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Transition plans and remuneration policies:

What are the challenges for financial actors?

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The content of this report is the sole responsibility of its authors.

TRIBUTE TO JULIE EVAIN

This publication is a tribute to co-author Julie Evain, who passed away in February 2025. Julie's life was defined by her passion, intellect and determination to fight climate change. Julie joined I4CE in 2018 and quickly established herself as a thought leader on integrating climate issues into financial regulation. She was a driving force in raising awareness among financial actors and encouraging them to support the low-carbon transition. At I4CE, we have lost both an exceptional colleague and a close friend. We miss her dearly.

https://www.i4ce.org/en/team/julie-evain/

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Tribute from the co-author, Mathieu Fantino

I would like to personally express my immense gratitude to Julie Evain, a co-author and a friend, not only for the trust she placed in me, but also for her many words of advice and support. I deeply admired her fighting spirit and her clear-sightedness in the fight for better integration of climate issues into financial regulation. I will miss her and her personality terribly.

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Integrating climate indicators into variable remuneration is a burning issue. Although it was removed at the last minute from negotiations on the Corporate Sustainability Due Diligence Directive (CSDDD), the proposal is still very much alive in the policy debate[1]. While the topic is becoming increasingly central to remuneration in large companies, it still appears to be a taboo within the banking sector. This requirement was already included in the European Central Bank's supervisory guidelines as early as 2020, yet it appears to have been largely neglected by banks.

In this report, I4CE explains why it is nevertheless essential to ensure consistency between a bank's transition plan and its remuneration schemes. Indeed, if variable remuneration does not integrate the objectives of banks' transition plans, then there is little chance of them being effectively implemented. Going beyond executive salaries, the question of integrating climate indicators into remuneration must also be extended to operational teams. I4CE recommends that supervisors conduct a more detailed analysis of banks' practices in this area and use this as a tool to drive transition plans forward.

I4CE then presents the most advanced practices that banks and supervisors can draw on to develop a remuneration scheme that is consistent with transition plans. These remuneration policies must first take a decentralised approach and be tailored to the specific realities of banks and their different divisions. The objectives set for investment teams cannot be the same as those set for human resources teams, for example. The criteria must be as quantifiable as possible to minimise any arbitrariness in the allocation of remuneration. The crucial issue of independent third-party monitoring of remuneration schemes is also addressed.

Finally, I4CE reviews the various obstacles that exist today in terms of the maturity of the issue, its acceptability, and associated technical challenges. I4CE proposes several avenues to address these obstacles, including flexibility in implementation, a broader reflection on equity in remuneration policies, and better training for bankers and their supervisors.

1 AEF info, "Promesse de campagne d'Emmanuel Macron, l'inclusion de critères ESG dans la rémunération des dirigeants est déjà amorcée", 2024.

TABLE OF RECOMMENDATIONS

WHERE IN THE REPORT?	RECOMMENDATIONS FOR SUPERVISORS
1.1	The adoption of transition plans within the Capital Requirements Directive (CRD) means banks need to review their internal governance, and in particular their remuneration policies.
1.2	Banks do not currently include any real climate component in their remuneration schemes, or if so, only at the executive level. To address this, they should draw on existing best practices within non-financial companies.
1.3	Through the Pillar 2 process, banking supervisors must ensure overall consistency between banks' remuneration policies and their transition plans.
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2.2	For operational teams, a decentralised approach should be adopted, with metrics tailored to each division. These should be quantifiable, time-bound and robust.
2.2	Within a common reference framework, supervisors can thus establish a list of criteria they deem relevant, according to the different divisions and the banks' level of progress.
3.2	External, independent auditors should verify the allocation of variable remuneration based on whether or not predefined objectives have been met. This approach appears to be the most effective in preventing any arbitrariness in remuneration allocation.
3.3	Banks should demonstrate flexibility in their implementation, even if this means taking corrective actions.
3.3	Training for bankers and supervisors must continue, to ensure the subject gains maturity.
3.3	Discussions on variable remuneration could also extend to the question of pay equity within banks.

INTRODUCTION

With the reform of the Capital Requirements Directive (CRD), banks will need to produce prudential transition plans. These transition plans are a major opportunity to drive the changes expected of banks in response to climate challenges. Verified by European supervisors, these plans could result in actions, or lead to significant fines in the event of non-compliance with regulations or insufficient actions. With the evolution of the Capital Requirements Directive and the new European Banking Authority guidelines, it is now important to consider how prudential transition plans will actually be implemented, for both banks and supervisors. In other words, it will not be enough for banks to simply adopt a transition plan. To effectively implement the plan, they will need to make changes. In addition to reviewing their financing strategies and addressing climate risks, banks will also have to reassess their internal operations. It would be detrimental for a bank if its organisation and governance were not consistent with its transition plan. It is the supervisor's role to ensure this overall consistency between a bank's internal operations and its transition plan. One of the key aspects of this reorganisation concerns remuneration policies.

1. ENSURING REMUNERATION POLICIES ARE CONSISTENT WITH BANK TRANSITION PLANS

KEY MESSAGES

To ensure the effective implementation of bank transition plans, banks must review their variable remuneration policies and integrate climate objectives into them.

At present, despite growing attention to the issue, banks have made little progress in this area and do not integrate any climate criteria into their remuneration schemes. To do so, they can draw on existing best practices within non-financial companies.

Through the Pillar 2 process, supervisors must ensure consistency between banks' remuneration schemes and the objectives set out in their transition plans. Existing regulations already partially incorporate this idea, but they remain limited to an ESG risk perspective. This perspective should be extended to include the achievement of transition plan objectives.

1.1. Why consistency between remuneration policies and transition plans is essential

Remuneration policies are at the forefront of the internal procedures that banks – and supervisors – must align with the implementation of transition plans.

In its report on financial institution transition plans[2], the Glasgow Financial Alliance for Net Zero (GFANZ) indicates that governance structures are key mechanisms to ensure the effective implementation of a net-zero transition plan. GFANZ thus recommends that remuneration – a fundamental element of these governance structures – should be directly linked to the objectives of transition plans.

Similarly, the London Business School Leadership Institute and PwC conclude their report "Paying for net zero" by stating that *"with the widening adoption of transition plans across the world, and especially in Europe, there will be an expectation of tight coherence between the objectives set out in those plans and targets that are included in executive pay"*[3]. **In short, the adoption of transition plans under the Capital Requirements Directive (CRD) calls for a review of the internal governance of banks, and in particular their remuneration policies, which must be consistent with their transition plans.** It is the supervisor's role to ensure this overall consistency between banks' remuneration policies and their transition plans.

In general terms, this consistency between remuneration policies and transition plans means that the factors determining remuneration should be adapted to the objectives set out in transition plans. In practice, this leads to a dual approach.

First, no bank executive or employee should be required to forgo their variable remuneration to implement the plan. In other words, no employee should be financially incentivised to make decisions that go against the plan. For example, some banks still have teams whose objectives are to close deals in fossil fuel sectors, despite the banks' commitments to gradually phasing out these activities. Achieving this consistency, beyond just remuneration, also requires changes in the way teams are structured.

But this consistency also implies that remuneration policy should directly encourage the effective implementation of the plan and the achievement of its objectives. In other words, bank executives and employees should be financially incentivised to make decisions that align with the transition plan. Consequently, in practical terms, this should entail the integration of climate objectives into variable remuneration. Doing so gives banks an effective means to ensure that their remuneration policy is consistent with their climate and environmental goals and their transition plan.

2 Glasgow Financial Alliance for Net Zero, "Financial Institution Net-zero Transitions Plans", 2022.
3 O'Connor and Gosling. "Paying for Net Zero: Using Incentives to Create Accountability for Climate Goals". PwC and London Business School, 2023.

The widespread adoption of this practice is a way for banks to accelerate the transformation of their activities to ensure compatibility with a low-carbon economy.

