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Aligning Executive Compensation with Long-Term Value: The Role of ESG-Linked Incentives in Modern Corporate Governance

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Abstract

This thesis examines whether ESG-linked executive compensation in European banking represents a meaningful governance innovation or a symbolic adaptation to regulatory and societal pressures. Drawing on agency theory and the European prudential framework, the study conducts a qualitative comparative analysis of UniCredit and Intesa Sanpaolo.

The analysis demonstrates that ESG metrics are no longer peripheral additions to executive remuneration. In both institutions, sustainability objectives are formally embedded in short-term and long-term incentive systems and operate within risk-adjusted deferral structures. However, the strength of ESG incentives depends on contractual design. UniCredit emphasizes explicit proportional weighting, enhancing economic visibility of sustainability allocation. Intesa Sanpaolo introduces a sustainability-based demultiplier within its long-term plan, mechanically affecting vesting outcomes but also reinforcing enforceability.

The findings suggest that ESG-linked compensation in European banking has progressed beyond symbolic inclusion. Yet its disciplining capacity remains conditional on economic salience, measurability, and transparency of realized payouts. The evolution of executive incentives reflects a governance transition in which sustainability increasingly intersects with financial resilience and risk management.

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Introduction

In recent decades, executive compensation has been increasingly used as a central mechanism for aligning managerial incentives with corporate objectives. Under the dominant shareholder-oriented paradigm, remuneration systems have traditionally relied on financial Key Performance Indicators (KPIs), often focused on short-term profitability and market-based outcomes. However, the growing relevance of environmental, social, and governance (ESG) risks has progressively challenged this model, raising questions about the adequacy of purely financial metrics in capturing long-term value creation and risk exposure.

The integration of ESG criteria into executive compensation has emerged as a widespread response to these concerns. Firms across jurisdictions now increasingly link variable remuneration to non-financial performance indicators related to sustainability, governance quality, and social responsibility. While this development is often framed as a shift toward stakeholder-oriented governance, it also reflects a more pragmatic need to incorporate ESG-related risks into managerial decision-making and incentive structures. In this sense, ESG-linked remuneration can be interpreted not only as a normative change in corporate objectives, but also as an instrument for improving risk management and long-term resilience.

Despite its rapid diffusion, the effectiveness of ESG-linked executive compensation remains highly debated. Existing academic and policy-oriented discussions largely agree on the growing prevalence of ESG incentives yet offer mixed assessments of their actual capacity to influence managerial behavior. A key concern relates to the design and implementation of ESG-linked pay schemes: the selection of relevant ESG metrics, their measurability and verifiability, the weight assigned within remuneration structures, and their consistency with firms' strategic objectives and risk profiles. As a result, the distinction between substantive incentive alignment and symbolic adoption – often associated with greenwashing – remains blurred.

This debate is particularly relevant in the banking sector, where ESG risks have increasingly been recognized as material drivers of financial and prudential risk. In response, European regulators have explicitly integrated ESG considerations into the supervisory and regulatory framework governing banks, including remuneration policies. This regulatory context provides a unique setting to examine whether and how ESG-linked incentives are coherently embedded into executive compensation systems, beyond generic sustainability commitments.

Against this background, the present thesis aims to address the following research question:

To what extent are ESG-linked executive compensation schemes coherently designed and implemented as tools for long-term value creation and risk management within the European banking sector?

To answer this question, the thesis adopts a qualitative and comparative approach, combining theoretical analysis, regulatory examination, and firm-level evidence. Chapter 1 reviews the academic literature on executive compensation, corporate governance, and ESG integration, highlighting the evolution from financially driven incentive systems toward broader performance frameworks. Chapter 2 examines the European regulatory and supervisory architecture relevant to ESG-linked remuneration, with particular attention to disclosure requirements, performance measurement challenges, and emerging best practices. Building on this framework, Chapter 3 develops a comparative case study analysis of two major European banking groups – UniCredit and Intesa Sanpaolo – assessing how ESG incentives are incorporated into executive remuneration structures in practice and evaluating their coherence with both theoretical expectations and regulatory objectives.

By focusing on the design, measurability, and governance of ESG-linked incentives, this thesis seeks to contribute to the ongoing debate on executive compensation by moving beyond the mere observation that ESG criteria are included in pay schemes and instead assessing whether such inclusion constitutes a meaningful mechanism for incentive alignment or a predominantly symbolic response to regulatory and societal pressures.

Chapter 1 – Theoretical Framework

1.1 Agency Theory

Agency theory provides the foundational framework for understanding the economic rationale behind executive compensation in modern corporations¹. The separation between ownership and control, which characterizes publicly listed firms, creates a potential misalignment of interest between shareholders, who supply capital, and managers, who are entrusted with decision-making authority². While shareholders seek value maximization, managers may pursue personal objectives such as private benefits, reputation, or job security. This divergence gives rise to agency costs, which corporate governance mechanisms aim to mitigate.

Within this framework, executive compensation is designed as a contractual device to align managerial incentives with shareholder interests³. By linking remuneration to performance, boards of directors seek to ensure that managers benefit when shareholders benefit. Equity-based compensation, annual bonuses, and long-term incentive plans represent the most common instruments used to tie managerial wealth to firm outcomes⁴. The underlying assumption is that performance-contingent pay can reduce opportunistic behavior and encourage decisions that enhance firm value over time. Historically, performance in executive compensation contracts has been predominantly measured using financial indicators. Accounting-based metrics, market returns, and profitability ratios have been regarded as appropriate proxies for value creation in a governance environment centered on shareholder primacy⁵. In this context, the reliance on financial KPIs was not arbitrary, but reflected the belief that financial outcomes provided the most direct and observable signal of managerial performance and firm success⁶. However, agency theory does not require performance measures to be exclusively financial. Theoretical and empirical research has long acknowledged that non-

¹ Jensen, M. C., & Meckling, W. H. (1976). Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of Financial Economics*, 3(4), 305–360.

² Core, J. E., Holthausen, R. W., & Larcker, D. F. (1999). Corporate governance, chief executive officer compensation, and firm performance. *Journal of Financial Economics*, 51(3), 371–406.

³ Cohen, S., Kadach, I., Ormazabal, G., & Reichelstein, S. (2023). Executive compensation tied to ESG performance: International evidence. *Journal of Accounting Research*, 61(3), 805–856.

⁴ Kaplan, S. N., & Minton, B. A. (2012). How has CEO pay evolved? *NBER Working Paper No. 19004*.

⁵ Healy, P. M. (1985). The effect of bonus schemes on accounting decisions. *Journal of Accounting and Economics*, 7(1–3), 85–107.

⁶ Ittner, C. D., Larcker, D. F., & Pizzini, M. (2007). Performance prospects and strategic use of nonfinancial measures. *Journal of Accounting Research*, 45(4), 727–757.

financial indicators may convey relevant information about future performance⁷. Measures related to product quality, customer satisfaction, or operational efficiency can function as leading indicators of long-term value creation⁸. Environmental, social, and governance (ESG) factors fit within this logic, insofar as they capture dimensions of risk and performance that may not be immediately reflected in financial results but can materially affect firms' future profitability and risk exposure⁹. At the same time, the inclusion of non-financial metrics in incentive contracts raises important challenges from an agency perspective. ESG-related measures often suffer from limited standardization, measurement difficulties, and verification problems¹⁰. While certain environmental targets – such as reductions in greenhouse gas emissions – are relatively quantifiable, many social or governance objectives rely on qualitative assessments and discretionary judgments¹¹. This ambiguity weakens the informational content of ESG metrics and increases the scope for managerial discretion. Critics argue that, rather than mitigating agency problems, poorly designed ESG-linked incentives may exacerbate them. The introduction of vague or weakly specified targets can expand opportunities for rent extraction, allowing executives to secure higher compensation without delivering commensurate performance improvements¹². Empirical evidence highlights this concern: while financial performance targets are frequently missed, ESG targets are almost always met or exceeded, suggesting that they may be calibrated in ways that limit accountability.

In sum, agency theory offers both justification and a warning with respect to ESG-linked executive compensation. On the one hand, ESG metrics can be interpreted as forward-looking indicators that enrich performance evaluation and improve alignment between managers and shareholders in a changing risk environment. On the other hand, if such metrics lack precision, materiality, or verifiability, they risk undermining the incentive function of compensation contracts and increasing agency costs. This tension

⁷ Khan, M., Serafeim, G., & Yoon, A. (2016). Corporate sustainability: First evidence on materiality. *The Accounting Review*, 91(6), 1697–1724.

⁸ Flammer, C., Hong, B., & Minor, D. (2019). Corporate governance and the rise of integrating corporate social responsibility criteria in executive compensation. *Strategic Management Journal*, 40(7), 1097–1122.

⁹ Bebchuk, L. A., & Tallarita, R. (2022). The perils and questionable promise of ESG-based compensation. *Journal of Corporation Law*, 47(4), 1–38.

¹⁰ Walker, D. I. (2022). The economic (in)significance of executive pay ESG incentives. *Stanford Journal of Law, Business & Finance*, 27(2), 318–349.

¹¹ Dell'Erba, M., & Gomtsyan, S. (2024). Regulatory and investor demands to use ESG performance metrics in executive compensation: Right instrument, wrong method. *Journal of Corporate Law Studies*, 24(1), 1–40.

¹² Badawi, A. B., & Bartlett, R. P. (2024). ESG overperformance? Assessing the use of ESG targets in executive compensation plans. *ECGI Finance Working Paper No. 1025/2024*.

represents the starting point for the broader debate on the role of non-financial performance measures in executive pay and provides the conceptual foundation for the analysis developed in the following sections.

1.2 Shareholder value vs. stakeholder value

The limitations of performance-based incentive systems grounded exclusively in financial metrics are closely linked to the broader debate on corporate objectives. For much of the twentieth century, corporate governance was dominated by the shareholder value paradigm, according to which the primary purpose of the firm is to maximize returns for its owners¹³. Within this framework, executive compensation served as a mechanism to align managerial decisions with shareholders' financial interests, reinforcing a focus on profitability, share price performance, and short-term financial outcomes.

