

Approach to stewardship

December 2017
Hermes Investment Management

HERMES APPROACH TO STEWARDSHIP

This disclosure highlights our delivery of the aims and the relevant substance of those Stewardship Codes to which we are pleased to be signatories in the UK and elsewhere.

Introduction to Hermes Investment Management

Our primary purpose is helping beneficiaries retire better by providing world class active investment management and stewardship services. We believe this purpose includes a duty to deliver holistic returns – outcomes for our clients that go far beyond the financial and consider the impact our decisions have on society, the environment and the wider world.

We understand that the way we achieve our investment objectives will have an impact that is more than purely financial – it will affect the world in which our beneficiaries live and the real value of their retirement incomes. We have a duty therefore to act as responsible owners of those companies in which we have invested and the assets that we manage to the advantage of society as a whole.

This belief necessitates recognising the importance of the long-term health and stability of the markets in which we invest and means extra work in analysing companies; understanding externalities, governance practices, environmental impacts, treatment of workforces and the influence of operations on local communities. It also means using our influence to improve the behaviour of those companies in which we have invested; the operations of the assets that we directly manage, and advocating for systematic improvements to the financial system in which we participate.

Fundamentally, we believe companies with strong governance and astute management of their environmental and social risks and opportunities not only make a more positive contribution than those that do not, but also provide greater long-term value and reduced risk for shareholders. There is increasingly robust evidence of this relationship and research from our own global equities team demonstrates this belief to be true with better-governed companies consistently outperforming their less well governed peers – see [here](#).

In the context of the increasing evidence and our responsibility as a fiduciary for our clients, we seek to:

- integrate awareness of ESG risks into our investment decision processes;
- ensure we remain cognisant of these risks within individual investments and across our portfolios;
- actively engage as appropriate, with those companies in which we, and our clients, have invested and utilise our rights as investors in a considered and informed fashion to promote long-term success, and;

- work with policy makers to promote responsible investment and advocate for a global financial system that operates in the interests of its ultimate beneficiaries

As a firm, our investment teams work closely with Hermes Equity Ownership Service (Hermes EOS), our stewardship team, to ensure that our approach to stewardship is joined up with our active investment approach across asset classes, geographies and strategies. Hermes EOS is one of the world leaders in stewardship services helping institutional investor clients to meet their duties for active stewardship. The team boasts an incredibly effective group of highly skilled, multi-national professionals all committed to promoting the long-term success of companies.

Importantly, we recognise we are global investors and our clients and their beneficiaries are in effect universal owners. By embedding responsibility we seek to align all the decisions we make with their needs and interests. It means we implement this approach consistently across the products we provide and the markets in which we invest.

How we discharge our stewardship responsibilities

At Hermes carrying out our stewardship responsibilities is an integral element of our overall approach to being a responsible investment management firm and a crucial contributing factor to delivering strong risk-adjusted performance over the short, medium and long-term.

While the responsibility for implementing our approach resides with all Hermes personnel, we have a number of structures and teams which ensure that across the firm we discharge our responsibilities effectively.

- We have established a Responsibility Working Group (RWG) which includes senior representatives from across our business and is chaired by our Head of Responsibility who reports directly to our CEO. The RWG is charged with developing our policy and approach in respect of all matters which appertain to our mission of delivering holistic returns this includes our approach to stewardship and the integration of ESG issues within investment processes
- Our dedicated Responsibility Office ensures that responsibility is embedded through the business. This extends to Hermes approach to its own governance and practices as well as the integration of engagement and ESG factors into investment strategies and processes
- Our investment office, acting on behalf of clients, provides independent oversight of all investment teams on a look-back, real-time, and look-forward basis, providing them with a detailed understanding of risk and how it is they are delivering performance
- Hermes EOS, our stewardship business, boasts one of the largest stewardship resources of any fund manager in the world

Ex-ante – ESG aware investing

Because we believe that companies with strong governance, astute management of their environmental and social risks and strong relationships with their key stakeholders provide greater long-term value and reduced risk for shareholders we analyse companies' ESG credentials before deciding whether to invest.