Indeed, the academic literature on the incentive nature of ESG-based remuneration highlights its effectiveness in terms of non-financial performance[4]. **Integrating climate criteria into variable remuneration is a powerful incentive, encouraging actions and behaviours among executives that contribute to the environmental performance of companies.**

1.2. Integrating climate criteria into variable remuneration: a rapidly growing trend that banks must embrace

More and more companies are integrating ESG criteria into their executives' variable remuneration. This suggests a consensus on the need to implement this practice, with the aim of aligning the interests of executives with those of the various stakeholders. ESG criteria, particularly climate-related ones, are becoming more prominent in executive remuneration schemes. **This is a clear, underlying trend concerning a growing number of companies across all sectors, and one that banks must also embrace.** In 2020, only 36% of the 25 largest global banks reported linking the remuneration of their top executives to climate objectives, with a stronger tendency to do so in the UK and Europe[5].

More specifically, in a report focusing on the 50 largest European companies[6], London Business School and PwC show that most of them have integrated climate objectives into their executives' remuneration. However, the authors of the report note a lack of communication regarding these objectives. More generally, there is no study at the European level that provides a precise assessment of these developments. Where France is concerned, the Observatoire de la Responsabilité Sociétale des Entreprises (ORSE - Corporate Social Responsibility Observatory) publishes a status report on practices every five years. The 2024 report shows that all of the CAC 40 companies had integrated ESG criteria into the short-term variable remuneration of their executive directors in 2022 (compared to 73% in 2017), and that an increasing number of CAC 40 companies are doing so for long-term variable remuneration (88% in 2022, compared to only 10% in 2017)[7]. In five years, significant progress has therefore been made. Finally, recommendations on executive remuneration, set out in the different corporate governance codes[8], are in line with this consensus, stipulating that remuneration must integrate *"several criteria related to social and environmental responsibility, including at least one criterion linked to the company's climate objectives"*[9].

However, these ESG criteria are often still too vague or deliberately ambiguous, and it is therefore important to clarify what they actually cover in order to assess the importance and weight attributed to climate criteria in particular. According to the same study, 36 CAC 40 companies reported including an environmental criterion in the short-term variable remuneration of their executive directors in 2022, and 31 do so for long-term variable remuneration. Furthermore, the number of SBF 120 companies that have integrated environmental performance criteria into their variable remuneration policy (short-term and/or long-term) for their director increased from 95 in 2022 to 105 in 2023[10].

Finally, in addition to the operational benefits, developing remuneration plans that are consistent with environmental and climate objectives carries strong symbolic value. It would enable banks to clearly demonstrate to external stakeholders their commitment and ability to fully adapt to the new climate reality. The study "Paying for good for all" found that 86% of the senior executives interviewed agreed on the importance of this signalling effect.

4 See Flammer et al (2019), Cohen et al (2023), Cavaco et al (2020).
5 KPMG, "Climate Disclosures within the Annual Financial Reports of Banks (Phase 1)", 2021.
6 O'Connor and Gosling. "Paying for Net Zero: Using Incentives to Create Accountability for Climate Goals". PwC and London Business School, 2023.
7 ORSE, "Critères RSE et rémunération : l'alignement stratégique", 2024.
8 See for example the AFEP-MEDEF Code in France, or the German Corporate Governance Code.
9 AFEP-MEDEF, "Code de gouvernement d'entreprise des sociétés cotées", 2022.
10 IFA, Chapter Zero France and Ethics & Board, "Baromètre des rémunérations – Le climat dans la politique de rémunération des CEO", 2023.

Box 1. Remuneration schemes that foster greenwashing? The case of DWS

Although giving significant weight to climate objectives in variable remuneration is crucial, choosing inappropriate metrics can undermine the effectiveness of remuneration policies in a bank's climate strategy.

The German asset management company DWS has faced this type of challenge[11]. Since 2020, DWS has been actively promoting its sustainability strategy. In line with the company's recommendations, this strategy was integrated into the variable remuneration schemes of its executive teams, with significant weight given to climate objectives: in 2021, ESG targets accounted for at least 20% of total variable remuneration[12]. At first glance, DWS's climate strategy thus appeared highly credible.

However, of the 459 billion euros in ESG assets disclosed by DWS in its 2020 annual report[13], only 70 billion could actually be considered sustainable under the Sustainable Finance Disclosure Regulation (SFDR), introduced by the European Union in 2021[14]. In reality, the increase in DWS's ESG assets from 2019 to 2020 was partly due to the simple conversion of non-sustainable funds into ESG products. Yet the bonuses of DWS's senior executives were linked to targets for increasing the volume of ESG-labelled assets, thereby creating a perverse incentive to boost the number of ESG assets without actually bringing about any significant change in DWS's investment strategy[15].

In other words, the poor design of DWS's executive remuneration scheme, based on inappropriate metrics, was partly responsible for this overstatement of the proportion of assets integrating ESG criteria. This led to investigations in both the United States and Germany into the Deutsche Bank subsidiary.

The case of DWS thus shows that integrating climate criteria into remuneration schemes is a complex issue that requires careful consideration by banks.

1.3. How supervisors can ensure consistency between remuneration policies and transition plans

For supervisors, ensuring consistency between banks' remuneration systems and their transition plans should be part of the Pillar 2 framework, under the Supervisory Review and Evaluation Process (SREP) carried out by the Joint Supervisory Teams for significant European banks. These recommendations are part of the ECB's supervisory expectations[16]. The recent guidelines from the European Banking Authority[17] also indicate that the Authority is preparing to work specifically on this issue. As previously noted in an I4CE report, the adoption of banking transition plans should make the supervisory process more operational for climate issues[18].

The tools available to supervisors include assessments of the governance and internal practices of banks. Among other things, supervisors should therefore now ensure that the overall governance framework of banks is aligned with the internal changes required to comply with their transition plans. The actions of supervisors are crucial, as they alone can verify the actual implementation of the transition plan and the consistency of all internal procedures.

The role of supervisors through supervisory processes would thus be to ensure that there are no inconsistencies in the remuneration policies for bank executives and employees that could undermine the implementation of the plan. Specifically, this consistency can be verified at different levels: in the objectives outlined in banks' transition plans, which must be reflected in the variable remuneration schemes for all employees concerned; in the time horizon for remuneration, which must be aligned with that of the plan; and in the robustness of the metrics used.

11 Vargas and Kuhn. "How the Remuneration System of Deutsche Bank Subsidiary DWS Undermines Effective Climate and Sustainability Goals". Greenpeace, 2023.
12 DWS, "Annual General Meeting - Compensation System for the Managing Directors of the General Partner", 2021.
13 DWS, "Annual report", 2020.
14 Beaujon, "DWS accusé de greenwashing: coup de semonce pour tous les gestionnaires d'actifs". Challenges, 27 August 2021. https://www.challenges.fr/green-economie/dws-accuse-de-greenwashing-coup-de-semonce-pour-tous-les-gestionnaires-d-actifs_778392.
15 Vargas and Kuhn. "How the Remuneration System of Deutsche Bank Subsidiary DWS Undermines Effective Climate and Sustainability Goals". Greenpeace, 2023.
16 ECB, "Guide on climate-related and environmental risks – Supervisory expectations relating to risk management and disclosure", 2020.
17 EBA, "Final report on guidelines on the management of ESG risks", 2025.
18 Evain, Calipel and Noguès. "Include mandatory banking transition plans within Pillar 2", I4CE, 2022.

Finally, if the supervisor finds that a bank's remuneration scheme is not consistent with its transition plan, they may demand that corrective actions be taken. Indeed, requesting a revision of variable remuneration policies is one of the steps supervisors can take to encourage the most reluctant banks to integrate climate criteria. Furthermore, an inconsistency between remuneration policies and the transition plan is a factor that supervisors can highlight to demonstrate the bank's non-compliance with supervisory requirements, and thereby impose additional capital requirements under Pillar 2.