This view was famously articulated by Friedman (1970), who argued that the social responsibility of business is to increase profits, provided that firms operate within the boundaries of law and ethical custom. The shareholder-oriented model offered conceptual clarity and accountability: managerial performance could be assessed using observable financial results, and compensation contracts could be designed accordingly. In stable environments, where externalities were limited and risks were largely internal to the firm, this approach appeared both efficient and coherent.

Over time, however, the adequacy of shareholder value as the sole corporate objective has been increasingly questioned. Firms operate within complex social, environmental, and institutional contexts, generating externalities that are not fully captured by financial performance indicators¹⁴. Environmental degradation, labor practices, and governance failures may impose costs on parties beyond shareholders, while also creating long-term risks for the firm itself. As these issues gained prominence, the exclusive focus on shareholder value began to appear insufficient to account for the broader consequences of corporate activity.

Stakeholder theory emerged as a response to these limitations, arguing that firms have responsibilities toward a wider set of constituencies, including employees, customers, suppliers, creditors, and local communities¹⁵. Rather than viewing stakeholder considerations as constraints on value maximization, this perspective emphasizes that long-term firm performance may depend on how effectively these relationships are

¹³ Friedman, M. (1970, September 13). The social responsibility of business is to increase its profits. *The New York Times Magazine*.

¹⁴ Hart, O., & Zingales, L. (2017). Companies should maximize shareholder welfare not market value. *Journal of Law, Finance, and Accounting*, 2(2), 247–274.

¹⁵ Freeman, R. E. (1984). *Strategic management: A stakeholder approach*. Pitman Publishing.

managed¹⁶. Hart and Zingales (2017) further develop this argument by suggesting that corporate objectives should reflect the preferences of shareholders as citizens, who may care intrinsically about social and environmental outcomes in addition to financial returns.

The rise of environmental, social, and governance considerations reflects this conceptual shift. ESG factors translate stakeholder concerns into categories that can be incorporated into corporate strategy, risk assessment, and performance evaluation. Institutional investors increasingly advocate for the integration of ESG objectives, using engagement and voting to influence corporate behavior¹⁷. Importantly, this evolution does not necessarily imply a rejection of shareholder value, but rather an expansion of the dimensions through which value creation and risk exposure are assessed.

This expansion, however, creates tension within corporate governance and executive compensation design. Managers are expected to pursue financial performance while simultaneously addressing stakeholder expectations related to sustainability, ethics, and social impact. Executive compensation becomes a critical arena in which these competing objectives are reconciled. Linking a portion of remuneration to ESG outcomes allows firms to signal responsiveness to stakeholder demands, but also raises questions about accountability, priority-setting, and the potential dilution of financial incentives.

In this sense, the shift from shareholder value to stakeholder-oriented perspectives does not resolve the agency problem identified in the previous section, but rather reframes it. The challenge is no longer limited to aligning managers with shareholders' financial interests: it extends to determining how multiple objectives – financial and non-financial – can be incorporated into incentive systems without undermining their effectiveness. This tension provides a direct bridge to the discussion of ESG principles and their operationalization within corporate governance frameworks.

1.3 Corporate Social Responsibility and ESG principles

As corporate objectives expanded beyond a narrow focus on financial performance, firms began to articulate broader responsibilities toward society and the environment through the concept of Corporate Social Responsibility (CSR). CSR frameworks traditionally emphasized voluntary initiatives aimed at improving firms' social legitimacy, including philanthropic activities, compliance with ethical norms, and efforts to

¹⁶ Eccles, R. G., Ioannou, I., & Serafeim, G. (2014). The impact of corporate sustainability on organizational processes and performance. *Management Science*, 60(11), 2835–2857.

¹⁷ Dimson, E., Marsh, P., & Staunton, M. (2020). Organs of coordination: How investor stewardship drives ESG performance. *The Journal of Portfolio Management*, 46(6), 37–49.

enhance corporate reputation¹⁸. While these initiatives reflected growing awareness of social and environmental concerns, they were often loosely defined and only weakly connected to firms' core economic activities.

A key limitation of CSR lies in its limited operational content. CSR practices were largely discretionary, with substantial variation across firms in terms of scope, reporting, and implementation. As a result, CSR disclosures frequently functioned as communication tools rather than as mechanisms of accountability¹⁹. The absence of standardized metrics and clear performance benchmarks made it difficult for investors and other stakeholders to assess whether stated commitments translated into meaningful changes in corporate behavior.

The emergence of the ESG framework marked an important shift in this respect. Beginning in the early 2000s, initiatives such as the UN Global Compact and the *Who Cares Wins* report introduced a more structured approach to sustainability by organizing environmental, social, and governance issues into distinct and potentially measurable categories²⁰. This development was further reinforced by the establishment of the UN Principles for Responsible Investment, which encouraged institutional investors to systematically incorporate ESG factors into investment analysis and ownership practices. Compared to CSR, ESG placed greater emphasis on materiality, data, and integration with financial decision-making.

Environmental criteria focus on firms' exposure to climate-related and resource-related risks, including emissions, energy use, and environmental efficiency. Social criteria capture aspects such as labor practices, human rights, workforce diversity, and community impact, while governance criteria address board structure, shareholder rights, executive compensation, and transparency. This tripartite structure allows ESG factors to be interpreted not only as ethical considerations, but also as sources of long-term risk and opportunity with potential financial implications²¹.

Despite its rapid diffusion, ESG reporting remains characterized by fragmentation and heterogeneity. Disclosure practices differ widely across firms and jurisdictions, and the absence of a single global reporting

¹⁸ Carroll, A. B. (1991). The pyramid of corporate social responsibility: Toward the moral management of organizational stakeholders. *Business Horizons*, 34(4), 39–48.

¹⁹ Gray, R., Owen, D., & Maunders, K. (1987). *Corporate social reporting: Accounting and accountability*. Prentice-Hall.

²⁰ Eccles, R. G., & Serafeim, G. (2013, May). The performance frontier: Innovating for a sustainable strategy. *Harvard Business Review*, 91(5), 50–60.

²¹ Eccles, R. G., & Serafeim, G. (2013, May). The performance frontier: Innovating for a sustainable strategy. *Harvard Business Review*, 91(5), 50–60.

standard has limited comparability²². In this context, ESG information may still be used strategically to signal legitimacy rather than to demonstrate substantive performance improvements. These concerns echo earlier critiques of CSR, suggesting that greater structure alone does not automatically ensure accountability.

Nevertheless, ESG has become a central reference point in corporate governance and financial markets. Investors, rating agencies, and regulators increasingly rely on ESG metrics to assess firms' long-term prospects and risk profiles. As ESG considerations gained prominence, attention naturally turned to the mechanisms through which sustainability objectives could be embedded into internal decision-making processes. Executive compensation emerged as one of the most visible and consequential instruments for translating ESG principles into managerial incentives, raising new questions about how non-financial objectives can be operationalized within performance-based pay systems.

1.4 Executive compensation as a governance mechanism

Executive compensation represents one of the most powerful instruments through which corporate governance systems seek to influence managerial behavior. Compensation packages typically combine fixed salary, short-term variable pay, and long-term equity-based incentives, each component serving a distinct purpose within the incentive structure²³. Fixed salary provides income stability, annual bonuses reward short-term performance, and long-term incentives aim to align managers' interests with those of shareholders over extended horizons. Together, these elements are intended to shape managerial decision-making by linking personal wealth to corporate outcomes.

From a governance perspective, the effectiveness of executive compensation depends not only on the level of pay, but also on the design of performance conditions. Well-structured incentive contracts can mitigate agency problems by encouraging managers to pursue value-enhancing strategies, while poorly designed schemes may exacerbate risk-taking, short-termism, or rent extraction²⁴. The literature emphasizes that incentives are inherently double-edged: they can improve alignment when performance measures are informative and verifiable, but they can also distort behavior when targets are misaligned, overly discretionary, or weakly enforced.

²² Berg, F., Kölbel, J. F., & Rigobon, R. (2022). Aggregate confusion: The divergence of ESG ratings. *Review of Finance*, 26(6), 1315–1344.

²³ Core, J. E., Holthausen, R. W., & Larcker, D. F. (1999). Corporate governance, chief executive officer compensation, and firm performance. *Journal of Financial Economics*, 51(3), 371–406.

²⁴ Holmström, B. (1979). Moral hazard and observability. *The Bell Journal of Economics*, 10(1), 74–91.

Traditionally, executive compensation has relied on financial performance metrics as the primary basis for incentive determination. Accounting profits, return measures, and stock price performance have been widely used to evaluate managerial success, reflecting the assumption that financial outcomes capture the results of managerial effort and strategic choices²⁵. Within this framework, incentive design focused on balancing short-term accountability with long-term alignment through equity ownership and deferred compensation.

As corporate objectives and risk environments have evolved, however, the limitations of purely financial incentive systems have become increasingly apparent. Financial metrics may fail to capture dimensions of performance related to sustainability, governance quality, or exposure to non-financial risks that materialize over longer horizons²⁶. In particular, environmental and social risks can affect firms' cost structures, regulatory exposure, and reputational capital in ways that are not immediately reflected in short-term financial results. This gap between observed financial performance and underlying risk exposure challenges the ability of traditional compensation schemes to fully align incentives with long-term value creation.

In response, firms have begun to experiment with the inclusion of non-financial performance measures within executive compensation frameworks. By incorporating indicators related to environmental impact, social practices, or governance quality, boards seek to broaden the scope of managerial accountability and to direct attention toward dimensions of performance that are increasingly regarded as economically material²⁷. Executive compensation thus becomes a channel through which broader strategic priorities and risk considerations can be translated into individual incentives.

At the same time, the use of non-financial metrics in compensation contracts raises complex governance issues. Non-financial indicators often involve greater measurement uncertainty and subjective assessment than financial metrics, increasing the role of discretion in pay-setting decisions. This discretion may weaken the disciplining function of incentives if not accompanied by clear performance criteria, transparent evaluation processes, and appropriate oversight²⁸.

²⁵ Bushman, R. M., & Smith, A. J. (2001). Financial accounting information and corporate governance. *Journal of Accounting and Economics*, 32(1–3), 237–333.

²⁶ Edmans, A., Gabaix, X., & Jenter, D. (2017). Executive compensation: A structured review. *Annual Review of Financial Economics*, 9, 435–464.