Our approach to investing responsibly goes beyond investments in public markets. We have been at the forefront of championing the integration of responsible investment principles in real estate investment for many years – our Responsible Property Investment principles can be found [here](#). Similarly, our private equity team has an explicit focus on responsible investing with extensive ESG due-diligence undertaken and our infrastructure business is particularly cognisant of the fundamental societal importance of many of the assets that we own.

Ex-post – acting as active owners

Crucially, we recognise that our duty extends beyond being responsible investors to acting as responsible owners of the companies and assets in which we have invested. The Hermes Responsible Ownership Principles articulate our expectations of listed companies and similarly what these companies can expect from us as owners. We believe that effective and constructive dialogue with boards and management by investors should contribute to better management of companies and ultimately support their long-term success. This in turn should lead to wider benefits to society and for our clients' beneficiaries.

Hermes' investment teams work closely with their colleagues in Hermes EOS and as a group we continue to strive to be at the forefront of responsible investing and stewardship.

The depth and global breadth of our stewardship resources reflect our philosophy that active ownership requires an integrated and skilled approach and engagement should be carried out by individuals with the right skills and with credibility. In that spirit, when engaging with companies our stewardship team will often be joined by relevant portfolio managers or analysts from our investment teams and at times by our stewardship clients.

The third pillar in our commitment to acting as good stewards stretches beyond our investment decisions and ownership practices to advocating for improvements to the overall working and stability of the financial system. We are committed to using our influence to promote responsible investment and ownership practices and challenge conflicts present in the financial system in order that it works in the interests of our ultimate beneficiaries and for the betterment of society.

Importantly, we regularly review the effectiveness of our activities both internally and with clients in order to ensure that we remain at the forefront of best practice.

All of our activities are supplemented by our belief in transparency – to our clients, to our investee companies and to wider stakeholders.

The management of conflicts of interest in relation to stewardship

Hermes acknowledges its position as a fiduciary for its clients and seeks always to act in their best interests. Accordingly we take all reasonable steps to identify conflicts of interest and maintain and operate arrangements to prevent such conflicts from giving rise to a material risk of damage to the interests of any of our clients.

We are proud to have a strong culture of responsibility and we aspire both to maintain and further foster this client focused culture. In 2015 we created the Hermes Pledge. This pledge is intended to express the commitment of each of us individually to put the interests of our clients and their beneficiaries at the heart of what we do and in so doing manage conflicts of interest fairly between all parties.

One potential conflict which has been identified for the Hermes group relates to our ownership structure. We were founded as the in-house manager for the BT Pension Scheme (BTPS) in 1983 and while remaining wholly owned by BTPS we now have numerous third party clients and investment partners from around the world.

We have internal procedures to regulate the processes and restrict the flow of information among, and within, business units so that activities are carried out with the appropriate level of independence.

In delivering our fund management and stewardship services for clients, the following real or perceived conflicts may arise:

- We may engage with or vote the shares of a company which is the sponsor of one of our pension fund clients – such as BT plc – or is a company within the same group as one of our clients
- We may engage with a government or government body which is the sponsor or associate of the sponsor of one of our clients
- We may engage with a company which has a strong commercial relationship with Hermes and/or with clients
- We may vote on a corporate transaction, the outcome of which would benefit one client more than another
- We may hold meetings with companies for the dual purpose of delivering both our fund management and engagement services
- We may otherwise act on behalf of clients who have differing interests in the outcome of our activities

Accordingly, Hermes takes all reasonable steps to identify conflicts of interest between: (1) Hermes, including its managers, employees and appointed representatives or any person with a relevant direct or indirect link to them, and Hermes clients as a body; or (2) any one client of Hermes and the client body.