However, there are currently no rules specifying how to integrate climate criteria into the various aspects of bank governance. The question of remuneration policies was initially included in discussions on the CRD, before being dropped during the trilogue[19]. This highlights just how strategic this issue is, and it is important that regulators reconsider this matter. However, supervisors can already address the issue within the current regulatory framework. Indeed, **the European Central Bank's supervisory expectations of May 2020 already specify that remuneration must be consistent with risk management, as well as with banks' voluntary climate commitments and long-term climate objectives.** In its guidelines on ESG risk management, the European Banking Authority also requires that banks detail their remuneration policies aimed at promoting robust governance of ESG risks.

Providing clarification on remuneration policies through updates to the European Banking Authority's guidelines is essential. **The challenge for regulators is therefore to clearly define these rules and to focus on climate and transition risks.** In this respect, the European Banking Authority's future work on remuneration will be crucial.

19 AEF Info, "Promesse de campagne d'Emmanuel Macron, l'inclusion de critères ESG dans la rémunération des dirigeants est déjà amorcée", 2024.

2. WHAT ARE THE DESIRABLE CHARACTERISTICS OF A VARIABLE REMUNERATION SCHEME THAT INTEGRATES CLIMATE CRITERIA?

KEY MESSAGES

The type and number of indicators included in variable remuneration schemes provide supervisors with a clear indication of the bank's maturity in terms of its remuneration policies and their consistency with the transition plan.

To effectively integrate climate criteria, a decentralised approach should be adopted, reflecting the realities of the different divisions within the bank and their means of action.

For executives, Scope 3 metrics are essential. For operational teams, the metrics used must be quantifiable, time-bound and robust to avoid arbitrary allocation of remuneration.

2.1. Adopting an approach tailored to the realities of banks and their different divisions

2.1.1. Integrating all variable remuneration, not just profit-sharing schemes

Recent developments seem to be moving towards a broader integration of climate criteria into variable remuneration. This dynamic is also supported by some French trade unions and employer organisations (CFDT, MEDEF)[20]. The latest ORSE report[21] thus shows that a growing number of French companies are extending this practice to include other groups within the company, beyond just executive directors: senior executives, members of the executive committee, managers, or other employees. However, there is still a lack of specific information about these other groups and their remuneration schemes. It is especially apparent that, in the vast majority of cases, extending the integration of climate criteria into remuneration for all employees is achieved through profit-sharing schemes. However, profit-sharing schemes are primarily a bonus mechanism that take account of the company's results or performance and cannot, under any circumstances, be based on the individual performance of employees[22]. In other words, bonus schemes are far from having the same level of incentive power as short- and long-term variable remuneration. **Therefore, for the integration of climate criteria into remuneration for all employees to be truly meaningful, it should not be limited to bonus schemes, but must also directly concern variable remuneration**.

It is thus crucial that the criteria and objectives are defined so that their achievement depends on the employees. This means building a set of objectives that are as closely aligned as possible with each individual's role, operational realities and responsibilities, which implies defining relevant criteria for each division or type of activity. Consequently, it is neither sufficient nor appropriate for the bank to adopt a single, aggregated and centralised indicator (see section **2.2** for more details on the issue of metrics and objectives).

20 ORSE, "Critères RSE et rémunération : l'alignement stratégique", 2024.
21 Ibid.
22 https://travail-emploi.gouv.fr/droit-du-travail/l-epargne-salariale/article/l-interessement

Box 2. ENGIE – Extending the integration of ESG criteria into variable remuneration to include all employees

In 2023, the variable remuneration of the CEO of ENGIE, the members of its Executive Committee and the 420 senior managers of the Group included CSR and climate criteria, in particular with annual decarbonisation goals for energy production. More specifically, *"senior managers whose role has a significant impact on the GHG emissions trajectory must include a climate target in their individual targets of at least 5%"* [23]. Furthermore, in 2022, 5 000 other employees benefited from the long-term bonus scheme, for which 20% of the performance conditions were based on climate and diversity criteria.

In 2024, there was an increase in the ESG criteria within the long-term incentive portion for the CEO, Executive Committee and senior managers, which rose from 20% to 30%. Moreover, the scope of the GHG emissions criterion was expanded to include emissions linked to gas sales, thereby covering 70% of the Group's emissions [24].

Finally, ENGIE's long-term goal is to base 10% of the variable remuneration of all 30 000 of its senior executives on CSR criteria [25].

This example is particularly interesting, as it demonstrates how the incentive-based remuneration scheme for the climate strategy can be extended to all employees. However, the defined shares are still relatively low, and the specific percentage allocated to climate objectives is not clearly disclosed. It will be interesting to see how this evolves in the coming years with further maturity on the issue.

2.1.2. Extending remuneration policies to operational teams across all bank divisions

Although there is a consensus on the need to integrate climate criteria into variable remuneration, both in the academic literature[26] and in practice, it remains largely confined to executive directors or senior managers, as shown by most studies and reports on the subject[27 28 29]. It is essential that managers address climate issues to ensure their operational teams commit to these goals. **However, extending climate objectives beyond just top management is all the more necessary given that the in-depth transformation of the business model requires the active involvement of all employees**[30].

The transition and climate challenges are topics that permeate all sectors of the economy and impact all activities and divisions within banks[31]. The responsibilities associated with implementing the transition plan will therefore involve functions across the entire structure of the bank and all of its commercial activities[32], not just its directors. For example, in investment banking, an M&A analyst might look for opportunities for more sustainable transactions within their energy or telecommunications portfolio. During financial transactions, they could also encourage the inclusion of contractual clauses linked to sustainability, such as emissions reduction commitments. An account manager, on the other hand, might encourage a household to include energy retrofitting works when securing a mortgage for a property with a low energy performance rating, thereby helping to reduce the bank's Scope 3 carbon footprint. Finally, even a human resources manager is concerned with climate issues. They can contribute to building the bank's internal capacities in this area, whether upstream, by recruiting qualified individuals, or downstream, by ensuring employee training.

Remuneration is a particularly sensitive area for banks, and they are cautious when communicating on this issue. However, the commitments announced by banks at the highest governance levels do not always translate into concrete action within operational teams. At the French level, these gaps have been highlighted several times by the work of certain NGOs[33 34 35], and confirmed year after year by the monitoring of commitments by French supervisors[36]. **Extending the integration of climate**

23 ENGIE, "2023 Integrated report – Accelerating the energy transition", 2023.
24 ENGIE, "2024 Integrated report – Acting for an affordable energy transition and desirable for all", 2024.
25 ORSE, "Critères RSE et rémunération : l'alignement stratégique", 2024.
26 See Flammer et al (2019), Cohen et al (2023), Cavaco et al (2020).
27 Bancel and Philippe, "Les pratiques des firmes en matière de rémunération à long terme des dirigeants", 2018.
28 ORSE, "Critères RSE et rémunération : l'alignement stratégique", 2024.
29 O'Connor and Gosling. "Paying for Net Zero: Using Incentives to Create Accountability for Climate Goals". PwC and London Business School, 2023.
30 Willis Towers Watson, "Executive Compensation Guidebook for Climate Transition", 2021.
31 Noguès and Evain, "Mettre en place des plans de transition prudentiels pour les banques : quels sont les impacts attendus ?", 2022.
32 Glasgow Financial Alliance for Net Zero, "Financial Institution Net-zero Transitions Plans", 2022.
33 Reclaim Finance, "Charbon : le Crédit Agricole enfreint sa propre politique", 15 February 2022. https://reclaimfinance.org/site/2022/02/15/charbon-le-credit-agricole-enfreint-sa-propre-politique/
34 Reclaim Finance, "Banking on climate chaos. Fossil Fuel Finance Report 2021", 2022.
35 Share Action, "Oil & Gas expansion – A lose-lose bet for banks and their investors", 2022.
36 ACPR/AMF, "Rapport commun – Suivi et évaluation des engagements climatiques des acteurs de la Place", 2022.

criteria into variable remuneration to all bank divisions therefore seems to be a promising way forward. In other words, climate criteria need to be integrated into remuneration across the entire organisation. This would help to address – and partially resolve – this disconnect, by ensuring that climate challenges and transition plan objectives are embedded at all levels of decision-making.