²⁷ Tsai, B. H., Chen, S. C., & Wang, J. R. (2022). ESG performance and executive compensation: International evidence. *Journal of Corporate Finance*, 75, 102255.

²⁸ Healy, P. M., & Wahlen, J. M. (1999). A review of the earnings management literature and its implications for standard setting. *Accounting Horizons*, 13(4), 365–383.

As a result, the integration of non-financial objectives into executive pay highlights a fundamental tension between flexibility and accountability in incentive design. In this sense, executive compensation occupies a central position in the debate on corporate governance and sustainability. It offers a potential mechanism for aligning managerial behavior with long-term objectives that extend beyond short-term financial performance, yet it also exposes firms to new risks of opportunism and symbolic compliance. Understanding how incentive structures evolve in response to changing objectives and risk profiles is therefore essential for assessing the role of executive compensation in contemporary governance frameworks.

1.5 ESG-linked pay: emerging practices and debates

The inclusion of ESG metrics in executive compensation has become a defining feature of contemporary corporate governance practices. Empirical evidence documents a rapid diffusion of ESG-linked pay over the past decade²⁹. Cohen et al. (2023) show that the share of firms adopting ESG-related performance criteria in executive compensation increased from approximately 3% in 2010 to more than 30% by 2021, with higher adoption rates among large firms, companies operating in environmentally intensive sectors, and jurisdictions characterized by stronger regulatory and investor pressure. These patterns suggest that ESG-linked pay is no longer a marginal phenomenon, but a mainstream governance practice in many corporate settings.

Several rationales have been advanced to explain this development. A first rationale builds on incentive contracting arguments. ESG metrics may act as forward-looking indicators of risks and opportunities that are not fully captured by short-term financial performance³⁰. Environmental risks, such as exposure to climate regulation or transition costs, and social or governance failures, such as labor disputes or weak internal controls, can materially affect firms' long-term profitability and risk profiles. From this perspective, linking executive compensation to ESG outcomes is intended to align managerial decisions with long-term value creation rather than short-term financial results.

A second rationale emphasizes stakeholder alignment. Firms face increasing pressure from institutional investors, regulators, and civil society to address sustainability concerns. Empirical studies indicate that the adoption of ESG-linked pay is more common among firms with high institutional ownership and often follows

²⁹ Tsai, B. H., Chen, S. C., & Wang, J. R. (2022). ESG performance and executive compensation: International evidence. *Journal of Corporate Finance*, 75, 102255.

³⁰ Gond, J.-P., & Herrbach, O. (2006). Social reporting as an organisational learning tool? A theoretical framework. *Journal of Business Ethics*, 65(4), 359–371.

engagement by large asset managers³¹. In this context, ESG-linked compensation can be interpreted as a response to external demands for greater accountability and as a mechanism for incorporating stakeholder preferences into managerial incentives.

A third rationale relates to signaling and credibility. Public commitments to sustainability objectives are vulnerable to accusations of greenwashing if they are not supported by internal governance mechanisms³². By tying executive pay to ESG targets, boards may seek to enhance the credibility of sustainability pledges and demonstrate that such commitments are backed by tangible incentives. Executive compensation thus becomes a visible tool through which firms attempt to translate ESG strategies into operational governance practices.

Despite these rationales, the empirical evidence raises substantial concerns regarding the effectiveness of ESG-linked pay. A recurring finding in the literature is that ESG performance targets are almost always met or exceeded. Badawi and Bartlett (2024) show that, in a sample of S&P 500 firms, only 2% failed to meet all ESG targets, whereas 22% failed to meet all financial performance targets. This pronounced asymmetry suggests that ESG metrics are often calibrated in ways that limit downside risk for executives, thereby weakening the disciplinary role of incentives.

Concerns also arise with respect to the economic relevance of ESG-linked incentives. Walker (2022) finds that, even when ESG metrics are included in compensation contracts, their economic weight is typically very small relative to executives' overall wealth. Once equity holdings and long-term incentives are taken into account, ESG-linked pay often represents less than 1% of the total economic value of executive compensation. This limited exposure casts doubt on the ability of ESG incentives to meaningfully influence managerial behavior, particularly when compared to the incentives embedded in equity-based compensation.

The design of ESG-linked pay further complicates the assessment of its effectiveness. Empirical evidence indicates that ESG metrics are overwhelmingly concentrated on short-term bonus plans rather than long-term incentive schemes. Cohen et al. (2023) document that ESG-related targets are rarely embedded in long-term equity awards, despite the long-term nature of many sustainability objectives. When ESG incentives are confined to annual bonuses, they typically affect only a small fraction of total compensation and may encourage short-term compliance rather than sustained behavioral change.

³¹ McLaren, D. (2020). The institutional investor ESG revolution: Market power or stewardship? *Journal of Sustainable Finance & Investment*, 10(3), 205–222.

³² Kolk, A., & Perego, P. (2014). Sustainable bonuses: Sign of corporate responsibility or window dressing? *Journal of Business Ethics*, 119(1), 1–15.

Taken together, these findings highlight the central tension surrounding ESG-linked executive compensation. While the adoption of ESG metrics has expanded rapidly and is supported by multiple governance rationales, their practical implementation often reflects weak incentive strength, limited economic relevance, and generous target calibration. As a result, ESG-linked pay may function more as a symbolic governance device than as an effective mechanism for aligning managerial incentives with long-term sustainability objectives. This unresolved tension underscores the importance of examining not only whether ESG-linked pay is adopted, but how it is designed and implemented in specific institutional and regulatory contexts.

1.6 Theoretical rationale and academic debate

This chapter has outlined the main theoretical foundations underpinning the integration of ESG metrics into executive compensation. Starting from agency theory, executive pay has been framed as a governance mechanism designed to align managerial incentives with corporate objectives through performance-based contracts. Within a shareholder-oriented paradigm, financial performance indicators historically represented the primary and most observable proxies for value creation, justifying their central role in compensation design.

As corporate objectives and risk environments evolved, however, the exclusive reliance on financial metrics revealed important limitations³³. The growing relevance of environmental, social, and governance risks highlighted dimensions of firm performance that are not fully captured by short-term financial outcomes, prompting a broader reconsideration of corporate objectives and performance evaluation. The emergence of stakeholder-oriented perspectives and the transition from Corporate Social Responsibility to ESG principles reflect attempts to structure sustainability concerns in ways that are more closely connected to economic materiality and long-term value creation.

Within this context, executive compensation has assumed a particularly salient role. As one of the most direct instruments for influencing managerial behaviour, compensation provides a channel through which broader strategic priorities and risk considerations can be translated into individual incentives. The rapid diffusion of ESG-linked pay indicates that firms increasingly view compensation as a tool for embedding sustainability objectives into governance frameworks. At the same time, the empirical evidence reviewed in this chapter raises persistent concerns regarding the effectiveness of this approach.

³³ Jensen, M. C. (2001). Value maximization, stakeholder theory, and the corporate objective function. *European Financial Management*, 7(3), 297–317.

Specifically, literature points to a set of unresolved tensions. ESG-linked incentives are frequently characterized by limited economic weight, concentration in short-term bonus plans, and generous target calibration, all of which may weaken their ability to affect managerial decision-making³⁴. Moreover, the heterogeneity of ESG metrics and the prevalence of qualitative or discretionary targets complicate performance evaluation and accountability³⁵. These features raise the risk that ESG-linked pay functions primarily as a symbolic governance device rather than as a substantive mechanism for aligning incentives with long-term sustainability objectives.

Taken together, these insights reveal a central gap in the existing literature. While the adoption of ESG-linked executive compensation has expanded rapidly and is supported by multiple theoretical rationales, it remains unclear under which conditions such incentives effectively contribute to long-term value creation and risk management. In particular, the interaction between ESG-linked pay design and the institutional and regulatory environment in which firms operate has received limited systematic attention.

Addressing this gap requires moving beyond abstract theoretical arguments and examining how ESG-linked compensation is shaped by regulatory frameworks and implemented in practice. The next chapter builds on the theoretical foundations developed here by analyzing the European regulatory architecture governing ESG disclosure, risk management, and remuneration policies. This regulatory context provides the basis for assessing how ESG objectives are translated into concrete incentive structures and sets the stage for the firm-level analysis developed in the subsequent chapters.

³⁴ Badawi, A. B., & Bartlett, R. P. (2024). ESG overperformance? Assessing the use of ESG targets in executive compensation plans. *ECGI Finance Working Paper No. 1025/2024*. European Corporate Governance Institute.

³⁵ Walker, D. I. (2022). The economic (in)significance of executive pay ESG incentives. *Stanford Journal of Law, Business & Finance*, 27(2), 318–349.

Chapter 2 – Regulatory context

2.1 Evolution of executive remuneration regulation in Europe

Within the European regulatory framework, executive remuneration is increasingly recognized as a key governance mechanism for ensuring the effective integration of ESG risks into institutions' strategic and risk management processes. The Guidelines on the management of ESG risks issued by the European Banking Authority explicitly require financial institutions to align their remuneration policies and practices with their ESG-related risk appetite and long-term strategic objectives³⁶.

In this context, remuneration is no longer framed solely as a reward for financial performance, but as an instrument to promote prudent behavior and the sound management of ESG risks. The Guidelines emphasize that ESG-related key performance indicators should be embedded into performance evaluation and incentive schemes, ensuring consistency between remuneration outcomes, prudential transition plans, and broader sustainability objectives³⁷. This includes the use of qualitative and quantitative ESG metrics, as well as an appropriate weighting of ESG-related targets within overall remuneration structures.

By linking remuneration frameworks to ESG risk management and transition planning, the regulatory approach reflects a shift towards incentive systems that support long-term value creation, accountability, and resilience. As a result, the integration of ESG criteria into executive compensation is increasingly positioned as a regulatory expectation rather than a purely voluntary corporate governance practice.

2.2 Guidelines on pay-for-performance and sustainability

Within the European Union, the integration of sustainability considerations into pay-for-performance frameworks does not derive from a single binding regulation, but emerges from a coordinated set of legislative acts, supervisory guidelines, and disclosure requirements that jointly shape executive remuneration practices. In this context, sustainability-linked compensation is positioned at the intersection of prudential regulation, corporate governance standards, and ESG disclosure regimes.

