

Shell's and BP's 2020 remuneration policies

Investor recommendations for the vote on Shell's and BP's proposed remuneration policies in the context of the low-carbon transition

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Executive Summary

Ahead of Shell's and BP's AGMs in May 2020, this briefing analyses the companies' proposed remuneration policies for 2020-2023 in the context of the low-carbon transition.

Royal Dutch Shell

This briefing analyses the executive remuneration policy up for binding vote at the 2020 Shell AGM¹.

It presents two reasons why investors should not support its approval, and should engage with the company on the need to ensure that its remuneration policy reflects and reinforces Shell's net-zero ambition announced in April 2020.

1. Over half of Shell's annual bonus consists of direct or indirect volume growth measures, and the long-term incentive plan (LTIP) also includes two indirect volume growth metrics. This encourages executives to chase higher levels of fossil fuel output in contrast to demand scenarios under the Paris Agreement, which presents both a risk to the climate and to the long-term value of the company.
2. Shell's annual bonus and LTIP both include a 10% climate measure to manage the risks associated with the climate transition. However, they are not afforded sufficient weighting compared to the volume growth metrics to drive change in executive decision-making at the speed and seriousness required for the energy transition.

Voting Recommendation – This briefing recommends that investors vote AGAINST Shell's proposed remuneration policy at the 2020 AGM. The policy is weighted too heavily towards measures that incentivise management to pursue a volume growth-oriented strategy, relative to the climate measures which are not robust enough to have a meaningful impact on executive behaviour.

BP

This briefing analyses the executive remuneration policy up for binding vote at the 2020 BP AGM².

It presents two reasons why investors should abstain from voting on the remuneration policy, and should engage with the company on the need for increased transparency to ensure that executive remuneration reflects and reinforces BP's recent net zero ambition announced in February 2020.

1. BP's proposed remuneration policy lacks the level of transparency required for effective engagement with shareholders. BP has not disclosed a breakdown of the metrics and weightings for the annual bonus in 2020, nor has it explained how the new energy transition metric included in the performance share framework will be measured.

2. BP's annual bonus includes an incentive to reward free cash flow, which could indirectly incentivise a strategy focused on an increase in fossil fuel production volumes. The annual bonus also includes a climate change measure related to sustainable emissions reductions, but it is not clear whether this extends beyond operational emissions to scope 3.

Voting Recommendation – This briefing recommends that investors ABSTAIN from voting on BP's proposed remuneration policy unless more detail is provided regarding how the framework will be measured, and provide a clear rationale for abstention. Investors are encouraged to actively engage with BP to disclose further information prior to the vote at the 2020 AGM.



Introduction and background

Shell and BP: the 2020 vote on remuneration

In May 2020, Shell and BP both face a binding vote on their new remuneration policies at their Annual General Meeting (AGM). If supported by 50% of shareholders, this policy will remain in place for three years until the 2023 AGM.

The next three years is a critical period for climate action, as the window of opportunity to avert the most severe impacts of climate change is closing quickly. If global temperatures continue to rise at the current rate, the Intergovernmental Panel for Climate Change (IPCC) predicts with high confidence that 1.5°C of warming will be reached between 2030 and 2052. To avoid this, a 45 per cent reduction in global greenhouse gas (GHG) emissions is needed by 2030 relative to 2010³.

Shell and BP have both recognised in their updated corporate strategies that a transition to a low-carbon energy system is both achievable and desirable. However, neither strategy is currently aligned with the Paris Agreement on climate change as they do not indicate that the company is prepared for an energy transition at the scale and pace required to limit warming to 1.5°C.

The 2020 vote on the new remuneration policies provides investors in both companies with an opportunity to signal that they expect executive pay to reflect the realities of the energy transition and safeguard their long-term interests as shareholders.

Remuneration in the oil and gas sector

The main aim of a remuneration policy is to attract and retain talented management, and incentivise them to direct their companies in line with corporate strategy.