2.1.3. Defining a significant share

In order to have sufficient incentive power, climate criteria must have a significant weight in variable remuneration schemes. In other words, the percentage – referred to as the share – corresponding to climate criteria must be sufficiently high.

First, before determining a significant share, it is essential to ensure that the objectives integrated into variable remuneration are truly relevant and meet the criteria (see below), that is to say that objectives must be quantifiable and time-bound and must integrate Scope 3 emissions. Associating a large share with objectives that are too easy to achieve can create real difficulties. In particular, it could lead to high levels of remuneration without actually bringing about any real reduction in the bank's carbon footprint. In simple terms, **a significant share and robust metrics that are consistent with the transition plan are two sides of the same coin: one cannot exist without the other**.

Concerning the definition of the share, the grey literature on the subject shows a wide variety of practices. In France, there has been an increase in the shares allocated to ESG criteria in executive variable remuneration. However, the average share dedicated to CSR is still limited to 23%, in both the short and the long term, and the percentage is even lower for other employee groups [37]. An older study on the extractive industries and energy services sector noted an average share of 10%. More specifically concerning the weight of climate criteria, the IFA-Ethics & Boards-Chapter Zero barometer showed that the average in 2022 was 10% for long-term variable remuneration and 6% for short-term variable remuneration within the SBF 120 [38]. More generally, it is often difficult to determine exactly how much is attributed to purely climate and environmental criteria. As the ACPR and the AMF pointed out in 2022 in their joint report, *"the achievement of climate commitments is too often 'lost' within the broader set of non-financial objectives, raising questions about how these various objectives are weighted in variable remuneration, as well as the direct link between this weighting and purely environmental commitments. In general, the methods for indexing remuneration to ESG or climate criteria lack precision"* [39].

This raises the question of whether the level of these shares is high enough to be a real incentive. While opinions on this may differ, it can be argued that **a weighting of less than 10% for climate criteria is clearly insufficient**. Consequently, allocating a significant share to climate objectives, without neglecting social criteria, automatically leads to an increase in the share allocated to non-financial criteria in general.

In 2022, Mirova, an asset management firm focusing on responsible investment, suggested increasing the share for non-financial criteria to 50% of variable remuneration [40], echoing the proposal from the Collège des Directeurs du Développement Durable (C3D - Council of Sustainable Development Directors) (see box). This symbolic threshold of 50%, which stems naturally from giving greater importance to environmental and social criteria, implies that non-financial criteria are at least as important as financial criteria. A French trade union organisation, CFE-CGE, even recommends that 75% of variable remuneration for executives and managers be based on environmental and social criteria [41].

Ultimately, at this stage, it is not possible to provide a definitive answer regarding an optimal share. **Potentially, different shares could be assigned depending on the level of responsibility and influence of the various employees. The supervisors' primary role would then be to ensure that the shares defined are consistent with the bank's maturity on the issue. Only once progress has been made in this area will supervisors be in a position to determine an appropriate share, based on the types of activity and the divisions concerned.**

37 ORSE, "Critères RSE et rémunération : l'alignement stratégique", 2024.
38 IFA, Chapter Zero France and Ethics & Board, "Baromètre des rémunérations – Le climat dans la politique de rémunération des CEO", 2023.
39 ACPR/AMF, "Rapport commun – Suivi et évaluation des engagements climatiques des acteurs de la Place", 2022.
40 Chapter Zero France, "Comment intégrer efficacement la trajectoire de décarbonation dans la rémunération des dirigeants ?"», 2022. https://www.youtube.com/watch?v=hxaCqOyc2Yg
41 ORSE, "Critères RSE et rémunération : l'alignement stratégique", 2024.

Box 3. The "golden climate" by the Collège des Directeurs du Développement Durable (C3D)

To acclerate decarbonisation within companies, C3D proposes the introduction of a "golden climate", which would account for 50% of both short- and long-term variable remuneration. This criterion would be awarded only if the company's absolute carbon footprint reduction trajectory across Scope 1, 2 and 3 is validated by the science, for example by the SBTi. This mechanism would replace existing variable remuneration schemes and should reduce the risk of offsetting harder-to-achieve financial criteria with more discretionary, qualitative non-financial criteria.

According to Fabrice Bonnifet, President of C3D, the golden climate is *"a natural step in integrating non-financial criteria, helping companies to reasonably anticipate the implementation of the CSRD directive on sustainability reporting. This new incentive tool will not be an issue for companies that are genuinely committed to their climate strategy and will even become a factor in attracting new talent"* [42]. The key challenge now is to promote this golden climate as an example of best practice.

2.2. Defining the metrics and criteria for the remuneration scheme

Choosing the right metrics and objectives to include in variable remuneration is a complex issue that presents several challenges. However, the type and number of indicators included in variable remuneration can provide supervisors with a strong indication of the bank's maturity in terms of its remuneration policies and their consistency with the transition plan. For instance, a single, aggregated objective at the bank level reflects a low level of progress on the matter, in contrast to a truly decentralised approach. With this in mind, several recommendations for best practice can be put forward.

2.2.1. Integrating Scope 3 for senior executives

It seems essential that remuneration objectives include Scope 3 GHG emissions, even though calculating these emissions still presents certain methodological challenges. Specifically for banks, integrating Scope 3 is particularly important as it covers the majority of their GHG emissions. A 2020 report by the Carbon Disclosure Project showed that the CO_2 emissions from the credit and investment portfolios of these institutions were 700 times higher than their direct emissions [43].A bank focusing solely on reducing its own GHG emissions (Scope 1 and 2) would therefore have a limited impact compared to reducing emissions linked to its investment and/or loan portfolios.

However, at present, many financial institutions do not include their Scope 3 emissions in their decarbonisation targets: in 2020, 49% of financial institutions indicated that they did not analyse how their portfolios impact the climate [44].

It nevertheless seems more appropriate to limit the integration of Scope 3 emissions to senior executives, who must be accountable for the bank's commitment to reducing financed emissions. For operational teams, the inclusion of Scope 3 is less relevant, and it would be better to focus on operational indicators (increasing certain categories of loans or transactions, for example), as discussed in section **2.2.2**.

42 AGEFI, "La rémunération des dirigeants deviendra un outil de la transition climatique", 7 May 2023. https://www.agefi.fr/news/entreprises/la-remuneration-des-dirigeants-deviendra-un-outil-de-la-transition-climatique.
43 Carbon Disclosure Project, "The time to green finance – CDP Financial Services Disclosure Report 2020", 2020.
44 Ibid.

Box 4. Calculation and transparency of GHG emissions – The PCAF methodology and the case of ABN AMRO

The Dutch bank ABN AMRO is a founding member of the Partnership for Carbon Accounting Financials (PCAF), an initiative launched in 2015 aimed at developing and harmonising a methodology for measuring and reporting emissions associated with loans and investments[45]. By joining the PCAF, financial institutions can benefit from technical support in implementing this common methodology.

Using the PCAF methodology, ABN AMRO was able to publish in its most recent annual report the emissions associated with 68% of its total loans and advances, and with 25% of its corporate loans[46]. ABN AMRO's financed and facilitated emissions (off-balance sheet) were 33 969 Mt CO_2eq and 6 479 Mt CO_2eq respectively in 2023. In total, its Scope 3 emissions amounted to 40 486 Mt CO_2eq, which is 8 000 times higher than its Scope 1 and 2 emissions[47].

2.2.2. Adopting quantifiable, time-bound and robust criteria

Regarding the nature of the environmental and climate criteria linked to variable remuneration, several characteristics are required. **Based on current discussions, it is clear from the literature and interviews that quantifiable, time-bound criteria provide a strong foundation for defining performance and variable remuneration**[48][49].