³⁶ European Banking Authority, *Guidelines on the management of environmental, social and governance (ESG) risks*, **EBA/GL/2025/01**, Section 6, “Remuneration policies and practices”; Article 74(1)(e) of Directive 2013/36/EU (Capital Requirements Directive).

³⁷ European Banking Authority, *Guidelines on the management of environmental, social and governance (ESG) risks*, **EBA/GL/2025/01**, Section 6, “Remuneration policies and practices to promote sound management of ESG risks”.

From a prudential perspective, the Capital Requirements Directive (CRD) establishes the core principles governing remuneration policies in the banking sector, requiring variable compensation to be consistent with sound risk management and the institution's long-term interests³⁸. Recent amendments to the CRD have expanded this framework by explicitly recognising ESG risks as potential drivers of financial risk, thereby creating the regulatory basis for incorporating ESG considerations into remuneration policies. Supervisory guidance issued by the European Banking Authority further operationalises these principles by clarifying that remuneration schemes should reflect ESG-related risk appetite and support the implementation of prudential transition plans³⁹.

In parallel, sustainability-oriented pay-for-performance practices are reinforced through the EU's corporate sustainability and transparency framework. The Corporate Sustainability Reporting Directive (CSRD) and the European Sustainability Reporting Standards (ESRS) increase the visibility and comparability of ESG targets, metrics, and governance arrangements, indirectly supporting their use within incentive schemes⁴⁰. Although these instruments do not prescribe specific remuneration structures, they strengthen the credibility and accountability of ESG-linked compensation by requiring consistent disclosure of sustainability objectives, performance indicators, and governance processes.

Taken together, these regulatory developments indicate that ESG-linked pay-for-performance frameworks are not the result of isolated voluntary initiatives, but rather the outcome of a progressively integrated regulatory approach. Within this framework, executive remuneration functions as a transmission mechanism through which sustainability objectives, risk management requirements, and long-term value creation considerations are translated into managerial incentives.

2.3 ESG disclosure, transparency, and performance measurement

The transparency of ESG performance measurement is a cornerstone for the effectiveness of sustainability-linked incentives in executive compensation. In the European context, the Corporate Sustainability Reporting Directive (CSRD, Directive (EU) 2022/2464) is expected to extend sustainability reporting obligations to nearly 50,000 companies, compared to roughly 11,700 under the previous regime, thereby substantially

³⁸ Directive 2013/36/EU (Capital Requirements Directive), Articles 74 and 94; subsequent amendments introducing ESG risks as relevant drivers of financial risk.

³⁹ European Banking Authority, *Guidelines on the management of environmental, social and governance (ESG) risks*, **EBA/GL/2025/01**, Section 6.

⁴⁰ Directive (EU) 2022/2464 on corporate sustainability reporting (CSRD); European Sustainability Reporting Standards (ESRS), governance disclosures.

expanding the population of firms subject to standardized ESG disclosure⁴¹. Consistently with this objective, CSRD-aligned reporting under the ESRS requires disclosure not only of sustainability policies and targets, but also of governance arrangements and internal processes that support implementation, including the use of incentive schemes where relevant⁴². Importantly, the EU framework also introduces an assurance layer: sustainability information reported under ESRS is subject to limited assurance, strengthening the credibility of disclosed metrics and outcomes⁴³.

Transparency is reinforced through more granular expectations around how firms define and operationalize metrics. In practice, disclosures increasingly describe how remuneration committees select and calibrate ESG KPIs and how these interact with pay structures. Evidence from executive pay disclosures shows that ESG elements can be embedded as discrete, weighted metrics (e.g., a stated percentage of an incentive plan tied to a carbon footprint reduction target), or as part of broader scorecards. Concrete examples also illustrate typical weighting approaches: Chevron’s proxy disclosures, for instance, allocate 10% of the annual incentive plan to an “energy transition” category linked to climate-related progress⁴⁴.

However, the central technical bottleneck remains measurability. ESG indicators vary in their degree of standardization and auditability: environmental metrics (notably emissions and decarbonization targets) tend to be more quantifiable, whereas social and governance dimensions frequently rely on proxies, composite indicators, or qualitative assessments. This heterogeneity creates scope for inconsistent calibration and for “low-signal” metrics that are easy to meet but weakly linked to material risks. Moreover, firms face significant data constraints - particularly in areas where disclosure quality remains uneven across ESG pillars and sectors - which complicates the construction of robust, comparable performance baselines⁴⁵.

Finally, reliance on external ESG ratings for benchmarking introduces additional measurement noise, as methodologies differ and the market has historically lacked uniform rules comparable to those applicable to

⁴¹ European Parliament, *Sustainable economy: Parliament adopts new reporting rules for multinationals*, press release, 10 November 2022.

⁴² CMS, *European Union rules on ESG and directors’ duties – Corporate Sustainability Reporting Directive (CSRD)*, updated 26 June 2024.

⁴³ European Commission, *Letter on non-binding assurance guidelines / CSRD assurance timeline*, 7 March 2024; CEAOB Guidelines on limited assurance for sustainability reporting, 30 September 2024.

⁴⁴ The Conference Board & ESGAUGE (via Harvard Law School Forum on Corporate Governance), *ESG Performance Metrics in Executive Pay*, 15 January 2024.

⁴⁵ Scope Ratings, *Assessing corporate ESG transparency: Europe, N. America lead ranking; social, environment disclosure trails governance*, 19 March 2021.

credit rating agencies. This has motivated EU-level initiatives aimed at improving the transparency and integrity of ESG rating activities, with the broader aim of reducing opacity and enhancing comparability of ESG information used by investors and firms⁴⁶. In sum, the effectiveness of ESG-linked incentives depends less on the mere inclusion of ESG terms in pay plans and more on whether disclosed KPIs are material, auditable, and consistently assessed over time under the emerging EU disclosure-and-assurance architecture.

2.4 International best practices in ESG-linked compensation design

International best practices in ESG-linked executive compensation display a growing convergence around a limited set of core design principles, despite differences in regulatory regimes and market structures. Across jurisdictions, effective ESG-linked remuneration frameworks are typically built on three foundational pillars: materiality, measurability, and long-term orientation. These principles aim to ensure that ESG incentives operate as credible governance mechanisms rather than symbolic additions to executive pay structures⁴⁷.

The first defining feature of best practices is the emphasis on materiality-based metric selection. Empirical evidence from recent proxy disclosures indicates that firms increasingly tailor ESG metrics to company-specific risks and strategic priorities, such as climate transition, human capital management, or governance quality, rather than relying on generic ESG scorecards⁴⁸. This materiality-driven approach is consistently reflected across jurisdictions and is associated with a higher likelihood that ESG targets influence managerial decision-making in a meaningful way.

Second, international experience highlights the central role of quantifiable and auditable performance indicators. Best-in-class remuneration schemes increasingly rely on clearly defined ESG key performance indicators supported by verifiable data, structured payout curves, and ex post performance assessments. In practice, ESG metrics are frequently incorporated through hybrid scorecards, combining absolute targets—such as greenhouse gas emissions reductions—with relative benchmarks linked to sector-adjusted ESG performance or total shareholder return. Empirical surveys and proxy analyses show that ESG criteria are typically assigned with material but limited weight, commonly ranging between 10% and 25% of variable

⁴⁶ European Parliamentary Research Service (EPRS), *Transparency and integrity of environmental, social and governance rating activities*, PE 753.185, November 2023.

⁴⁷ Harvard Law School Forum on Corporate Governance, *ESG Performance Metrics in Executive Compensation: Strategies and Trends*, 7 January 2025; Sustainalytics, *Incentivizing Change: How ESG-Linked Compensation Can Advance Sustainability Initiatives*.

⁴⁸ Harvard Law School Forum on Corporate Governance, *2024 Proxy Roundup: ESG Metrics in Incentive Compensation Plans*, 5 August 2024.

compensation, reflecting a balance between sustainability objectives and traditional financial performance incentives⁴⁹.

A third recurring element concerns the time horizon of ESG-linked incentives. While ESG metrics remain prevalent in short-term incentive plans, evidence suggests that reliance on annual bonuses alone may weaken incentive effectiveness and encourage short-termism. As a result, best practices increasingly embed ESG criteria within long-term incentive plans, often featuring vesting periods of three to five years and supported by deferral mechanisms. Market data indicate that, although ESG metrics are still more common in annual plans, their gradual extension into long-term incentives represents a key indicator of more substantive incentive alignment⁵⁰.

Robust governance safeguards further distinguish advanced ESG-linked compensation frameworks. Across regions, firms adopting best practices typically rely on independent remuneration committees, enhanced shareholder oversight, and explicit clawback provisions that extend to ESG underperformance. The growing influence of proxy advisors has reinforced these trends, as remuneration structures perceived as “pay-for-non-performance” face increased scrutiny and voting opposition. Recent evidence also points to the use of pilot phases and external verification mechanisms to test ESG metrics before full integration into executive pay structures, particularly for complex indicators such as Scope 3 emissions or social performance metrics⁵¹.

Despite this convergence, important regional differences persist. North American firms tend to prioritize environmental and energy-transition metrics, while social and human capital indicators are more prominent in Asia-Pacific practices. In Europe, ESG-linked compensation is increasingly shaped by sustainability reporting and disclosure requirements, reinforcing the connection between remuneration, governance, and regulatory compliance. Across all regions, persistent challenges remain, including metric dilution across ESG pillars, divergence among ESG rating methodologies, and the risk of short-termism when ESG incentives are confined to annual pay components.

Overall, international best practices suggest that ESG-linked executive compensation is most effective when designed around material, measurable, and long-term performance indicators, supported by strong governance

⁴⁹ Southlea Group, *ESG Metrics in Executive Incentive Plans: Global Trends and Practices*, November 2023; Harvard Law School Forum on Corporate Governance, *ESG Performance Metrics in Executive Compensation*, 2025.

⁵⁰ Harvard Law School Forum on Corporate Governance, *2024 Proxy Roundup: ESG Metrics in Incentive Compensation Plans*, 5 August 2024.