Traditionally, this has led to companies in the oil and gas sector rolling out pay packages that encourage the board to pursue volume growth and higher levels of fossil fuel production and/or reserves. A study by the Carbon Tracker Initiative⁴ (CTI) found that 34% of variable remuneration at top oil and gas companies was linked to metrics that directly or indirectly incentivise volume growth in 2019.

Executives should not be rewarded for chasing “growth for growth’s sake” for two main reasons:

1. There are already more fossil fuels available in the world’s proven reserves to exceed the carbon budget set out by the Paris Agreement in 2015⁵;
2. In the context of the low-carbon transition, energy companies should focus on value over volume to ensure that their business models are resilient and flexible enough to respond to market, policy, and technological changes within the industry.

Along with value-centric measures, non-financial metrics linked to the environment and safety are also important in remuneration packages in order to focus executive attention on corporate social responsibility. Despite the increasing emphasis on climate change in the oil and gas sector, however, the inclusion of climate metrics are often lacking in weight and/or substance to

have a significant impact on executive behaviour when compared to the full suite of measures perpetuating fossil fuel expansion. Furthermore, climate metrics are often introduced at the expense of other sustainability metrics rather than volume growth metrics. For example, Shell replaced a measure aimed at minimising oil spills with a climate change metric in its 2017 policy⁶. The Environmental Defense Fund⁷ contend that climate incentives must be robust enough to 'change decision-making with the speed and seriousness required to achieve the energy transformation we need'.

Incentives should reflect long-term risk horizons

Variable pay in the oil and gas sector is commonly split into two elements: an annual bonus to reward the delivery of short-term operational targets each year, and a stock or share award linked to performance and value-creation over a multi-year period (often three years).

However, the investment horizon for oil and gas companies is much longer and capital expenditure decisions made today have the potential to lock in fossil fuel projects for decades. For example, Shell's investment horizon is 10 to 20 years⁸. Similarly, the most severe impacts of climate change on the industry are likely to materialise later than the performance timelines in the remuneration structure.

It is important that executives are not constrained by short-term thinking and that incentives motivate management to ensure the long-term resilience of the company and safeguard the long-term interests of shareholders whose money is at stake.

Shell and BP: Corporate strategies on climate change

Remuneration packages are designed to incentivise executive directors to deliver the company's strategic priorities in line with the short- and long-term business plan. Shell and BP have both recently announced new corporate strategies to navigate the energy transition, which include a commitment to update their executive remuneration policies to reflect and reinforce their climate ambition^{9,10}.

The climate strategies are summarised below.

Shell's Net-Zero Ambition¹¹:

- In April 2020, Shell announced a long-term ambition to become a net-zero emissions energy business by 2050 or sooner.
- Shell aims to be net-zero on all operational emissions (scope 1 and 2) from the manufacture of all products by 2050, including non-energy products.
- Shell has increased its long-term ambition to reduce the Net Carbon Footprint (NCF) of the energy products it sells (scope 3 emissions).
- Shell's updated ambition is to reduce its NCF by 65% by 2050 and by 30% by 2035.

- Shell has set a 2021 target to reduce its NCF by 2-3% compared to 2016 levels and a 2022 target to reduce its NCF by 3-4% compared to 2016 levels¹². This target is linked to executive remuneration and the pay of around 16,500 employees.
- The NCF is a carbon intensity measure – not an absolute measure – that takes into account the full life-cycle of emissions including final use by the customer (scope 3 emissions).
- Shell also aims to help its customers to decarbonise by identifying and enabling decarbonisation pathways for each sector.

BP's Net Zero Ambition¹³:

In February 2020, BP set a new ambition to become a net-zero company by 2050 or sooner, and to help the world get to net zero.

