HERMES
INVESTMENT MANAGEMENT

Excellence. Responsibility. Innovation.

Q1 2015

Hermes EOS

Public Engagement Report

The road to Paris – Taking action on climate change

This report contains a summary of the responsible ownership activities undertaken by Hermes EOS on behalf of its clients. It covers significant themes that have informed some of Hermes EOS' intensive engagements with companies in Q1 2015.

The report also provides information on its voting recommendations and the steps Hermes EOS has taken to promote global best practices, improvements in public policy and collaborative work with other shareholders.

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What is Hermes EOS?

Hermes EOS helps long-term institutional investors around the world to meet their fiduciary responsibilities and become active owners of public and private companies. Hermes EOS' team of engagement and voting specialists monitors its clients' investments in companies and intervenes where necessary with the aim of improving their performance. Hermes EOS' activities are based on the premise that companies with informed and involved shareholders are more likely to achieve superior long-term performance than those without.

Through pooling resource with other like-minded funds to create a strong and representative shareholder voice, our joint company engagements are more effective. We currently act on behalf of 41 clients and £124 billion* assets under advice.

Hermes has one of the largest stewardship resources of any fund manager in the world. Our 26-person team includes industry executives, senior strategists, corporate governance and climate change experts, fund managers and lawyers.

The depth and breadth of this resource reflects our philosophy that ownership activities require an integrated and skilled approach. Intervention at senior management and board director level should be carried out by individuals with the right skills and with credibility. Making realistic and realisable demands of companies, informed by significant hands-on experience of business management and strategy-setting is critical to the success of our engagements.

Hermes EOS has extensive experience of implementing the Principles for Responsible Investment (PRI) and other stewardship codes. Its chief executive Colin Melvin chaired the committee that drew up the original principles and we are actively engaged in a variety of workstreams through the PRI clearinghouse. This insight enables Hermes EOS to help signatories in meeting the challenges of effective PRI implementation.

How does Hermes EOS work?

Our corporate, public policy and best practice engagement programmes aim to enhance and protect the value of our clients' investments and safeguard their reputations. We measure and monitor progress on all engagements, setting clear objectives and specific milestones. In selecting companies for engagement, we take account of their environmental, social and governance risks, their ability to create long-term shareholder value and the prospects for engagement success.

The Hermes Responsible Ownership Principles set out our basic expectations of companies in which our clients invest. These cover business strategy, communications, financial structure, governance and management of social, ethical and environmental risks. The Principles and their regional iterations guide our intervention with companies throughout the world. Our approach is pragmatic and company- and market-specific, taking into account individual company circumstances.

We escalate the intensity of our engagement with companies over time, depending on the nature of the challenges they face and the attitude of the board towards our dialogue. Some engagements involve one or two meetings over a period of months, others are more complex and entail multiple meetings with different board members over several years.

At any one time around 400 companies are included within our core engagement programmes. All of our engagements are undertaken subject to a rigorous initial assessment and ongoing review process to ensure that we focus our efforts where they can add most value for our clients.

While we are robust in our dealings with companies, the aim is to deliver value for clients, not to seek headlines through campaigns, which can often undermine the trust that would otherwise exist between a company and its owners. We are honest and open with companies about the nature of our discussions and will aim to keep these private. Not only has this proven to be the most effective way to bring about change, it also acts as a protection to our clients, so that their positions will not be misrepresented in the press.

For these reasons, this public report does not generally contain specific details of our interactions with companies unless they are already public. Rather it explains some of the most important issues relevant to responsible owners and outlines Hermes EOS' activities in these areas.

We would be delighted to discuss Hermes EOS with you in greater detail.

For further information please contact:
Colin Melvin on +44(0)207 680 2251

* as of 31 March 2015

Hermes EOS team

Leadership

Colin Melvin
Chief Executive

Matthew Doyle
Director

Dr Hans-Christoph Hirt
Director

Leon Kamhi
Director

Jennifer Walmsley
Director

Engagement professionals

Roland Bosch
Sector lead: Financial Services, Sectors: Consumer Goods and Retail

Darren Brady
Sector lead: Technology
Sectors: Oil and Gas

Natacha Dimitrijevic
Sectors: Financial Services, Pharmaceuticals, Utilities

Bruce Duguid
Sector lead: Mining, Pharmaceuticals
Sectors: Oil and Gas, Utilities

Rochelle Giugni
Sectors: Consumer Goods and Retail, Financial Services

Lui Goldie
Sectors: Pharmaceuticals, Technology

Tim Goodman
Sector lead: Oil and Gas
Sectors: Mining

Naheeda Rashid
Sector lead: Consumer Goods and Retail
Sectors: Technology

Karin Ri
Sector lead: Utilities
Sectors: Financial Services, Industrials

Sachi Suzuki
Sector lead: Industrials
Sectors: Technology

Maxine Wille
Sectors: Consumer Goods and Retail, Industrials, Pharmaceuticals

Business and Client Development

Dominic Burke
Client Relations

Mais Hayek
ESG Integration

Bram Houtenbos
Operations

Amy Lunn
Head of Business and Client Development

James O'Halloran
Head of Operations

Nina Röhrbein
Reporting

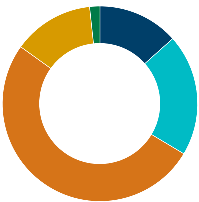
Lucy Saville
Client Relations

Engagement by region

Over the last quarter we engaged with 136 companies on 292 social, environmental, business strategy and governance issues. Hermes EOS' holistic approach to engagement means that we typically engage with companies on more than one issue simultaneously. The engagements included in these figures are in addition to our discussions with companies around voting matters.

Global

We engaged with **136** companies over the last quarter.



- Environmental **13.4%**
- Social and ethical **20.2%**
- Governance **51.4%**
- Strategy and risk **13.4%**
- Stewardship **1.7%**

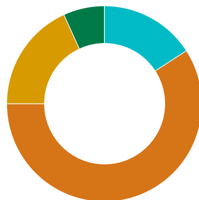
Australia and New Zealand

We engaged with **nine** companies over the last quarter.

- Environmental **25.0%**
- Social and ethical **31.3%**
- Governance **43.8%**

Developed Asia

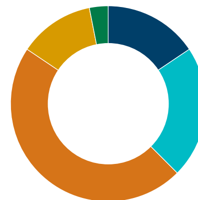
We engaged with **21** companies over the last quarter.



- Social and ethical **15.9%**
- Governance **59.1%**
- Strategy and risk **18.2%**
- Stewardship **6.8%**

Emerging and Frontier Markets

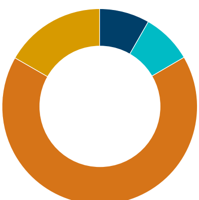
We engaged with **13** companies over the last quarter.



- Environmental **15.6%**
- Social and ethical **21.9%**
- Governance **46.9%**
- Strategy and risk **12.5%**
- Stewardship **3.1%**

Europe

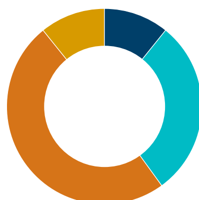
We engaged with **26** companies over the last quarter.



- Environmental **8.3%**
- Social and ethical **8.3%**
- Governance **66.7%**
- Strategy and risk **16.7%**

North America

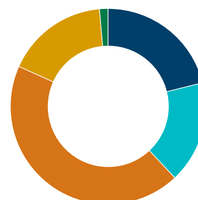
We engaged with **36** companies over the last quarter.



- Environmental **10.8%**
- Social and ethical **29.2%**
- Governance **49.2%**
- Strategy and risk **10.8%**

United Kingdom

We engaged with **31** companies over the last quarter.



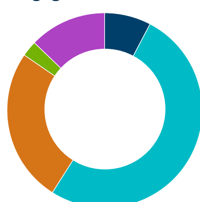
- Environmental **21.1%**
- Social and ethical **16.9%**
- Governance **43.7%**
- Strategy and risk **16.9%**
- Stewardship **1.4%**

Engagement by issue

A summary of the 292 issues on which we engaged with companies over the last quarter is shown below.

