OUTCOMES BEYOND PERFORMANCE

PUBLIC ENGAGEMENT REPORT

Too much or not enough – Engaging on the world's most precious resource

Hermes EOS
Q2 2017

HERMES INVESTMENT MANAGEMENT

www.hermes-investment.com

This report contains a summary of the stewardship activities undertaken by Hermes EOS on behalf of its clients. It covers significant themes that have informed some of our intensive engagements with companies in Q2 2017.

The report also provides information on voting recommendations and the steps we have taken to promote global best practices, improvements in public policy and collaborative work with other long-term shareholders.

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 companies. Our team of engagement and voting specialists monitors the investments of our clients in companies and intervenes where necessary with the aim of improving their performance and sustainability. Our 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.

Pooling the resources of other like-minded funds creates a strong and representative shareholder voice and makes our company engagements more effective. We currently act on behalf of 42 clients and £310.7/€353.8/$403.5 billion* in 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, accountants, ex-fund managers, former bankers and lawyers.

The depth and breadth of this resource reflects our philosophy that stewardship 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, experience and 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.

We have extensive experience of implementing the Principles for Responsible Investment (PRI) and various stewardship codes. Our former CEO led the committee that drew up the original principles, and we are actively engaged in a variety of workstreams through the PRI Collaboration Platform. This insight enables us to help signatories in meeting the challenges of effective PRI implementation.

How does Hermes EOS work?

Our company, 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 for our most intensive engagements. 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 fundamental 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 engagement programme we have agreed with our clients, as well as the Principles and their regional iterations, guide our intervention with companies throughout the world. Our approach is pragmatic, company- and market-specific, taking into account the circumstances of each company.

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 in our core engagement programme. 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 can be robust in our dealings with companies, the aim is to deliver value for clients, not to seek headlines through campaigns, which could 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 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 media.

For these reasons, this public report contains few specific details of our interactions with companies. Instead, it explains some of the most important issues relevant to responsible owners and outlines our activities in these areas.

We would be delighted to discuss Hermes EOS with you in greater detail.
For further information please contact:
Head of EOS Dr Hans-Christoph Hirt on +44(0)207 680 2826

* as of 30 June 2017

[1] https://www.hermes-investment.com/wp-content/uploads/2015/09/the-hermes-ownership-principles.pdf

Hermes EOS team

Engagement

Dr Hans-Christoph Hirt
Head of EOS

Carl Short
Director of Engagement

Dr Emma Berntman
Sectors: Chemicals, Financial Services, Mining, Oil and Gas, Pharmaceuticals, Utilities

Roland Bosch
Sector lead: Financial Services

Dr Christine Chow
Sectors: Financial Services, Mining, Oil and Gas, Technology

George Clark
Voting and Engagement Support

Natacha Dimitrijevic
Sector lead: Pharmaceuticals

Bruce Duguid
Sector lead: Mining, Utilities

Claire Gavini
Sectors: Consumer Goods and Retail, Industrials

Tim Goodman
Sector lead: Oil and Gas

Jaime Gornsztejn
Sectors: Industrials, Mining, Oil and Gas, Technology, Utilities

Bram Houtenbos
Voting and Engagement Support

Pauline Lecoursonnois
Sector lead: Consumer Goods and Retail

James O'Halloran
Head of Voting and Engagement Support

Nina Röhrbein
Reporting and Communications

Sachi Suzuki
Sector lead: Industrials

Dr Michael Viehs
Sector lead: Automotive

Maxine Wille
Sector lead: Chemicals

Business Development and Client Service

Amy D'Eugenio
Head of Business Development and Client Service

Alan Fitzpatrick
Client Relations

Rochelle Giugni
Client Relations

Alice Musto
Client Relations

Engagement by region

Over the last quarter we engaged with 298 companies on 664 environmental, social, governance and business strategy issues and objectives. Our holistic approach to engagement means that we typically engage with companies on more than one topic simultaneously.

Global

We engaged with **298** companies over the last quarter.

- Environmental **14.2%**
- Social and ethical **18.5%**
- Governance **51.5%**
- Stewardship and shareholder rights **0.2%**
- Strategy, risk and communication **15.7%**

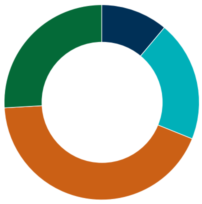
Australia and New Zealand

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

- Governance **100.0%**

Developed Asia

We engaged with **46** companies over the last quarter.



- Environmental **11.1%**
- Social and ethical **20.0%**
- Governance **43.0%**
- Strategy, risk and communication **25.9%**

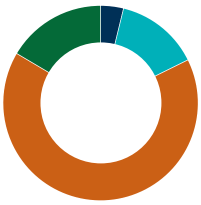
Emerging and Frontier Markets

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

- Environmental **25.7%**
- Social and ethical **23.8%**
- Governance **33.7%**
- Strategy, risk and communication **16.8%**

Europe

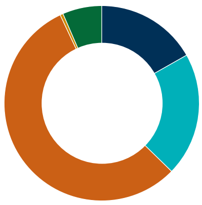
We engaged with **44** companies over the last quarter.



- Environmental **3.8%**
- Social and ethical **13.9%**
- Governance **65.8%**
- Strategy, risk and communication **16.5%**

North America

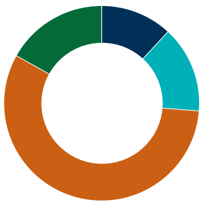
We engaged with **82** companies over the last quarter.



- Environmental **16.8%**
- Social and ethical **20.5%**
- Governance **55.7%**
- Stewardship and shareholder rights **0.5%**
- Strategy, risk and communication **6.5%**

United Kingdom

We engaged with **86** companies over the last quarter.



- Environmental **11.9%**
- Social and ethical **14.4%**
- Governance **56.9%**
- Strategy, risk and communication **16.9%**

Engagement by theme

A summary of the 664 issues and objectives on which we engaged with companies over the last quarter is shown below.

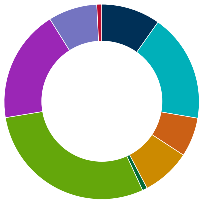
Environmental

Environmental topics featured in **14.2%** of our engagements over the last quarter.

- Climate change **64.9%**
- Environmental policy and strategy **11.7%**
- Pollution and waste management **16.0%**
- Water **7.4%**

Social and ethical

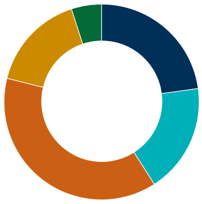
Social topics featured in **18.5%** of our engagements over the last quarter.



- Bribery and corruption **9.8%**
- Conduct and culture **17.9%**
- Cyber security **6.5%**
- Diversity **8.1%**
- Human capital management **0.8%**
- Human rights **29.3%**
- Labour rights **18.7%**
- Supply chain management **8.1%**
- Tax **0.8%**

Governance

Governance topics featured in **51.5%** of our engagements over the last quarter.



- Board diversity, skills and experience **22.8%**
- Board independence **18.1%**
- Executive remuneration **38.0%**
- Shareholder protection and rights **16.1%**
- Succession planning **5.0%**

Stewardship and shareholder rights

Stewardship and shareholder topics featured in **0.2%** of our engagements over the last quarter.

- Shareholder rights **100.0%**

Strategy, risk and communication

Strategy and risk topics featured in **15.7%** of our engagements over the last quarter.

- Audit and accounting **5.8%**
- Business strategy **35.6%**
- Integrated reporting and other disclosure **24.0%**
- Risk management **34.6%**

Environmental

Too much or not enough – Engaging on the world's most precious resource

Water is one of the three environmental themes of our engagement programme and complements our efforts on climate change.

Setting the scene

Due to increasing populations and economic growth, demand for water is projected to exceed sustainable supply by 40% in 2030, according to the UN[2]. By 2025, it is estimated that 1.8 billion people will be living in countries or regions with absolute water scarcity, while two thirds could be living in water-stressed conditions.[3] In addition, almost 800 million people at the moment do not have access to clean water.[4] The World Economic Forum's Global Risk Report 2016 identified water crises as the third-highest risk to the global economy and therefore a threat to long-term shareholder value creation.[5] Companies reported water-related impact costs of $14 billion in 2016 to the CDP initiative, a five-fold increase from the previous year. However, to date, investors and companies have largely focused their efforts on climate change only, although the themes are inextricably linked. Of those companies reporting to the CDP, 53% say that better water management is delivering reductions in greenhouse gas emissions.[6]

Water risks vary by nature. They can include the threat of water shortages, so-called water stress, which can be temporary or longer-term, and a lack of sufficiently cold water for cooling purposes, as well as the challenge of excess water, for example flooding. These risks have been exacerbated by climate change.