- BP has outlined five aims to get BP to net zero:
 1. Net zero across entire operations on an absolute basis by 2050;
 2. Net zero across the carbon in its upstream oil and gas production on an absolute basis by 2050;
 3. Cut the carbon intensity of the products it sells by 50% by 2050;
 4. Install methane measurement at all major sites by 2023 and reduce methane intensity of its operations by 50%;
 5. Increase the proportion of investment into non-oil and gas businesses.
- BP outlines a further five aims to help the world get to net zero, which cover lobbying, remuneration, transparency and its new clean energy business.
- BP will provide more information on the future strategy and near-term plans at its capital markets day in September 2020.

Methodology

This briefing will analyse the 2020 remuneration policies of Shell and BP in turn. For each company, it will analyse only the variable pay element of the proposed remuneration policy, which is conditional on short- and long-term performance against a number of pre-defined metrics. This briefing makes no assessment of the actual quantum of pay awarded to executive directors.

To assess the robustness of these policies in the context of the energy transition, this briefing uses CTI's classification of incentive measures established in its 'Paying with Fire' report¹⁴:

- *Direct growth measures* – measures that directly incentivise executives to develop and produce as much oil and gas as possible (e.g. reserves replacement, production). These metrics should be avoided.
- *Indirect growth measures* – measures that encourage growth but are also influenced by other factors (e.g. cash flow, net income). These metrics incorporate both a growth and value perspective and should be considered in the context of other applicable incentive measures. In these cases, there may be a better alternative to achieve the same end.
- *Growth neutral measures* – measures that encourage improved performance but without incentivising growth (e.g. total shareholder return, return on capital employed). These metrics are welcome as they put emphasis on returns and value, not growth.
- *Climate measures* – measures that directly link executive pay to initiatives that contribute towards mitigating climate change (e.g. emissions intensity and investment in renewables). These metrics are desirable as they place climate change firmly on the board's agenda.



Royal Dutch Shell

Overview of Shell's proposed remuneration policy

Shell's executive remuneration structure is made up of a fixed element of basic pay, which is tied to two variable elements to reward both short- and long-term performance: the annual bonus and the long-term incentive plan (LTIP), respectively.

| Element | 2020 Policy and Link to strategy |
|--------------------------|--|
| Base salary and benefits | <p>The maximum available base salary is €2,000,000. This fixed level of earnings (plus benefits) is designed to attract and retain executive directors.</p> |
| Annual bonus | <p>The annual bonus rewards the delivery of short-term operational targets derived from Shell's operating plan. From 2020, the annual bonus is worth up to 250% of salary for the CEO and 240% for the CFO. 50% of the bonus is delivered in cash and 50% is delivered in shares to reinforce alignment with shareholder interests.</p> <p>Shell announced that there are no changes to the scorecard measures and weightings from its 2017 policy. Measures are related to operational excellence (weighted at 50%), financial performance (30%) and sustainable development (20%). Scorecard targets are disclosed once no longer deemed commercially sensitive.</p> <p>For 2020, operational excellence is measured using production (12.5%), LNG liquefaction volumes (12.5%), refinery and chemical plant availability (12.5%), and project delivery (12.5%). Financial performance is measured using cash-flow from operating activities. Sustainable development is measured by process safety (5%), injuries by total recordable case frequency or TRCF (5%) and greenhouse gas emissions (10%).</p> |
| LTIP | <p>The LTIP rewards longer-term value creation linked to Shell's strategy over a three-year period in the form of performance shares. From 2020, the LTIP is worth up to 600% of salary for the CEO and 540% of the salary for the CFO.</p> <p>The measures focus on financial growth and increases in value compared to other oil majors. For 2020, performance is based on cash-flow from operating activities growth (22.5%), return on average capital employed growth (22.5%), total shareholder returns (22.5%), free cash-flow (22.5%) and Shell's strategy to thrive in the energy transition (10%). The first three measures are measured relative to peers, and the other two measures are absolute and compared to a set target over 3 years. The energy transition metric was implemented a year early in 2019.</p> |

| Element | 2020 Policy and Link to strategy |
|--------------------------|--|
| Pension | Provides a retirement provision under the individual's base country benefits policy, to attract and retain executive directors. |
| Shareholding requirement | Executive directors are expected to build up their shareholding in the company to align their interests with those of shareholders. The figures under the 2020 policy are 700% of base salary for the CEO and 500% of base salary for CFO. |