A specific Hermes stewardship conflicts of interest policy has been developed and is publicly available on our website. The stewardship conflicts policy, which is reviewed annually, outlines how in all of our activities we seek to promote the long-term success of the companies in which we and our clients have invested. This singular focus holds true in all circumstances including those where we engage with or vote the shares of a company which is the sponsor of one of our pension fund clients – including BT plc – or when we engage with or vote the shares of a company with whom we have a commercial relationship or where clients may have differing interests in the outcome of an activity.

We maintain a register of conflicts as they arise and in those limited circumstances where a conflict over our approach to voting (aside from that directed by client specific policies) or engagement arises which is not able to be resolved through normal processes the matter is escalated to an 'escalation group' which reports to an independent sub-committee of the Board. The group is guided in reaching its decisions by Hermes' mission to delivering long-term holistic returns and if there is no majority view on the group then the Hermes CEO will make a final decision. All escalated instances are documented and reported to Hermes' Risk and Compliance Committee – an independent sub-committee of the Hermes Fund Managers Limited Board.

The monitoring of investee companies

We believe that active monitoring of investee companies is integral to delivering positive investment performance for our clients; this requires us taking an active interest in a wide range of aspects of the companies and assets in which we are invested. Resources are allocated to those companies with the most material governance, social or environmental issues.

We have developed a number of proprietary tools which include our ESG Dashboard, ESG Portfolio Monitor and climate change risk analytics tool – enable all of Hermes' investment teams to pinpoint ESG risks at both the company and portfolio level.

The proprietary Hermes ESG dashboard ensures that all companies (subject to the availability of the data) can be compared against their peers on a sector, regional or global basis with respect to a range of ESG considerations. Our proprietary developed QESG score captures how well a company manages its ESG risks, and importantly whether this is improving or not. The QESG score not only incorporates third party research indicators but also the insights of our voting and engagement activity. The change in score can provide an early warning signal or suggest that management is successfully grappling with an issue. This stock-specific analysis is a valuable input to the investment process as well as ongoing monitoring of, and, where appropriate, engagement with companies.

Similarly, our climate change analytics tool allows us to see in real-time and in detail, the level and intensity of carbon and water risk across their portfolios and which portfolio companies are the greatest emitters. We look at the data through multiple lenses to identify those companies whom may be better or worse placed and where additional research or engagement may be necessary. In turn, we have a firm-wide commitment to engage with the highest emitting stocks in each of our funds and our analysts are subsequently able to see the progress of ongoing engagement towards mitigating the potential risk.

The notes of all engagement meetings of our stewardship team with companies are shared across investment teams and Hermes EOS clients in order that all are kept informed of developments and the progress against the milestones of particular engagements.

The Hermes Responsible Ownership Principles set out clearly what we expect of the companies that we and our clients are invested in. This includes an expectation that companies maximise long-term shareholder value through the economic, efficient and effective provision of goods or services that customers or society need or want. We have also developed our own corporate governance principles for many countries and regions addressing specific local issues. Hermes' overriding expectation is that companies be run in the long-term interest of shareholders; this requires a clear commitment to the principles of good governance which in the UK are well articulated within the UK's Corporate Governance Code. We urge companies to consider carefully how best to apply the principles and the spirit of the Code to their own circumstances and clearly communicate the rationale behind their chosen approach. We similarly endorse the global expectations set out within the ICGN's Global Governance Principles and the OECD's Principles of Corporate Governance.

In order to succeed in the long-run, we believe companies will need to effectively manage relationships with key stakeholders and be mindful of their impact on the environment and their role in those communities in which they operate as well as within broader society both of whom grant them their licence to operate. We are therefore interested in

and seek if necessary to influence a company's management of these wider risks and believe we have a duty to use our influence to improve the behaviour of the companies in which we invest, to the benefit of society as a whole. As our clients will in effect be "universal owners", their portfolios are exposed to the growing external costs, such as environmental damage, caused by companies, we therefore monitor and engage with companies to reduce these externalities and in so doing minimise their overall exposure to these costs.