It is essential that metrics are quantifiable to make their measurement and achievement more objective and straightforward. Qualitative criteria, on the other hand, leave too much room for subjective, discretionary judgements regarding the achievement of objectives. Indeed, the more qualitative the criteria, the more their achievement depends on the subjectivity of senior management. Qualitative criteria are more ambiguous for employees, which reduces the incentive power of variable remuneration. This can also lead to tension within teams, make the measure less acceptable, and ultimately discredit the mechanism.

Today, European companies seem to agree on the need to adopt quantitative criteria. According to the IFA-Ethics & Board-Chapter Zero barometer, in 2021, 74% of CAC 40 companies included at least one quantitative climate objective in the short- and/or long-term variable remuneration policy of their CEO[50]. Similarly, at the European level, the "Paying for Net Zero" report by the London Business School Leadership Institute and PwC shows that more than 90% of STOXX Europe 50 companies have set measurable carbon targets in their remuneration policies[51].

These criteria also need to be time-bound. This raises the thorny issue of how to articulate short- and long-term variable remuneration[52]. One possible approach would be to link employee and executive remuneration to a combination of short- and long-term objectives, ensuring both immediate and lasting implementation of the bank's climate strategy.

In reality, the key is for banks to establish a clear and comprehensive link between the metrics tied to remuneration and the bank's transition plan. This means that for each division or type of activity, banks must define the long-term objective, the intermediate steps to achieve this objective, and the way in which remuneration objectives are linked to these steps.

Finally, when selecting metrics, banks must clearly distinguish between those integrated into variable remuneration and metrics aimed at communication with external stakeholders. More complex but more robust metrics are preferable to communication metrics. While adopting overly simplistic metrics may initially help employees to adapt to them and take ownership of them, this also runs the risk of teams using them to highlight their shortcomings, which could hinder uptake. Based on the interviews conducted, using external ratings produced by rating agencies, for example, does not seem advisable. Banks should prioritise internal metrics that are sufficiently granular to allow their teams to take full ownership them.

45 https://carbonaccountingfinancials.com/about
46 ABN AMRO, "Integrated Annual Report", 2023.
47 Ibid.
48 IFA, Chapter Zero France and Ethics & Board, "Baromètre des rémunérations – Le climat dans la politique de rémunération des CEO", 2023.
49 AFEP-MEDEF, "Code de gouvernement d'entreprise des sociétés cotées", 2023.
50 IFA, Chapter Zero France and Ethics & Board, "Baromètre des rémunérations - Le climat dans la politique de rémunération des CEO", 2023.
51 O'Connor and Gosling. "Paying for Net Zero: Using Incentives to Create Accountability for Climate Goals". PwC and London Business School, 2023.
52 The concepts of short-term and long-term can have different meanings depending on the context and the studies. Here, short-term remuneration refers to annual variable remuneration, while long-term variable remuneration covers a period of 3 to 5 years.

Box 5. A climate goal achievement rate of more than 100%: is the ambition still too low?

In 2022, the average reported achievement rate for environmental and climate objectives by SBF 120 companies was 113% [53], exceeding the overall achievement rate for objectives. This raises valid questions about why this rate is more than 100%.

Several factors could explain this overperformance. First, it is possible that the indicators used are not the most relevant, for example by excluding Scope 3 emissions, even though these are the main component in some industries, as is the case in the banking sector (see section **2.2.3**). Another complementary explanation is simply that the objectives lack ambition and are too easy to achieve. This seems to be confirmed by the survey by the London Business School Leadership Institute and PwC: in general, most carbon-related objectives in executive remuneration do not meet investors' expectations [54].

It is clearly essential that the objectives linked to variable remuneration are achievable by the teams concerned and remain within their scope of responsibility, particularly to ensure their buy-in and to maintain their incentive power (see section **2.2.1**). However, these objectives should not be used as safety nets to offset poor financial performance, and it is critical that they are aligned with the bank's transition plan.

2.2.3. Fostering a decentralised approach

First of all, it seems more appropriate at this stage to let banks choose which indicators are relevant [55], rather than imposing them from the top down. This is mainly justified by the fact that not all banks have the same level of maturity and progress when it comes to the ecological transition. Clearly, an indicator related to the number of oil assets in a bank's portfolio would be irrelevant for a bank that has already ceased financing fossil fuel projects. While there may be some advantages to this approach, in terms of comparability for example, it would not make sense to impose the same criteria for all banks.

However, this does not mean that supervisors should play no part in defining criteria and objectives. **Within a common reference framework, supervisors can, for example, establish a list of criteria they deem relevant, tailored to the different divisions and according to the banks' level of progress. This reference framework would thus serve both banks, to define their criteria, and supervisors themselves, to assess the overall consistency of banks' remuneration policies.**

As mentioned above, extending the integration of climate-related criteria into variable remuneration across all operational teams should involve tailoring criteria to specific divisions and activities. Linking the payment of variable remuneration to the evolution of a single, group-wide index that aggregates a range of different actions seems inappropriate and reflects a low level of progress on the matter. Indeed, setting a single objective for the entire bank fails to capture the granularity of options for reducing the bank's carbon footprint according to the different activities. It does not make sense, for example, to tie the variable remuneration of a human resources manager to a target for reducing Scope 3 GHG emissions, over which they have no direct influence.

Banks will thus need to ensure that, depending on the divisions and activities, the performance criteria are fully actionable from the employees' perspective. Banks must explain how these objectives are defined and show how they are tangible and consistent with their sectoral policies and transition plans. In this respect, several possible criteria can be proposed:

- **In the context of granting a mortgage**, an account manager's variable remuneration could encourage them to advise their client to include energy retrofitting in their property acquisition or renovation plans. Thus, the variable remuneration could be activated by the client signing a contract for such works and the achievement of a certain energy performance rating. This would create a mechanism for awarding variable remuneration that is straightforward and easy to understand for account managers, and which they can influence more directly. This type of incentive would enable the bank to increase its business, while reducing the risks associated with its lending policy and contributing to the achievement of its transition plan objectives by lowering its Scope 3 emissions.
- **In the automotive sector**, the payment of a business manager's variable remuneration could be partly linked to the number of consumer loans for the purchase of electric cars or soft mobility options, which is an interesting target.

53 IFA, Chapter Zero France and Ethics & Board, "Baromètre des rémunérations – Le climat dans la politique de rémunération des CEO", 2023.
54 O'Connor and Gosling. "Paying for Net Zero: Using Incentives to Create Accountability for Climate Goals". PwC and London Business School, 2023.
55 Institut de la Finance Durable, "Gouvernance de la transition climat dans les entreprises : 10 recommandations de la place de Paris", 2024.

- **In an investment bank**, an objective concerning a reduction in the number of merger and acquisition agreements in the oil and gas sector could be consistent with the objective of achieving carbon neutrality by 2050, while being sufficiently tangible for an operational team.

In all cases, the indicators must be clear enough to ensure that the individuals concerned can easily understand how this could affect their variable remuneration, thus creating a genuine incentive, rather than working against the objectives of the plan.

Box 6. Rethinking the internal structure of banks to ensure consistency with transition plans and to facilitate their effective implementation

Remuneration policies are just one aspect of the reflection on the internal operations of banks. A decentralised approach concerning the objectives to be defined and included in the variable remuneration schemes for bank employees implies in return that the way teams are structured must be consistent with these objectives, and more broadly, with the transition plan.

For instance, as explained in a previous report by I4CE, *"it would not necessarily be relevant to keep an 'oil and gas' team with portfolio emission reduction objectives but rather to create a new 'energy' team integrating renewable energies financing objectives. This would allow sectoral teams to continue to have development and growth objectives, and facilitate the transfer of skills from teams specialising in decarbonised sectors to teams specialising in more carbon-intensive sectors"* [56].

Moreover, the same report suggests that *"coherent governance organisation could also be put in place so that internal teams can, for example, report effectively all information and problems encountered to the top management. To this end, intersectional committees can be set up to provide a link between all the business lines and management. These committees can also ensure that climate issues are regularly discussed by the management committee"* [57].