Shell also aligns its pay structures for executive directors and employees to ensure “internal proportionality” and reinforce a common commitment to the company’s strategic goals. The majority of Shell’s employees share the same annual bonus scorecard, while 16,500 employees are now granted performance share awards on terms broadly similar to the executive LTIP structure.

Analysis of Shell’s 2020 remuneration policy

The focus of this analysis will be on the variable elements of the remuneration structure: the annual bonus and the LTIP awards.

Annual bonus

Direct growth measures → Production (12.5%); LNG liquefaction volumes (12.5%)

Indirect growth measures → Cash flow from operating activities (30%)

Growth-neutral measures → Project delivery (12.5%); Refinery and chemical plant availability (12.5%); Safety (10%)

Climate measures → Greenhouse gas emissions (10%)

Production and LNG liquefaction volumes are both direct growth measures within the annual bonus structure. The production metric measures the sum of the average daily volumes of unrefined oil and natural gas produced for sale, while LNG liquefaction volumes is a measure of the operational performance of Shell’s Integrated Gas business and LNG market demand.

The annual bonus also includes cash flow from operating activities as an incentive, which is the total of all the cash receipts and payments associated with sales of oil, gas, chemicals and other products. This is an indirect growth metric as, although there is a value element, it is likely to encourage capital expenditure commitments to increase production volumes from Shell’s oil and gas businesses.

Direct and indirect growth metrics incentivise management to pursue increased fossil fuel production, contrary to demand scenarios in line with the Paris Agreement goal to limit global warming to 1.5°C. The IPCC find that to meet this target, the share of primary energy supplied

by oil must decrease by 39 to 77 per cent and the share of natural gas must decrease by 13 to 62 per cent by 2050¹⁵. This challenges the recent strategic push towards gas across the sector, including Shell, as a response to climate change. The increased role of natural gas does not provide a long-term pathway to global climate objectives¹⁶. If Shell is to meet its net-zero ambition, it should not lock in new gas infrastructure that will be in place for decades.

In light of the uncertainty over future demand for oil and gas, remuneration incentives relating to volume growth present a risk of overinvestment in potential stranded assets in the future as market, policy, and technological responses to climate change come into play. For example, CTI find that Shell's \$13 billion LNG Canada project falls outside a "well below 2 degrees" budget on cost grounds¹⁷. This type of investment could oversupply the market leading to lower oil prices and thus have a detrimental impact on company value and total returns across the sector.

In the context of the low-carbon transition companies must be prepared for resilience and lower output, which should be reflected in the remuneration policy. Instead of a focus on volume growth, incentives geared towards value and/or returns are more appropriate. Executives should be encouraged to focus on low-cost projects to extract maximum value from their operations and generate the highest returns for its shareholders, even if this means shrinking production or redirecting capital to other business areas such as renewables or returning it to its shareholders¹⁸.

The remaining incentives included in the annual bonus are growth-neutral, which are preferable to volume growth metrics. Refinery and chemical plant availability is an indicator of the operational efficiency of Shell's downstream manufacturing facilities while project delivery motivates management to complete projects on time and within budget. Safety measures such as process safety and injury frequency are also clearly relevant and important in remuneration packages.

The annual bonus also includes a climate metric focused on greenhouse gas emissions. A company board that is motivated to consider climate issues is more likely to be aware of the risks and opportunities associated with the low-carbon transition. However, the impact of this measure is limited as it accounts for just 10% of the annual bonus compared to growth metrics (direct and indirect) which total a combined 55% of the reward. Shell's executive directors are rewarded far more substantially for chasing higher levels of fossil fuel output than they are for considering the impact of such a strategy on climate change and on the long-term resilience of its business model.