Environmental

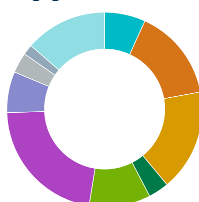
Environmental issues featured in **13.4%** of our engagements over the last quarter.



- Biodiversity **7.7%**
- Climate change/carbon intensity **51.3%**
- Environmental management **25.6%**
- Waste **2.6%**
- Water stress **12.8%**

Social and ethical

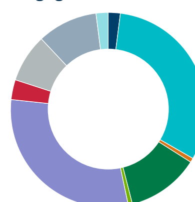
Social issues featured in **20.2%** of our engagements over the last quarter.



- Bribery and corruption **6.8%**
- Community relations **15.3%**
- Corporate culture **16.9%**
- Customer relations **3.4%**
- Employee relations **10.2%**
- Health and safety **22.0%**
- Licence to operate **6.8%**
- Operations in troubled regions **3.4%**
- Political risk management **1.7%**
- Supply chain management **13.6%**

Governance

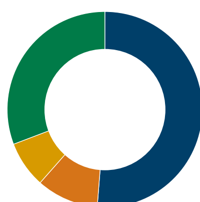
Governance issues featured in **51.4%** of our engagements over the last quarter.



- Accounting or auditing issues **2.0%**
- Board structure **31.3%**
- Committee structure **0.7%**
- Other governance **12.0%**
- Poison pill **0.7%**
- Remuneration **30.0%**
- Separation of chair/CEO **3.3%**
- Shareholder communications **8.0%**
- Succession planning **10.0%**
- Voting rights – not 1 share 1 vote **2.0%**

Strategy and risk

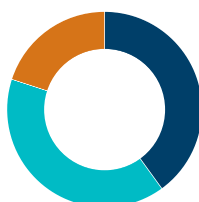
Strategy and risk issues featured in **13.4%** of our engagements over the last quarter.



- Business strategy **51.3%**
- Reputational risk **10.3%**
- Returns to shareholders **7.7%**
- Risk management **30.8%**

Stewardship

Stewardship issues featured in **1.7%** of our engagements over the last quarter.



- Reporting/disclosure **40.0%**
- Stewardship code **40.0%**
- Tax **20.0%**

Environment

The road to Paris – Long but leading in the right direction

Hermes EOS has been engaging with policy-makers and companies in the run-up to the climate summit in Paris.

Timeline to COP21 in Paris
1992: Earth Summit in Rio de Janeiro
1997: Kyoto Protocol
2009: Copenhagen COP 15 ends in no formal agreement
2010: Green Climate Fund agreed at Cancún COP 16
2011: Agreement at Durban COP 17 for developing countries to be involved in climate treaties
2014: China-US deal to cut carbon emissions
January 2015: World Economic Forum in Davos
February 2015: Geneva UNFCCC Session
March 2015: UN Disaster Risk Reduction Conference
May 2015: Hermes EOS co-sponsored Business & Climate and Finance Summits
June 2015: G7 Talks, Live Earth, UNFCCC session
September 2015: Sustainable Development Goals Summit and UN General Assembly
October 2015: France Finance Day, Global Environment Facility Council Meeting
November 2015: G20 Turkey
30 November – 11 December 2015: Paris COP 21

Setting the scene

The year 2015 has been hailed as the year of climate change. This may give some readers a sense of déjà vu; after all, we had similar hopes for a new climate deal at the UN climate conference in Copenhagen in 2009. However, a legally binding deal proved impossible, resulting in the de facto expiry of the Kyoto Protocol at the end of 2012. Following much reflection, countries in the UN agreed in Durban in 2011 to develop a new universal legal agreement by no later than 2015. This set in train the negotiations leading up to the next major UN climate conference in Paris in December 2015. And there is now positive momentum towards these talks, following the much publicised bilateral agreement between China and the US on reducing carbon emissions together with collective country commitments to contribute $10 billion to the Green Climate Fund, which aims to redistribute money from developed to developing countries to assist the latter in tackling the effects of climate change. These events, together with a draft negotiation text arising out of the Lima climate talks in December 2014, have raised hopes of achieving a universal agreement to limit global warming to less than 2°C. Action is urgently required as, according to the Intergovernmental Panel on Climate Change, to meet the 2°C target, the global economy needs to cut carbon intensity by 6% every year between now and 2100. However, with current decarbonisation rates at only 0.7% a year, realistically, time is running out.

A different kind of deal

The 21st Conference of the Parties (COP) – the UN Climate Change Conference – in Paris is the third big attempt at a global deal on climate following the Kyoto Protocol in 1997 and the failed attempt at a follow-up at COP 15 in Copenhagen in 2009.

But by using a more flexible framework to ensure that emerging economies make emissions reduction commitments in addition to developed countries the deal to be struck in Paris will differ from previous attempts.

There are a number of major issues on the negotiating table in Paris. These include the nature and scope of each country's emissions reduction commitment, whether or not to include a collective long-term goal for decarbonisation, how to finance decarbonisation in developing economies and the legal framework and institutions supporting the deal. At the heart of this will be each country's carbon emission reduction commitment. This is an issue of extreme sensitivity and, learning from the Copenhagen experience, each country's commitment shall be voluntarily submitted in a document known as an Intended Nationally Determined Contribution (INDC). The nature and scope of INDCs is intentionally flexible, although there are guidelines as to the contents. While some may only refer to mitigation measures, others may also include methods for finance, adaptation and technical assistance. The nature of the INDC targets is also expected to vary – some countries may state absolute emissions reductions, while others will aim for reductions versus intensity targets – for example against GDP – or even peaking targets. INDCs only need to cover the timeframe from 2020-2025. However, the hope is that many countries will also indicate their intentions over the period in the run-up to 2020 as well as over the period to at least 2030 and, ideally, to 2050. While developed countries and emerging economies are expected to submit INDCs, the least developed nations are not required to.

Soft targets

While it remains to be negotiated, emission targets agreed as part of the Paris deal are unlikely to be legally binding. Similarly, the monitoring, reporting and review process is expected to be voluntary, mainly because of resistance by some emerging economies to intrusion in their domestic affairs.

Countries were strongly encouraged to submit INDCs by 31 March to enable appraisal of the collective level of ambition by the UN secretariat. Australia, Canada, China and Japan missed this submission deadline for their INDCs but most other developed nations met it. Developing countries can submit as late as 30 September, leaving only one month for the final report on collective ambition to be prepared by the UN.

Ratchet mechanism

The expectation is that the first round of submitted INDCs will prove insufficient to restrict global warming to 2°C. For this reason, the UN process allows time for improved draft INDCs to be resubmitted prior to or even during the Paris negotiations. This approach will continue

after Paris, allowing countries to further improve their commitments over time, perhaps triggered by events such as a change of government or new scientific findings. This flexibility to improve commitments is informally referred to as the 'ratchet mechanism' and will significantly rely on peer pressure and a sense of international commitment by individual countries to meet the common goal of limiting global warming to 2°C.

The road to Paris

The fact that the two largest emitters – China and the US – came to an agreement and publicly stated their carbon emissions reduction commitments – albeit with different goals, the US with an emission reduction target and China with an ambition relating to its peak emissions – has set a precedent on the road to Paris. It is particularly notable as the US failed to ratify the 1997 Kyoto Protocol and China was never bound by the treaty, having been classed at the time as a developing country. A number of other public policy events have also given reasons for optimism on the road to Paris.

The European Commission published its preparation document for COP21 – The Paris Protocol: a blueprint for tackling global climate change beyond 2020. In its INDC, the EU set a binding domestic greenhouse gas emissions reduction target of at least 40% by 2030 compared to 1990 for all its members. It also states that the aggregate commitments by all participating countries should aim to reduce global emissions by at least 60% below 2010 levels by 2050.

The European Parliament, meanwhile, backed a proposed regulation to introduce a market stability reserve during 2018. This could lead to the withdrawal of 12% of CO_2 allowances from the EU Emissions Trading System (ETS) in order to revive the region's carbon price, which fell to less than €3 per tonne in early 2013 and has been struggling ever since. For the same reason, the European Parliament also agreed to postpone the auction of 900 million CO_2 allowances during the 2014-2016 phase of the ETS and hold them in reserve.

