Institute for Sustainable Finance

ISF White Paper

From Ambition to Accountability

Trends and challenges in linking executive compensation to environmental goals

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Contents

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EXECUTIVE SUMMARY

The integration of environmental metrics into executive compensation is increasingly recognized as a critical tool in shaping corporate governance and sustainability practices. As the impacts of climate change escalate and stakeholder expectations intensify, companies have been under mounting pressure to embed sustainability into their core business strategies. While the effects of recent "ESG backlash" remain to be seen, there has been growing momentum in corporate boardrooms behind linking executive incentives to environmental performance to ensure targets are achieved.

This white paper analyzes recent trends and presents data showing the striking growth in number and variety of these types of incentives among the largest U.S. firms. It then covers the current literature to examine remaining barriers to connecting these increasing incentives for executives with real-world environmental progress.

Below are the key findings:

- **Growing Adoption:** From 2016-2022, adoption of environmental performance metrics in executive compensation surged. As recently as 2016, it was exceedingly rare for the largest U.S. companies to report adopting environmental metrics for executive compensation. In 2022, the most recent year studied, it was commonplace, with 141 companies in the data set identified as having such targets. Notably, the most significant year-on-year growth in the adoption of environmental goals occurred in 2021 (+83.9 % YoY), highlighting an accelerated integration. Both S&P 500 and non-S&P 500 companies in the carbon-intensive sectors like petroleum and natural gas, and utilities sectors emerged as early adopters of environmental goals. Within S&P 500 companies, these sectors collectively accounted for approximately 64.5% of environmental goals integrated into executive pay.
- **Focus Areas:** The most common environmental performance indicators relate to climate change and energy use (49%), followed by environmental protection (32%) and resource use (7%). Companies are increasingly including ambitious multi-goal strategies in the executive pay model.
- **Incentive Award Types:** Environmental goals are more frequently linked to short-term cash incentives. However, equity-based awards are steadily gaining traction for long-term alignment.

Despite positive momentum, several challenges persist that may hinder the effectiveness of aligning executive pay with environmental outcomes:

- **Minimal Weighting and Greenwashing Concerns:** Many companies assign minimal weight to environmental metrics in executive incentives, raising concerns about greenwashing and the authenticity of their commitments.
- **Short-Termism:** A key risk is that environmental targets are set for quick wins rather than meaningful, long-term impact. Our findings highlight this concern, with short-term incentives accounting for 81% of the total count of awards, compared to just 17% for Restricted Stock Units (RSUs) and 2% for long-term incentives.
- **Gaming and Transparency**: Executives may modify metrics for personal gain, while opaque bonus structures and disclosure practices undermine stakeholder trust.
- **Regulatory and Stakeholder Pressure:** Companies often respond reactively to external demands rather than proactively catalyzing genuine environmental reforms.
- **Evolving sustainability landscape:** Remuneration committees encounter heightened complexity in selecting key performance indicators (KPIs) that balance climate mitigation, operational realities, and stakeholder expectations.

INTRODUCTION

In recent years, the corporate landscape has witnessed a growing emphasis on embedding environmental and sustainability considerations into governance and business practices. As climate change intensifies, expectations from stakeholders evolve and companies face mounting pressures to integrate sustainability into their core business strategies. While Environmental, Social and Governance (ESG) frameworks guide these efforts, leading organizations are increasingly recognizing the targeted 'E' metrics, that establish a link between leadership incentives and the corporation's environmental impact.

When designed with rigour and transparency, these metrics can make executive compensation a critical lever for credible climate action. However, Morningstar Sustainalytics' 2023 research found that approximately 86% of large cap companies in the U.S. do not have concrete, quantifiable sustainability targets tied to their remuneration structures (Morningstar Sustainalytics, 2024a). This gap prompts questions about the benefits of integrating non-financial metrics into remuneration schemes and whether such measures truly deliver financial value to companies and investors.

According to the ISS Governance 2021 Global Benchmark Policy Survey, a significant proportion of investors believe that embedding non-financial metrics — specifically those related to ESG dimensions — into executive compensation plans is the most effective way to incentivize executives (Belyeu et al., 2021). Investors are also increasingly seeking standardization and transparency in disclosures related to environmental and social information (Reali et al., 2021). This growing investor support for sustainability can be viewed as both encouragement for corporate sustainability initiatives and a challenge to traditional financial priorities. Regardless of perspective, tying executive compensation to non-financial outcomes, such as environmental targets, is widely regarded as a powerful tool to drive meaningful changes in corporate culture.

Further evidence suggests that the executives' "green cognition"[1] significantly enhances both green innovation and the quality of environmental disclosures (Tu et al., 2024). This effect is largely driven by executives' ability to recognize and choose opportunities that tackle environmental challenges and allocate resources to green initiatives. Additionally, ESG contracting motivated by say-on-pay voting laws, has been shown to measurably improve ESG performance through greater adoption of environmentally friendly policies (Pawliczek et al., 2023). However, the financial benefits of environmental performance linked pay depend on the broader sustainability environment. Such benefits are more likely to materialize during periods of strong investor enthusiasm and robust regulatory support for sustainability initiatives but may diminish in an environment characterized by skepticism (Hazarika et al., 2023).