However, while climate change is a global challenge, water risks tend to be local and changeable, even depending on seasonal variations. Thus, they are more difficult to assess than climate change and a risk appraisal is important for businesses to undertake. Companies may believe that they can diversify the risk, either through supply chains or by moving operations elsewhere. But this could be costly to achieve. Moving operations may involve the expensive early retirement of fixed assets, while moving supply chains could be difficult at a time when competitors may seek the same outcome.

Globally, water use is dominated by agriculture, which makes up 70% of demand. Industries and municipalities represent 20% and 10% respectively. However, in some industrialised countries with low agricultural economies, industrial use can make up to 80% of water use. The 2016 CDP Water Report identified utilities as suffering the greatest financial impact from water, followed by the materials sector, including mining, oil and gas, as well as the consumer sectors. Some technology companies are also increasingly exposed to water risks as their data centres can be in need of large amounts of cooling water.

Engagement

The focus of our engagement in at-risk sectors follows a progression in sophistication of water risk management at individual companies.

As a first step of our engagement, we seek to raise awareness of water risks by companies and their disclosure of at-risk water consumption, as well as the development of a water consumption policy. The second phase focuses on the management of the direct water risks, with the boards of companies holding the responsibility for this.

In addition, companies should manage the water risks they are indirectly exposed to through their suppliers. They ought to engage with their suppliers on risks, encourage information-sharing between suppliers and push them to develop an action plan and set goals, in addition to ensuring compliance with all the relevant laws and regulations. The companies should monitor the results of their suppliers and ideally join the CDP's supply chain programme.

At the most progressive stage, we want to see leadership in collaborative risk management by companies that are already highly efficient in their water use and management to encourage others to follow suit. This involves identifying and engaging with local catchment users and local stakeholders, such as key user groups, governments and municipalities. Furthermore, we would like to see these companies influence and support government policy in terms of goals, the regulatory framework and additional shared infrastructure investment.

As part of our engagement programme, we have created objectives in relation to water risk appraisal and disclosure, flood risk, water risk management plans, water risk leadership and supply chain water risk management. We have pushed for water stress analysis to be undertaken, water management systems and controls to be put in place, local reduction targets to be set and appropriate reporting to the CDP's water programme to be undertaken. Furthermore, we have encouraged the development of best practice water management systems, which implies the introduction of controls and targets at existing and future water-stressed sites.

Mining

We focus our water-related engagements on the mining, utilities and consumer goods and retail sectors. Water is a critical input to mining and ore processing, especially copper but also iron ore, gold and other metals. It is, among others, used in extraction processes from the ground, the washing of ores, the mineral processing to extract the desired element, dust suppression, as well as cooling and employee requirements on site. Another issue is the dewatering and disposal of groundwater to access minerals below the water table. There is a close link to social licence to operate where water supplies to the local community are threatened and a link to water pollution as mining and materials operations create large volumes of polluted water. Mines are also often vulnerable to inundation and damage from extreme weather events.

Companies in the sector have already experienced water shortages, although these tend to be specific to the individual mines. Often, these present an engineering challenge, for example how to get a sufficient amount of water transported to the mine. As a response to water stress, for example, the joint venture part-owned by BHP Billiton decided to build a $3.4 billion desalination plant near the Escondida mine in Chile to deliver water to the local inhabitants, as well as the mine.[7]

Anglo American meanwhile has announced that over the long time it is exploring the potential to introduce waterless mining techniques.[8]

We seek disclosure by mining companies of water-related risks to the CDP water questionnaire because we believe what is measured can be managed. In addition, we want to see the deployment of best practice water management plans, as well as the adoption of a leadership role in managing water demand across water-stressed catchments in order to maintain a social licence to operate.

Following pressure from investors , including through our own engagement, one major mining company now focuses on water as a major risk to its operations. It plans to organise a workshop on the issue to identify the right framework for reporting, to which we will contribute.

Utilities

In the utilities sector, water is used in electricity production, transmission, distribution and trading. Water is needed as a coolant but also in steam and thermal power generation, including at fossil fuel and nuclear power plants. Plentiful water supplies are also vital to hydro-electric plants, particularly in key regions such as Brazil.

With regard to risk management, the utilities we have engaged with have been building additional capacity to increase the resilience in their network and go beyond a single source of water. Severn Trent, for example is creating additional back-up to the single aqueduct that supplies the UK city of Birmingham.[9]

In the aftermath of the flooding in the UK in late 2015, we have also discussed the challenge of flooding, and particularly the development of a long-term flood management strategy with a number of the country's water utilities. We are pleased that some have have updated their flood response approach in the light of learnings from that experience.

In general, we call on utilities to disclose the water-related risks they face to the CDP Water project, deploy direct water management solutions, including infrastructure solutions, and undertake a long-term appraisal of flood risk management and the necessary investment required.

Consumer goods and retail

Many consumer goods and retail companies can face a challenge with their own water use, for example those involved in brewing or food processing. In addition, however, they are exposed to indirect water-related risks through their supply chains, which are disparate according to region.

We ask companies with long supply chains to understand the complexities involved and exert pressure on their suppliers to encourage appropriate water risk management. We urge consumer goods and retail companies to disclose their water-related risks to the CDP, with a particular focus on the supply chain. We want those companies to deploy best practices, including on supply chain reporting and disclosure of actions and, where possible, adopt a leadership role in managing water demand across water-stressed catchments in order to maintain their social licence to operate.

Some have begun to look at water risks in their supply chain, while others have already made progress towards demonstrating a credible strategy on water stress is developed by each of their businesses, as well as in relation to the reporting to the CDP.

Public policy

Transparency and reporting on the risks in relation to water are crucial if investors are to fully understand a company's exposure to water risks. It is also an indicator of a company's overall approach to corporate governance and stewardship.

We are working with the CDP initiative to ensure that it has a good reporting methodology in place. Although the organisation reported a 50% increase in the number of its responses from companies in 2016 to its water survey – to the highest level yet – some companies have refused to use the survey or even ceased participation due to its complexity. We have therefore been working with the organisation on a new simplified water risk disclosure.

We will continue to support the CDP Water report through membership of the steering committee reviewing its water reporting methodology. In addition, we seek to work with the International Council of Mining and Metals to improve the level of water appraisal risk, disclosure and mitigating actions in accordance with international best practice.

Furthermore, we have supported the collaborative water engagement project of the Principles for Responsible Investment and provided input into the architecture of a report of best practice learnings for water risk management.

Outlook

While they are not new, water risks are only set to increase, as climate change exacerbates the availability of water. A warmer planet will not have any less water but it will be in different places and often be too little or much in volume, according to the Intergovernmental Panel on Climate Change. Technology is often part of finding a solution to these, as are improvements in efficiency, for example through trickle-feed systems in agriculture or piping in water via aqueducts.

We will continue to raise water risks with companies which may be exposed to specific risks, including at oil and gas companies, with a particular focus on the deployment of hydraulic fracturing best practices through which companies can achieve freshwater neutrality, as well as in relation to water-intensive industrial activities, including water used for cooling in technology data centres and in the manufacturing of silica wafers. The time has come for water to step out of the climate change shadow.

For further information, please contact:

Bruce Duguid
bruce.duguid@hermes-investment.com

2 http://unesdoc.unesco.org/images/0024/002440/244041e.pdf
3 http://www.un.org/waterforlifedecade/scarcity.shtml
4 http://www.un.org/en/sections/issues-depth/water/
5 http://www3.weforum.org/docs/GRR/WEF_GRR16.pdf
6 https://www.cdp.net/en/water
7 http://www.bechtel.com/projects/escondida-water-supply/
8 http://www.angloamerican.com/~/media/Files/A/Anglo-American-PLC-V2/documents/futuresmart-mining.pdf
9 https://www.waterbriefing.org/home/company-news/item/13675-severn-trent-starts-work-on-%C2%A3300m-birmingham-resilience-project

Social

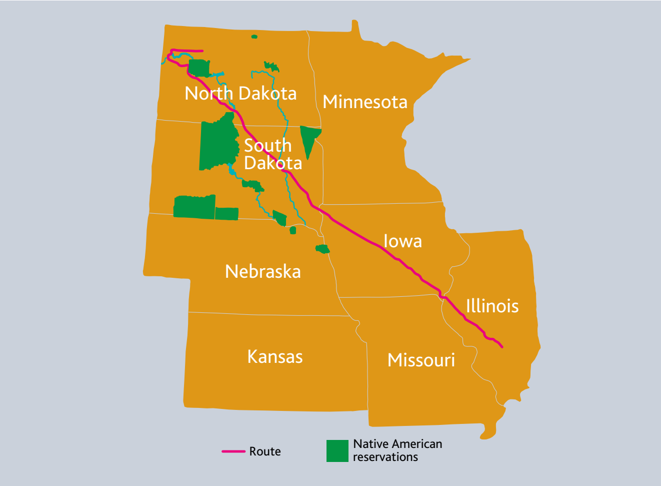
Due diligence at the core – Lessons from the Dakota Access Pipeline

We have been engaging with companies that have been involved in financing the controversial Dakota Access Pipeline.