COP 21 is unlikely to have any impact on the price of EU carbon credits, as these are mainly influenced by decisions made in the EU. But an ambitious deal in Paris could stimulate carbon markets in the EU, China, the US and elsewhere.

Another positive sign is the emergence of a draft negotiating text for the Paris Protocol, agreed at the UN Framework Convention on Climate Change (UNFCCC) session in Geneva in February 2015.

Hermes EOS' involvement

We have intensified our engagement efforts on climate change related issues in the run-up to Paris.

In 2014, we attended a gathering of climate finance specialists, including the chair of the UNFCCC, to discuss investment solutions that will bridge the gap between the finance community and climate change solutions.

We also joined 348 global investors, representing more than $24 trillion in assets, in the biggest ever global investor statement to date calling on governments to take action that supports investment in clean energy and climate solutions. The statement voiced an international ambition to accelerate investment in low carbon assets, carbon foot-printing and portfolio decarbonisation. We will support a similar statement by the Institutional Investors Group on Climate Change (IIGCC) in Paris and have informally met UNFCCC representatives to explain the resolve of institutional investors to support efforts to tackle climate change.

As a member of the IIGCC, we have contributed to the initiative's COP programme by engaging with regulators and companies on carbon risk and fossil fuel subsidies. In addition, we are supporting an IIGCC project to improve the quality of research into low-carbon disruptive technologies, such as solar and battery storage, to broaden our understanding of which renewable technologies are becoming more economically viable and thus appealing to investors.

As part of the UN Environment Programme Finance Initiative's (UNEP FI) Climate Change Advisory Group, we will attend the Business & Climate Summit in May 2015 and have lobbied governments to support the new global agreement in Paris.

Hermes EOS will assist UNEP FI through membership of the Climate Change Advisory Group, input into the Inquiry into the Design of a Sustainable Finance System as well as through contributions to the UNEP Fiduciary III project, which looks at fiduciary duties, particularly from a US perspective.

We will follow progress made at the relevant events leading up to the Paris negotiations and continue to support movement on public policy and engage with companies on their specific climate change risks.

Corporate engagements

Our engagements with companies on climate change have also intensified, as we seek to address concerns in relation to carbon and stranded assets. Through the Carbon Asset Risk Initiative, a project by the IIGCC and sustainability leadership organisation Ceres, we have engaged with over 50 global, carbon-intensive companies and continue to work with them to understand and address their exposure to climate change risks. We will have also supported the climate change proposals filed at energy majors such as BP and Shell.

What will Paris mean for investors?

Long-term investors want to see a smooth transition to a low-carbon economy. In particular they are willing to accept modest reductions in short-term growth in return for stronger, more secure growth in the long term.

But the soft-target deal currently expected may make it difficult for investors to interpret its consequences, on, for example, demand for fossil fuels and long-term commodity prices, together with the financial impact on the companies extracting them.

A weak deal will leave investors with uncertainty, as climate change efforts are unlikely to be sustained without a change in policy. A straightforward deal, on the other hand, will help investors and companies to address the risks of climate change. Any global agreement achieved in Paris will have a five-year implementation period, only becoming fully effective from 2020. However, given the potential for the ratchet mechanism, companies will need to be prepared for stronger policy action on climate change over time.

The road to Paris has been long and winding but, despite the different nature of the expected deal, the destination now looks more promising than ever.

For further information, please contact:

Bruce Duguid
bruce.duguid@hermes-investment.com

Social

Minimising cyber security risks – Dealing with the hackers

Hermes EOS has stepped up its engagements on cyber security and data privacy as companies are increasingly being targeted by hackers.

Setting the scene

Cyber crime has been fast climbing up board agendas. According to a 2014 report by the World Economic Forum in collaboration with McKinsey, more than half of the 200 industry leaders interviewed and 70% of executives from financial institutions believe that cyber security is a strategic risk for their companies. With businesses now increasingly reliant on the digital economy, companies understandably want to try to tackle the huge risks and difficulties that come with an online presence, especially as this sales channel enables them to collect more data on their consumers for fulfilment of orders, advertising and analytical purposes. However, according to PwC's Global State of Information Security Survey 2015, global budgets for information security decreased by 4% in 2014 compared with a year earlier. To protect themselves against potential attacks – be it in the form of viruses, corporate espionage or identity theft – the measures and systems companies deploy often remain shrouded in mystery.

Rising cyber attacks

The year 2014 may be remembered as the year of the cyber attack after incidents of hacking hit headlines with unprecedented frequency. During the year a 48% increase in the number of security incidents was recorded, reaching 42.8 million, according to PwC's Global State of Information Security Survey 2015. This is more than a 12-fold increase since its first survey of 2009.

Sony was just one of the high-profile victims of hackers when it refused to pay a ransom to keep stolen data private. It also came under attack as a result of its production of a satirical film. In a separate attack, widely believed to have been a result of a breach of Apple's iCloud online storage, stolen images of female celebrities were leaked. According to news reports, data breaches also enabled hackers to obtain the data of 83 million households and small businesses in the US who were customers of JP Morgan.

Similarly, US retailer Home Depot incurred a theft of 56 million sets of credit and debit card details, according to the media, despite reinforcing security on its point-of-sale equipment after its peer Target Corporation had come under attack a year earlier. In this incident in late 2013, the personal information of up to 70 million customers, including credit and debit card details, was stolen from Target Corporation. Customer claims relating to the breach – not including the sharp losses in sales – cost shareholders $191 million in 2014 and $61 million in 2013 although this was partly offset by respective insurance payouts of $46 million and $44 million for each year.

Risks

The above incidents highlight that cyber security has emerged as a new and growing area of risk for companies across all sectors. Theft of customer data can harm a company's reputation and revenues, while corporate espionage – which is widespread, albeit less publicised, among business-to-business companies – can damage the competitive advantage of one company over another, in particular by stealing intellectual property which leads to the illegal erosion of the competitive advantage. In addition, the spread of viruses by hackers can disrupt business operations, leading to increasing costs and unwelcome distractions from running the core business.

The most sophisticated cyber attacks are extremely difficult to intercept completely. Therefore, the risk of an attack must be managed. Good risk management needs to be in place to ensure that data privacy systems are effective. This is particularly crucial when it comes to restoring customer trust in companies affected by a breach. Home Depot and Target have set good examples in how to restore the trust of their customers. This had less to do with their privacy systems but was a result of their response to the breaches, which was swift and effective.

The link to governance

Cyber and data security cannot be viewed in isolation. Often they highlight corporate governance weaknesses. This has been reflected in the number of resignations in the wake of cyber attacks – from the cyber security experts at Home Depot to the co-chair of Sony Entertainment whose emails were leaked as part of the attack on the company. Target's CEO and CIO also left their positions after the retailer's systems were hacked. Worryingly, according to PwC Global, at most organisations, the board of directors does not participate in key information technology activities such as security strategy, budget and review of risks.

The Committee of Sponsoring Organizations of the Treadway Commission – a joint initiative of five financial and accounting private sector organisations – has published guidance that provides direction on how companies can effectively evaluate and manage cyber risks.

As part of our engagement, we discuss companies' preparedness to combat cyber attacks, including their programmes for remedial action. We also press companies to improve their management of potentially critical risks. Boards need to discuss cyber security regularly and carefully and oversee investment in security technologies. They also ought to scrutinise the processes and controls in place to manage

access to the company's systems – in particular to sensitive data – review data protection policies and their implementation. They also need to look at the time it takes to detect and remediate a cyber attack. By understanding cyber risk, boards play a crucial role in helping companies be secure, vigilant and resilient.

We ask companies how their board of directors develops an understanding of their respective cyber risk profile and how it is informed about the management of evolving cyber risk. In addition, companies need to understand what information systems are most critical to their operations to avoid overprotecting certain information systems and under-protecting others. For pharmaceutical companies, for example, the most critical information can be chemical formulas or other intellectual property.