This white paper examines the current landscape of integrating environmental metrics into executive compensation. We present an analysis of trends in corporate adoption of environmental goals in executive compensation, explore industry variations, describe the key indicators used, review types of incentive awards, and discuss the criticisms and challenges before concluding with reflections on the ongoing evolution of these practices.

DATA SOURCE

This study reviewed the firms covered by ISS Incentive Labs which includes 2,300 active U.S. issuers starting in 2015 (market cap >$1B).

A cleaned data set of ISS Absolute Performance Goals Data indicates that in 2022, 1,086 firms reported executive compensation metrics including activity-related, balance sheet-related, cash flow, corporate social responsibility (CSR), earnings/profit-related, economic value, financial/investment return ratios, liquidity/solvency-related, market-related, non-financial, revenue-related, social, and other metrics. Of those firms, 141 or 13% reported having environmental metrics for executive compensation.

1 Also known as 'Green Executive Cognition' – referring to executives' perceptions of environmental concerns, primarily shaped by their knowledge, values and experiences.

TRENDS IN CORPORATE ADOPTION OF ENVIRONMENTAL GOALS IN EXECUTIVE COMPENSATION

FIGURE 1.

Adoption of Environmental Goals in Executive Compensation

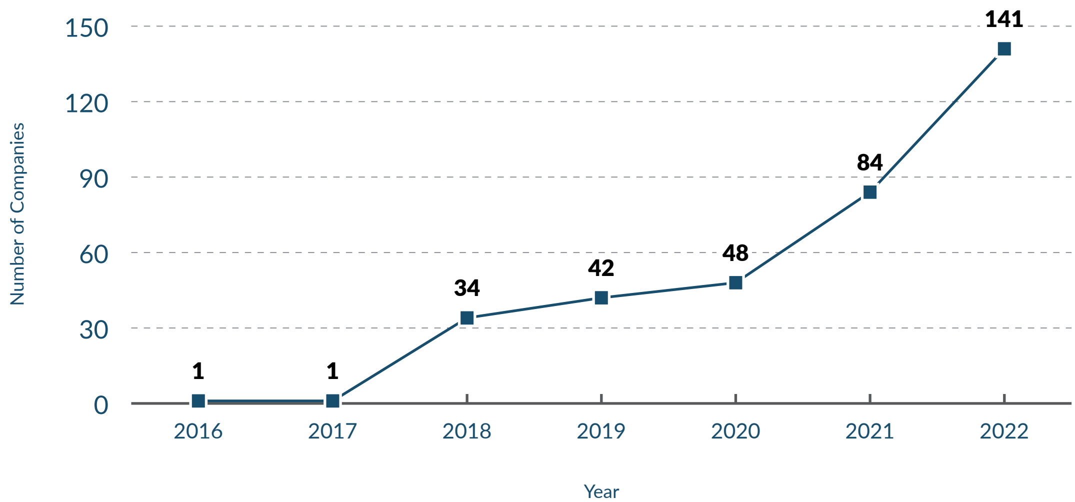


FIGURE 2.

Distribution of Environmental Performance Metrics Linked to Executive Compensation

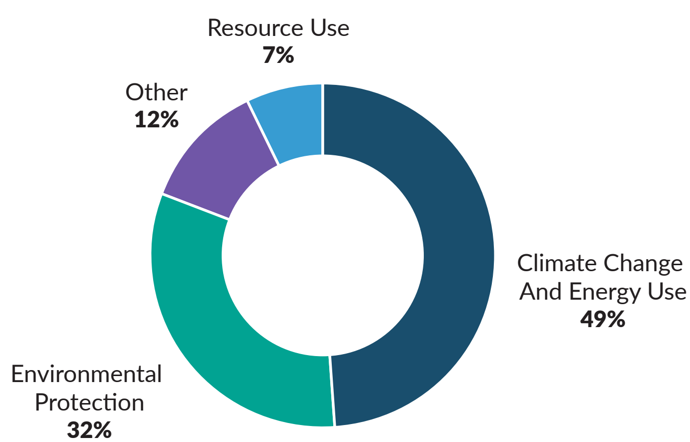
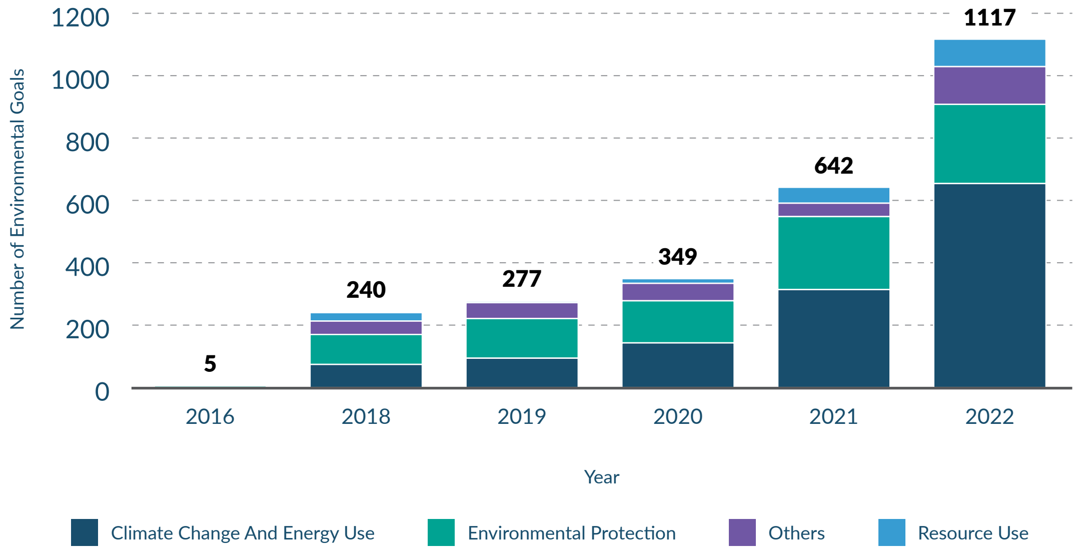