Setting the scene

The Dakota Access Pipeline is a 1,172 mile-long underground structure transporting crude oil from the Bakken production fields in North Dakota to Illinois. The project has been controversial, with the Standing Rock Sioux Tribe, other Native Americans and climate change activists protesting against its construction. The tribe argued that the pipeline could endanger nearby water supplies and cultural heritage sites and that local tribes were neither adequately consulted nor given the opportunity to express or withhold free, prior and informed consent (FPIC). In January 2017, US president Donald Trump signed an executive order to expedite the project, in contrast to his predecessor who had delayed the project at the end of his term. In March 2017, a UN special rapporteur issued an end of mission report following on-the-ground investigations. The report found clear failures in the planning, permitting and building process during which the local tribes' human right to meaningful consultation and FPIC were violated. On 1 June 2017, the pipeline began transporting oil. However, a federal judge[10] has since ruled that the permits issued by the Trump administration authorising the pipeline to cross the Missouri violated the law in certain critical respects, stating that the impacts of an oil spill on fishing rights, hunting rights or environmental justice or the degree to which the pipeline's effects were likely to be highly controversial was not adequately considered by the US Army Corps of Engineers.

Dakota Access Pipeline



Source: Energy Transfer Partners, Bureau of Indian Affairs, United States Department of the Interior, CTV News

The Dakota Access Pipeline (DAPL) is owned by Energy Transfer Partners, Energy Transfer Equity, Sunoco Logistics, Enbridge Energy Partners, Phillips 66 and Marathon Petroleum or entities with which they are associated. A syndicate of several banks provided loans and other services to finance the project.

While it is too late for any changes to be made to the DAPL, it has become an important human rights issue to learn lessons from. The lessons have also become the main focus of our efforts with the banks in our engagement programme that have been involved in the project.

Reputational risk is a considerable worry, in particular for universal retail banks, and some of their customers have closed their accounts in protest over the DAPL. Even if banks can sell on their interests, their reputational risk for poor due diligence remains. Moreover, they lose any influence over the project. And once the necessary agreements were in place, the banks in the syndicate were contractually obliged to provide the remaining financing.

Free, prior and informed consent

The controversy surrounding the DAPL centres on the alleged lack of effective due diligence undertaken prior to the construction of the project, in particular the reported failure to adequately consult local tribes or provide them with the opportunity to express or withhold free, prior and informed consent (FPIC).

The end of mission statement by the UN's special rapporteur on the rights of indigenous peoples from March 2017 stated that the tribes potentially affected by the DAPL had been denied access to information and been excluded from consultations at the planning stage of the project. Furthermore, the report says that the US Army Corps of Engineers had approved a draft environmental assessment regarding the pipeline that ignored the interests of the tribe.

Together with investors representing $653 billion in assets under management, including the NYC Comptroller on behalf of the New York City Pension Funds and the California Public Employees Retirement System, we signed the investor statement on the DAPL, seeking an equitable resolution of the concerns of the Native American tribe in relation to the construction of one section of the pipeline and lessons from it to apply to future projects.

Due diligence

The opposition to the DAPL is likely to make companies and those financing them much more sensitive about projects that may affect the rights of indigenous peoples. This should lead them to be much more thorough in their due diligence. We will encourage companies to ensure that this is the case. In our view, due diligence – by carrying out human rights impact assessments – needs to be part of a company's risk management and reporting processes.

In a syndicate, it is important for investors to find out who the lead financiers are, as the due diligence should be undertaken by the financial institutions leading the group, as others are more likely to merely follow their lead. In order to make this accountability system work, the lead financiers should also be able to prove that effective due diligence has taken place.

In the case of the DAPL, banks need to investigate whether sufficient human rights due diligence had been undertaken or whether possible consequences had been ignored. If the due diligence failed to provide enough comfort or was insufficient, they need to report openly on the lessons learned. In our dialogue, a bank involved in the DAPL realised that it needs to revise its due diligence and risk assessment accordingly and we encouraged its efforts to do so.

If a project is identified as higher risk, we will push companies for a mitigation plan that outlines to what extent legal, financial and reputational risks have been taken into account and on how they ensure that the rights of the people affected by project are protected.

Impact assessments

Companies should articulate their salient human rights issues – those at risk of having the most severe impact on human rights holders. We expect companies to influence business partners and the state where possible to minimise any negative impact on human rights.

We ask companies to conduct a thorough and independent human rights due diligence assessment in line with the UN Guiding Principles on Business and Human Rights Reporting Framework. We also urge them to set goals in line with their human rights policies and develop processes to ensure that their operations respect internationally recognised human rights, including on remedy. In our engagements to address allegations of human rights violations or to ensure effective management of human rights risks, we attempt to take account of the most important factors, including analysis of the political situation. We focus on how adverse impacts can be mitigated, using the leverage that a company can exert to improve human rights outcomes as a result of its strategy, operations, supply chain or products and services.

Before agreeing to any financing, banks can expect to review the environmental impact assessments of any projects, which are generally required by law or regulation. An impact assessment should focus on the details of the project, for example what permits are required and which requirements of those permits have been met. The banks should additionally insist on a social impact assessment, including a human rights impact assessment. The financial services organisations involved need to obtain sufficient information about the project from a variety of sources, including the project owners and independent experts.

We have spoken to banks in our engagement programme that have helped finance the project about their impact assessments in relation to DAPL.

We visited the headquarters of a North American bank involved in the DAPL. As a signatory to the Equator Principles, the bank is required to ensure that adequate due diligence has been undertaken, including verification of FPIC of indigenous peoples, before providing financing to any projects. Together with other banks, it hired a third party – law firm Foley Hoag – to investigate the due diligence undertaken by the project owners and report on the adequacy of the engagement with the tribe. The public version of the Foley Hoag report set out how US law provides inadequate guidance and made recommendations for effective engagement and project security.

Another financial services company, which reported that financing of the DAPL would result in high risk for environmental and social impact, in the end decided to co-fund the project as it determined that the project met its environmental and social risk management policy. While it may not have underestimated the environmental risk, it appears to have misjudged the concerns of stakeholders, thus putting its reputation at risk. As the situation deteriorated, the bank met a number of stakeholders from the human rights, academic, investor and non-governmental organisation communities, as well as the Standing Rock Sioux Tribe to understand the different perspectives and how it might use its leverage to help. It also posted a series of public statements, including one that voiced its support for the efforts of the US federal government to work directly with Native American tribes to improve the consultation process and was among the group of banks commissioning the Foley Hoag report.

Lessons learned

Based on our dialogue with them, some of the banks appear to be learning lessons from the problems over the DAPL. Several have made commitments to review and update their due diligence policies which means that future projects will undergo more demanding due diligence before any financing is approved. We urge companies with good processes in place to speak out to encourage others to follow suit.

A key lesson learned for one bank from its involvement in DAPL and the related independent report is the need to address the gaps between US laws and international industry good practice for engaging with indigenous peoples. As noted in the Foley Hoag report, reliance solely on national law even in developed countries does not always protect the rights of indigenous peoples in line with international human rights norms. Consequently, the bank will now update its environmental and social risk management policy, which it confirmed in a dialogue with us. In the meantime, it will require enhanced due diligence on the activities of its clients in line with the UN Guiding Principles for Business and Human Rights. It will also make early and sustained good faith efforts to engage in a culturally appropriate manner with potentially affected communities of indigenous peoples.

Some banks have since divested from the project, opening up the debate again on whether to engage or divest.

We are also in communications with three of the part-owners of the DAPL. At the AGM of one of the owners of the project, we supported a shareholder proposal calling for the company to report on its environmental and human rights due diligence because we believe that its existing disclosure does not allow investors to fully assess its approach to identifying social and environmental risks in its operations.

We will continue to engage with the companies involved that are part of our engagement programme and use the example of the DAPL more widely to encourage companies to treat their stakeholder outreach and social and human rights impact assessments as a vital part of managing their reputational, legal and financial risks. On a public policy level, we will continue to call for improvements to and support best practice on human rights.

For further information, please contact:

Tim Goodman
tim.goodman@hermes-investment.com

[10] http://earthjustice.org/news/press/2017/in-victory-for-standing-rock-sioux-tribe-court-finds-that-approval-of-dakota-access-pipeline-violated-the-law

Governance

Remuneration, climate change and diversity – The issues dominating this voting season

Our activities around company AGMs complement our engagement work.