On an exceptional basis, when we believe it is consistent with our being a responsible owner and is in the best long-term interests of our clients, we are prepared to be made insiders in order to assist company boards. However, we would expect to make a decision to be made an insider only after due consideration and due diligence has been conducted internally in order to confirm that on balance it is the right course of action.

Our approach to escalating engagement

Our stewardship team has clear and well-established protocols for how to identify engagement issues, to escalate an engagement and how to measure an engagement's effectiveness. Engagements with companies will normally relate to longer-term strategic, environmental, social or governance issues. Generally our engagement activity becomes more active where we believe:

- engagement will lead to an increase in the value of a company over the long term; and/or
- engagement will prevent or limit a decrease in the value of a company over the long term

In determining whether and how the engagement is taken forward, due regard is given to:

- the level of the company's exposure to the issue at hand,
- the likelihood of engagement success and potential to bring about positive change, and,
- the value of our clients' ownership of the company

Such considerations are based around an assessment of the likely impact of the engagement and the ultimate benefit to the value of the underlying holding. Each engagement is subsequently given an appropriate intensity tiering. Measuring and monitoring progress on engagements is carried out by setting clear engagement objectives and systematically measuring milestone progress against four objectives, these are:

- 1 the raising of the issue with the company
- 2 recognition by the company that the concern is valid
- 3 a plan to address the particular issue, and
- 4 successful delivery of the objective.

We consistently review the progress we are making against these objectives utilising a system that we have designed for managing and tracking our engagement activities.

We escalate the intensity of an engagement activity over time, depending on the nature of the challenges each company faces and the attitude of the board towards our dialogue – as a result a company's intensity tiering may change. Some engagements may involve just one or two meetings; others are more complex and will entail multiple meetings with management and board members over several years.

Such activity often requires persistence. Helpfully our long-term perspective enables us to persist with these difficult and time-consuming engagements.

Our engagements with companies may involve at various junctures:

- meetings with executive and non-executive directors;
- meetings with other company representatives;
- discussions with other shareholders of the company;
- participation in collaborative investor initiatives;
- discussions with other relevant stakeholders such as industry representatives, the regulator, customer groups etc, and,
- attendance at and/or submission of shareholder resolutions at shareholder meetings

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. With all engagements, we seek to build a strong relationship with the company and are willing to be patient, remaining focused on the achievement of goals which are directed towards long-term success.

We seek at each stage to work with boards, management teams and other shareholders and stakeholders to bring about changes in either strategy, financial structure, operational or risk management or governance. Any change we encourage a board or management team to make will be with the intent of improving a company's long-term performance.

We are fully cognisant that we, as shareholders, are granted a wide range of rights which both offer us protection and enable us to fulfil effectively our stewardship responsibilities. In particular, we consider the vote as part of the asset and accept that we have a responsibility to exercise this right in a considered fashion.

While we can be robust in our dealings with companies, the aim is to deliver value for clients, not to seek headlines which could undermine the trust that we believe should otherwise exist between a company and its owners. We therefore generally prefer not to take a public route when seeking change at companies. In our experience, working constructively with boards and management in private is most effective in achieving positive change. However, when no progress is made over an extended time period, we are willing to use the news media and other public forums to drive change. When doing so, we would normally notify a company in advance. Similarly, we have demonstrated a willingness to use the full range of rights that we have at our disposal, including the tabling of resolutions at shareholder meetings when necessary.

Our willingness to act collectively with other investors

We recognise the benefits of working with like-minded peers to advocate for change at particular companies as well as at a broader market level.

Hermes is proud to be an active participant in, and indeed be a founding member of many associations of investors; not least among these are the United Nations-supported Principles for Responsible Investment, the International Corporate Governance Network and the Investor Forum in the UK. The list of groups and associations in which we participate and promote responsible investment and stewardship are listed on our website.