FIGURE 3.

Year-on-Year Growth in Companies Linking Key Environmental Metrics to Executive Compensation



Over the period from 2016 to 2022, there has been a notable increase in environmental goals being adopted in the executive pay structures (Figure 1.) As recently as 2016, it was exceedingly rare for the largest U.S. companies to report adopting environmental metrics for executive compensation. In 2022, the most recent year studied, it was commonplace, with 141 companies in the data set identified as having such targets. The rising frequency underscores the growing strategic importance of environmental initiatives at the senior leadership and corporate management levels. The findings further indicate that environmental performance is gradually evolving into a core driver of long-term business value and risk management.

For the purpose of this study, the environmental performance indicators are broadly grouped into four main categories: climate change and energy use, environmental protection, resource use, and others (See (Table 1.) for indicator descriptions). The KPIs related to climate change and energy use constitute the largest share (49%) among all categories, followed by environmental protection indicators (Figure 2.). Across all categories, a pronounced increase in adoption is observed in 2022. Notably, the most significant year-on-year growth in the adoption of environmental goals occurred in 2021 (+83.9 % YoY), highlighting an accelerated integration (Figure 3.). However, this period reflects the exceptional market conditions induced by the Covid-19 pandemic and the sentiments of these companies regarding pay structures may have been significantly influenced by those circumstances. In summary, these trends indicate that remuneration committees have increasingly prioritized and incorporated the environment-related objectives into the executive remuneration structures, in addition to traditional financial performance measures.

TABLE 1.

Description of broad categories of environmental metrics integrated into executive compensation structure

Category	Description	Content Examples
Climate Change & Energy Use	Metrics and targets associated with reduction of greenhouse gas (GHG) emissions, improvement of energy efficiency, and progress toward transition to clean energy.	GHG emission reduction, carbon footprint goal, fuel efficiency, net zero goal, Renewable energy and carbon offsets.
Environmental Protection	Metrics focus on reducing the company's impact on air, water, and land, as well as ensuring compliance with environmental regulation.	Pollution prevention, reduction of oil spill rate, waste elimination, environmental incident rates, wildfire mitigation plan, environmental compliance, certification to sustainable forestry practices.
Resource Use	Metrics address the efficient and responsible use of natural resources and waste reduction.	Aqua water compliance, water strategy, recycled and reused waste, chemical use transparency, green building certifications, single use plastic reduction.
Others	Flexible category for environmental metrics that are relevant to the company's environmental agenda.	Circular economy, environmental safety, green certifications, supplier engagement, other unique sustainability KPIs.

FIGURE 4.