Setting the scene

On behalf of our many of our clients, we make voting recommendations and cast draft votes at all shareholder meetings of companies in their portfolios in line with their voting policies. Voting complements our engagement programme with companies and can be used to send a powerful message to them. Issues that cause us not to support management and lead us to initiate or intensify an engagement often vary by region.

Our 2017 voting season has been heavily influenced by three issues – remuneration, climate change and board composition, particularly with regard to diversity. To complement our engagement on these topics, and following the publication of our Remuneration Principles: Clarifying Expectations[11], we have taken a tougher stance than ever before.

UK

In the UK, remuneration has remained the most contentious issue this voting season, with many companies obliged to hold a binding vote on their remuneration policy following the third anniversary of the introduction of this requirement.

We have scrutinised the appropriateness of pay outcomes relative to performance achieved, even where remuneration policies were previously approved by investors, for example at media company WPP. In general, we oppose pay proposals which appear excessive in the context of industry practices and where executive pay significantly exceeds the inflation rate or that granted to the workforce without a convincing justification. We also believe that boards should apply discretion where pay outcomes are not justifiable in the context of the company's long-term performance. In the case of WPP, the legacy incentive plan introduced in 2009 once again resulted in what we regard an excessive level of CEO remuneration for 2016. We therefore opposed the remuneration report, while voting in favour of the revised policy which will reduce the size of future awards.

We also opposed a number of proposals due to excessive leverage of variable pay opportunity. While we were supportive of its remuneration report, we recommended voting against the remuneration policy of Imperial Brands because of a significant increase in the maximum opportunity under the variable remuneration plan without accompanying higher performance targets. Following consultations with shareholders, including ourselves, the company announced the withdrawal of the proposal to adopt a new remuneration policy. Furthermore, we recommended voting against overly complex remuneration arrangements, including at Inmarsat, Shire, Thomas Cook and Randgold Resources.

In line with our proxy voting guidelines for 2017, we oppose the election of nomination committee chairs of FTSE 100 companies which fall significantly short of the 2015 Davies' review target of a quarter of their directors being women and cannot demonstrate credible plans to achieve the goal of 33% women directors by 2020. Similarly, we recommend voting against FTSE 250 company chairs with no female board directors and no credible plans to rectify this in the near future.

Following changes to the board earlier this year, including the appointment of three male non-executive directors, only two out of the 12 board directors at mining company Rio Tinto are women, which falls significantly short of the 25% target. Although the company has stated its commitment to diversity and seeking to ensure better gender balance in future board appointments, we believe it must demonstrate a credible plan to reach the 33% target by 2020. Due to the lack of diversity and in the absence of a credible plan to address this, we recommended voting against the re-election of the chair of the nominations committee. We also opposed the election of the nomination chairs and/or chairs of Antofagasta, Glencore and RSA Insurance because of a lack of board diversity.

Breaches in risk oversight have also led us to recommend voting against. At Barclays, we opposed the re-election of the audit committee chair as a result of the CEO's interference with an inquiry initiated by a whistleblower. This showed a breakdown in the company's internal controls and compliance processes in a vital area to protect employees raising grievances at a bank that has incurred conduct-related issues in the past. We also recommended abstaining on the re-election of the CEO. And following the company's scandal with humidifier sanitisers in South Korea, in view of the apparent deficiencies in risk oversight, we decided to oppose the audit chair of Reckitt Benckiser. We were not alone, as the level of dissent was 40%.

North America

In the US, shareholder proposals have continued to provide an effective forum to raise concerns about company performance on a variety of environmental, social and governance matters. In particular, we have witnessed many shareholder proposals on climate change, the disclosure of lobbying activities, as well as on the appointment of independent chairs, most of which we have supported.

Following the mis-selling and fraud scandal at Wells Fargo, a number of directors at the bank were only narrowly re-elected. We opposed the election of seven of the eight members of the board's audit and risk committees, many of whom are longstanding board members. We also supported two shareholder proposals. One sought the bank to commission and publish a report to investors on the root causes and remediation in relation to the fraud, while another called for the adoption of a policy regarding the rights of indigenous peoples and communities who are potentially impacted by the bank's financing activities. At least partly as a result of the pressure from the shareholder proposal we filed in 2016, the bank's board had already agreed to adopt the by-law amendments we proposed in our resolution requiring it to have an independent non-executive board chair.

The proposal on a 2°C degree scenario analysis we co-filed in 2016, which gained the support of 41% of its shareholders, successfully encouraged Chevron to publish its Managing Climate Change Risks report. As a positive gesture to the company, we withdrew a similar proposal for the 2017 AGM we had co-filed although we will continue to engage with the company on the topic. This decision may have made it easier for some large asset management firms to vote in favour of a similar proposal at ExxonMobil, which resulted in momentous support of 62.3%. Given the importance of the company to the US and the oil and gas industry globally, we believe this will have positive repercussions for our work on climate change.

Our guidelines for the US also recommend voting against the chairs of governance committees at companies with no women on board and we have supported shareholder proposals seeking greater diversity. Furthermore, we oppose the governance committee chairs at companies with multiple share classes, which we did at companies such as Alphabet and Ford.

Japan

In Japan, we continued to see improvements to the board structure of companies, in particular the levels of independence and gender diversity, although these remain low by global standards. We recommended voting against the most senior members of boards which do not meet the minimum independence standards set by the country's Corporate Governance Code, as well as non-executive directors whose independence is questionable because of their affiliation with the company through major shareholders or business partners. We also opposed the top management of companies with poor track records on return on equity.

However, we welcomed that an increasing number of companies published their AGM circulars earlier this voting season, thus giving shareholders more time to analyse the proposals and seek dialogue where necessary to make informed voting decisions. This has been particularly helpful given the high concentration of AGMs in a short space of time in June. We observed an increase in the number of shareholder proposals filed. Combined with a rise in the number of votes against management in recent years, this has resulted in more companies reaching out to us to explain their views ahead of the AGMs in order to gain our support. We welcome this trend, as it promotes engagement between companies and investors.

Europe

Legally, German companies are not required to put their executive remuneration to a vote every year, and even if they do, the vote is only advisory. Nonetheless, many of the largest German companies nowadays put the remuneration system up for shareholder approval, which we consider best practice. This voting season, we have opposed the remuneration policies of companies such as Munich Re and ProSiebenSat.1. Insufficient disclosure of performance targets, a lack of ambitious and stretching targets and overly complex systems were the main reasons for our opposition.

At the AGM of Deutsche Bank, we welcomed that its supervisory board exercised discretion and did not pay any bonuses to the members of the management board for a second year in a row, as well as the significantly reduced size of the bonus pool for senior employees. We thus supported the bank's new remuneration system.

At Volkswagen, we recommended voting against the discharge of the management and supervisory boards due to the unsatisfactory progress made by the company in uncovering and resolving the corporate governance and culture problems which contributed to the company's emissions scandal. We also opposed the revised remuneration policy of the car manufacturer. While it has made some overdue improvements to the policy, such as the introduction of absolute pay caps and above-average transparency of the performance metrics and targets for the variable remuneration components, it still lacks sufficiently challenging performance metrics for the variable components.

Remuneration has also been a concern in France. In the wake of the Loi Sapin 2 law, which was ratified in December 2016, companies experienced their first binding say-on-pay on forward-looking remuneration policies. The vote on the payout of the variable component of remuneration will become binding in 2018. As a result, we witnessed slightly better disclosure on pay by companies and a number of requests to increase the payout opportunities. Following, its failed say-on-pay in 2016, Renault significantly enhanced its remuneration policy and disclosure in an attempt to mitigate discontent. After intensive engagement with the company, we commended its improvements but still opposed the policy, which passed despite over 45% dissent.

In Switzerland, after we raised concerns about the proposed variable remuneration awards of its executive board, Credit Suisse issued an impromptu statement, stating that it would reduce payouts by 40%. The bank also acknowledged that the significant conduct fines it incurred from the US Department of Justice for its mis-selling of mortgage-backed securities had not been appropriately reflected in the original remuneration proposal.

Emerging markets

In Brazil, we still witnessed poor transparency in relation to executive remuneration, with some companies failing to comply even with the minimum disclosure required by the country's regulator. We also opposed the bundled election of insufficiently independent boards. On the positive side, there was an unprecedented level of engagement by institutional minority shareholders in nominating independent candidates for the board of directors and fiscal council at several Brazilian companies, such as Petróleo Brasileiro and Vale.

In Mexico, we were pleased with the improvements in transparency companies have made to their governance. Many Mexican companies now disclose the nominees for election to their boards, as well as details about the proposals on the agenda, in advance of the AGM, which has been a focus of our engagement in that market. However, the boards proposed were often oversized, long-tenured and lacked in independence and diversity.