In our engagement, we challenge how a company would respond to, manage and communicate a cyber risk event. Companies should increase their communications to shareholders when they have suffered a security breach to restore trust and confidence in their management teams. Good communication between the board and management is also critical for the former to fulfil its oversight responsibilities.

In short, best practice goes beyond technology and includes the training of employees, high quality management, an effective detection process and remediation plan in the case of identified breaches. Target, for example, appointed a chief information security officer following the breach and reportedly committed to maintaining a written cyber-security plan, developing a new process to monitor and respond to cyber threats and providing security training to its employees.

Our engagements

We have so far concentrated our cyber risk engagement on companies in the financial, retail and technology sectors, as the impact of an attack on these types of companies seems likely to be severe.

After the 2014 attack on its independent subsidiary, one company provided us with details about its information system and the gravity of the damage. It is in the process of rebuilding most of its information system. In view of this and an earlier cyber attack on another of its divisions, we questioned whether it has a sufficiently strong security system in place. The company conceded that the 2014 attack may have been a result of certain complacencies in its efforts and lack of investment in security systems. The company has now changed the security contractor at the independent entity and is working to strengthen its defences. But it cautioned that excessive tightening of its security could become an obstacle to smooth communication and collaboration between different business segments. We encouraged it to communicate details of its efforts more clearly to provide shareholders with confidence.

We again discussed this company's approach to cyber security in a meeting with its CEO in March 2015. We asked the CEO how the event has changed his and the board's thinking on cyber security. We were encouraged by the CEO's keen awareness of, and involvement, in cyber security discussions, as well as efforts to strengthen group-wide safeguards although we acknowledge that not all such incidents, especially when perpetrated by foreign governments, will be avoidable. In a subsequent meeting with the company's CFO, we sought an explanation of how the governance practices and accountability of its subsidiaries are overseen and monitored.

At another company that fell victim to theft of its customer data, we wanted to ensure an effective remediation programme was in place to minimise any resulting long-term damage. We completed the objective in 2014 after the company provided further detail of the improvements it has made, including its move to chip and pin cards. The results of its customer satisfaction surveys were similar to pre-theft levels, other than for trust, which has taken longer to recover. In our view, the company responded rapidly and appropriately and has been receptive to our ideas on disclosures about risk and governance.

Data privacy

Individuals and organisations that hack into companies' cyber systems include a variety of actors, such as hostile foreign nation states and spies, organised criminals, terrorists, hacktivists – those wanting to make social or political statements – and people operating within the organisation. North Korea has been widely accused of being behind the hacking of Sony's film division, according to media reports. While this is to date unproven, state-sponsored attacks are a reality as governments increase their cyber capabilities to be offensive as well as defensive.

The complexities and risks arising from cyber related issues mean that we cannot engage on this topic without also engaging on civil liberties. These include the right to data privacy, balancing legitimate law enforcement and anti-terrorism activity against the human right to privacy. Companies have increasingly been seeking to ensure the legality of requests from governments to disclose data in order to protect the privacy of their customers, using legal experts to evaluate the requests. Best practice companies also publish transparency reports on data requests as part of their education and public policy efforts in this area.

Realities

Companies need to wake up to the fact that cyber attacks are extremely likely to happen and very difficult to prevent, especially as hackers continue to evolve and find new ways to exploit weaknesses. Therefore, cyber risk is something that must be managed. But finding talent in cyber security is also challenging. In particular, often due to demographics, expertise in technology tends to be limited among directors which many companies are working hard to resolve, among them many banks. Morgan Stanley, for example, searched for and appointed a director with technology experience as far back as 2012.

Equally in today's world, where many services are outsourced, companies need to monitor the security of their partners, suppliers and customers. A unified legal framework to legislate cyber crime is difficult to achieve due to the different jurisdictions involved and competition issues may prevent companies from revealing too much about their security systems. Moreover, it is difficult to claim success in the area of cyber security – more often than not companies are judged on how they have responded to an attack.

But prevention before damage is caused needs to be the focus and we have received considerable assurances from companies about the measures they have taken. We recognise that public disclosure of the actual defence measures companies have in place is neither practical nor sensible but companies do need to give investors confidence about the processes they have implemented and how they monitor the effectiveness of these. To that extent, we will continue to encourage companies to become more open about cyber risk management.

For further information, please contact:

Tim Goodman
tim.goodman@hermes-investment.com

Governance

Tackling taxation – A focus on policy, governance, risk management and transparency

Hermes EOS has stepped up its engagement programme on the tax practices of companies in which its clients invest in light of growing societal concern about the issue.

Setting the scene

Amazon, Apple, Google and Starbucks are among the household names that have made headlines in recent years for allegations of avoiding tax in certain jurisdictions by shifting profits to locations with more favourable tax conditions. Scrutiny of the tax practices of large multinational companies by regulators and the public has never been greater. The OECD, for example, is leading an international project to crack down on tax avoidance by large global organisations through its Base Erosion and Profit Sharing (BEPS) initiative. The double Irish corporate tax regime meanwhile effectively ended in early 2015 and new rules have been announced in the US to prevent companies from using so-called tax inversions, which involve deliberately relocating their legal headquarters overseas to reduce tax payments. What makes engagement on tax more complex is that, in most instances, companies are using legal avenues to reduce their tax liabilities. Ostensibly, investors should welcome the pursuit of lower tax bills as this will equal a higher short-term profit. However, as we have seen with the examples of companies utilising even legal tax avoidance mechanisms, this brings the possibility of substantial reputational and operational risks related to their apparent failing to support the communities and environment in which they operate. Given this delicate balance, we approach our tax engagement from a risk management perspective.

Key questions on tax for investee companies:

- Does the board have sufficient oversight of the tax policy and is it spending enough time on tax issues?
- Has the company's tax policy been reviewed and amended to reflect the changing tax landscape?
- How does the company manage its tax planning (implementation, communication, training and monitoring of compliance)?
- Is there sufficient communication between the audit committee and risk management function on tax?
- Are the internal controls, processes and policies for tax-related risks robust? How are these tested?
- Are mechanisms in place to allow and encourage employees to whistleblow?
- How do the company's disclosures on tax compare with its peers, developing and best practice?
- Has the company considered voluntarily disclosing profits, employees and tax on a country-by-country basis? If not, for what reasons?

Risky business

As investors, we are concerned about the potential reputational and financial risks arising from companies' tax planning and the effects this can have on their operations and shareholder value. For example, tax avoidance can significantly affect consumer sentiment towards companies, which can negatively impact sales.

The European Commission is investigating the tax practices of large multinationals due to concerns about the use of complex structures to shift profits and costs between divisions in different countries. It is, for example, looking at Amazon's tax arrangements in Luxembourg where a significant portion of the company's European profits are directed through a subsidiary, which in turn pays royalties to other entities.

Amid the general crackdown by regulators, companies found guilty of breaching tax laws may also incur penalties and pay for the financial consequences of litigation.

We have recently worked together with a number of key stakeholders, including research providers, NGOs, tax experts and other institutional investors to devise our engagement programme on tax, specifically, the most effective way we can screen companies within our universe to identify those most vulnerable to tax issues. Our research partner Sustainalytics rates companies on their level of disclosure about tax and we used this indicator as a starting point for our screening process. High-scoring companies provide a reasonably detailed overview of the amount of taxation borne, including a breakdown of taxes paid per

country. However, we have found that companies only tend to disclose what is legally required. Therefore, from a risk, as opposed to a legal, perspective we concluded that companies currently provide insufficient information on their tax practices and that encouraging better disclosure should be a key engagement objective.

At risk

Through our discussions we have determined that companies in certain sectors are more at risk of attracting controversy for their handling of tax issues. These include consumer-facing companies and those in the pharmaceutical, retail, extractives and IT sectors, as well as those with complex organisational structures and operations in multiple jurisdictions.

In addition, companies in industries that tend to have higher levels of intangible assets such as intellectual property can be at greater risk due to their ability to take advantage of transfer pricing to shift taxable profits to tax-friendly jurisdictions.