Despite the company's NCF ambition to reduce the impact of the energy products sold to customers, only operational emissions were considered in the 2019 bonus award and there is no indication of any change for 2020. As such, it is likely that scope 3 emissions will remain excluded from the annual bonus award under the new policy. In 2019, these emissions represented 88% of Shell's total greenhouse gas emissions (576 million tonnes CO₂ equivalent [MtCO₂e]), compared to operational emissions which accounted for just 12% of total emissions (80MtCO₂e)¹⁹. Remuneration incentives targeted at greenhouse gas emissions must encourage a holistic approach to climate mitigation by covering the full life-cycle of the company's emissions.

Long-term incentive plan (LTIP)

Direct growth measures → None

Indirect growth measures → Cash flow from operating activities (22.5%); Free cash flow (22.5%)

Growth-neutral measures → Total shareholder returns (22.5%); Return on average capital employed (22.5%)

Climate measures → Energy transition (10%)

There are no direct growth measures in Shell's LTIP. However, cash flow from operating activities and free cash flow (FCF) could both be considered indirect growth metrics. FCF measures the generation of cash flow excluding acquisitions and divestment activities, while cash flow from operating activities is the total of all cash receipts and payments associated with sales of oil, gas chemicals and other products. Cash flow is important to reduce debt, pay dividends, buy back shares and make future capital investments. However, management could also meet these targets by increasing sales volumes from fossil fuel projects without necessarily creating value.

An argument in support of indirect growth metrics related to cash flow or earnings is that it could also lead to increased investment in low-carbon alternatives such as energy companies' renewables businesses. However, a report by CMS²⁰ found that oil majors invested just 3% of their combined capital expenditure into renewables in 2018. Indeed, Shell's projected spending on its clean energy business over 2021-25 is \$2-3 billion per year, which is less than 10% of the total capital expenditure of \$30-32 billion per year expected over the same period²¹. As such, these metrics are highly likely to incentivise the business-as-usual expansion of oil and gas activities rather than renewables.

The LTIP also includes two growth-neutral metrics in total shareholder returns (TSR) and return on average capital employed (ROACE). Both are appropriate incentives that reward good management without requiring continued fossil fuel growth. TSR involves an assessment of the actual wealth created for shareholders in the form of returns, while ROACE is a strong indicator of capital discipline.

In the context of the energy transition, remuneration structures should incentivise value creation and financial returns over fossil fuel growth. Companies must retain a degree of resilience and flexibility to respond to uncertainty over future fossil fuel demand and potential price volatility. Maximising value by focusing on low-cost projects and maintaining capital discipline is a more sustainable approach to ensure that the long-term interests of the company are aligned with its shareholders.

Shell introduced the energy transition measure to the LTIP in 2019 and it has been formalised in the new 2020 policy. This metric focuses on Shell's strategic aim to "thrive in the energy transition" and on the long-term NCF ambition to reduce the energy intensity of products sold by 65% by 2050, and by 30% by 2035²². Shell's first nearer-term target of a 2-3% intensity reduction by 2021 is also tied to this transition metric. Other levers included under the energy transition

measure include the development of biofuels, carbon-capture and storage technology, carbon sinks and the growth of its power business. The energy transition metric directly links executive pay to initiatives targeted at reducing Shell's impact on climate change.

Again, there is a concern that this metric is only weighted at 10%, although Shell has announced its intention to increase this weighting over time. It is also important to note that this metric is measured by emissions intensity rather than absolute emissions. This does not prevent Shell from increasing fossil fuel output in absolute terms, nor does it prevent the firm from investing in projects that are inconsistent with the goals of the Paris Agreement and may consequently destroy value in a world of weak demand for fossil fuels^{23, 24}.