In Russia, progress on board composition has been mixed. While some companies nominated new independent directors whose skills and experiences are aligned with their strategy, others failed to explain why their boards lack a core of genuinely independent directors. We also opposed proposals to reduce the notification period for related party transactions. Although companies can set out in their articles of association notification periods shorter than prescribed by law, we believe this is detrimental to the rights of shareholders, particularly in a market where related party transactions are a major concern.

Across all regions and sectors, we will continue to use our voting rights to complement our engagement efforts and push for positive change.

For further information, please contact:

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

[11] https://www.hermes-investment.com/ukw/wp-content/uploads/sites/80/2016/12/Hermes_Remuneration_Principles_2016.pdf

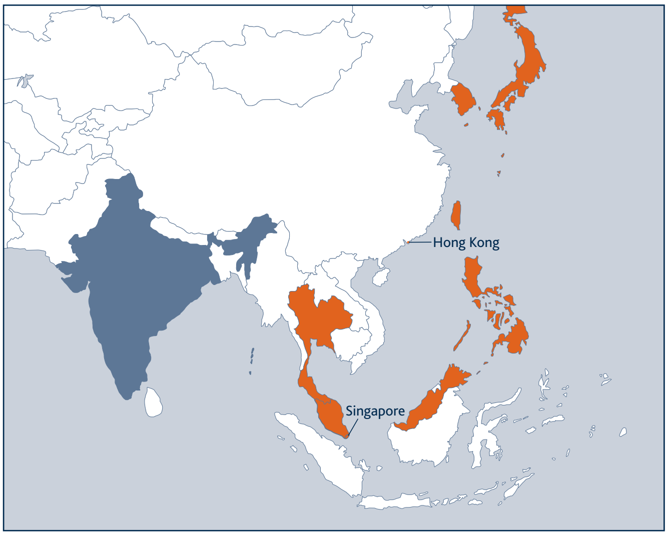
Strategy

Where Japan leads, others follow – Implementing stewardship codes in Asia

We have contributed to the development of stewardship codes across Asia and support their implementation.

Setting the scene

Following its publication in July 2010, the UK Stewardship Code quickly became a global trendsetter. Similar codes have since followed in Brazil, Canada, Denmark, Italy, Kenya, the Netherlands, South Africa, Switzerland and even the US. A blueprint for a global stewardship code for jurisdictions without their own meanwhile was launched by the International Corporate Governance Network in 2016. However, the most remarkable flurry of stewardship codes or similar guidance occurred across Asia between 2014 and 2016, covering various countries from Japan to Thailand.



Key: Stewardship code Code for insurers

The introduction of stewardship codes around the world has encouraged investors to monitor the companies they invest in and interact with them proactively through voting and engagement. We have contributed to the development of many of them and offer and provide ongoing support after their launch.

In March of this year, we hosted a roundtable on the proliferation and implementation of stewardship codes and principles in Asia. The roundtable tackled the underlying question of whether investor stewardship, as developed over the last decades in the UK, is relevant and appropriate in Asian economies where companies are often controlled by large shareholders and cultures and regulations differ significantly. It concluded that, if suitably adjusted to the local environment, stewardship can contribute towards the development of better governance, greater accountability of boards and management and ultimately to long-term value creation. All participants agreed that accommodating regulation plays a major role in the success of stewardship in practice, for example with regard to investor collaboration.

Across Asia, where the codes are still in their early stages, stewardship is challenging due to a variety of reasons. Apart from regulatory issues and cultural differences, this includes the ownership structures of companies in the regions, which can be controlled by families, other dominant shareholders or the state, or have a large number of cross-shareholdings. These ownership structures, which can pit minority against majority investors, have not always been taken into account of during the development of stewardship guidance.

Based on our experience, five factors are likely to aid the success of stewardship codes namely to 1) Develop a market-relevant code, taking into account feedback from stakeholders, including companies, 2) Have the support from local asset owners, particularly major ones, reflected in them becoming early signatories and investing in resources, 3) Have a regulator and possibly the government as a driving force, 4) Have enough interest from foreign investors who are likely to focus on the main capital markets and 5) Have a regulatory environment that provides certainty for investors around the issues they can collaborate on when engaging with companies.

Japan

Japan was the first country in Asia to introduce a stewardship code in 2014, the so-called Principles for Responsible Institutional Investors, and thus became the front-runner on the continent. We – like other relevant stakeholders – had contributed to the development of the draft of the principles and responded to their public consultation. We were also one of the first signatories to the guidance, which had regulatory, as well as local and international stakeholder support and buy-in from the start. The development of the comply-or-explain code was driven by the country's government in an attempt to promote sustainable growth and had the backing from its Financial Services Agency (FSA). It represented a switch from a traditionally rules-based corporate culture to one based on principles and has been a significant step forward in responsible ownership activities in Japan.

After its launch, we followed up with the FSA council responsible for Japan's stewardship code on its effective implementation and the meaningful explanation companies are expected to provide in case of non-compliance. Our dialogue focused particularly on the facilitation of investor collaboration, as this has been one of the most contentious issues in the country due to the takeover rules of companies. We sought further clarification on the legal status to assure investors and encourage them to collaborate. We also highlighted that the revision of the code and investor efforts to implement its principles would need to match reforms in other parts of the capital markets for stewardship activities to be effective. We pointed out the sizeable cross-shareholdings by companies which are not accountable in the same way as institutional investors who sign up to the code and cautioned that the influence of asset owners may be limited without a swift and substantial reduction in cross-shareholdings.

The FSA had committed to regularly reviewing the principles and their first revision took place earlier this year. We largely welcomed the proposed amendments[12], particularly the note on collaborative engagement, which was in line with our requests. Japan also is one of the few countries that has published a list of the code's signatories. The number of signatories at the end of December 2016 stood at 214 and includes 26 pension funds, such as the influential Government Pension Investment Fund, which is one of the world's biggest funds.[13]

We believe that the Japanese principles may over time facilitate the creation of a stewardship culture, given that they now include a reference to collaborative action as well, which continues to be a significant obstacle in their effective implementation. We are involved in work with the International Corporate Governance Network in Japan to facilitate an effective implementation of the code.

Malaysia

Other countries have struggled more with the implementation of their stewardship codes. Malaysia, which launched its Code for Institutional Investors shortly after Japan in 2014, is one such example. Again we had been involved in the development of its comply-or-explain code. We responded to the public consultation on the draft version of the code by the government-sponsored Minority Shareholder Watchdog Group and the Securities Commission of Malaysia and spoke at its launch. However, there had been a lack of commitment by local funds and, as a result, initial uptake, in particular from the country's main asset owners, had been poor. To address this, the Institutional Investor Council (IIC) was set up. As a member of the IIC, we have worked alongside local funds and put stewardship code implementation on the agenda of one of its working committees. We contributed to the IIC's first report, which set out priorities for the development of the role of institutional investors in the governance of investee companies, including collaborative engagement. The IIC seems to have generated some momentum, which has resulted in several major funds signing up to the code.

Hong Kong

We had discussed our experience with stewardship codes with Hong Kong's Securities and Futures Commission (SFC) as far back as 2013. After some delay, Hong Kong's Principles for Responsible Ownership, which also follow a comply-or-explain approach, saw the light of day in 2016, with the backing from the SFC. However, while we welcome it, overall the code appears to be lenient on addressing investor concerns about the concentrated shareholding structures of companies and their inadequate disclosure on conflicts of interest. In addition, there is no official way to sign up to the principles, making their enforcement difficult to achieve. In 2016, we held a seminar at the SFC to educate its staff on stewardship in practice and have been invited back to hold another for local asset owners, managers and companies.

Singapore

As a result of our engagement on the topic in 2014, we were invited to join the Singapore Stewardship Principles Working Group, chaired by the think tank the Stewardship Asia Centre, to develop a stewardship code for the city state. Together with industry players and organisations in the Singapore investment community, we participated in a series of conference calls throughout 2015 and provided extensive written feedback. We were also the only representative of foreign institutional investors to address the inaugural forum of Stewardship Asia in 2015.

The Singapore Stewardship Principles (SSP) for Responsible Investors launched in late 2016, supported by the Monetary Authority of Singapore and the Singapore Exchange.[14] We are pleased that following our feedback on the initial draft, the principles primarily target institutional investors and include an additional principle on collaboration between investors, which we strongly pushed for.

However, similar to Hong Kong, we question the lack of a commitment mechanism and the absence of a regulator or large asset owner driving the stewardship agenda. We are also concerned about an apparent lack of interest in the principles, particularly among foreign investors.

South Korea

After calling for the introduction of stewardship guidance in our keynote speech at a conference hosted by South Korean regulators in 2014, we welcomed the development of a draft code in 2015. The Korean Stewardship Code was launched in December 2016, with a commitment made by a number of local asset managers. We have urged local asset management companies to sign up to the code. To date, dozens of domestic signatories have done so with the exception of pension funds and insurance companies.[15] As the circular shareholding structure of Korean companies is similar to the cross-shareholdings in Japan, we expect collaborative engagement to be a concern. We have met Korea's Financial Services Commission to discuss the implementation of the code. Its success depends to a large extent on the new government's commitment to governance reform. However, it seems that the political appetite for stewardship is growing.