Pilot engagement

We have selected a sample of companies from the "at risk" sectors identified with which we will engage on tax practices. None of the companies in our pilot engagement programme have made headlines on tax but all have received low scores from Sustainalytics on their tax disclosure.

The majority of companies in our pilot engagement programme have subsidiaries or operations in known tax havens, such as the Bahamas, Belgium, Bermuda, the Cayman Islands, Hong Kong, Ireland, Jersey, Luxembourg, the Netherlands, Panama, Singapore and Switzerland. In addition, many have complex operating structures scattered across various locations.

Our engagement approach

While our role as investors is not to question the technicalities of a company's tax practices, we can encourage best practice in terms of how companies consider and manage the risks associated with their approach to tax. To that end, we advocate an appropriate level of disclosure from companies on their tax strategy, policy and management of key risks. Considerable thought needs to go into developing a sustainable tax strategy that ensures compliance with regulations, particularly when operating in different jurisdictions, but also goes beyond what is legally required.

Our engagement focuses on four areas, namely policy, governance, risk management and transparency of reporting.

On policy, our objective is to assess the quality of a company's tax policies. We seek to understand the approach taken by companies – for example whether relatively conservative and low-risk or more aggressive – and expect them to be able to justify this. The policy should be prepared with input from other departments such as risk as well as consultation with the audit committee. Board oversight of and input into tax policies is crucial. To be effective, the policy must be regularly reviewed in light of operational, strategic and regulatory changes. We also consider what taxes are significant to the company given its nature and operations. Ideally, companies should publish their policy on their websites.

For companies with legal entities registered in low-tax jurisdictions, we also seek to understand if there is a legitimate reason for having a presence there, the level of business activity relative to the amount of profit the company is recording and whether sufficient information is given about subsidiaries in low-tax jurisdictions.

In the area of governance, we seek to assess how the company's tax policy is implemented, regularly reviewed and managed across the group. We expect the board to have oversight of how tax is managed within the group. Furthermore, we question how the policy is communicated to employees and assess the resources and systems dedicated to training and monitoring tax compliance.

We assess how the risks associated with potentially questionable tax practices are taken into account at the various levels of a company, including the board. Similar to other engagements, we examine how tax risks are identified and the effectiveness of the internal controls and mechanisms in place for individuals to raise concerns. In addition, we encourage companies to maintain open communication channels with relevant tax authorities to proactively seek advice, for example clarifying appropriate transfer pricing methodology in advance.

It is evident that standards of reporting and transparency need to be significantly improved, as the level of disclosure by companies in this area is generally minimal. We strongly encourage greater transparency from companies about their tax affairs.

Those companies that have already been involved in tax scandals should review their tax policy, involve the board in the debate and try to improve their practices in line with developing best practice. We seek an understanding of how companies prepare for potential back payments as are threatened by certain regulators.

We will conclude our tax engagement for the selected sample of our tier one companies within the identified industries by the end of the third quarter 2015. Following this, we will evaluate the outcomes and potentially modify the screening methodology as required. We expect to extend our screening and engagement to other tier one and tier two companies.

Public policy engagement

In addition to our corporate engagement, where appropriate, we collaborate in the public policy arena to improve the transparency and quality of tax disclosures. For example, we publicly support the OECD's Base Erosion and Profit Shifting (BEPS) initiative, which looks at how tax strategies in countries differ, allowing companies to move taxable profits to countries with tax-friendlier conditions and measures to address this. As the BEPS initiative encourages governments to amend their tax regulations to restrict opportunities to shift profits off-shore, thus promoting a fairer tax system, it is expected to dramatically transform the tax landscape.

Amid a changing regulatory landscape, we will continue our engagement work on this multi-faceted, often delicate issue.

For further information, please contact:

Rochelle Giugni
rochelle.giugni@hermes-investment.com

Dr Hans-Christoph Hirt
hans-christoph.hirt@hermes-investment.com

Integrating ESG in real estate – Time to do so in earnest

One key aspect of Hermes EOS' engagement on climate change [see pages 6-7] has been to promote energy efficiency, particularly in buildings. The real estate sector is highly susceptible to the benefits of greater energy efficiency and provides a good example of how environmental and social factors can be integrated into investment decision making.

Setting the scene

Today, driven by a range of factors, the sustainability characteristics of buildings are changing real estate market conditions. Studies point to growing climate and sustainability regulatory pressure, an increasing understanding of the long-term physical, regulatory and market risks by institutional investors and rising occupier demand for green buildings. A strong body of evidence indicates medium and long-term risks from the impact of climate change on real estate investment performance as they influence market fundamentals, including client demand, void lengths, obsolescence, rate of depreciation, operational costs and liquidity.

Moreover, the sector is at risk from increasingly extreme weather events. Insurance companies point to the growing costs of covering the heightened risks from physical impacts on buildings associated with climate change. The cost of doing nothing is already being felt with resulting monetary losses related to real estate and infrastructure tripling over the last decade; global direct losses recorded by re-insurance companies amounted to an average of around $150 billion annually between 2002 and 2012, according to Munich Re.[1]

Business case

Buildings account for approximately a third of the world's energy consumption and global greenhouse gas emissions. In the EU, the sector is responsible for over 40% of final energy consumption and 35% of CO_2 emissions[2], although a strong European policy commitment to address the causes of climate change and growing geopolitical risks have strengthened the region's focus on energy security and energy efficiency. This has cast the spotlight on the building sector.

The focus of policy-makers is supported by research identifying the building sector as the one offering the most cost-effective opportunities for improving energy efficiency and reducing environmental impact. Research shows that implementing existing technologies, such as better insulation, efficient lighting and heat recovery, can reduce a building's energy consumption by at least 30% and by up to 80% in bigger refurbishment projects.[3]

Over the last few years, as part of the Institutional Investors Group on Climate Change and the UNEP FI programme, global institutional investors have made the business case for investing in energy efficient buildings[4] based on the fundamentals of the real estate market. At the asset level, owner and occupier preferences for buildings with better environmental performance will lead to those assets experiencing higher net income growth due to lower depreciation and operational costs. A correlation exists globally between more sustainable and energy-efficient buildings, higher rents and higher sale prices as well as between low-performing buildings, value decline and longer vacancy rates. Furthermore, energy efficiency measures in buildings can pay back quickly, depreciate slowly and deliver returns for decades.

Growing regulatory requirements are pushing the mean performance of buildings upward. Buildings with low performance are losing value as the benchmark moves up and may become difficult to sell as they will require upgrades merely to meet legal requirements. Buildings with stronger environmental credentials are expected to be less exposed to unforeseen costs resulting from step-changes in regulations that retrospectively impose improvements. And amid rising demand, this should make them easier to sell than their less efficient counterparts.

Fiduciary duty

For institutional investors and investment managers, a core principle of real estate investment is to create and sustain long-term value and to avoid losses. Fiduciary duty dictates that institutional investors should understand and actively manage market shifts, such as occupier preferences and changing behaviour, new regulatory frameworks and legal requirements. In light of the evidence and the long-term risks that climate change, energy security and resource scarcity pose to their real estate investments, institutional investors recognise it as their fiduciary duty to understand and actively manage these risks today.

Socio-economic benefits

In addition, investment in responsible real estate can deliver significant benefits to support economic and social growth. European studies have shown that improving the energy efficiency of new and refurbished buildings in Europe by 20% could create over 750,000 jobs by 2020 for an investment of around €40 billion per year[5]. This is an important gain for society, not least in light of the prevailing levels of unemployment, especially among the young. It would also help stimulate the construction industry and support the real estate market in the long term.

Green buildings with good air quality and high levels of daylight have been shown to reduce absenteeism, improve productivity and concentration, reduce stress levels and achieve an overall increase in the well-being of occupants. In turn, this has been proven to translate into financial benefits. Greening existing building stock represents an opportunity to realise tangible financial savings. If Europe were to achieve its 20% energy efficiency target by 2020, this would represent €50-75 billion in potential annual financial savings as a result of lower energy bills.