Finally, banks could also draw inspiration from "democratic" governance practices, such as those in place in cooperative banks, which focus on meeting the needs of their members and society as a whole. Admittedly, actual participation in such organisations presents some challenges, and the decisions made by shareholders are still quite removed from the strategic decisions of the bank [58]. However, the internal structure of these banks offers interesting avenues for reflection on governance practices in light of the ecological transition and the requirement for banks to adopt transition plans.

56 Evain, Calipel and Noguès. "Include mandatory banking transition plans within Pillar 2", I4CE, 2022.
57 Ibid.
58 Slimane and Pallas. "Chapitre 1. Démocratie et gouvernance des banques coopératives : Les formes de participation des sociétaires dans les lieux alternatifs d'animation de la vie coopérative de Banque Populaire". In Organisons l'alternative !, 21-36. Versus. Caen: EMS Editions, 2021. https://doi.org/10.3917/ems.beji.2021.01.0021.

3. WHAT ARE THE OBSTACLES AND CHALLENGES IN IMPLEMENTING REMUNERATION SCHEMES AND HOW CAN THEY BE ADDRESSED?

KEY MESSAGES

To fully implement a coherent variable remuneration scheme, there are still certain obstacles to overcome. These include technical challenges, due to the lack of maturity on the subject, as well as issues of acceptability.

The question of monitoring of remuneration schemes is also crucial. The option of external monitoring by independent third parties appears to be the most effective in preventing arbitrariness in the allocation of remuneration.

To help to remove these obstacles, three avenues for reflection can be outlined: the need for flexibility in implementation, better training for bankers and supervisors on the subject, and a review of equity in remuneration.

3.1. Technical and political obstacles

3.1.1. The dual challenge of individual and political acceptability

To ensure consistency with transition plans, banks must integrate climate criteria into the variable remuneration of their executives and employees. However, the widespread adoption of this practice comes with a number of challenges, and may even meet resistance.

Indeed, there is some reluctance among stakeholders to integrate climate criteria into remuneration, as remuneration policies are one of the most sensitive issues within companies. According to a survey by the London Business School Leadership Institute and PwC, for the majority of senior executives, corporate culture is the main driver for successfully integrating climate issues – and non-financial issues in general – into a company's strategy and operations, far more so than remuneration[59]. In other words, a shift in corporate culture would be a much more effective way to bring about changes in practices than remuneration, and should therefore be prioritised. However, the importance of a cultural shift should not be used as an excuse to avoid addressing the issue of remuneration, especially given that this practice is increasingly widespread (see section **1.2**).

In reality, both culture and remuneration go hand in hand. First, remuneration tied to climate criteria serves as an incentive and can support the cultural shift within the company[60]. Remuneration therefore plays a key role, provided it is accepted by employees and internal stakeholders. However, for the integration of climate criteria into remuneration policies to be accepted, employees must fully understand the indicators used. Communication aimed at employees is therefore crucial. Banks must clearly explain internally the reasons for integrating climate criteria into variable remuneration and justify the choice of criteria based on individual responsibilities, in line with the bank's decarbonisation strategy and transition plan. Furthermore, a better understanding of these remuneration issues could be achieved through enhanced training on climate challenges and the ecological and social transition (see section **3.3.2**). Finally, the adoption of initiatives such as the European Green Taxonomy or the CSRD Directive reflects a cultural shift that is already underway: this momentum now needs to be strengthened, particularly through remuneration policies.

59 O'Connor and Gosling. "Paying for good for all: Global research into ESG and reward beyond the boardroom". PwC and London Business School, 2022.
60 Willis Towers Watson, "Executive Compensation Guidebook for Climate Transition", 2021.

In addition to the cultural obstacle, other reasons can explain this reluctance to integrate climate criteria into variable remuneration: concerns about the technical challenges of design and implementation, a lack of understanding of the issues, or simply resistance to change, which can be partly explained by generational or sociological factors. Overall, most of the interviews show that banks – and businesses in general – lack maturity on this issue. The topic is still relatively new and requires coherent answers to a number of technical questions, such as how to define and choose the right metrics. However, it is precisely because these issues are complex that banks and supervisors must tackle them head-on, to advance the discussions, address the challenges, and gain maturity on the subject of remuneration policies.

Ultimately, integrating climate criteria into variable remuneration raises the question of the social acceptability of the ecological transition. As environmental concerns gain ground in the public debate, they tend to provoke stronger reactions and opposition. The ecological and social transition will inevitably lead to profound changes within the banking and financial sector – such as withdrawing financing from certain sectors –, and these changes will not come without turbulence and heated debate. However, this upheaval is both normal and desirable: the stronger the reactions, the more they reflect the importance of the issue, and debates involving all stakeholders are necessary to move these questions forward.

3.1.2. The technical challenge of remuneration structures

Beyond the issue of its acceptability, the integration of climate criteria into remuneration policies raises technical questions related to the design and implementation of such mechanisms. These questions are critical: it is essential to carefully design the variable remuneration system to ensure it is consistent with the bank's strategic and climate objectives and that it motivates employees to achieve their targets.

The first challenge to overcome is defining and selecting robust indicators to be integrated into variable remuneration, a topic discussed above (see section **2.2**).

The design and structure of variable remuneration is another key issue, although at this stage it is not possible to determine which remuneration structure would be the most effective. Currently, the most common mechanism is based on a share model, in which a percentage of an employee's total remuneration is variable, and is directly linked to the achievement of predefined objectives.

The allocation of remuneration is not necessarily binary, based solely on whether or not a target is met. It is common to define a minimum threshold, a target and a maximum cap: for example, reducing Scope 3 emissions by 15%, 25% and 30% compared to a baseline. This approach helps to avoid excessive discontinuity between performance and remuneration, which can be problematic.

However, this type of mechanism, based on thresholds that activate remuneration when objectives are met, is not the only option. Variable remuneration can also be based on accelerator and/or reducer coefficient principle, to create more dynamic and flexible remuneration systems. With an accelerator, the more an employee meets or exceeds performance targets, the faster the amount of variable remuneration increases. Conversely, a reducer decreases the bonus or reward the further an employee's performance falls from the targets. In other words, the accelerator rewards overperformance by offering rewards proportional to the additional effort made, while the reducer can discourage underperformance by reducing rewards when goals are not met.

Another option is to introduce a bonus/malus system to prevent climate-related variable remuneration from becoming merely an adjustment variable. By adopting the approach of the taxonomy's "Do No Significant Harm" objectives, variable remuneration could become negative if certain climate damage thresholds are exceeded. However, this idea needs further exploration, as it poses legal risks and remains controversial.

Finally, the integration of performance criteria in general – and climate criteria in particular – into remuneration can have certain harmful effects that banks and supervisors need to be aware of.

First, implementing financial rewards to encourage the achievement of carbon neutrality could undermine the motivations of employees and executives who are driven by values other than just financial interests, such as their environmental conscience or their sense of responsibility towards future generations. In other words, a financial incentive could crowd out prosocial behaviours[61 62]. It is therefore important to strike a balance, for example by combining financial incentives with training and awareness programmes on climate issues, to maintain long-term employee engagement on these topics (see section **3.3.2**).

Moreover, distortions can occur when remuneration is based on performance criteria, particularly due to a "target ratcheting effect,"[63]. If better performance in the current period leads to higher targets for subsequent periods, this may encourage employees to focus only on meeting the predefined climate performance target, rather than striving to significantly exceed it. This is why it is essential that the objectives tied to variable remuneration are clearly time-bound and linked to the timeline of the transition plan (see section **2.2.2**).

61 Gneezy and Rustichini. "A Fine is a Price", 2000.
62 Benabou and Tirole. "Incentives and Prosocial Behavior", 2006.
63 Bennett et al, "Compensation Goals and Firm Performance", 2015.