Taiwan

Taiwan has a list of signatories[16] for its Stewardship Principles for Institutional Investors, which came into force in 2016. The principles were facilitated by the Taiwan Stock Exchange and have the backing of the Financial Supervisory Commission of Taiwan, which is driving the guidance. Given the limited stewardship asset coverage in this market, our engagement experience with companies has not changed significantly as a result of the introduction of the guidance but we have noticed that local asset management companies have become more active in their voting. We have spoken at conferences in Taiwan to share our experience with the development and implementation of stewardships globally. We also gave evidence on the draft guidance in early 2016 and subsequently spoke at its soft launch.

Outlook

Overall, it is too early to say what the impact of the codes will be, as the creation of a stewardship culture will take years. Japan appears to be on the right track, but it is important to note that the country is in a unique position as its government and biggest pension funds have been driving stewardship. In addition, its large and sophisticated financial services industry means that it is in a better position to implement stewardship guidance than some of its neighbours. This combination of stewardship-facilitating factors does not exist elsewhere on the continent, and access to non-executive directors by shareholders remains rare across the region. Collaborative action between international and local investors can be a highly effective tool to change this. We will therefore continue to adjust our engagement approaches across Asia and speak to regulators in key markets to ensure the local environment does not interfere with investor collaborations.

For further information, please contact:

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

[12] https://www.hermes-investment.com/wp-content/uploads/2017/05/Revision-of-Japans-Stewardship-Code-May-2017.pdf
[13] http://www.fsa.go.jp/en/refer/councils/stewardship/20160315.html
[14] http://www.stewardshipasia.com.sg/principles/SSP_press_release.pdf
[15] http://www.cgs.or.kr/CGS_main.asp?MenuIndex=E&SubIndex=4
[16] http://cgc.twse.com.tw/stewardshipList/listEn

Strategy

Engagement on strategy

Many of our most successful engagements include discussions on business strategy and structural governance issues.

Overview

We adopt a holistic approach to engagement, combining discussions on business strategy and risk management, including social, environmental and ethical risks, with structural governance issues. We 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

Data privacy

Lead engager: Jaime Gornsztejn

Based on the dialogue we have had with a European company, we were satisfied that its data privacy policy follows best practice. Following our previous engagement on the matter, we examined the policy in detail. It covers what data is collected and how it is obtained, analysed and protected. The policy also establishes a grievance mechanism for data subjects to exercise their rights of access, rectification and cancellation.

We challenged the company on how it develops a culture of compliance with data privacy rules, given that it collects an enormous amount of consumer data. The company assured us that extensive training is provided to all of its employees. A data privacy unit, which is led by the company's chief data security officer, enforces the policy. We also investigated the processing of consumer data by contractors providing services to the company. It explained the contractual provisions and audit procedures in place to ensure contractors comply with the company's data protection standards. We were satisfied with the data privacy policy developed by the company and will follow up on its implementation.

Health and safety

Lead engager: Bruce Duguid

We were pleased to hear that a UK company has materially improved its safety performance as reported through a series of indicators in its annual report, in line with our engagement. It attributes this to a four-year initiative sponsored at the board level designed to improve performance in the area in response to client and investor demands. The company will also shortly publish its first ever public health and safety report to provide more transparency on its performance. It believes that it operates at best practice in most areas and has evidence that it is performing above the levels of its immediate peers. The company noted that it is still working to improve in some areas, such as driving-related accidents. It also wants to enhance the reporting of leading indicators of potential safety incidents and encourage mitigating actions, such as the number of management walk-arounds with internal and external staff. We requested to see evidence of the performance of the company against its peers and will review the public report on safety performance before completing our objective in this area.

We were also comforted by the description of the company's strategic planning process which appeared robust and considers a range of energy scenarios, including low-carbon scenarios aligned with keeping the rise in global average temperature to 2°C. These have helped the company form its view on the approach it is likely to take to more marginal project areas which may not be profitable in low-carbon scenarios. It is also willing to entertain providing enhanced reporting of the potential financial impact of low-carbon scenarios.

Integrated reporting

Lead engager: Jaime Gornsztejn

We commended an emerging markets company for the publication of its first integrated report, which sets a benchmark in its home market. In previous engagements with its head of sustainability, we had encouraged it to adopt the integrated reporting framework and provided examples of best practice. We reviewed the sustainability targets published in the integrated report and were encouraged that the company responded to our previous engagements on supply chain sustainability by committing to cover 55% of its procurements with due diligence and audit procedures by 2020. While commending the company for publishing this ambitious target, we challenged the feasibility of achieving it by 2020, given that at the moment only 17% of its purchases are covered by the programme. The company acknowledged the ambitiousness of the target and admitted that progress has been slow to date. However, it sought to reassure us that the group-wide target is achievable.

The issue is now part of the executive committee's agenda and local management in each country of the company's operations has been set a supply chain target under the programme. We will follow up with the senior executive who was appointed to the new position of vice president for sustainability. His participation in the executive committee also indicates that environmental, social and governance issues such as supply chain management, occupational safety and environmental impact are of greater priority to the company now.

Low-carbon stress-testing

Lead engager: Bruce Duguid

The CEO confirmed in a meeting with us that the extractives company he is leading has embarked on a detailed exercise to stress-test its strategy against low-carbon scenarios. It is confident that demand will remain robust under low-carbon scenarios for a number of its products, driven by the imperative of increasing electrification and the lightweighting of materials. Meanwhile, the company is gradually divesting from coal. We challenged it to evidence this with data and also to explain the potential impact on iron ore demand. The company in principle is committed to providing investor disclosure in line with the best practice guidelines provided by the Financial Stability Board's Task Force on Climate-related Financial Disclosures. However, it is wary of providing a financial quantification of the impact of low-carbon scenarios due to the uncertainty involved with various assumptions.

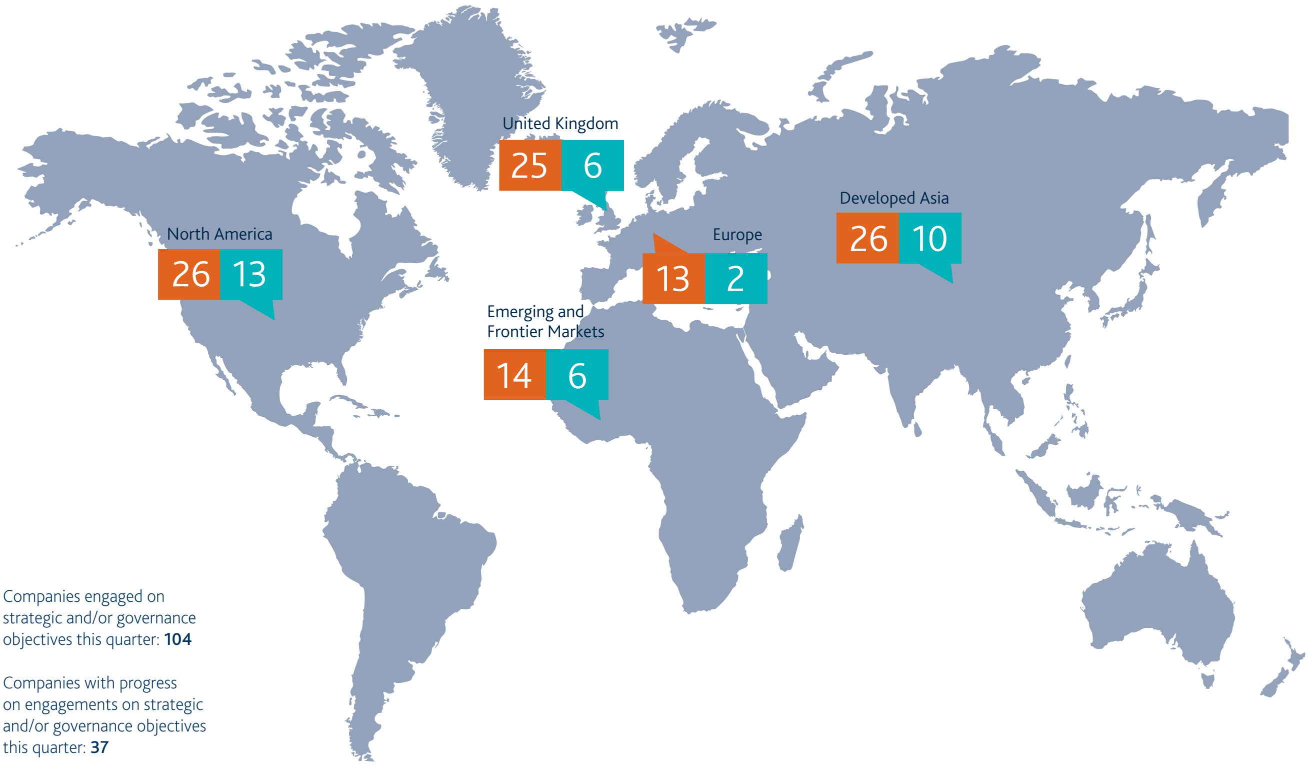
We explained the investor need to understand financial materiality. We were comforted to hear that the company is developing longer-range greenhouse gas reduction targets, although it is not yet committed to including these in the executive remuneration scorecard. We asked to set up a meeting with the key people involved in reporting on climate change once the results of scenario work is available. The chair had earlier responded positively, but cautiously, to our questions at the company's AGM. At the shareholder meeting, we had asked the company to set out its pathway to achieving its commitment to substantially decarbonise its business by 2050, including its strategy, capital expenditure on low-carbon research and development and stretching greenhouse gas targets.