ESG integration

In response to the above-mentioned trends, the integration of ESG into real estate investments has made big steps forward over the last few years. However, steady progress is still required to fully integrate sustainability and climate risks into the investment processes across a larger share of the real estate investment sector.

Asset owner practices vary from monitoring their investment managers and consultants to assessing whether and how these integrate sustainability and climate change considerations into their practices. Others go further and have embedded sustainability in their standard risk assessment methods and, through their selection and monitoring processes, ensure it is a fully integrated process. This is reflected in the growing number of requests for proposals requiring specific ESG credentials. Investment managers are increasingly integrating ESG into their risk management processes but the level of integration varies according to the respective understanding of risk.

Guidance and benchmaking tools

The monitoring of asset managers has become easier with the emergence and uptake of a large number of sustainability benchmarks, reporting guidelines and investment frameworks.

The Principles for Responsible Investment (PRI), for example, whose signatories professionally invest an estimated €5.6 trillion in real estate in Europe as of mid-2014[6], has a dedicated real estate section in its annual reporting requirements. The number of participants in the global real estate sustainability benchmark (GRESB) meanwhile has increased exponentially over the last three years with the benchmark now covering over $1.6 trillion in assets under management. The tool enables peer comparison of ESG integration as well as policy, management and implementation factors. And regional tools and guidelines have emerged that enable the benchmarking of sustainability risks and performance in real estate.

Integrating responsible property management

A crucial element of full integration is the necessity to collect, share and link sustainability information between the various organisational levels of an investment house and integrate tools across the investment and asset management process. Leading investors – including Hermes EOS parent' Hermes Investment Management – jointly published a corporate sustainability management framework[7] which is a useful tool for managing and mitigating these risks and opportunities across the investment process at company, portfolio and single building levels.

Spreading responsibility

The responsibility for managing ESG risks in property has spread to a wide range of real estate practitioners. An important shift is the growing recognition of the role and responsibilities of valuers in integrating ESG considerations in their assessment of building investment values. The January 2014 edition of the Professional Valuation Standards Red Book by the Royal Institute of Chartered Surveyors now specifically lists sustainability as a factor that valuers need to take into account when performing valuations and risk assessments for their clients. Consequently, valuers are now advised to refer to sustainability metrics, as this will contribute to the level of information available.

Challenge for investors

The challenge now is to be more explicit about how sustainability affects the value of individual assets and the risk of depreciation of entire portfolios. To do this, investors need to measure and benchmark sustainability in earnest and integrate the information into the discounted cash flow models of real estate investments and the valuation assessment of portfolios. This would strengthen the current risk management frameworks and unlock and redirect the capital required for the creation of commercially sound and sustainable assets.

For further information, please contact:

Tatiana Bosteels
Head of responsible property investment at Hermes Real Estate (Hermes Investment Management)
tatiana.bosteels@hermes-investment.com

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Engagement on strategy

Many of the most successful engagements undertaken by Hermes EOS combine discussions of business strategy and structural governance issues.

Overview

Hermes EOS adopts a holistic approach to engagement, combining discussions on business strategy and risk management, including social, environmental and ethical risks, with structural governance issues. Our engagements seek to challenge and support corporate management in their approach to the long-term future of the businesses they run, often when there is minimal outside pressure for change. We are generally most successful when we engage from a business perspective and present environmental, social and governance issues as risks to the company's strategic positioning. Companies may benefit from new perspectives on the board and from promoting fresh thinking at the head of the company. An independent chair or change of CEO is frequently the key to improving performance and creating long-term value for shareholders.

Examples of recent engagements

AGM statement support

Due to his AGM attendance the following day, Hans-Christoph Hirt succeeded in obtaining highly unusual access to the CFO – a key decision-maker – of an Asian consumer goods manufacturer. A day before the AGM, the CFO attempted to explain the company's recent controversial land purchase as a necessary investment to attract world class employees to the company and improve the speed of internal processes. Hans pointed to the strongly negative reaction in the company's share price, which suggested that the arguments put forward by management were not understood by the market.
At the AGM, Hans lent support to a statement delivered by a large Dutch asset manager on behalf of a group of institutional investors. As agreed with the company in conversations prior to the AGM, the statement raised concerns about its corporate governance, including its controversial land purchase. It also commended some of the company's recent announcements, particularly the increase in dividend payments and made some specific proposals for wide-ranging corporate governance reforms. These included a thorough review of the existing corporate governance arrangements, the creation of a dedicated committee and a designated lead independent director role with specific responsibilities for related party transactions and issues related to the controlling shareholder, as well as regular board level contact with investors on corporate governance matters. The chair expressed his gratitude for the statement and the proposals and will consider their implementation. Overall Hermes EOS is pleased with the changes that are now likely to happen at the company. They demonstrate what a corporate governance controversy and collaborative engagement work can achieve, even in difficult markets.

Commitments to shareholders

An emerging markets technology company made some significant commitments in the wake of its engagement meeting with Hans-Christoph Hirt. At that meeting with an adviser to the CEO, Hans had made clear that Hermes EOS would escalate the engagement around the AGM if progress failed to materialise by the end of April 2015. The company has since informed him that it is developing some materials to more effectively explain its long-term business strategy on its website and in direct communication with shareholders. The materials, which expand on the current one-page strategy slide the company has occasionally used, will be finalised in the near term. Moreover, the company's investor relations function has started to work with the sustainability committee to include more detailed information in the upcoming sustainability report on the actions the company has taken to improve working conditions. It also invited Hans to review and provide feedback on these materials. In addition, the company is attempting to find an opportunity for investors to meet with the company's chair/CEO. If a meeting before the AGM is impossible, Hans will push for a side meeting for institutional investors around the shareholder meeting. The company also offered to arrange a visit to one of its fully automated factories. The use of robots for monotonous work is one way in which it is trying to address underlying human capital management issues. Hermes EOS is pleased that the company has committed to meeting some of the key suggestions. Depending on the progress towards delivering on the commitments and an assessment of the promised materials, Hermes EOS will consider what – if any – action is required at the AGM.

Corporate governance moves

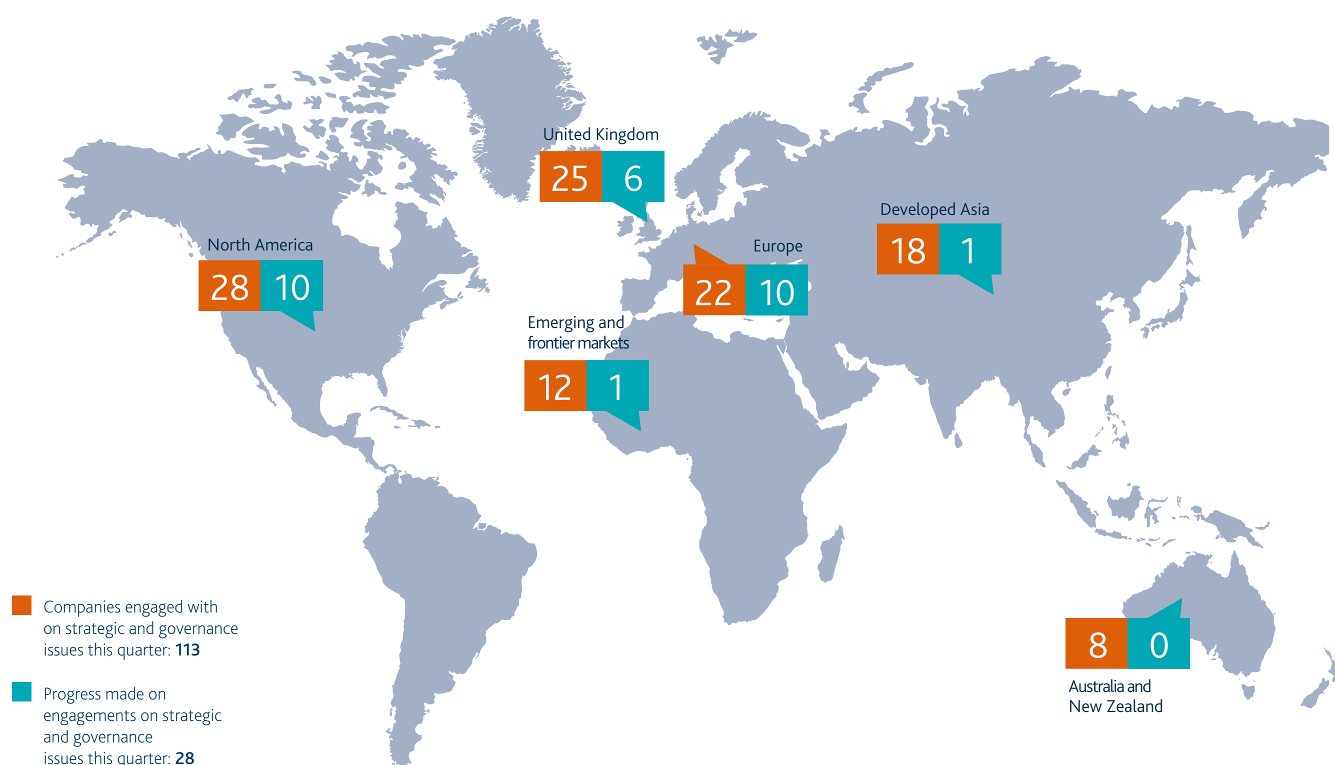
Hans-Christoph Hirt spoke at the 2015 AGM of a European conglomerate about the positive progress the company has made. Following intensive private engagement with the company, at the company's 2014 AGM he had raised concerns about the composition and work of the supervisory board on behalf of Hermes EOS' clients and a group of institutional investors from around the world.
The criticism was also directed at the change of CEO in 2013, which appeared ill-prepared and poorly executed, as well as the intention of the chair to serve another full term despite the implicit understanding of large shareholders that he would not do so following his re-election. Hans' criticism at the AGM in 2014 prompted the board to react decisively. It has since carried out an externally facilitated board evaluation, revamped a key committee and replaced two supervisory board members at this year's AGM – three years prior to the expiry of