Summary and recommendations for investors

Finding 1: 55% of Shell's annual bonus is made up of direct or indirect growth measures that encourage executive directors to pursue increased fossil fuel production. Shell's LTIP also includes two cash flow metrics which indirectly incentivise a growth-oriented approach.

Recommendation 1: Investors should engage with Shell to remove the metrics relating to production, LNG liquefaction volumes and cash flow from its remuneration structure and replace them with growth-neutral incentives that focus on value and returns.

Finding 2: Shell's annual bonus and LTIP both include a 10% climate measure to manage risks associated with the energy transition, which are too minor to have a meaningful impact on executive behaviour compared to the volume growth-oriented measures.

Recommendation 2: Investors should engage with Shell to increase the weighting of the energy transition metric in the LTIP so that it can be a change agent at the executive level and drive performance to match Shell's long-term net-zero ambition. Investors should also encourage Shell to ensure that the climate metric in the annual bonus covers scope 3 emissions.

Voting Recommendation – This briefing recommends that investors vote AGAINST Shell's proposed remuneration policy at the 2020 AGM. The policy is weighted too heavily towards measures that incentivise management to pursue a volume growth-oriented strategy, relative to the climate measures which are not robust enough to have a meaningful impact on executive behaviour.

BP

Overview of BP's proposed 2020 remuneration policy

BP's executive remuneration structure is made up of a fixed element of basic pay, which is tied to two variable elements to reward both short- and long-term performance: the annual bonus and the performance share framework, respectively.

| Element | 2020 Policy and Link to strategy |
|--------------------------|---|
| Base salary and benefits | <p>There is no maximum salary under this policy. This fixed level of earnings (plus benefits) is designed to reflect the scale and complexity of the business and the role.</p> |
| Annual bonus | <p>The annual bonus rewards the delivery of performance in line with targets in the annual plan. From 2020, executive directors may earn a maximum annual bonus of 225%. Half of the bonus is paid in cash and half is delivered in a share award to reinforce the long-term nature of the business and the importance of sustainability.</p> <p>For 2020, bonus is measured against an annual scorecard including financial (weighted at 50%), operational (10%), safety (20%) and environmental (20%) goals. Compared to the 2017 policy, the weighting for environmental measures has increased from 10% to 20% with a commensurate decrease in operational weighting.</p> <p>BP has not disclosed the specific metrics under each category for 2020, but confirms that fewer measures are included on the annual bonus scorecard. Measures for safety and reliable operations have been reduced from two to one compared to 2017. Financial measures have been reduced from three to two, with free cash flow as one of the metrics. Environmental performance is measured by sustainable emissions reductions.</p> |
| Performance shares | <p>Performance shares are granted with a three-year performance period to link the largest part of remuneration opportunity with long-term performance of the business. From 2020, performance shares are worth up to 500% of salary for the CEO and 450% of salary for other executive directors.</p> <p>From 2020, the framework will include two financial measures – relative total shareholder value (40%) and return on average capital employed (30%) – as well as an assessment related to the low-carbon transition (30%). The underlying metrics within these are not disclosed. Compared to 2017, the weighting for financial performance has been reduced from 80% to 70% and the energy transition metric replaces a broader focus on “strategic progress” which made up 20% of the framework. The strategic progress measure was increased from 20% to 30% for 2019.</p> |

| Element | 2020 Policy and Link to strategy |
|--------------------------|--|
| Pension | Recognises competitive practices in home country. |
| Shareholding requirement | Executive directors are expected to build up their shareholding in the company to align their interests with those of shareholders. The figures under the 2020 policy are 500% of base salary for the CEO and 450% of base salary for CFO. |

This executive director remuneration policy is structurally similar to remuneration for the majority of the wider workforce. However, executive directors are subject to longer-term measures and no individual performance element, whereas the majority of the wider workforce receive variable pay that is based on annual performance measures, including their own individual performance.