Supply chain management

Lead engager: Christine Chow

Despite the challenges of addressing human rights issues in its home market, an Asian company took the first step by publishing a policy and associated due diligence guide for responsible supply chain management and conflict minerals, leading local best practices. This was at least partly the result of our extensive engagement on its supply chain. The company's efforts to improve the management of its supply chain were already reflected in its 2015 sustainability report, with further notable progress outlined on its website in 2016. It has identified conflict minerals from the Democratic Republic of Congo and adjoining countries as one of its salient human rights issues. The company has also laid out the actions to be taken to ensure its supply chain is free from human rights violations and created a five-step framework for risk-based due diligence in mineral supply chains. This includes independent third party audits and improvements in reporting and public disclosure over time. We commended its efforts in addressing human rights issues within its sphere of influence.

Engagements on strategy and/or governance



Companies engaged on strategic and/or governance objectives this quarter: **104**

Companies with progress on engagements on strategic and/or governance objectives this quarter: **37**

Public policy and best practice

Hermes EOS contributes to the development of policy and best practice on corporate governance, sustainability 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 operations 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. 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 instead of being moulded to the narrow interests of other market participants whose interests may be markedly different – particularly companies, lawyers and accounting firms, which tend to be more active than investors in these debates.

Highlights

Fiduciary duty roadmap

Lead engager: Sachi Suzuki

We welcomed the launch of the fiduciary duty roadmap for Japan by the Principles for Responsible Investment and the UNEP Finance Initiative, to which we contributed with our experience from our stewardship activities in Japan. The document provides recommendations on stewardship and engagement, corporate governance and disclosure. We were particularly pleased to see the issue of cross-shareholdings highlighted as a key challenge to corporate governance in the country, as well as the difficulties for investors to engage collaboratively, in line with our input.

Modern Slavery Act

Lead engager: Sachi Suzuki

We supported an investor statement to welcome the inquiry into creating a Modern Slavery Act in Australia by the joint standing committee on foreign affairs, defence and trade of the parliament of Australia. The statement was co-ordinated by the Principles for Responsible Investment and supported by investors with $2.17 trillion in assets under management. It encouraged the act to include requirements such as board level commitments on modern slavery statements and annual public reporting, consistent with the UK Modern Slavery Act. In addition, it called for disclosure of the efforts by companies to map their supply chains to undertake due diligence and the establishment of a central repository of statements to enable investors and other stakeholders to access the disclosure with ease.

Paris Agreement on climate change

Lead engager: Bruce Duguid

We signed the letter prepared on behalf of institutional investors to the intergovernmental meetings of the G7 and G20, requesting that governments continue to implement the 2015 Paris Agreement on climate change, which is in the interests of long-term investors. In particular, the letter requested governments to support the implementation of nationally determined contributions and climate plans to 2050 to achieve the goals of that agreement, drive investment to facilitate the transition to a low-carbon world by aligning climate-related policies, phase out fossil fuel subsidies and include carbon pricing where appropriate, as well as implement climate-related financial reporting frameworks. This includes the recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosures.

Proxy voting

Lead engager: Bram Houtenbos

We launched a new initiative aimed at improving the proxy voting chain. In a meeting with a like-minded asset manager and a representative of the International Corporate Governance Network, we discussed the vulnerabilities and inefficiencies in the voting chain. In addition to bureaucratic formalities in some markets, end-to-end vote confirmation is usually not provided, leading to uncertainty whether votes cast arrive as instructed at AGMs. The amended Shareholders' Rights Directive II, however, which is due to be implemented across the EU over the next two years, will require intermediaries to provide vote confirmation. Within this context, we agreed that it would be helpful to draw up a clear set of expectations for custodians and other intermediaries in the voting chain to be used by investors when selecting their service providers. We will form a working group together with a few other investors and draft a paper.

US Choice Act 2017

Lead engager: Tim Goodman

We signalled our opposition to the passage of the US Choice Act 2017 by writing to the chair and the ranking member of the US House of Representatives' Committee on Financial Services, endorsing the letter that the Council of Institutional Investors (CII) had sent to them both. We also co-signed a letter from the CII to selected members of the House of Representatives. Among the counter-reforms contained in the draft legislation are plans to make it more difficult to file shareholder proposals, greater regulatory requirements on proxy advisory firms, restrictions on voting in contested director elections, as well as reductions in the rights of shareholders to an advisory vote on executive pay and in the ability of the Securities and Exchange Committee to carry out its regulatory functions. We are concerned that these measures will make it harder for shareholders to hold boards to account in the US and so will continue to seek ways to push back against the proposals.

Other work in this quarter included

Promoting best practice

- Together with UK and German board members, including the chair of the Women on Boards Review, we participated in a panel discussion on **board diversity**, presenting the perspective of investors. We explained how investors can systematically integrate diversity into investment decisions and stewardship activities, including in engagement and voting.
- We attended an investor seminar on child labour and contributed with our latest insights into **child labour in the cobalt supply chain**. Our proposed approach to better harnessing technology for supply chain monitoring was supported by a representative of large Swedish pension funds, who was on the panel. We also participated in discussions relating to child labour in the palm oil industry, noting that the audit standards of the Roundtable on Sustainable Palm Oil need to be strengthened. We also addressed child labour issues in the tobacco sector and cocoa supply chain.
- We spoke at **China's first responsible investment forum**, which was hosted by the asset management association of the China Securities Regulatory Commission. Keynotes from director-generals from the National Social Security Fund and Development Research Centre of the State Council sent a strong message of the Chinese government's commitment to responsible investing, from ESG assessment to impact investments. Encouragingly, the chair of the China Association for Public Companies advocated the involvement of boards in the sustainability strategy of their companies to promote ESG awareness and implementation.
- We provided comments on **disclosure** to Japan's Financial Services Agency, which had sent out a questionnaire to investors on the issue. We expressed our view that the existing system, which requires companies to produce at least three types of reports with overlapping content can be improved, adding that it would be helpful to have all information in one place. We highlighted the importance of having all the information relating to corporate governance ahead of the AGM, which is not the case at present. We also made recommendations on key issues companies should be required to disclose, such as the remuneration structures of senior executives, strategic shareholdings, information about senior advisers and consultants, as well as non-financial risks and opportunities.
- We contributed to the Reimagining Disclosure Initiative of the CDP to help formulate a sector-based and more insightful form of **disclosure system for climate change risks** and the management of these by companies. We supported the proposal for the CDP to align its new disclosure approach with the framework established by the Task Force on Climate-related Financial Disclosures.
- We provided a response to the UK Financial Conduct Authority's discussion paper reviewing the **effectiveness of the UK's primary markets**. The paper questioned whether the company's listing regime should be re-balanced to create an international segment with more relaxed requirements for overseas than for domestic companies. We argued strongly that we do not see any merit in this proposition and believe that the same rules should apply to domestic and overseas companies listing on the UK market.
- We reviewed a letter from institutional investors to the institutions of the EU concerning the tripartite negotiations on the proposed **Energy Union Package**. We supported many of the proposals, including a long-term decarbonisation goal for 2050 and an ambitious and binding energy efficiency target. However, we commented that capacity payments for some types of fossil fuel power are likely to be necessary to accommodate an increasing proportion of intermittent renewables on the grid.
- In the International Finance Corporation's (IFC) Practice Group Meeting on Corporate Governance Codes, Standards and Transparency and Disclosure, we gave our perspective on **ESG integration and stewardship**. We also provided feedback on the draft Toolkit for Transparency and Disclosure, a set of guidelines developed by the IFC to help companies improve the quality of their reporting.
- We participated in a seminar hosted by the World Federation of Exchanges and the Global Reporting Initiative alongside companies, exchanges and fellow investors to discuss the next steps for enhancing the quantity and quality of **ESG reporting** globally. We explained that disclosures need to be concise, current, comparable and consistent.
- We presented our expectations of **executive remuneration** in the UK, in line with our remuneration principles, to a group of senior reward executives at FTSE 100 companies. The presentation stimulated a lot of interest and indicated that many companies could be supportive of our proposals. In particular, there was interest in moving towards more radical, simplified and less leveraged models of executive pay based on lower variable and more fixed pay in the form of restricted shares.
- We met the International Organization for Standardization and its human resource management working group, which are developing ISO standards in the field of human resources. We discussed one of the standards under development, the **Human Capital Reporting** for Internal and External Stakeholders principle, which aims to measure the impact of human capital on a company's performance.
- We were one of the lead contributors to a publication from the Institutional Investors Group on Climate Change on **investor engagement with oil and gas companies**.
- At the international CSR forum in Beijing, we gained further insight into the progress on **supply chain management** of major companies globally. It was agreed that a stringent supply chain management system consists of clear guidelines and guidance, a transparent compliance process covering self-assessment, the involvement of buyers, verification, traceability and certification, as well as work with communities and local governments.
- We signed a statement on the website of sustainability organisation Ceres to support the **2°C scenario resolutions** that had been filed at a number of US companies, particularly in the oil and gas and utility sectors. We believe that these proposals encourage better disclosure of the risk management processes companies carry out to help assess and improve their resilience to the transition to a low-carbon economy.