their mandates. The latter is remarkable, given that all 10 shareholder representatives were elected for five-year terms in January 2013. Although the chair now seems likely to stay until 2018, at this year's AGM, Hans welcomed the progress the company has made, as the supervisory board's technology and innovation experience and skills have been significantly strengthened through the new members, and most importantly there now appear to be potential successors for the chair. Hans asked questions about the company's new strategy and acquisition. He also urged the management board to focus on executing the portfolio optimisation plan and strengthening project management and sought more detailed information about the board evaluation.

Proxy access success

Following Hermes EOS' advice on how to best respond to recent corporate governance challenges, a North American retailer announced its plans to appoint an independent chair upon the succession of the current chair and make enhancements to its executive compensation plans. The company informed Darren Brady that it will also appoint a new lead independent director following the retirement of the current one and enhance the responsibilities of this role. Moreover, the retailer agreed to adopt a policy providing shareholders with proxy access, the right of shareholders to nominate candidates for the board, at its next annual meeting. Its adopted proxy access model follows the popular 'three and three' formula recommended by the US Securities and Exchange Commission, which Hermes EOS supports. The formula allows shareholders owning at least 3% of shares for three years to nominate up to 20% of the directors, if the board comprises 10 or more directors, or 25% of the directors, if the size of the board is nine or fewer. Hermes EOS has been discussing proxy access with the retailer for a number of years and Darren pleased with the company instituting these provisions in response to strong indications from shareholders. The retailer is one of a growing number of US companies that has adopted proxy access in 2015 and Hermes EOS is encouraged by the momentum this important shareholder right is beginning to experience.

Engagements on strategy and governance issues



Public policy and best practice

Protecting and enhancing value by promoting better regulations

Hermes EOS contributes to the development of policy and best practice on corporate governance, corporate responsibility and shareholder rights to protect and enhance the value of its clients' shareholdings over the longer term.

Overview

We actively participate in debates on public policy matters to protect and enhance value for our clients by improving shareholder rights and boosting protection for minority shareholders.

This work extends across company law, which in many markets sets a basic foundation for shareholder rights, securities laws, which frame the operation of the markets and ensure that value creation is reflected in value for shareholders, and developing codes of best practice for governance, management of key risks and disclosure. In addition to this work on a country-specific basis, we address regulations with a global remit, which are currently in the areas of accounting and auditing standards. Investment institutions are typically absent from public policy debates even though they can have a profound impact on shareholder value. Hermes EOS seeks to fill this gap. By playing a full role in shaping these standards we can ensure that they work in the interests of shareholders rather than being moulded to the narrow interests of other market participants – particularly companies, lawyers and accounting firms, which tend to be more active than investors in these debates – whose interests may be markedly different.

Highlights

Double voting rights

On behalf of Hermes EOS, Rochelle Giugni contacted French companies regarding the pending dilution of shareholder rights as a result of the Florange Act, which seeks to reward long-term investment. Equal voting rights should be attached to shares regardless of the total holding or other characteristics of an investor. Therefore, Rochelle urged the companies to maintain their current application of one-share, one-vote or reconsider the implementation of double voting rights and re-instil the principle of one-share, one-vote. Hermes EOS also disagreed with the provision in the Act allowing boards to take any action to prevent or frustrate an unsolicited takeover bid without the approval of shareholders at a general meeting. Rochelle requested they exercise the opt-out clause contained in the Act to maintain the principle of board neutrality. In such situations, shareholders can be consulted and their interests protected.

Hong Kong Stewardship Code

Encouragingly, Hong Kong's Securities and Futures Commission (SFC) has revealed its plan to introduce a local stewardship code. The SFC launched a public consultation on the draft of the so-called Principles of Responsible Ownership, which follow a comply-or-explain approach. After an investor members' group discussion at the Asian Corporate Governance Association, Karin Ri met a number of senior directors at the SFC in Hong Kong to further exchange views and share experience in other markets of introducing local stewardship codes and engagement activities. Therefore, Hermes EOS firmly welcomes the initiative taken by the SFC and will continue involvement in development of a stewardship code in Hong Kong.

New governance code for Japan

On behalf of Hermes EOS, Karin Ri responded to the consultation on Japan's first Corporate Governance Code. Over the past few years, Hermes EOS has worked closely with the country's regulators pushing for the introduction of a local corporate governance code. Hermes EOS therefore welcomed and supported the general principles proposed by the code and its comply-or-explain approach. In its response, Hermes EOS highlighted the importance of meaningful and good quality explanations if a company chooses not to comply with the code's recommendations. While the effective implementation of comply-or-explain will take time to develop, Hermes EOS would like to avoid a box-ticking approach or boilerplate explanations. Hermes EOS also presented its views on issues relating to board effectiveness and shareholder communications.

Proposed stewardship code in Singapore

Hans-Christoph Hirt provided feedback to the stewardship code working group in Singapore on its first draft document. While the draft is a good starting point, Hans made suggestions on a number of areas. These included his thoughts on the proposed application of the code to individual shareholders as it raises conceptual and practical issues, as well as regarding the collaboration between investors and the voting practicalities for highly diversified institutional investors. Hermes EOS will have the opportunity to explain its comments and suggestions to the working group's secretariat. The code is on track for a launch in late 2015 following a period of consultation over the summer.