Intensity of Environmental Goal Adoption by Companies

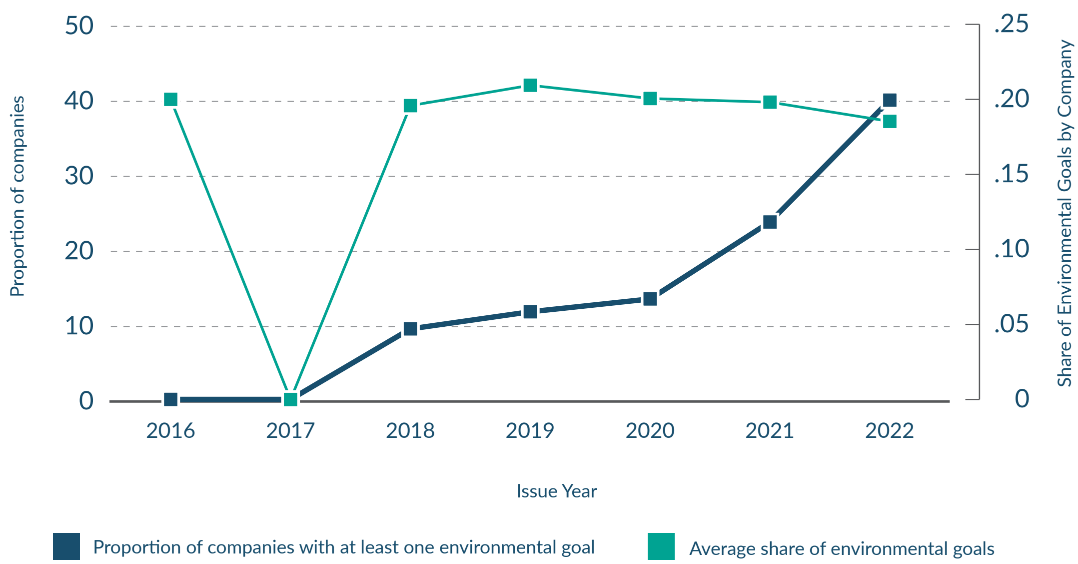
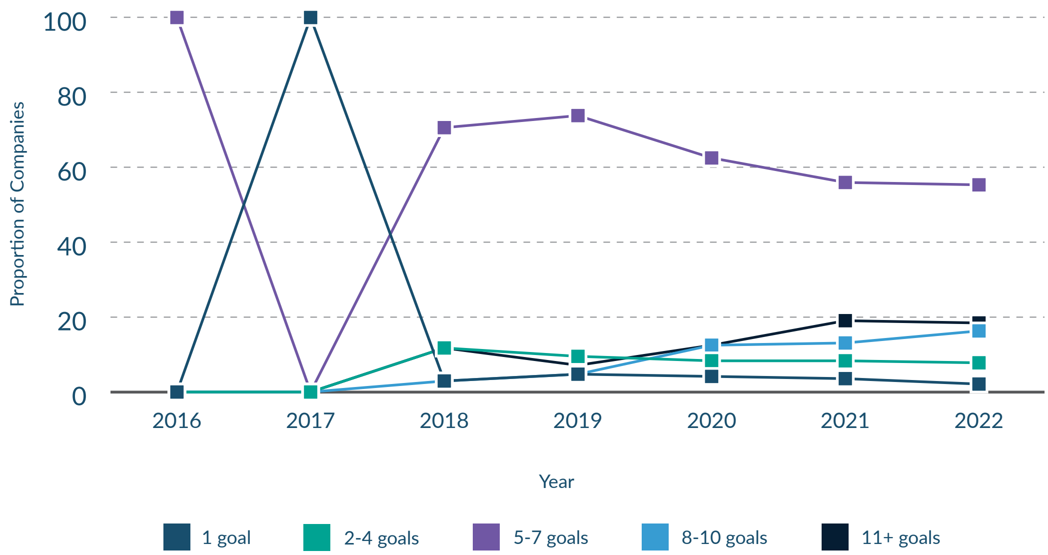


FIGURE 5.

Distribution of Companies by the Number of Environmental Goals



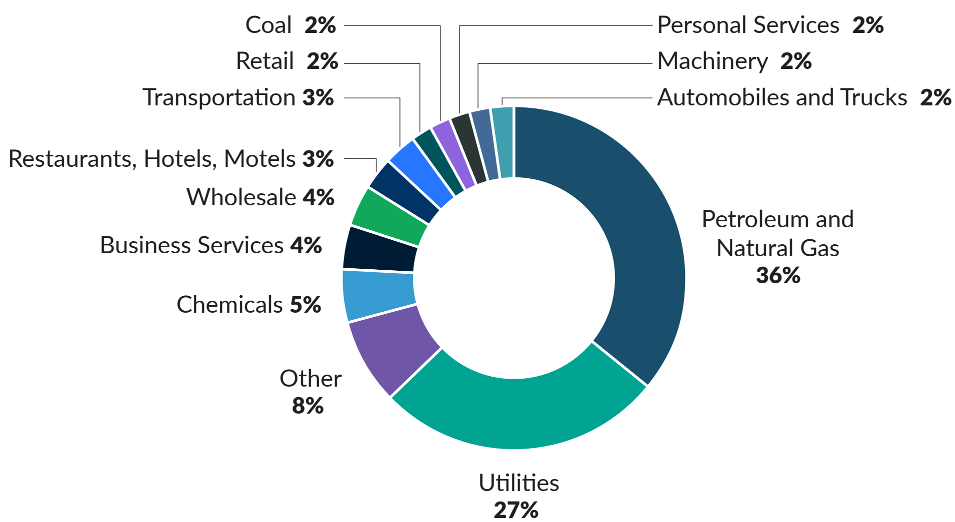
(Figure 4.) presents the trend in both the participation and intensity of environmental goal adoption by companies within their executive compensation models.[2] After 2017, there is a steady increase in the proportion of companies adopting at least one goal, with this growth accelerating after 2020. The average share of environmental goals in executive compensation surged sharply between 2017 and 2018, and after which it plateaus and remains relatively stable, even as more firms continue to adopt such goals. Further, there is a unique trend observed among companies incorporating multiple environment-related goals into their executive pay structures (Figure 5.). The data reveals a significant increase in companies adopting more ambitious, multi-target strategies, with the share of firms setting 11 or more goals rising from 0% in 2016 to 18.4% in 2022. Evidently, 2018 marked a shift in the goal distribution where the proportion of firms with "5-7 goals" began to decline, while those with "8-10" and "11+ goals" increased steadily. The rising prevalence of ambitious goals in executive remuneration contracts points to growing commitment to environmental action and broader transformations in sustainability approaches across companies.