Public policy

- In our response to a consultation by the Singapore Exchange (SGX), we made clear that we are not supportive of the proposed introduction of a **dual-class share framework in Singapore**. We expressed our strong belief in the principle of one-share one-vote, which gives all shareholders equal rights and aligns voting rights with economic interests and investment risks. Nevertheless, we acknowledged the thorough consideration the SGX has given this matter and the steps it has suggested to address the risks of a dual-class share structure. We urged the SGX to mandate all of the suggested criteria and safeguards should it proceed with the introduction of a dual-class share structure in Singapore.

Report written and produced by Nina Röhrbein

Hermes EOS makes voting recommendations at general meetings wherever practicable. We take a graduated approach and base our recommendations on annual report disclosures, discussions with the company and independent analyses. At larger companies and those where clients have significant interest, we seek to have dialogue before recommending a vote against or abstention on any resolution.

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

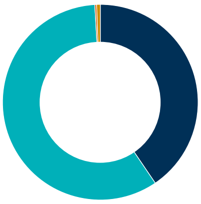
Hermes EOS makes voting recommendations at companies all over the world, wherever its clients own shares.

Overview

Over the last quarter we made voting recommendations at 6,137 meetings (72,742 resolutions). At 3,596 of those meetings we recommended opposing one or more resolutions. We recommended voting with management by exception at 36 meetings and abstaining at 19 meetings. We supported management on all resolutions at the remaining 2,486 meetings.

Global

We made voting recommendations at **6,137** meetings (**72,742** resolutions) over the last quarter.



- Total meetings in favour **40.5%**
- Meetings against (or against AND abstain) **58.6%**
- Meetings abstained **0.3%**
- Meetings with management by exception **0.6%**

Australia and New Zealand

We made voting recommendations at **48** meetings (**288** resolutions) over the last quarter.

- Total meetings in favour **47.9%**
- Meetings against (or against AND abstain) **52.1%**

Developed Asia

We made voting recommendations at **1,313** meetings (**14,278** resolutions) over the last quarter.

- Total meetings in favour **37.7%**
- Meetings against (or against AND abstain) **61.7%**
- Meetings with management by exception **0.6%**

Emerging and Frontier Markets

We made voting recommendations at **1,244** meetings (**13,772** resolutions) over the last quarter.

- Total meetings in favour **32.3%**
- Meetings against (or against AND abstain) **67.3%**
- Meetings abstained **0.2%**
- Meetings with management by exception **0.2%**

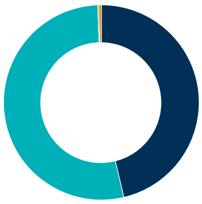
Europe

We made voting recommendations at **931** meetings (**13,676** resolutions) over the last quarter.

- Total meetings in favour **34.3%**
- Meetings against (or against AND abstain) **64.2%**
- Meetings abstained **0.3%**
- Meetings with management by exception **1.2%**

North America

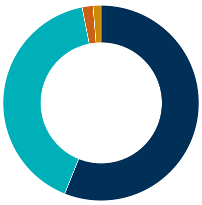
We made voting recommendations at **2,153** meetings (**23,795** resolutions) over the last quarter.



- Total meetings in favour **46.3%**
- Meetings against (or against AND abstain) **53.1%**
- Meetings abstained **0.2%**
- Meetings with management by exception **0.4%**

United Kingdom

We made voting recommendations at **448** meetings (**6,933** resolutions) over the last quarter.

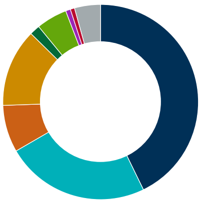


- Total meetings in favour **56.0%**
- Meetings against (or against AND abstain) **40.8%**
- Meetings abstained **1.8%**
- Meetings with management by exception **1.3%**

The issues on which we recommended voting against management or abstaining are shown below.

Global

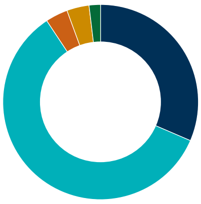
We recommended voting against or abstaining on **9,028** resolutions over the last quarter.



- Board structure **42.7%**
- Remuneration **23.8%**
- Shareholder resolution **7.8%**
- Capital structure and dividends **12.9%**
- Amend articles **1.7%**
- Audit and accounts **5.1%**
- Governance **0.8%**
- Poison pill/Anti-takeover device **0.7%**
- Other **4.3%**

Australia and New Zealand

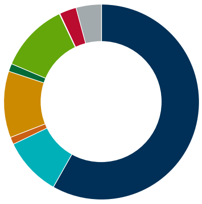
We recommended voting against or abstaining on **54** resolutions over the last quarter.



- Board structure **31.5%**
- Remuneration **59.3%**
- Shareholder resolution **3.7%**
- Capital structure and dividends **3.7%**
- Amend articles **1.9%**

Developed Asia

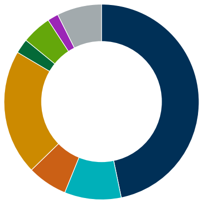
We recommended voting against or abstaining on **1,781** resolutions over the last quarter.



- Board structure **58.2%**
- Remuneration **9.7%**
- Shareholder resolution **1.2%**
- Capital structure and dividends **11.0%**
- Amend articles **1.3%**
- Audit and accounts **11.5%**
- Governance **0.1%**
- Poison pill/Anti-takeover device **2.8%**
- Other **4.2%**

Emerging and Frontier Markets

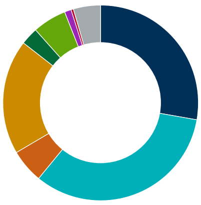
We recommended voting against or abstaining on **2,452** resolutions over the last quarter.



- Board structure **46.7%**
- Remuneration **9.4%**
- Shareholder resolution **6.6%**
- Capital structure and dividends **20.7%**
- Amend articles **2.4%**
- Audit and accounts **4.9%**
- Governance **1.8%**
- Other **7.4%**

Europe

We recommended voting against or abstaining on **2,230** resolutions over the last quarter.



- Board structure **27.8%**
- Remuneration **33.2%**
- Shareholder resolution **5.6%**
- Capital structure and dividends **19.0%**
- Amend articles **2.9%**
- Audit and accounts **5.6%**
- Governance **1.1%**
- Poison pill/Anti-takeover device **0.4%**
- Other **4.5%**

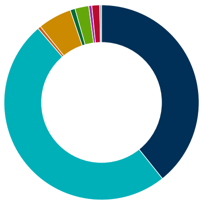
North America

We recommended voting against or abstaining on **2,117** resolutions over the last quarter.

- Board structure **41.8%**
- Remuneration **37.0%**
- Shareholder resolution **18.6%**
- Capital structure and dividends **0.6%**
- Amend articles **0.2%**
- Audit and accounts **0.2%**
- Governance **0.2%**
- Poison pill/Anti-takeover device **0.1%**
- Other **1.3%**

United Kingdom

We recommended voting against or abstaining on **394** resolutions over the last quarter.



- Board structure **39.3%**
- Remuneration **49.5%**
- Shareholder resolution **0.5%**
- Capital structure and dividends **5.6%**
- Amend articles **0.8%**
- Audit and accounts **2.3%**
- Governance **0.5%**
- Poison pill/Anti-takeover device **1.3%**
- Other **0.3%**

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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