Analysis of BP's 2020 remuneration policy

The focus of this analysis will be on the variable elements of BP's remuneration structure: the annual bonus and the award of performance shares. For the 2020 annual bonus, BP has not disclosed the weighting of the free cash flow metric or what the second financial metric will be.

Annual bonus

Direct growth measures → None

Indirect growth measures → Free cash flow (not disclosed)

Growth-neutral measures → Reliable Operations (10%); Safety (20%);

Climate measures → Sustainable emission reductions (20%)

BP has not disclosed the full breakdown of its metrics and their weightings in its remuneration policy, so much of this analysis relies on assumptions based on specific disclosures made in its annual report or its 2019 annual bonus scorecard. This should raise significant concern regarding the transparency of BP's remuneration process as shareholders are expected to vote on the policy at the AGM in May without a full breakdown of incentives beyond the high-level categories. This directly contravenes Principle Q of the UK Corporate Governance Code, which requests a 'formal and transparent procedure for developing a policy on executive remuneration' (p.13)²⁵.

The notes to the policy table in the 2020 remuneration report confirm that one of two financial indicators is the measurement of FCF, which replaces operating cash flow from the 2019 scorecard. FCF is an indirect growth measure as, although there is a value element attached, it is likely to encourage increased fossil fuel volume growth. The 2019 scorecard also included underlying replacement cost profit within the financial performance category, which is a proxy for

net profit and another indirect growth measure. It is not clear if this will be included in the 2020 policy, although metrics focused on value or returns should be preferred to those that encourage fossil fuel expansion.

Oil and gas companies could argue that indirect growth metrics related to cash flow or earnings could also lead to increased investment in low-carbon businesses such as renewables. Although this may be the case in other industries, the continued dominance of fossil fuels in the investment plans of oil and gas companies such as BP means that business-as-usual investment in the upstream is more likely. For example in 2019, BP spent almost \$12 billion on capital expenditure in its upstream oil and gas business compared to just \$337 million on “other businesses and corporate” which includes its alternative energies business²⁶.

Based on the 2019 scorecard, the remaining performance measures in the annual bonus are likely to be growth-neutral or climate-positive targeted at operational efficiency, safety and climate change. Such measures are welcome in the remuneration package ahead of volume growth metrics as they encourage management to focus on sustainable value creation and shareholder returns.

A positive change from a climate perspective in BP’s 2020 annual bonus is that the environmental measure tied to sustainable emissions reductions has increased from 10% to 20%. This is also linked directly to the pay of around 37,000 employees at BP to incentivise the delivery of emissions targets across senior management level. This highlights BP’s commitment to improving its reward structure around climate change to be aligned with its new net-zero by 2050 ambition announced in February 2020²⁷. Indeed, aim 7 of this strategy is ‘to incentivise our global workforce to deliver on our aims and mobilise them to become advocates for net zero’.

However, it is not clear whether the sustainable emissions reduction metric in the annual bonus applies to those emissions beyond BP’s operational control, i.e. scope 3. In 2019, BP’s operational emissions accounted for just 13% of BP’s total emissions (54 MtCO₂e) whereas scope 3 emissions represented 87% (357 MtCO₂e)²⁸. It is therefore imperative that pay incentives are tied to emissions across the life-cycle of BP’s products, which is reflected in Aim 2 of the new strategy to reach net-zero “across the carbon” in its production. More transparency is required from BP on this issue.

Performance shares

Direct growth measures → None

Indirect growth measures → None

Growth-neutral measures → Relative total shareholder returns (40%); Return on average capital employed (30%)

Climate measures → Energy transition (30%)

BP's remuneration framework for the multi-year performance share award is a good example of a growth-neutral incentive structure that prioritises the energy transition. The two financial components – relative total shareholder returns and ROACE – are growth-neutral and promote a focus on capital discipline, value and returns. Almost a third of the performance framework is measured by an assessment related to the low-carbon transition, which puts climate change firmly on the agenda for executive directors.