2 Fluctuations in 2016-18 in both (Figure 4.) and (Figure 5.) due to small number of companies with targets.

INDUSTRY VARIATION

FIGURE 6.

Share of Industries Adopting Environmental Metrics in Executive Remuneration



Note: "Other" includes sectors such as Steel Works, Medical Equipment, Communication, Apparel, Aircraft, Construction Materials, Construction, Pharmaceutical Products, Candy and Soda, Precious Metals, Food Products, Tobacco Products, Consumer Goods, and others, each individually accounting for 1% or less of the total.

Among 26 sectors adopting environmental goals in executive compensation contracts, the Petroleum and Natural Gas, and Utilities sectors stand out for their significant and growing adoption rates (Figure 6.). The distribution of industries indicates that the highly scrutinized, carbon intensive sectors are more inclined to demonstrate their sustainability commitment in comparison to other sectors. However, only 3 percent of CEO compensation among the largest U.S. oil and gas companies for 2023 was linked to their performance and achievement against climate-related targets, with most incentives geared toward minor or short-term environmental measures that have little effect on business as usual, rather than long-term decarbonization goals (Morningstar Sustainalytics, 2024b). The broader adoption but weaker alignment with climate-related objectives raises questions about the authenticity and genuineness of these companies' commitments.

FIGURE 7.

