

Larry Fink's 2021 Letter to CEOs: Implications for Executive Pay in Canada

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Introduction

Larry Fink's annual [Letter to CEOs](#) has become known for its emphasis on stakeholder capitalism, climate change, and sustainability. The 2021 edition of this highly influential letter builds on these themes, which have become even more significant considering the global pandemic, the increasing physical toll of climate change, and political turmoil in the US.

Consistent with prior years, the themes and issues highlighted indirectly have implications on executive pay as they provide insight on the priorities and expectations of the institutional shareholder community which may influence executive pay considerations (e.g. incorporating climate change in performance metrics). This summary provides our key takeaways from his 2021 letter, and potential implications for executive pay.

Capital Reallocation & the Net Zero Transition

Fink's 2020 letter predicted a fundamental reallocation of capital as markets begin to price climate risk into their investing frameworks. His 2021 letter notes that this reallocation began in earnest in 2020: *"from January through November 2020, investors in mutual funds and ETFs invested \$288 billion globally in sustainable assets, a 96% increase over the whole of 2019. I believe that this is the beginning of a long but rapidly accelerating transition – one that will unfold over many years and reshape asset prices of every type."*

Additionally, Fink expects that a company's preparedness to transition to a net zero business model (essentially, "carbon neutral") will serve to differentiate it among shareholders and stakeholders, while those that are not able to communicate their net zero transition strategy will see their valuations suffer.

Takeaway for Boards: *As a first step, issuers should consider to what degree, and in what way, your business is susceptible to climate change-related risk, and how capital may be reallocated to mitigate risk. Reallocation of capital may initiate Board-level discussions about how the strategy may need to evolve, and what the related impact to operations may be. Once the strategy is refined, consider whether any adjustments are required to the approach to executive compensation (such as the incorporation of new metrics) to better align pay with performance and executing on the refined strategy.*

Importance of Disclosing Climate Strategy & Risks

In keeping with the emphasis on climate strategy, Fink notes the importance of climate-related disclosures, and explicitly asks companies to disclose a plan for how their business model will be compatible with a net zero economy, and how this plan is incorporated into long-term strategy and reviewed by the Board. While he notes that BlackRock strongly supports a move to a single global standard of climate-related financial disclosures, they continue to endorse TCFD and SASB reporting.

Takeaway for Boards: Consider your company's approach to disclosing climate strategy and related risks, including assessing the merits of adopting disclosure frameworks such as TCFD and SASB. Regardless of a disclosure framework being formally adopted, Boards may consider how climate risk and opportunities are currently reflected in the corporate scorecard.

Continued Emphasis on Stakeholders

Again, building on themes from previous years, Fink notes that companies with strong ESG profiles and a clearly articulated "purpose" outperform other companies, even within industries. Specifically, he notes that *"the more your company can show its purpose in delivering value to its customers, its employees, and its communities, the better able you will be to compete and deliver long-term, durable profits for shareholders."* Additionally, he notes that talent strategies should explicitly reflect diversity, equity, and inclusion, and that such strategies should be clearly disclosed.

Takeaway for Boards: Purpose, trust and values can be a material competitive advantage in the attraction and retention of key talent and the next generation of leaders. Consider how effective your company's human capital management and talent strategy are and if this is incorporated in the measurement of corporate performance through a culture dashboard or assessment of leadership.

For further information, or for support with addressing the unique circumstances of your organization, we invite you to reach out to a Hugessen consultant.

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