⁵¹ Sustainalytics, *Incentivizing Change: How ESG-Linked Compensation Can Advance Sustainability Initiatives*; Harvard Law School Forum on Corporate Governance, *ESG Performance Metrics in Executive Compensation: Strategies and Trends*, 2025.

and transparency mechanisms. These principles provide a structured benchmark for evaluating firm-level remuneration practices and form the analytical framework for the case study analysis developed in the following chapter.

Chapter 3 – Case Studies

3.1 Research design and analytical framework

This chapter adopts a qualitative case study approach in order to examine the design and implementation of ESG-linked executive compensation within the European banking sector. Consistent with the theoretical and regulatory framework developed in Chapters 1 and 2, the objective is to assess the coherence between theoretical rationales, regulatory expectations, and observed compensation practices.

The analysis focuses on two systemically relevant Italian banking groups: UniCredit S.p.A. and Intesa Sanpaolo S.p.A. The selection is justified by their comparable size, international exposure, and operation within the same European prudential regulatory framework. Both institutions are subject to CRD V remuneration requirements, EBA Guidelines on sound remuneration policies, and increasing supervisory attention to ESG and climate-related risks. This common institutional environment ensures comparability, while differences in strategic positioning and ESG integration allow for meaningful analytical contrast.

The analysis relies primarily on the 2024 Remuneration Reports of UniCredit and Intesa Sanpaolo, which reflect the most recent and currently applicable structure of executive compensation policies.

The analytical framework applied in this chapter derives directly from the theoretical insights discussed in Chapter 1 and the regulatory architecture examined in Chapter 2. In order to ensure consistency and comparability, the assessment of each case is structured around four core dimensions:

1. **Materiality:** the extent to which ESG metrics reflect risks and strategic priorities that are financially and prudentially relevant to the bank.
2. **Measurability and quantification:** the degree of precision, transparency, and verifiability of ESG key performance indicators.
3. **Economic weight:** the relative importance of ESG-linked components within total variable compensation (both short-term and long-term).
4. **Risk and governance safeguards:** the presence of malus, clawback, discretion limits, and risk-adjustment mechanisms, but also coherence of the remuneration structure with prudential expectations and ESG-related supervisory guidance.

By applying this structured grid to both UniCredit and Intesa Sanpaolo, the chapter seeks to evaluate whether ESG-linked executive compensation operates as a substantive governance instrument aligned with risk

management and long-term value creation, or whether it functions primarily as a symbolic response to institutional and reputational pressures.

3.2 Analytical Expectations for ESG-Linked Executive Compensation in Banking

The integration of ESG metrics into executive compensation within the banking sector must be evaluated against the specific characteristics of prudentially regulated financial institutions. Unlike non-financial firms, banks operate under a governance framework in which remuneration policies are already tightly linked to risk management, capital adequacy, and long-term stability. This institutional environment generates distinct expectations regarding the structure and substance of ESG-linked incentives.

First, given the centrality of risk-adjusted performance in banking regulation, ESG metrics should be meaningfully connected to material risk exposures. In particular, climate-related financial risks, governance failures, and conduct-related issues are directly relevant to credit risk, reputational risk, and supervisory assessments. Consequently, ESG-linked compensation in banks should reflect risk-sensitive indicators rather than generic sustainability objectives.

Second, the prudential emphasis on long-term stability suggests that credible ESG incentives should not be confined exclusively to short-term bonus plans. If ESG considerations are genuinely embedded in strategic decision-making, their incorporation into long-term incentive plans (LTI), with multi-year performance horizons and deferred vesting structures, would be consistent with both agency-theory alignment and supervisory expectations.

Third, due to the stringent disclosure and governance requirements applicable to banks, ESG performance indicators are expected to display a high degree of measurability and transparency. Quantitative targets – such as financed emissions, diversity ratios, or sustainable financing volumes – should be clearly defined ex ante, accompanied by performance thresholds and subject to ex post verification. Excessive reliance on discretionary or qualitative criteria may weaken the incentive function of compensation contracts.

Fourth, governance safeguards remain central. In a prudential context, variable remuneration is typically subject to malus and clawback provisions, risk adjustments, and deferral mechanisms. A credible ESG-linked pay framework should therefore be integrated within these mechanisms, ensuring that ESG underperformance or misconduct can trigger downward adjustments in compensation.

Finally, consistency with regulatory developments is expected. As supervisory authorities increasingly emphasize the management of climate and sustainability risks, remuneration frameworks should demonstrate

coherence with internal risk governance structures and sustainability strategies. ESG-linked pay that remains detached from risk frameworks or internal control systems would appear more symbolic than substantive.

These analytical expectations provide the benchmark against which the remuneration structures of UniCredit and Intesa Sanpaolo will be assessed in the following sections. The objective is not merely to document the presence of ESG metrics, but to evaluate their economic relevance, risk integration, and governance robustness within the specific institutional context of European banking.

3.3 UniCredit: Design and Implementation of ESG-Linked Executive Compensation

3.3.1 Structure of the Executive Compensation Framework

The executive compensation framework of UniCredit combines fixed remuneration with a structured variable component articulated across short-term and long-term incentive plans. The fixed component consists of base salary reflecting the executive's role and market positioning, while the variable component is designed to align managerial performance with financial, risk-adjusted, and strategic objectives.

For the Chief Executive Officer, variable remuneration is structured through a Short-Term Incentive (STI) linked to annual performance and a Long-Term Incentive (LTI) based on multi-year performance conditions. Approximately 60% of variable remuneration is deferred over a multi-year horizon and remains subject to ex post risk adjustment mechanisms, including malus and clawback provisions. This deferral structure extends the evaluation period of performance outcomes beyond the annual accrual cycle and exposes compensation to subsequent risk developments.

The report further highlights the explicit linkage between performance evaluation and the Group's Risk Appetite Framework (RAF), indicating that both financial and non-financial objectives are assessed within a prudential governance context. This structural alignment is particularly relevant for the integration of ESG-related targets, as sustainability performance is evaluated within a compensation system already constrained by capital, risk, and compliance filters. Against this institutional background, the following sections examine in detail how ESG metrics are incorporated within the STI and LTI components and whether their design reflects substantive integration within UniCredit's remuneration architecture.

Unless otherwise specified, all quantitative and structural information in Sections 3.3.1–3.3.4 is drawn from UniCredit's 2024 Group Remuneration Policy and Report.

3.3.2 ESG Integration in the Short-Term Incentive (STI)

Within UniCredit's 2024 remuneration architecture, sustainability represents 20% of the Chief Executive Officer's Short-Term Incentive (STI) scorecard, while the remaining 80% is allocated to financial performance indicators. ESG therefore operates as a clearly identifiable weighted component of annual variable remuneration rather than as a residual qualitative overlay.

The sustainability objective is structured around three pillars that connect environmental and social performance to core banking activity and risk exposure. The first pillar links remuneration to the expansion of sustainable financial intermediation. For 2024, performance drivers include a 15% incidence target for ESG lending on new production, a 15% target for sustainable bond issuance, and a 50% target for ESG Assets under Management (AuM)⁵². These indicators anchor executive incentives to measurable shifts in credit origination and asset allocation toward ESG-aligned activities. By tying compensation to the proportion of new sustainable lending and to the composition of managed assets, the incentive design targets structural balance sheet dynamics rather than isolated transactions, thereby embedding sustainability within commercial strategy.

The Net Zero pillar further enhances the economic relevance of the ESG component by incorporating sector-specific decarbonization pathways for carbon-intensive industries. The 2024 framework includes quantitative transition targets such as a –29% reduction in Scope 3 financed emissions in the Oil & Gas sector, a –47% reduction in physical intensity in Power Generation, and a –41% reduction in Tank-to-Wheel emissions in Automotive⁵³, alongside transition targets for additional sectors. These metrics focus on financed emissions and portfolio intensity measures rather than the bank's operational footprint, directly linking managerial incentives to climate-related credit exposure and transition risk management. The integration of such sector-based targets situates sustainability performance within the bank's core risk perimeter.

The third pillar concerns Diversity, Equity and Inclusion (DE&I), embedding human capital governance within the incentive structure. Although less directly tied to quantitative balance sheet variables, DE&I objectives contribute to organizational resilience and governance quality and form part of the broader non-financial performance assessment.

⁵² UniCredit S.p.A., *2024 Group Remuneration Policy and Report* (2024), pp. 76–77.

⁵³ UniCredit S.p.A., *2024 Group Remuneration Policy and Report* (2024), pp. 76–77.

The non-financial section of the CEO scorecard is evaluated through a five-point rating scale, subsequently converted into a 0–120 performance range⁵⁴. This mechanism confirms the presence of a hybrid evaluation structure: while quantitative targets are disclosed ex ante, final scoring allows calibrated assessment within a bounded performance interval. The architecture is therefore not strictly formula-driven with predefined threshold, target, and maximum payout curves specific to sustainability; rather, ESG performance is translated into remuneration through a weighted scorecard framework combined with structured evaluative discretion.

From an incentive-contract perspective, the ESG component operates proportionally. Underperformance in sustainability reduces the relevant 20% portion of annual variable remuneration but does not automatically preclude overall bonus realization. The intensity of the incentive effect thus derives from its explicit weight within the STI and from the calibration of scorecard outcomes, rather than from gating or demultiplier mechanisms.

3.3.3 ESG Integration in the Long-Term Incentive (LTI)

Sustainability objectives are not confined to annual performance measurements but extend to UniCredit's long-term incentive architecture. The variable remuneration of the Chief Executive Officer is subject to a deferral structure under which approximately 60% of the total variable award is deferred over a multi-year horizon. Vesting of this deferred component is subject to an Additional Long-Term Condition composed of two quantified performance drivers: 80% Return on Tangible Equity (RoTE) and 20% Sustainability KPIs, assessed over the 2024–2026 performance cycle⁵⁵. RoTE, defined as net income divided by tangible equity, operates as the primary profitability benchmark, while the sustainability component introduces ESG exposure into the vesting mechanics of deferred remuneration.

The inclusion of Sustainability KPIs within the Additional Long-Term Condition ensures that ESG performance affects not only annual bonus determination but also the realization of deferred compensation over a three-year horizon. Because the deferred portion represents the majority of variable remuneration, ESG performance effectively influences a substantial share of the CEO's wealth that remains exposed to intertemporal reassessment. This structure reduces the risk that sustainability objectives function merely as short-term signaling devices and instead connects them to medium-term strategic outcomes.