Adoption of Environmental Goals Across Industries by Year – S&P 500 companies

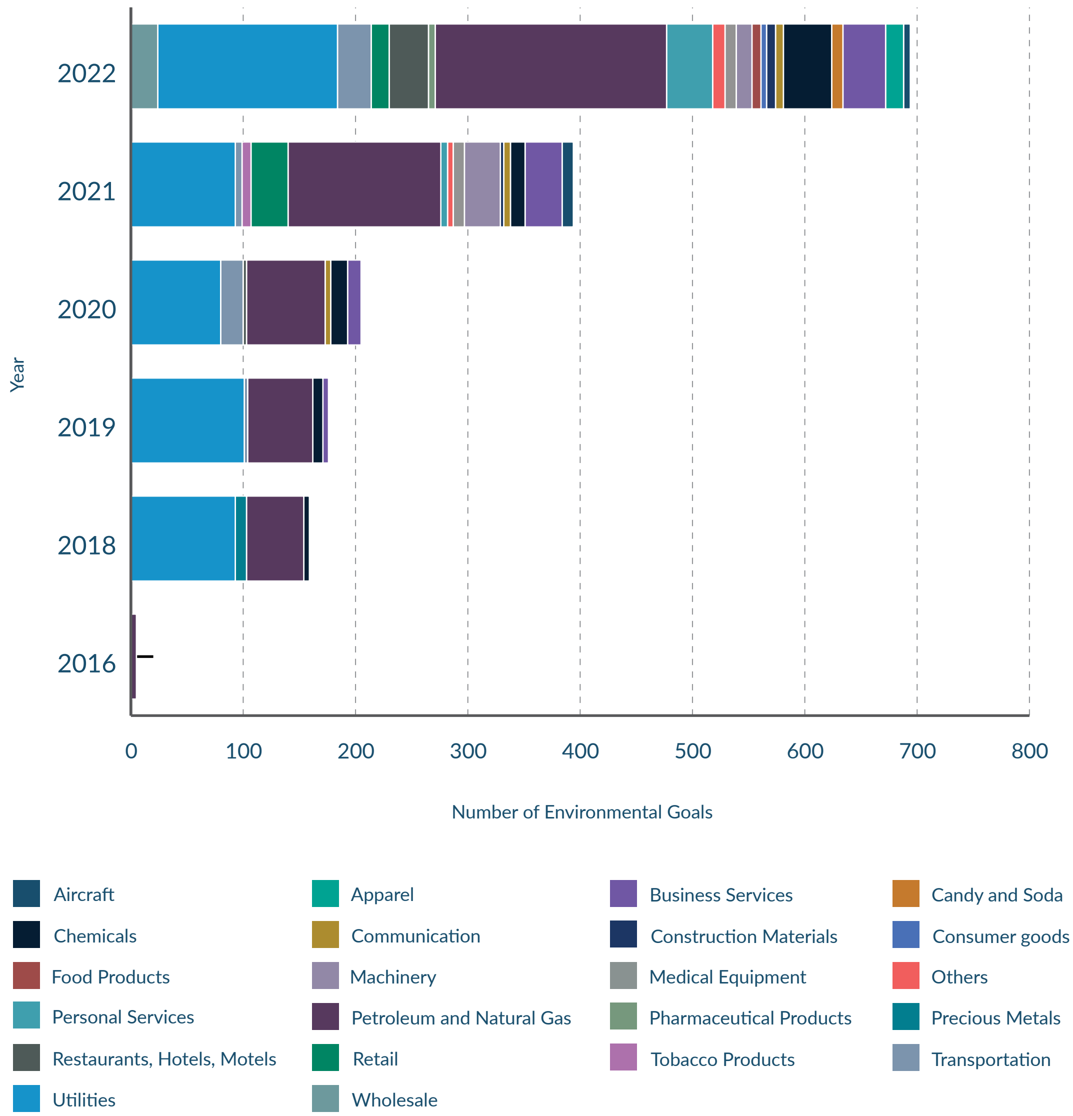
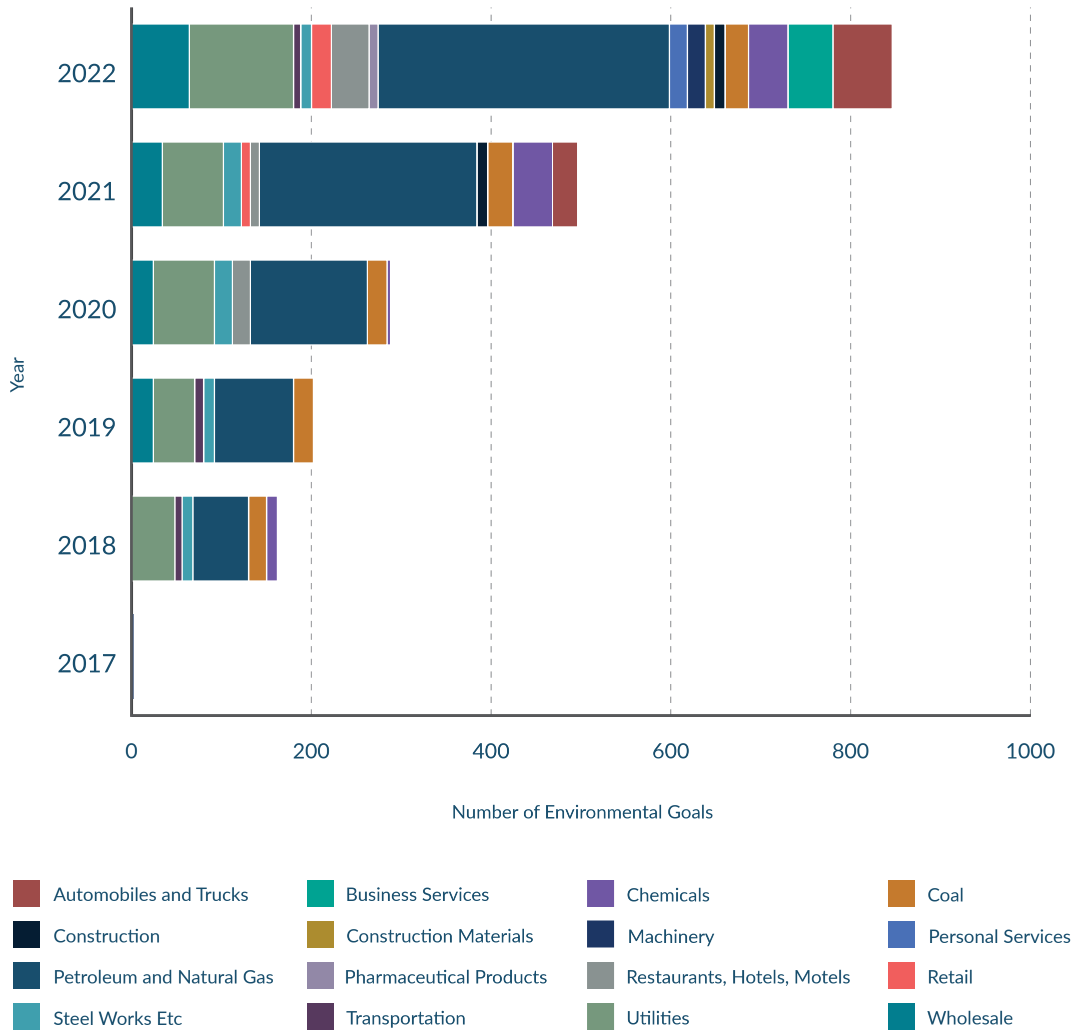


FIGURE 8.

Adoption of Environmental Goals Across Industries by Year – Non-S&P 500 companies



(Figure 7.) and (Figure 8.) illustrate the adoption of environmental goals across industries among S&P 500 and non-S&P 500 companies, respectively. Within S&P 500[3], 93 companies have incorporated environmental goals into their compensation structures. This proportion represents a small but growing minority, reflecting the early stages of structural shift among leading companies. The Petroleum and Natural Gas, and Utilities sectors emerged as early and significant adopters of environmental goals, influenced by growing investor demands and regulatory focus. Notably, these two sectors accounted for approximately 64.5% of the environmental goals integrated into executive pay among S&P 500 companies during this period.