Other work in this quarter included

Promoting best practice

- Karin Ri held a series of conversations with representatives of **Japan's Financial Services Agency** about how to improve disclosure. She welcomed the ongoing discussions at Japanese companies about moving their AGM to a date beyond the end of June, by when most usually have held theirs. However, Karin highlighted that the existing regulatory requirement for companies to submit and publish their annual audited securities report within three months of the fiscal year-end – which tends to be the end of March in Japan – remains essential, as this enables shareholders to receive any relevant information prior to an AGM.
- Hans-Christoph Hirt obtained some insights into the **German Corporate Governance Commission's most recent recommendations**, which have been published for consultation. One important aspect – the setting of a limit on the number of supervisory board mandates an individual can hold before having to provide an explanation – has been significantly watered down in the proposal. Hermes EOS will raise this issue in its consultation response.
- In a meeting with the chair of the German Corporate Governance Commission, Hans-Christoph Hirt made some suggestions to the country's **Corporate Governance Code**, whose recommendations have been published for consultation, such as providing guidance on overboarding and investor-board dialogue. He also raised pension entitlements and reporting on board evaluations as topics that need addressing.
- Hans-Christoph Hirt met a remuneration consultant to discuss **long-term pay developments in Germany** and share Hermes EOS' experience with the country's new compensation disclosures introduced in 2014. While transparency has increased and investors can now quickly find out about minimum and maximum remuneration, as well as the overall pay figure, the additional disclosure has substantially increased the length of the reporting, making it difficult for readers not familiar with the German format to follow. On the positive side, remuneration seems to have become more tightly controlled.
- Together with a global proxy solicitor, Hermes EOS hosted a roundtable in Switzerland for companies and investors on the **implementation of the Minder law**, which has introduced binding votes on pay packages for board members and executive management. Positively, the implementation of this fairly legal change, which entails moving the decision-making power on remuneration paid from the board to shareholders, seems to be smoother than many had predicted. Most participants were convinced that the law has not only enhanced the scrutiny of remuneration systems and amounts at the board level but has also encouraged more intensive dialogue between the issuers and investors beyond remuneration issues.
- Bruce Duguid attended the stakeholder meeting organised by the Principles for Responsible Investment (PRI) on behalf of the UN Environment Programme Finance Initiative (UNEP FI) to identify the principal issues which need to be addressed to clarify how **fiduciary duty** relates to responsible investment.
- Tim Goodman had some useful interactions on climate change with companies and officials at a conference about the **Canadian gas industry**. It became clear that there is some momentum in the run-up to the Paris climate change conference to make commitments on climate change.
- Leon Kamhi participated in a meeting of the **Stewardship Code Steering Group** to review the investor responses to the UK Stewardship Code survey. At 45%, the response rate was slightly higher than previous years. The quality of the engagement case studies outlined in the survey has significantly improved as the respondents provided detailed evidence of their dialogue with the companies.
- Bruce Duguid participated in a call by the Institutional Investor Group on Climate Change to review the implications of a new piece of **academic research on modelling of the geographic distribution of unburnable fossil fuels** carried out by an energy research team at University College London. The model identified a 66% difference in coal consumption between the 2°C and 5°C climate policy scenarios by 2030, as well as a 15% reduction in oil consumption. However, gas consumption would rise under a 2°C scenario.
- Bruce Duguid met the chair of the **Aiming for A coalition** to understand its aims and explore ways in which Hermes EOS could be supportive of its goal to improve the climate risk management of highly exposed carbon-intensive companies. Currently there are two campaigns, one focusing on engagement with companies to achieve an improvement in scores from responses to the Carbon Disclosure Project and another focusing on filing specific shareholder resolutions that request detailed disclosure of climate-related risks.
- Tim Goodman had a productive meeting with the **Climate and Clean Air Coalition's Oil & Gas Methane Partnership**, which attempts to build a best practice coalition to reduce methane emissions in upstream oil and gas operations. In the short term, methane has far greater greenhouse gas effects than CO_2 until it begins to largely break down after 30 years. Cuts in methane emissions can therefore lead to important and quick reductions in global warming.

Public policy

- Hans-Christoph Hirt was delighted to learn that work on a **local stewardship code** is underway, according to senior representatives from the Korea Corporate Governance Service, a research provider and think tank connected to the local stock exchange. At the International Symposium on Corporate Governance in Seoul in November 2014, Hans had set out the case for the introduction of local investor guidance.
- Hans-Christoph Hirt discussed the pending **implementation of the directive on non-financial reporting across Europe** with representatives from the European Commission, the German Ministry of Justice, members of the German Parliament and other stakeholders to. He suggested that the Commission and member states should work together to ensure some degree of comparability when implementing the directive. One tool for this could be non-binding guidance for companies, which the Commission plans to issue next year.
- Hermes EOS co-signed **the UN Guiding Principles Reporting Framework Investor Statement**. By doing so, Hermes EOS lent support to its Reporting Framework as an essential tool for investors to review companies' disclosure on their understanding and management of human rights risks. Hermes EOS hopes this framework will encourage companies to pro-actively assess and manage human rights risks, which could pose financial and legal risks to their business.
- Tim Goodman participated in a meeting of US asset owners and other institutional investors to discuss a way forward on the fundamental shareholder right of **proxy access in the US**, the right of shareholders to nominate candidates for the board. The country's Securities and Exchange Commission reversed a decision that could have made it difficult for shareholders to file effective proposals on the issue at shareholder meetings. This is welcome but companies may be emboldened by its previous stance and file management proposals that, if passed, would make it all but impossible for long-term shareholders to nominate directors on the board's proxy statement. Hermes EOS will push for a universal rule based on the right of shareholders owning 3% of shares for three years to nominate up to 25% of directors.

Hermes EOS votes at general meetings wherever practicable. We take a graduated approach and base our decisions on annual report disclosures, discussions with the company and independent analysis. At larger companies or those where clients have a significant stake, we seek to have dialogue ahead of voting against or abstaining on any resolution.

In most cases of a vote against at a company in which our clients have a significant holding, we follow up with a letter explaining our concerns. We maintain a database of voting and contact with companies and, if we believe further intervention is merited, we include the company in our main engagement programme.

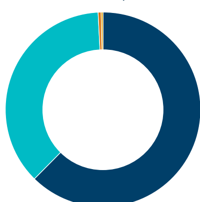
Hermes EOS votes at company meetings all over the world, wherever its clients own shares.

Overview

Over the last quarter we voted at 1,319 meetings (10,902 resolutions). At 486 of those meetings we opposed one or more resolutions. We voted with management by exception at four meetings and we abstained at six meetings. We supported management on all resolutions at the remaining 823 meetings.

Global

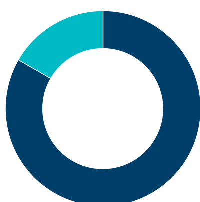
We voted at **1,319** meetings (**10,902** resolutions) over the last quarter.



- Total meetings voted in favour **62.4%**
- Meetings where voted against (or voted against AND abstained) **36.8%**
- Meetings where abstained **0.5%**
- Meetings where voted with management by exception **0.3%**

Australia and New Zealand

We voted at **12** meetings (**39** resolutions) over the last quarter.



- Total meetings voted in favour **83.3%**
- Meetings where voted against (or voted against AND abstained) **16.7%**

Developed Asia

We voted at **380** meetings (**2,657** resolutions) over the last quarter.

- Total meetings voted in favour **60.8%**
- Meetings where voted against (or voted against AND abstained) **38.9%**
- Meetings where voted with management by exception **0.3%**

Emerging and Frontier Markets

We voted at **306** meetings (**2,331** resolutions) over the last quarter.

- Total meetings voted in favour **53.3%**
- Meetings where voted against (or voted against AND abstained) **46.1%**
- Meetings where abstained **0.3%**
- Meetings where voted with management by exception **0.3%**

Europe

We voted at **226** meetings (**2,765** resolutions) over the last quarter.

- Total meetings voted in favour **50.4%**
- Meetings where voted against (or voted against AND abstained) **47.8%**
- Meetings where abstained **1.8%**

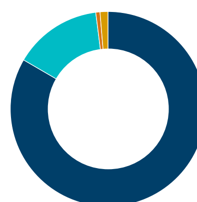
North America

We voted at **244** meetings (**1,675** resolutions) over the last quarter.

- Total meetings voted in favour **73.4%**
- Meetings where voted against (or voted against AND abstained) **26.6%**

United Kingdom

We voted at **151** meetings (**1,435** resolutions) over the last quarter.



- Total meetings voted in favour **83.4%**
- Meetings where voted against (or voted against AND abstained) **14.6%**
- Meetings where abstained **0.7%**
- Meetings where voted with management by exception **1.3%**

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Hermes EOS enables institutional shareholders around the world to meet their fiduciary responsibilities and become active owners of public companies. Hermes EOS is based on the premise that companies with informed and involved shareholders are more likely to achieve superior long-term performance than those without.

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