In the context of the energy transition, there is considerable uncertainty over future demand for oil and gas so companies should adapt their business models to be resilient and flexible enough to thrive in periods of oil price volatility. CTI analysis shows that in the years following the oil price crash in 2014, US oil and gas companies with financial-returns based metrics focused on value creation and returns outperformed more volume growth-oriented companies²⁹.

For 2020, the low-carbon transition metric represents a significant improvement to the broader focus on strategic priorities under the 2017 framework. This 2017 measure directly incentivised management to increase fossil fuel output as one of the strategic priorities was “growing gas and advantaged oil”. The inclusion of the energy transition as a substantial part of the performance framework establishes climate change as a core priority for executives. It is also consistent with the strategic shift that BP signalled in February 2020, and shows that the company recognises the need for a remuneration policy to reflect and reinforce its net zero ambition and the low-carbon energy transition.

However, BP has not disclosed the specific measures that will be used to measure performance against the energy transition metric. This will be announced following the strategy update in September 2020, after the vote on the remuneration policy in May.

Summary and recommendations for investors

Finding 1: BP has not disclosed a breakdown of the metrics and weightings for the annual bonus scorecard, nor that of the specific measures relating to the new energy transition metric introduced to the performance share framework.

Recommendation 1: Prior to the AGM in May 2020, investors should engage with BP to disclose a comprehensive breakdown of the measures used to calculate the annual bonus, and how the energy transition metric will be measured. Transparency is critical to facilitate effective engagement with shareholders under the UK Corporate Governance Code.

Finding 2: BP's annual bonus includes an incentive to reward free cash flow, which could indirectly encourage a volume growth-oriented approach. The annual bonus also includes a climate metric related to emissions reductions but it is not clear if this extends beyond operational emissions.

Recommendation 2: Investors should engage with BP to replace free cash flow with a growth-neutral alternative that prioritises value creation and shareholder returns. Investors should also encourage BP to include scope 3 emissions in the application of the climate measure.

Voting Recommendation – This briefing recommends that investors ABSTAIN from voting on BP's proposed remuneration policy unless more detail is provided regarding how the framework will be measured, and provide a clear rationale for abstention. Investors are encouraged to actively engage with BP to disclose further information prior to the vote at the 2020 AGM.

Conclusions and voting recommendations

Since the landmark 'Aiming for A' resolutions at Shell and BP in 2015, both companies have made measurable progress on their response to climate change, and their recent net-zero ambitions are a welcome development to focus long-term thinking on climate change. However, these long-term ambitions are meaningless if they are not supported by fixed interim targets and aligned remuneration practices that support them.

In the context of the low-carbon energy transition, executive directors should be incentivised to adapt their business models for resilience against the backdrop of the long-term risks associated with climate change. However, Shell's proposed remuneration package for 2020 still places too much focus on short-term fossil fuel growth at the expense of long-term value creation and shareholders returns. BP's proposed policy lacks the requisite detail to assess how performance will be measured in the context of the low-carbon energy transition.

At the AGMs in May, investors must exercise their voting rights to signal to both Shell and BP that they expect executive pay to reflect the realities of the energy transition and safeguard their long-term interests as shareholders. In light of the latest IPCC report on the need to limit global warming to 1.5°C, incremental changes to policy are no longer enough and climate change must be firmly embedded into the executive remuneration framework.

Voting recommendations:

1. **This briefing recommends that investors vote AGAINST Shell's proposed remuneration policy at the 2020 AGM. The policy is weighted too heavily towards measures that incentivise management to pursue a volume growth-oriented strategy, relative to the climate measures which are not robust enough to have a meaningful impact on executive behaviour.**
2. **This briefing recommends that investors ABSTAIN from voting on BP's proposed remuneration policy unless more detail is provided regarding how the framework will be measured, and provide a clear rationale for abstention. Investors are encouraged to actively engage with BP to disclose further information prior to the vote at the 2020 AGM.**

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