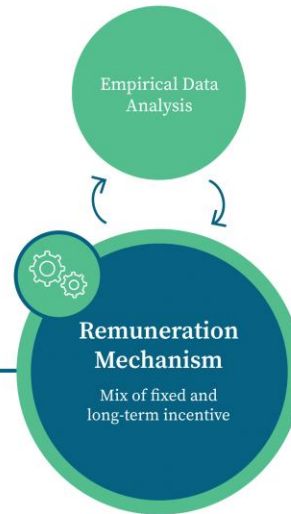
- a. **Performance measures.** How can ESG measures be integrated with traditional financial measures to arrive at a more reliable, universally accepted and risk-adjusted metric for sustainable long-term value creation?
- b. **Performance evaluation.** What is the optimum performance evaluation time horizon?
- c. **Remuneration structure.** Which pay-mix best aligns executive and stakeholder interests?
- d. **Corporate governance.** How can external regulators and internal boards of directors apply the new model while ensuring board independence and limiting the scope for executives to maximize their benefits?

ELEMENTS OF RESEARCH


Identify




Redesign




Optimise



Improved Remuneration Structure