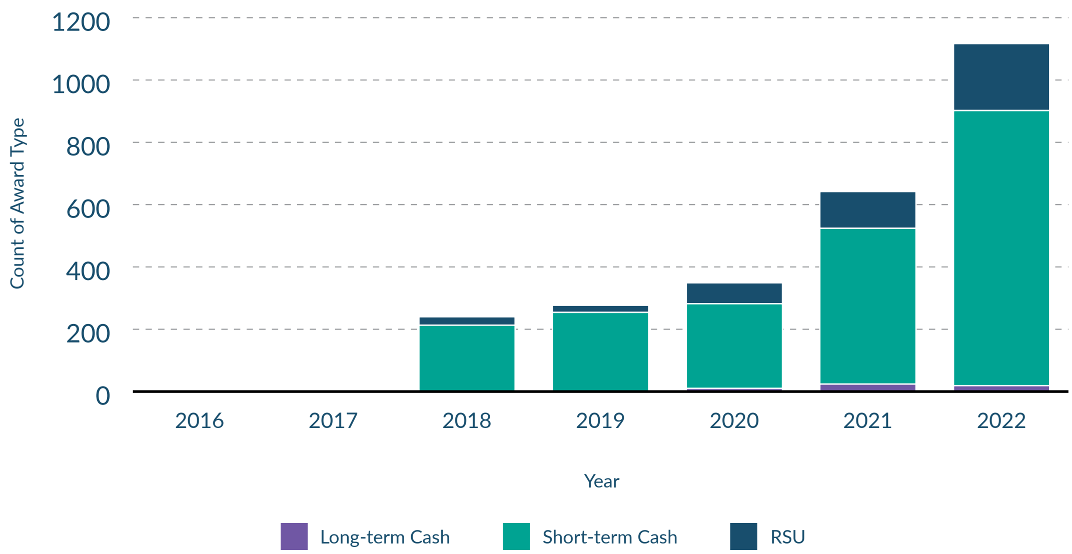
While non-S&P 500 companies began adopting similar goals by 2017, they generally lag due to fewer resources and limited oversight. The adoption trend among S&P 500 companies signals market expectations around sustainability; however, substantial and meaningful alignment with climate objectives remains nascent.

3 We used Central Index Key (CIK) numbers to identify companies that form part of S&P 500 index.

TYPES OF INCENTIVE AWARDS FOR 'E' PERFORMANCE METRICS

FIGURE 9.

Trends in Award Types by Year



(Figure 9.) presents the annual distribution of types of executive awards, illustrating a significant rise in the total count of awards. The dataset reveals that cash-based (short-term and long-term cash) and equity-based (Restricted Stock Units, or RSUs) awards are integrated into the executive remuneration contracts[4]. Environmental performance metrics are largely embedded in short-term incentive plans (STIP). In contrast, the long-term incentive plans (LTIP) are less commonly used for incorporation of 'E' goals into executive pay contracts. Equity-based awards in the form of RSUs shows a notable presence of environmental goals, highlighting the trend toward growing alignment between long-term shareholder value and environmental performance outcomes. Overall, while short-term cash incentives remain a predominant vehicle, equity-based awards are gaining momentum, reflecting the evolving integration of sustainability objectives into both short- and long-term executive performance metrics and targets.

4 'Short-term Cash' is a short-term incentive awarded for achieving specific short-term targets and is generally disbursed within a year; 'Long-term Cash' is a long-term incentive typically tied to multi-year performance goals and is disbursed gradually over time; Restricted Stock Units (RSUs) refer to a stock-based award structure designed such that executives must meet certain predefined conditions before the units can vest. The parameters 'Non-equity Threshold,' 'Non-equity Target,' and 'Non-equity Maximum' are utilized to define performance levels that determine the cash reward's payout, while the parameters 'Equity Threshold,' 'Equity Target,' and 'Equity Maximum' define the conditions for vesting RSUs.

CRITICISMS AND CHALLENGES

The inclusion of non-financial metrics, such as ESG components, has sparked significant debate within and beyond the financial community. While these measures are intended to support companies' long-term objectives, several criticisms and challenges often undermine their effectiveness.

1. **Minimal weighting and greenwashing concerns** – Companies could be window-dressing the compensation structure to appear sustainable and environmentally friendly. In such cases, they risk setting targets that are insufficiently ambitious and fail to possess material weight in the incentive model. Assigning low weightings to metrics suggests higher flexibility in target adjustments, which potentially reduces executive accountability for delivering tangible and relevant outcomes (Efing et al., 2024). As these non-financial objectives are not directly tied to financial outcomes, such pay structures risk appearing figurative and not material.
2. **Short-termism** – The mere inclusion of non-financial business performance metrics in executive pay does not necessarily indicate a genuine long-term commitment to mitigate environmental issues. Instead, it may reflect a short-term outlook, where companies try to align with the 'sustainability' trend while appeasing stakeholders and enhancing corporate reputation. For instance, executives may prioritize unambitious and easily achievable environmental targets that conform to immediate operational needs, instead of incorporating impactful changes and driving long-term progress.
3. **Gaming tendencies**[5] – While evidence indicates that linking executive bonuses to emission reductions can effectively lower carbon emissions (Cohen et al., 2023), concerns persist that executives might be "gaming" these incentives by optimizing the metrics over substantive improvements. Executives might prioritize short-term emission cuts using existing technologies instead of investing in long-term innovation and broader environmental impacts. To mitigate gaming risk, companies should utilize multiple rating agencies with independent scoring methodologies (Chaigneau & Sahuguet, 2025). Further, they should rely on transparent, rigorous disclosure to ensure transformational progress toward decarbonization goals.
4. **Lack of transparency and regulatory preparedness** – Opaque structuring of bonuses can lead to myopic tendencies among executives, leading them to forgo valuable investment opportunities to meet the short-term performance targets. Investors seek greater transparency in climate disclosures, especially how the executive remuneration is linked to the companies' climate transition strategies. Additionally, integrating externality mitigation measures (eg., reducing carbon emissions and addressing environmental concerns) into compensation structures aligns leadership incentives with broader societal interests. As regulatory frameworks such as the SEC's climate disclosure rules (U.S. Securities and Exchange Commission, 2024[6]) further evolve, the companies would likely be required to shift to structured accountability mechanisms. Thus, the firms that preemptively integrate relevant environmental measures into pay structures are better positioned to gain compliance readiness and meet stakeholder demands for accountability.