3.2. The issue of monitoring remuneration schemes

3.2.1. Improving transparency and communication

Banks need to be more transparent in their communication, both ex ante and ex post, about the elements of executive variable remuneration. This is a key factor in building credibility for the transition plan and the decarbonisation strategy with the different stakeholders. For example, Société Générale sets a volume-based objective for sustainable finance activities for its senior executives [64]. Where other employees are concerned, it may be unrealistic for a bank to disclose specific criteria, but it can communicate the general terms (the teams involved and the share allocated, for example).

In particular, the objectives integrated into variable remuneration must be quantitative and measurable (see section **2.2.2**). However, while the quantitative nature of these objectives is necessary, it is not sufficient: according to Proxinvest, within the CAC 40, 55% of ESG criteria are considered quantitative, but 21% of these quantitative criteria cannot be verified as the results are not disclosed. In other words, banks must not only communicate in advance on objectives, criteria and shares, but also disclose the results afterwards. While some progress has been made on this issue over the past five years [65], most reports agree that there is still a lack of communication, and particularly that practices vary significantly.

The majority of SBF 120 companies that have integrated a climate objective into their executive remuneration disclosed the achievement rate in 2022 [66], but barely more than half of these companies reported the achievement rate for each specific objective. In other words, communication on the achievement of climate objectives is often still based on aggregated results within a broader set of ESG criteria. Consequently, it is rarely possible to isolate the climate criteria, contrary to financial results, which are almost always reported by individual objectives. Banks should therefore aim to communicate more transparently, detailing specific objectives and their individual achievement rates.

Regarding the communication of objectives and results, it is important to distinguish between executive and employee remuneration. For executives, publishing these objectives in advance is crucial to build credibility for the strategy with external stakeholders, as well as directly with employees. This send a strong signal and helps to ensure operational teams buy into these commitments. However, this practice is still not widely adopted: fewer than half of STOXX Europe 50 companies publish these objectives in advance [67]. **For other employees, the variable remuneration schemes and associated objectives can remain private, but banks must make sure they can communicate these to supervisors to enable them to verify the consistency of remuneration policies with transition plans.**

3.2.2. Ensuring independent, external monitoring: the key role of auditors

While the communication and verification of objectives should first be done internally by the banks themselves, it would be good practice to ensure monitoring is also carried out by independent third parties [68] [69].

As mentioned above, it is the role of supervisors to ensure the overall consistency of remuneration schemes with transition plans (see section 1.1). However, it is not their responsibility to verify whether objectives are met or to ensure the accuracy of the results reported. Given that executive and employee remuneration is a sensitive matter, this external monitoring could be done by auditing firms and professionals responsible for verifying information on sustainability. With the implementation of the CSRD, an increasing number of auditors will choose to certify sustainability data. The monitoring and verification of the achievement of objectives tied to variable remuneration for the different employees could therefore be part of this process.

This will undoubtedly incur additional costs, but it ensures that objectives are robust enough to be audited. It also helps to prevent any arbitrariness in remuneration allocation and addresses the problem of inadequate training of bank teams.

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64 Société Générale, “Rapport sur les politiques et pratiques de rémuneration”, 2023.
65 ORSE, “Critères RSE et rémunération : l’alignement stratégique”, 2024.
66 IFA, Chapter Zero France and Ethics & Board, “Baromètre des rémunérations – Le climat dans la politique de rémunération des CEO”, 2023.
67 O’Connor and Gosling. “Paying for Net Zero: Using Incentives to Create Accountability for Climate Goals”. PwC and London Business School, 2023.
68 O’Connor and Gosling. “Paying for Net Zero: Using Incentives to Create Accountability for Climate Goals”. PwC and London Business School, 2023.
69 Institut de la Finance Durable, “Quelles clefs pour l’évaluation de l’impact des financements pour les banques ?”, 2024.

3.3. Moving the topic forward and overcoming remaining obstacles

3.3.1. The need for flexibility and adaptability in implementation

As already mentioned, the issue of climate-related remuneration is relatively new and is still being explored. However, the lack of maturity on the subject does not justify banks avoiding making a significant commitment to this approach, or only integrating climate criteria into the variable remuneration of their executives. **Banks must acknowledge that the different metrics they adopt, as well as the mechanisms they choose, will need to be refined. They must be prepared to demonstrate flexibility in their implementation[70], even if this means taking corrective actions**. To achieve this, banks can draw inspiration from existing best practices, while being fully aware of the potential challenges this may pose and the technical obstacles they will need to address (see section **3.1.2**).

However, this does not mean that incentive-based remuneration should be subject to discretionary adjustments to account for unusual events or to respond to crises and changing economic conditions. On the contrary, it is crucial that remuneration remains as non-discretionary and non-manipulable as possible[71]. In other words, the non-financial elements of variable remuneration should not be used as safety nets to offset poor financial performance. This once again highlights the importance of using quantitative and measurable criteria, as qualitative non-financial criteria are, by nature, more discretionary (see section **2.2.2**).

Box 7. The risks of discretionary management of remuneration practices – The case of General Electric

In 2020, due to the exceptional circumstances surrounding the COVID-19 crisis, General Electric's board of directors decided to change certain terms of its CEO's contract. In particular, the board opted to lower the performance thresholds included in his variable remuneration. However, as the think tank Reward Value points out, changing the rules midway through a global crisis reflects poor salary governance and an inappropriate approach to remuneration for a number of reasons[72].

Indeed, maintaining the same level of remuneration for lower performance thresholds significantly undermines the incentive effect of variable remuneration. Modifying a remuneration scheme midway through a global crisis raises serious concerns, making individual performance objectives almost meaningless. In the case of General Electric, the performance threshold was lowered to reflect pre-COVID targets. In other words, a simple return to normality resulted in a significant level of remuneration, even though it was undoubtedly due to the broader economic recovery more than to the CEO's personal performance.

While the example of General Electric concerns the company's financial performance, the analogy with climate and environmental criteria is clear. For the same reasons, reducing climate objectives in variable remuneration in response to the slightest crisis would make the incentive ineffective and would be counterproductive. Indeed, the frequency of climate and ecological crises is expected to increase significantly in the coming years. Changes in economic conditions cannot therefore be considered a valid reason to make discretionary changes to variable remuneration schemes.

3.3.2. Towards better training for bankers and supervisors

As already mentioned, improving the understanding and acceptability of integrating climate criteria into variable remuneration will undoubtedly require enhanced training on climate challenges and the ecological and social transition. Poor or limited training on climate issues may prevent employees from fully grasping the importance of including climate criteria in their variable remuneration. This can also limit their ability to work towards the bank's transition plan. For example, some account managers may not actively offer certain types of loans or financial products to their clients if they do not fully understand

70 Willis Towers Watson, "Executive Compensation Guidebook for Climate Transition", 2021.
71 Reward Value, "A world that works. But for whom? How executive remuneration can go wrong".
72 Ibid.

them or if they believe they are unprofitable, despite their immediate value for the bank's decarbonisation policy.

This is the case, for example, with the Zero Interest Eco-Loan (Eco-PTZ), a scheme set up by the French government to encourage energy retrofitting of homes. It allows homeowners to benefit from an interest-free loan to finance work aimed at improving the energy performance of their primary residence. However, the Eco-PTZ still lacks visibility and remains largely underused[73]. One reason for this is that banks are often reluctant to offer it[74].

It can thus be assumed that better training on the benefits and implementation of these financial schemes would help to improve their distribution. One reason why financial institutions are reluctant to offer these products is that account managers struggle to reconcile the active promotion of projects concerning energy-retrofitting, for example, with the core activities of a universal bank. More generally, substantial training efforts are therefore essential to provide account managers with the tools they need to support SMEs and households, particularly those with lower incomes, in undertaking more sustainable and energy-efficient projects.

If such training programs become mandatory eventually, it would be feasible, initially and for a short period, to link variable compensation to a training objective. This is the approach taken by the company Lunii, where 80% of the team must have completed sustainability training to unlock 10% of the collective bonus[75]. This type of scheme has the dual advantage of motivating employees to undertake such training while helping to raise awareness about climate issues among those who are less advanced on the subject and may not yet be ready to integrate climate criteria into their variable remuneration.