⁵⁴ UniCredit S.p.A., *2024 Group Remuneration Policy and Report* (2024), pp. 73–74.

⁵⁵ UniCredit S.p.A., *2024 Group Remuneration Policy and Report* (2024), pp. 90–92.

However, the structural role of ESG within the LTI remains proportional rather than constraining. Sustainability operates as a weighted component of the additional long-term condition rather than as a gate or demultiplier affecting the vesting of the entire award. Underperformance in ESG reduces the sustainability-linked portion of the deferred tranche but does not mechanically eliminate vesting of the remaining RoTE-based share. The architecture therefore preserves a financial dominance structure in which profitability remains the primary determinant of long-term payout.

From a contractual perspective, embedding Sustainability KPIs within the deferred 60% of variable remuneration strengthens temporal alignment between transition objectives and executive wealth exposure. Nevertheless, since ESG operates through proportional weighting rather than binding vesting conditions, its incentive force ultimately depends on calibration and performance scoring rather than on automatic enforcement mechanisms.

3.3.4 Governance Mechanisms and Risk Alignment

The effectiveness of UniCredit's ESG-linked remuneration cannot be assessed solely by reference to the formal inclusion of sustainability metrics within the STI and LTI scorecards. Rather, it must be examined within the broader prudential governance architecture in which variable remuneration operates.

Approximately 60% of variable remuneration is deferred over a multi-year horizon and remains subject to ex post risk adjustment mechanisms, including malus and clawback provisions⁵⁶. Deferred tranches may be reduced or cancelled in cases of material risk management failures, regulatory breaches, or misconduct. These safeguards apply uniformly across financial and non-financial performance metrics.

Within this structure, ESG-linked performance is embedded in a remuneration framework already constrained by capital, compliance, and supervisory filters. The integration of Net Zero commitments into the Group's Risk Appetite Framework further situates sustainability objectives within the bank's formal risk governance perimeter, linking them to broader prudential considerations such as capital adequacy and risk exposure⁵⁷.

However, the architecture does not introduce ESG-specific vesting constraints. In the absence of gating or demultiplier mechanisms, sustainability performance affects remuneration proportionally through its weighted allocation but does not operate as an autonomous constraint on total variable pay.

⁵⁶ UniCredit S.p.A., *2024 Group Remuneration Policy and Report*, pp. 48–54.

⁵⁷ UniCredit S.p.A., *2024 Group Remuneration Policy and Report*, pp. 76–77.

UniCredit's model therefore reflects an institutionalized and risk-adjusted integration of sustainability objectives, while preserving financial performance as the primary determinant of payout. The incentive effectiveness of ESG-linked components ultimately depends on the precision of performance measurement and on the calibration of scorecard outcomes rather than on mechanically binding enforcement mechanisms.

3.3.5 CEO 2024 Remuneration Outcome and ESG Disclosure

The 2024 Remuneration Report discloses that the Chief Executive Officer received total remuneration of €9.957 million for financial year 2023, of which €6.5 million corresponded to variable compensation. The annual performance scorecard reached 120 points out of a maximum of 120, with both the financial (80%) and non-financial (20%) sections assessed at maximum performance levels. The entire variable award was granted in shares, with 40% delivered upfront and 60% deferred and subject to the Additional Long-Term Condition (80% RoTE and 20% Sustainability KPIs over the 2024–2026 cycle).

While the remuneration architecture clearly identifies the weighting of sustainability objectives within both the STI (20%) and the deferred component of the LTI (20% within the Additional Long-Term Condition), the report does not provide a granular breakdown of the monetary impact attributable specifically to ESG performance. The non-financial section is disclosed as fully achieved, but the report does not isolate the contribution of individual ESG indicators nor quantify the exact portion of the €6.5 million variable award generated by sustainability performance. The architecture of ESG integration is therefore transparent ex ante, whereas the ex post economic attribution of ESG outcomes remains aggregated within the broader non-financial score.

3.4 Intesa Sanpaolo: Design and Implementation of ESG-Linked Executive Compensation

3.4.1 Structure of the Executive Compensation Framework

Intesa Sanpaolo structures executive variable remuneration through a scorecard-based incentive system combining quantitative economic-financial KPIs and qualitative non-financial objectives. For the Managing Director and CEO, the annual incentive operates through a deterministic calculation based on predefined KPI weights and performance curves, subject to activation conditions and the absence of individual compliance breaches.

A defining feature of Intesa's architecture is the extended deferral horizon applied to variable pay. The annual incentive is delivered partly in cash and partly in Intesa Sanpaolo shares and is recognised over a five-year deferral horizon; each deferred tranche is subject to ex post malus conditions, and clawback may be activated in the five years following the payment of each tranche.

Within this framework, ESG objectives are embedded in both the annual incentive system and the long-term incentive architecture. At CEO level, ESG enters (i) as a dedicated KPI in the annual Performance Scorecard and (ii) as a sustainability-based demultiplier within the long-term Performance Share Plan (PSP). This dual placement is central to assessing whether ESG-linked pay is merely additive or instead capable of influencing realised remuneration through enforceable contract design.

Unless otherwise specified, the quantitative and structural information reported in Sections 3.4.1–3.4.4 is drawn from Intesa Sanpaolo’s 2024 Remuneration Report and related corporate disclosures.

3.4.2 ESG Integration in the Short-Term Incentive (STI)

In the annual incentive system, ESG is embedded through the CEO’s Performance Scorecard, which assigns explicit weights to both financial and non-financial objectives and specifies threshold, target, and maximum reference levels for the quantitative KPIs. The CEO scorecard allocates a 15% weight to a qualitative ESG KPI within the set of strategic actions linked to the 2022–2025 Business Plan⁵⁸. This is articulated through ex ante evaluation drivers rather than a single reputational label. It includes (i) the bank’s presence in sustainability indices compiled by specialised providers; (ii) actions to promote an inclusive workplace, with an explicit focus on gender equity commitments assigned at Division/Governance Area level (including annual hires and candidate pools for first-time managerial appointments); and (iii) Group ESG initiatives. The climate-related component is framed around support for the green and circular economy and is operationalised via concrete drivers, including the development of ESG lending volumes, the definition of targets for reducing financed emissions in additional priority sectors, the reduction of exposures to ESG-risk sectors, and completion of the ESG Credit Framework; the KPI also evaluates the growth of sustainable investments through the incidence of ESG investments over total AuM.

Two design choices increase the contractibility of this annual ESG component. First, Intesa constrains KPI salience by imposing minimum and maximum weights (at least 10% and no more than 30% for each KPI), limiting the scope for marginal or purely symbolic objectives. Second, the payout is described as deterministic, i.e., mechanically derived from the scorecard outcomes, subject to activation conditions and compliance filters, thereby reducing the reliance on ex post discretionary override in the conversion of ESG performance into remuneration.

⁵⁸ Intesa Sanpaolo S.p.A., *Report on Remuneration Policy and Compensation Paid 2024*, Section “Managing Director and CEO – Annual Incentive System”, pp. 40–45.

ESG accountability is also broadened beyond the CEO. A transversal Group ESG KPI is assigned to approximately 3,000 managers in Italy and abroad with a weight of 10% or 15%, indicating a diffusion of ESG-linked incentives across a managerial population rather than a CEO-only signal.

3.4.3 ESG Integration in Long-Term Incentives (LTI)

In addition to the annual incentive system, Intesa Sanpaolo's remuneration framework incorporates a long-term incentive component structured through deferred variable remuneration and a Performance Share Plan (PSP). A significant portion of variable remuneration is deferred over a five-year horizon, reinforcing intertemporal alignment between executive wealth exposure and medium-term performance outcomes. Within the PSP architecture, sustainability operates through a structurally binding mechanism rather than as a simple weighted performance block. The plan includes a composite ESG KPI that functions as a demultiplier applied to the number of shares vesting at the end of the performance cycle. In the event of underachievement of the sustainability targets defined in the 2022–2025 Business Plan, the number of shares otherwise due may be reduced by 10% or 20%, depending on the degree of deviation from target levels⁵⁹. This mechanism differs materially from proportional weighting structures. In a weighted scorecard, ESG performance affects only the allocated portion of the award. By contrast, a demultiplier operates on the total vesting outcome of the PSP tranche. Sustainability performance therefore has the capacity to reduce the overall long-term award, rather than merely influencing a predefined sub-component.

Importantly, the ESG composite KPI is structured around environmental, social, and governance drivers aligned with the strategic objectives of the Business Plan. Although the Report does not isolate ESG as a standalone percentage block within the LTI scorecard, the demultiplier mechanism embeds sustainability within the enforceable vesting logic of the plan. ESG performance thus directly influences the effective realization of deferred executive compensation.

From a contractual perspective, this architecture increases the enforceability of sustainability-linked incentives. Because the demultiplier applies at the level of share vesting, ESG underperformance has a mechanically binding impact on realized long-term remuneration. The incentive transmission mechanism therefore differs from proportional weighting models: sustainability does not determine a fixed share of the award ex ante, but can constrain the final vesting outcome ex post. Within the prudential governance context

⁵⁹ Intesa Sanpaolo S.p.A., *Report on Remuneration Policy and Compensation Paid 2024*, Section “Performance Share Plan – ESG Composite KPI”, pp. 101–105.

of a regulated bank, the interaction between extended deferral and ESG-based demultiplier strengthens the temporal and structural linkage between sustainability performance and executive wealth exposure.

3.4.4 Governance Mechanisms and Risk Alignment

Intesa's remuneration framework operates within a prudential governance architecture characterized by strong ex ante and ex post controls on variable pay. Both the annual incentive system and the long-term PSP are subject to activation conditions, compliance breach filters, and risk-adjustment mechanisms. In the annual incentive, payment is recognised over a five-year deferral horizon; each deferred tranche is subject to malus conditions and clawback may be applied in the five years following payment⁶⁰.

The long-term PSP introduces an additional layer of enforceability through the interaction between prudential gates and ex post de-multipliers. On the one hand, gateway conditions link vesting to RAF-consistent constraints; on the other, the ESG composite KPI operates as a sustainability-based demultiplier (10%/20%), while the Capital Target demultiplier ties vesting to CET1 maintenance above RAF targets (10% per breach year, capped at 40%)⁶¹.