5 'Gaming' refers to executives strategically managing performance metrics linked to their pay — such as environmental or social measures — to appear to be delivering these performance measures without genuinely improving actual outcomes. This may include focusing on easily achievable metrics, timing carbon emissions reductions to meet temporary targets, or exploiting inconsistencies in ESG scoring systems to appear compliant.

6 On March 27, 2025, the U.S. SEC voted to end its defence of the climate-related disclosure rules that it had adopted in March 2024 (Find the article here). These rules would have required public companies to disclose detailed information about climate-related risks, greenhouse gas emissions (Scope 1 and 2, if material), and the impact of severe weather events on financial reporting. The rules never went into effect, as they were subject to immediate legal challenges and a voluntary stay. The change in political administration and SEC leadership was also a factor in the decision to withdraw its defense. Despite this regulatory rollback, many companies continue to adopt voluntary climate-related disclosures. Additionally, some jurisdictions, such as California, are moving ahead with formulating mandatory climate reporting laws.

5. **Pressure from external stakeholders** – The external pressures from investors and activists has compelled companies, particularly those in carbon intensive industries, to link ESG metrics to executive pay. Although investors find embedding long-term perspective on performance in CEO pay as relevant and helpful (Reali et al., 2021), companies may only adopt such strategies reactively to appease stakeholders rather than proactively to foster substantive advancements. As a result, if heavy emitters link modest carbon emissions reduction targets to compensation without aligning them with quantifiable metrics, concerns around greenwashing are likely to arise.
6. **Environmental KPIs amid ESG backlash** – Remuneration committees are currently facing the complex task of selecting environmental KPIs that meaningfully address climate mitigation and adaptation, while aligning with operational realities. They can utilize standards such as the SASB Materiality Map[7] to identify industry-specific, financially material, environmental metrics and select relevant and measurable ones to link with executive pay. Amidst ESG's evolving trends, it is essential that these metrics remain resilient to growing scrutiny and backlash. Further, ensuring that executive pay is linked to credible environmental outcomes can help maintain long-term stakeholder trust.

CONCLUSION: A WORK IN PROGRESS

In the advent of growing public interest, integrating environmental metrics into executive remuneration as a means to address climate issues represents a positive and promising trajectory. This trend is generally viewed as a beneficial development potentially improving innovation, corporate responsibility, and the alignment of executive interests with environmental goals. Our findings show a clear rise in adoption across sectors, particularly those with significant environmental impact. The most common environmental indicators centre on climate, energy, environmental protection and broader sustainability initiatives, with both cash- and equity-based incentive structures being utilized to support these goals. These developments make a compelling business case for boards to approve plans that ramp up executive pay linked to long-term environmental performance targets. Such measures can expedite corporate decarbonization efforts and facilitate the seamless integration of sustainability goals into governance structures.

However, this practice is not without critics. Widespread skepticism arises from concerns about superficial implementation, short-termism and overall effectiveness. Questions largely remain around whether this approach genuinely drives meaningful corporate action toward environmental concerns or merely serves as a public relations tool.

Amid competing imperatives — financial performance, political oversight, organizational support and public interest — companies naturally value survival over sustainability. Yet, the growing adoption of environmental metrics in executive compensation suggests that the corporate sustainability initiatives are likely to maintain positive momentum in the coming years. Over time, companies are expected to follow through on their commitment and strive to balance broader adoption with stronger alignment to environmental goals. While highly scrutinized sectors are compelled to show their sustainability commitment due to investor pressures, stakeholders' expectations and regulatory requirements, companies more broadly should focus on incentivizing executives based on the achievement of relevant and measurable goals.

7 The Sustainability Accounting Standards Board (SASB) developed an interactive tool — SASB Materiality Map — to help companies and investors identify financially material sustainability issues for a given industry. It visually maps 26 general sustainability topics like greenhouse gas emissions, labour practices, and product safety, across 77 different industries while recognizing that material issues vary significantly by sector.

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