In this context, human resources managers will play a strategic role, not only by developing and implementing such training programmes, but also by recruiting individuals with expertise in climate and ecological transition issues. Banks will need to address the risk of "competence greenwashing"[76], in other words claiming expertise in climate issues without having practical experience or sufficient training to support these claims. Operations linked to sustainable finance and ESG investments deal with large amounts of non-financial data and scientific performance indicators, such as GHG emissions, biodiversity loss, hydrology and atmospheric science. However, relatively few people working in this field have in-depth training or knowledge in natural sciences[77], especially at the senior levels. Human resources managers should thus be encouraged to recruit individuals who are genuinely qualified in these subjects, through objectives linked to their variable remuneration[78].

Finally, both European and French supervisors will also need to invest significant efforts in training and strengthening teams to address changes in remuneration practices and in the monitoring of their consistency with transition plans. The main focus should be on the Joint Supervisory Teams (JST). There are still significant differences in how climate issues are prioritised and in how supervisors interpret their mandates, especially among the French supervisors within the JST[79] [80]. Therefore, appropriate training programmes and clear guidelines on integrating climate issues within Pillar 2 would make it easier to assess the consistency of remuneration policies with transition plans and would ensure consistent treatment across the significant banks in the eurozone.

3.3.3. Towards greater equity in remuneration policies

Integrating climate criteria into remuneration policies is very closely linked to another issue: the question of pay equity. The regulation of remuneration policies underwent significant changes following the 2008 crisis. Bonus-based remuneration for traders, which encouraged risky behaviour and short-term management, was identified as a potential factor in the crisis. Since then, banks' remuneration policies have been governed, inter alia, by a set of European regulations, transposed into national law. Moreover, the COVID-19 crisis brought the debate on moderating executive remuneration back into the spotlight[81]. From this perspective, many experts and NGOs argue that a credible approach to integrating transition issues into remuneration schemes should be based on the principle of proportionality, among other elements[82] [83] [84].

This principle of proportionality first reflects the idea that the remuneration of executives and senior management should not exceed the usual level without a specific

73 Reporterre. "Rénovation énergétique : l'éco-prêt à taux zéro prolongé jusqu'en 2027". Reporterre, le média de l'écologie - Indépendant et en accès libre. Consulted on 25 Match 2024. https://reporterre.net/Renovation-energetique-l-eco-pret-a-taux-zero-prolonge-jusqu-en-2017.
74 Giraude, "Pourquoi le recours à l'éco-prêt à taux zéro est-il si faible ?", n. d. https://enpc.hal.science/hal-03278386/document.
75 ORSE, "Critères RSE et rémunération : l'alignement stratégique", 2024.
76 Schumacher, "Environmental, Social, and Governance (ESG) Factors and Green Productivity: The Impacts of Greenwashing and Competence Greenwashing on Sustainable Finance and ESG Investing", 2022.
77 Ibid.
78 Evain, Calipel and Noguès. "Include mandatory banking transition plans within Pillar 2", I4CE, 2022.
79 WWF, "SUSREG Annual Report".
80 Evain, Calipel and Noguès. "Include mandatory banking transition plans within Pillar 2", I4CE, 2022.
81 Institut des Politiques Publiques, "Critères RSE intégrés à la rémunération des dirigeants : un nouvel élément de gouvernance pour les entreprises ?", 2020.
82 hkp/// group, "Guidelines for Sustainable Management Board Remuneration Systems", 2020.
83 Vargas and Kuhn. "How the Remuneration System of Deutsche Bank Subsidiary DWS Undermines Effective Climate and Sustainability Goals". Greenpeace, 2023.
84 O'Connor and Gosling. "Paying for Net Zero: Using Incentives to Create Accountability for Climate Goals". PwC and London Business School, 2023.

reason, with this level being determined by comparing it to industry standards. This is, for example, one of the recommendations of the German Corporate Governance Code (GCGC). Such moderation is even more important given that integrating climate criteria into variable remuneration is a sensitive issue, and its implementation can be challenging. By ensuring coherence and equity in remuneration practices between the executive team and other employees, the bank establishes an effective way to engage its entire workforce. In other words, moderating executive remuneration can make it more acceptable for employees that their own pay may be subject to new conditions, such as the integration of climate objectives.

More generally, equity in remuneration also ties into the issue of value sharing within the company. The question of whether social and environmental performance creates financial value is still open and unresolved. It is possible that an ambitious climate policy, for example withdrawing financing from certain projects, could lead to lower financial returns. This raises the question of how to pay the account managers responsible for this ambitious climate policy, who would thus have met their climate objectives and should consequently receive their variable remuneration. One solution is therefore to increase pay equity and proportionality within the bank itself: by moderating the variable remuneration of top executives, funds can be freed up to reward account managers who meet their climate objectives. Specifically, banks would then need to review the way in which variable remuneration budgets are allocated. Currently, this allocation is decided at the highest level of management and distributed from the top down. A more equitable distribution would therefore be beneficial, to ensure better proportionality in variable remuneration.

CONCLUSION

In conclusion, to ensure the implementation of transition plans, banks need to engage in a thorough review of their governance and their internal operations. Revising remuneration policies is a crucial part of this process and represents one of the most important steps to be taken.

Although the integration of climate criteria into variable remuneration is a relatively new and sensitive issue for many banks, this report has revealed that some banking and financial institutions are already reflecting on the question internally, even if they have not yet communicated about it publicly.

In this process, banks and supervisors must work together. Where banks are concerned, I4CE recommends drawing inspiration from existing best practices within non-financial companies and extending this integration of climate objectives into remuneration across all divisions that have an impact on the implementation of the transition plan. The way in which banks approach the integration of climate factors into remuneration reflects their maturity on climate issues and their commitment to implementing the transition plan. In particular, the development within banks of additional, more granular climate indicators, which are closely aligned with the operational realities of the different divisions, is a good indicator of their level of progress.

Where regulators are concerned, I4CE recommends clarifying details on regulation within the European Banking Authority's guidelines. Currently, the texts focus only on integrating ESG risks. This clarification should concern the need to ensure consistency between the strategic objectives of the transition plan and the objectives of variable remuneration.

As for supervisors, I4CE suggests that they engage with this issue and encourage banks to begin reflecting on it and implementing it through the Pillar 2 process. I4CE also recommends that the ongoing training efforts by European supervisors be maintained and strengthened for the issue of remuneration.

Finally, it is to be hoped that significant progress will be made on this issue in the coming years, driven by changes in attitudes, indicators, practices and regulations.

To move forward on this issue, better coordination and increased dialogue between banks will also be essential, for example through initiatives such as the Net-Zero Banking Alliance (NZBA), in particular to foster the convergence of practices. Going beyond banking alliances, international bodies like the Basel Committee and the Network for Greening the Financial System will need to take ownership of this issue.

ANNEX

INTERVIEWS CONDUCTED

Supervisors

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Financial sector

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Karen Degouve, *Fédération Bancaire Française*

Ladislas Smia, *MBO*

Nicholas Vantreese and **Mickael Raoul Vignal**, *La Banque Postale*

Maxime Druais, *Natixis*

Maya Vié and **Jean Charles Fournol**, *Observatoire de la Responsabilité Sociétale des Entreprises*

Joyce Stevenson, *Mandarine Gestion*

NGOs

Antoine Pugliese, *WWF*

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Research institutes

Stéphane Voisin, *Institut Louis Bachelier*

Consultants

Tom Gosling, *PwC*

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I4CE is a non-profit research organisation that provides independent policy analysis on climate change mitigation and adaptation. We promote climate policies that are effective, efficient and socially fair. Our 40 experts engage with national and local governments, the European Union, international financial institutions, civil society organisations and the media.

Our work covers three key transitions – energy, agriculture, forests – and addresses six economic challenges: investment, public financing, development finance, financial regulation, carbon pricing and carbon certification.

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