From an ESG-governance standpoint, this architecture is analytically relevant because sustainability performance is not insulated from the bank's prudential logic. ESG is incorporated both as a CEO-specific STI KPI (15%) with clearly articulated drivers and as a PSP mechanism that can mechanically reduce the number of shares vesting at the end of the plan. This configuration increases the credibility of ESG-linked incentives by strengthening the contractibility of sustainability targets and embedding them within a framework where capital adequacy, compliance, and risk discipline can directly affect realised pay outcomes.

3.4.5 CEO Compensation Outcomes and ESG Disclosure

According to the 2024 Remuneration Report, the Managing Director and CEO of Intesa Sanpaolo received variable remuneration of €4.585 million for financial year 2023, corresponding to 175% of fixed remuneration and reflecting an overall performance outcome of 120% of target. The annual incentive result incorporates both financial KPIs and a 15% ESG-related KPI within the CEO scorecard.

⁶⁰ Intesa Sanpaolo S.p.A., *Report on Remuneration Policy and Compensation Paid 2024*, Section "Malus and Clawback Mechanisms", pp. 114–118.

⁶¹ Intesa Sanpaolo S.p.A., *Report on Remuneration Policy and Compensation Paid 2024*, Section "Capital Target de-multiplier", pp. 103–107.

Although the structure of the scorecard and the weight assigned to the ESG KPI are clearly disclosed, the report does not provide a disaggregated monetary allocation showing the specific portion of the variable award attributable to sustainability performance. Similarly, while the long-term Performance Share Plan includes an ESG-based demultiplier capable of reducing vesting by 10% or 20% in case of underachievement, the report does not quantify any ex post adjustment related specifically to ESG performance for the relevant cycle.

As in the UniCredit case, the contractual architecture of ESG-linked incentives is transparent and formally structured, yet the disclosure of realized economic impact at CEO level remains aggregated within overall performance outcomes rather than individually attributable to specific sustainability metrics.

3.5 Comparative Analysis: UniCredit and Intesa Sanpaolo

Table 1: *Comparative Architecture of ESG-Linked Executive Compensation: UniCredit vs Intesa Sanpaolo*⁶²

Dimension	UniCredit	Intesa Sanpaolo
ESG Weight – STI	Explicit 20% allocation within annual CEO variable remuneration	15% dedicated ESG KPI within CEO scorecard (within weighted deterministic structure)
ESG Weight – LTI	20% Sustainability KPIs within Additional Long-Term Condition (80% RoTE, 20% ESG) applied to deferred remuneration	No standalone percentage weight; ESG operates through PSP demultiplier (-10%/-20% vesting reduction)
ESG in LTI	Separate sustainability component within LT performance condition	ESG composite KPI embedded in PSP vesting logic
Structural Role of ESG	Weighted performance block operating proportionally (STI and LTI)	Vesting adjustment mechanism affecting total share vesting (PSP)
Evaluation Method	Quantitative targets combined with calibrated qualitative assessments (5-point scale converted into 0-120 range)	Deterministic formula-based scorecard (STI) + predefined demultiplier rules (LTI)
Deferral Horizon	60% of variable remuneration deferred over multi-year period	Five-year deferral structure with PSP
Malus / Clawback & Risk Alignment	ESG subject to malus/clawback; linked to Risk Appetite Framework	ESG subject to malus/clawback; embedded in Business Plan and PSP demultiplier structure

Table 1 summarizes the key architectural differences in the integration of ESG metrics within the executive remuneration frameworks of UniCredit and Intesa Sanpaolo. A structured comparison reveals institutional convergence in the formal adoption of ESG-linked incentives, but material divergence in their contractual configuration. Both institutions integrate sustainability objectives in short-term and long-term incentive

⁶² Analytical synthesis developed by the author on the basis of corporate disclosures.

components and subject them to deferral, malus, and clawback provisions. ESG performance is therefore not insulated from prudential governance mechanisms in either case.

The primary difference lies in the structural transmission mechanism through which ESG performance affects realized remuneration. UniCredit adopts an explicitly quantified architecture, assigning a 20% weight to sustainability objectives in both the STI and the Additional Long-Term Condition governing deferred remuneration. This design enhances transparency and allows direct observation of the economic allocation of ESG within total variable pay. However, ESG operates proportionally within a weighted scorecard framework, and final performance translation incorporates calibrated board-level assessment in the non-financial section. The incentive intensity of ESG is therefore determined by its explicit weight and by scorecard calibration rather than by binding vesting constraints.

Intesa Sanpaolo adopts a structurally different configuration. In the STI, ESG enters as a 15% KPI within a deterministic scorecard structure characterized by predefined performance curves and bounded weights. In the long-term Performance Share Plan, sustainability operates through a composite ESG demultiplier capable of reducing the number of shares vesting by 10% or 20% in case of underachievement. Unlike proportional weighting, the demultiplier mechanism applies to the overall vesting outcome, thereby introducing a constraining effect on realized long-term remuneration.

The distinction is therefore not between presence and absence of ESG incentives, but between proportional weighting and structural conditioning. UniCredit emphasizes numerical visibility and explicit allocation, whereas Intesa embeds sustainability within formula-based enforcement mechanisms that can mechanically affect vesting outcomes. In incentive-contract terms, UniCredit increases transparency of economic allocation, while Intesa potentially increases contractual rigidity and ex post enforceability.

Neither institution transforms ESG into a dominant determinant of executive wealth; financial performance remains the primary driver of payout in both cases (80% RoTE within UniCredit's Additional Long-Term Condition; financial KPIs forming the core of Intesa's STI and PSP structure). However, Intesa's demultiplier introduces a qualitatively different governance lever compared to UniCredit's weighted-only model. From an agency-theoretic perspective, the divergence concerns the mechanism through which sustainability performance enters the compensation contract. UniCredit relies on proportional economic salience within a hybrid evaluative structure; Intesa relies on deterministic calculation combined with a structurally binding demultiplier. These alternative architectures reflect different balances between transparency, contractual precision, and prudential enforceability within ESG-linked executive compensation.

An additional point of convergence concerns ex post disclosure. While both institutions clearly articulate the structural weight and contractual positioning of ESG metrics within CEO compensation, neither provides a granular monetary attribution of the realized variable remuneration specifically to sustainability performance. The transparency of incentive architecture therefore exceeds the transparency of realized ESG-driven payout, limiting the ability to isolate the effective economic impact of sustainability outcomes at CEO level.

3.6 Theoretical Assessment of ESG-Linked Compensation Architectures

While Section 3.5 compared the structural architecture of the two remuneration models, this section evaluates their governance effectiveness in light of the theoretical framework developed in Chapter 1. To assess the substantive integration of ESG-linked compensation within the two remuneration frameworks, the analysis applies four evaluative criteria derived from the theoretical and regulatory discussion developed in Chapters 1 and 2: materiality, measurability, economic weight, and risk alignment. Time horizon and regulatory alignment are incorporated within the economic weight and risk alignment dimensions. These parameters operationalize key insights from agency theory⁶³ and from the academic debate on ESG-linked remuneration⁶⁴ (Cohen et al., 2023; Walker, 2022), allowing a structured evaluation of whether sustainability incentives function as effective governance mechanisms or remain primarily symbolic.

1. **Materiality:** Agency theory suggests that incentive contracts reduce agency costs only if performance measures reflect dimensions that materially affect firm value and risk exposure⁶⁵. The literature on sustainability performance further emphasizes that ESG metrics must capture issues that are financially material⁶⁶ to the firm in order to influence long-term value. In both cases examined, ESG metrics are linked to strategically relevant banking activities. UniCredit emphasizes sustainable finance penetration, Net Zero commitments in carbon-intensive sectors, and DE&I priorities—dimensions directly connected to transition risk, asset allocation, and governance exposure. Intesa Sanpaolo integrates ESG within the cost-of-risk/sustainability driver, explicitly linking sustainability performance to balance sheet resilience and credit

⁶³ Jensen, M. C., & Meckling, W. H. (1976). Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of Financial Economics*, 3(4), 305–360.

⁶⁴ Cohen, S., Kadach, I., Ormazabal, G., & Reichelstein, S. (2023). Executive compensation tied to ESG performance: International evidence. *Journal of Accounting Research*, 61(3), 805–856.; Walker, D. I. (2022). The economic (in)significance of executive pay ESG incentives. *Stanford Journal of Law, Business & Finance*, 27(2), 318–349.

⁶⁵ Jensen, M. C., & Meckling, W. H. (1976). Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of Financial Economics*, 3(4), 305–360.

⁶⁶ Khan, M., Serafeim, G., & Yoon, A. (2016). Corporate sustainability: First evidence on materiality. *The Accounting Review*, 91(6), 1697–1724.

risk management. In this respect, both institutions appear to align ESG metrics with material risk exposures rather than peripheral reputational initiatives.

2. **Measurability:** The effectiveness of performance-based incentives depends on the precision and contractibility of performance measures. As highlighted in the literature, ESG metrics often suffer from limited standardization and high discretion⁶⁷, potentially increasing managerial latitude (Bebchuk & Tallarita, 2022; Badawi & Bartlett, 2024). UniCredit discloses explicit percentage weights and identifiable quantitative sustainability drivers; however, final evaluation incorporates qualitative board-level assessment. This hybrid structure enhances transparency in allocation but introduces interpretative flexibility in payout determination. From an agency perspective, such discretion may weaken pay–performance sensitivity. Intesa Sanpaolo relies on predefined KPI weights within a deterministic scorecard framework. Although it does not disclose a consolidated ESG percentage within the LTI, the formula-based conversion of scorecard performance into payout reduces the scope for ex post discretionary calibration. The trade-off thus emerges between transparency of explicit weighting (UniCredit) and rigidity of evaluation criteria (Intesa). In line with agency theory, the degree of contractual determinism becomes central to incentive effectiveness.
3. **Economic Weight:** The academic debate has questioned whether ESG-linked incentives carry sufficient economic weight to meaningfully influence executive behavior. Walker (2022) argues that ESG incentives often represent a marginal fraction of total executive wealth, limiting their disciplining capacity. Similarly, empirical evidence suggests that ESG targets are frequently met⁶⁸, raising concerns about weak calibration. UniCredit assigns a formal 20% allocation to sustainability objectives in both STI and LTI components. The duplication of ESG weighting across time horizons enhances the visible economic salience of sustainability performance and allows stakeholders to quantify its share within variable remuneration. Intesa Sanpaolo does not isolate a single aggregate ESG weight in the LTI, making the standalone economic share of sustainability less immediately observable. In formal terms, UniCredit’s structure offers clearer evidence of allocation, whereas Intesa’s economic impact depends more heavily on internal calibration of strategic drivers. However, a further theoretical issue concerns ex post transparency. While both institutions disclose the formal weight or structural positioning of ESG metrics within the remuneration architecture, neither provides a granular monetary breakdown of the realized CEO variable remuneration specifically attributable to sustainability

⁶⁷ Bebchuk, L. A., & Tallarita, R. (2022). The perils and questionable promise of ESG-based compensation. *Journal of Corporation Law*, 47(4), 1–38.; Badawi, A. B., & Bartlett, R. P. (2024). *ESG overperformance? Assessing the use of ESG targets in executive compensation plans*. ECGI Finance Working Paper No. 1025/2024. European Corporate Governance Institute.

⁶⁸ Badawi, A. B., & Bartlett, R. P. (2024). *ESG overperformance? Assessing the use of ESG targets in executive compensation plans*. ECGI Finance Working Paper No. 1025/2024. European Corporate Governance Institute.

performance. From an agency perspective, this limits the external observability of pay–performance sensitivity in practice, even where contractual design appears economically meaningful *ex ante*.

4. **Risk Alignment:** Both institutions operate within a prudentially regulated banking environment characterized by deferral requirements, malus provisions, and clawback mechanisms. The integration of ESG within risk-adjusted remuneration structures responds to regulatory expectations that sustainability risks be embedded within governance frameworks. UniCredit explicitly links sustainability objectives to its Risk Appetite Framework, reinforcing coherence between ESG performance and risk tolerance thresholds. Intesa integrates sustainability within the cost-of-risk/sustainability driver and applies a five-year deferral horizon, strengthening intertemporal exposure of remuneration to risk-adjusted outcomes. In both cases, ESG performance is subject to the same prudential constraints as financial metrics, reducing the risk that sustainability incentives operate independently from capital protection logic.

Taken together, the two models reflect alternative contractual responses to the concerns identified in the academic debate. UniCredit emphasizes explicit quantification and visibility of ESG weighting, enhancing formal transparency and stakeholder observability. Intesa Sanpaolo emphasizes structural embedding within deterministic and risk-sensitive drivers, prioritizing procedural discipline over standalone disclosure.

Consistent with the findings of Cohen et al. (2023), ESG-linked incentives are clearly present in both institutions. From an agency-theoretic perspective, the critical question is not whether ESG metrics are included in remuneration contracts, but whether their design increases the sensitivity of managerial wealth to sustainability-related performance in a manner that is both verifiable and economically meaningful. In line with Walker (2022) and Bebchuk & Tallarita (2022), their effectiveness ultimately depends on the material economic exposure of executive wealth, the precision of performance measurement, and limits on discretionary calibration. The two institutions, however, differ in the structural intensity of ESG enforcement. UniCredit relies on proportional weighting mechanisms within both STI and LTI structures. Intesa Sanpaolo, by contrast, incorporates a sustainability-based demultiplier within its long-term Performance Share Plan, allowing ESG underperformance to mechanically reduce overall vesting outcomes. While neither institution transforms ESG into the dominant determinant of executive wealth, Intesa’s architecture introduces a constraining mechanism that exceeds simple proportional weighting.

The comparative evidence suggests that ESG-linked compensation in European banking has moved beyond purely symbolic inclusion. Nevertheless, its capacity to mitigate agency costs depends critically on contractual design choices (weight allocation, formula determinism, transparency, and integration within prudential governance) rather than on formal adoption alone.

3.7 Discussion: Theoretical Implications, Practical Implications and Limitations

The analysis conducted in this thesis contributes to the ongoing academic debate on ESG-linked executive compensation by clarifying not merely whether sustainability metrics are present in remuneration contracts, but how they are structurally embedded within incentive architectures. The comparative evidence suggests that the effectiveness of ESG-linked pay depends less on formal inclusion and more on contractual design choices governing enforceability, economic salience, and interaction with risk management constraints.

3.7.1 Theoretical Implications

From a theoretical perspective, the findings refine agency-based interpretations of ESG-linked compensation. Agency theory posits that incentive contracts mitigate agency costs when performance measures are both value-relevant and contractible. The comparative evidence between UniCredit and Intesa Sanpaolo highlights that at least two distinct incentive transmission mechanisms are emerging in European banking: proportional weighting architectures and conditional vesting architectures.

UniCredit's model illustrates a configuration based on explicit economic visibility. ESG metrics are clearly quantified and allocated a transparent share of total variable remuneration in both short-term and long-term components. This enhances observability and stakeholder clarity regarding economic allocation. However, proportional weighting combined with calibrated assessment preserves a degree of interpretative flexibility in translating performance into payout.

Intesa Sanpaolo's architecture, by contrast, emphasizes contractual enforceability. The presence of a sustainability-based demultiplier within the long-term Performance Share Plan introduces a conditional mechanism capable of mechanically affecting vesting outcomes. In incentive-contract terms, this design reduces discretion in the conversion of ESG performance into realized remuneration.

The comparative contribution of this thesis therefore lies in distinguishing between economic visibility of ESG allocation and contractual enforceability of ESG conditions. Both institutions have moved beyond symbolic inclusion; however, the strength of incentive alignment depends on whether ESG operates merely as a weighted performance block or as a structurally constraining condition within vesting mechanics. This distinction advances the debate beyond binary classifications of "ESG present" versus "ESG absent" and instead focuses on the depth of contractual integration.

3.7.2 Practical Implications

From a governance standpoint, the findings show that future improvements in ESG-linked compensation should mainly focus on three dimensions.

First, enhanced ex post disclosure of ESG performance outcomes would strengthen transparency. While remuneration reports describe the architecture of ESG metrics in detail, granular breakdowns of the quantitative contribution of sustainability performance to final payouts remain limited. Improved reporting on target achievement levels and their impact on remuneration would increase accountability and stakeholder trust.

Second, greater standardization and quantification of ESG metrics would enhance contractibility. Although both institutions integrate financially material sustainability drivers – such as financed emissions and sustainable finance volumes – the presence of qualitative calibration or composite structures may attenuate pay–performance sensitivity. Increasing the precision and comparability of ESG indicators would reduce interpretative latitude and strengthen incentive credibility.

Third, the broader use of conditional mechanisms (such as gating thresholds or vesting adjustments) could be considered where sustainability underperformance has a structurally binding impact on remuneration. While neither institution transforms ESG into a dominant determinant of executive wealth, the analysis suggests that enforceability mechanisms may enhance the disciplining capacity of sustainability-linked incentives within risk management and prudential governance systems.

3.7.3 Limitations

This study is subject to several limitations.

First, it relies on publicly disclosed remuneration reports, which, although detailed in structural design, provide limited ex post quantification of ESG-specific payout contributions. The absence of granular breakdowns constrains the ability to measure precisely the realized economic impact of sustainability performance on executive wealth.

Second, the analysis focuses on two systemically relevant Italian banking institutions operating within a shared European regulatory framework. While this ensures institutional comparability, it limits the application of findings to other jurisdictions characterized by different governance structures.

Third, ESG metrics remain an evolving field. Measurement methodologies, regulatory expectations, and market standards continue to develop, particularly with respect to climate-related financial risk. As ESG frameworks mature and become more standardized, the contractual architecture of incentive systems may undergo further transformation.

Despite these limitations, the comparative analysis demonstrates that ESG-linked executive compensation in European banking has progressed from reputational signaling toward structurally embedded incentive design. The decisive question is no longer whether sustainability is included in remuneration contracts, but how forcefully it shapes managerial wealth exposure, and consequentially decisions, within a risk-sensitive governance framework.

Conclusion

This thesis investigated whether ESG-linked executive compensation in European banking operates as a substantive governance mechanism capable of aligning managerial incentives with long-term sustainability and prudential stability, or whether it remains primarily symbolic. In order to do this, it performs a comparative analysis of UniCredit and Intesa Sanpaolo, demonstrating that ESG metrics are no longer external or reputational add-ons within remuneration frameworks: in both institutions, sustainability objectives are formally integrated into STI and LTI systems and operate within deferral, malus, and clawback structures. ESG has entered the contractual architecture of executive pay.

However, the effectiveness of these mechanisms depends on how sustainability is embedded. The research question can therefore be answered with nuance: *ESG-linked compensation can function as a substantive governance instrument, but its disciplining capacity is conditional on contractual design, enforceability, and integration within risk management frameworks.*

Financial performance remains the primary determinant of executive wealth in both cases. Sustainability influences incentives, but it does not redefine the objective function of management. ESG-linked remuneration represents an evolutionary shift in governance rather than a structural transformation. Its strength lies in embedding sustainability within the logic of risk-adjusted performance; its limitation lies in the still-partial economic centrality of ESG within total compensation.

The broader significance of this evolution extends beyond remuneration technique. Banks allocate capital across sectors, technologies, and time horizons. Executive incentives influence those allocation decisions. When sustainability metrics are incorporated into compensation structures, they contribute to shaping strategic priorities and risk assessment processes. When they remain marginal, their influence is correspondingly limited.

ESG-linked executive compensation reflects a deeper transition in corporate governance: the gradual recognition that environmental and social risks are inseparable from financial resilience. Yet the effectiveness of governance mechanisms depends on precision, transparency and enforceability to meaningfully shape managerial behavior.

Ultimately, the structure of executive incentives is not merely a technical governance issue. It is one of the institutional channels through which economic systems translate societal awareness into concrete decision-making. If sustainability challenges are systemic and intergenerational, then the alignment of managerial wealth with long-term resilience becomes part of a broader collective responsibility.

The evolution of ESG-linked compensation therefore raises a question that extends beyond corporate governance: whether financial institutions, and the societies that regulate them, are willing to align economic incentives with a growing collective consciousness of environmental and social interdependence.

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