Where there are shared objectives – in particular the promotion of long-term sustainable value – we use both formal forums and other more informal links which we have globally to work collaboratively with other investors on an ad hoc and on an ongoing basis.

Crucially, the primary concept of Hermes' stewardship service is to provide a mechanism for like-minded asset owners to pool their resources and in so doing create a stronger and more effective stewardship voice.

Our policy on voting and voting disclosure

Hermes considers the vote as part of the asset that a shareholder owns and recognises that we have an implicit fiduciary duty to exercise, or to recommend the exercising of this right in a considered and intelligent fashion.

We believe it is right that companies are clear as to our expectations of them and how it is that we will exercise our votes in line with these expectations. To that end, the Hermes Responsible Ownership Principles and our various regional corporate governance principles – including our Remuneration Principles for building and reinforcing long-term success – provide a clear framework for our voting policy.

We manage our voting via a partnership with proxy advisory firm ISS. While we have developed our own best practice regional principles which are based on local market standards, we benefit from the additional research and vote processing service ISS provide. The research received from ISS is however, only one of several inputs that we utilise in reaching a judgement and making voting recommendations to clients.

We generally seek to support and work with management resolving any concerns outside of the AGM cycle. Where however, we do consider voting against or abstaining on management resolutions, or voting in favour of shareholder resolutions opposed by management, and recommending as such to voting clients, we will whenever practicable contact the company before the meeting to discuss our concerns, thus ensuring that we are making a fully informed decision. If we vote against, or recommend voting against management recommendations on any matter we will inform the company after the meeting of our reasons for so doing and engage for relevant changes at the company.

We publish our voting disclosure one quarter in arrears so that we are transparently accountable publicly but that our dialogue with companies around voting issues is not compromised. This disclosure provides a description of where and why we have opposed management.

As a firm we do not engage in stock lending and endorse best practice principles such as the Securities Lending Code of Best Practice issued by the International Corporate Governance Network. Fundamentally, we believe that shareholders have a duty to see that the votes associated with their shareholdings are not cast in a manner contrary to their stated policies and economic interests.

Ensuring quality

Hermes receives an annual independent assurance on our internal controls which includes those relating to our proxy voting processes which supplement the periodic reviews undertaken by our internal audit function. In addition, we obtain independent assurance over the policies and procedures which underpin our stewardship policy statements in line with the AAF 01/06 Stewardship Supplement. We are happy to share this assurance with clients on request.

We are particularly cognisant of the need to maintain a focus on ensuring our engagements remain of a consistently high quality and outcome focused. For that reason, we have established a quality assurance programme through which directors in our stewardship team hold regular sessions with each engager to review and challenge the quality of their engagements. There is similar oversight and challenge with respect to the analysis and work being undertaken through our sector and theme teams. Finally, in compiling case studies to illustrate the success of engagement activities we invite the companies to review and sign-off on the claims that we make which we consider a helpful discipline.

HOW WE REPORT ON STEWARDSHIP ACTIVITIES TO OUR CLIENTS

We strongly believe in the principle of transparency and therefore include in our investment team client reports relevant information about our stewardship activities, including engagement, voting and ESG integration activity.

In addition, our public reporting on stewardship matters includes Hermes EOS' annual report; quarterly public engagement reports, quarterly voting disclosure, public case studies and weekly blog.

In addition to the above, Hermes EOS engages with stewardship clients on the formulation of its rolling three-year engagement plan, a short version of which is publicly available on our website, and the corresponding KPIs (key performance indicators); subsequently clients are kept informed of the progress of engagements against the various agreed milestones. Further still, clients are provided with a suite of reporting on our stewardship activities which includes:

- daily voting recommendation reports; detailed voting disclosures; quarterly voting statistics;
- weekly engagement news; detailed engagement reports and quarterly reports; and,
- client alerts on specific engagement news stories.

The EOSi portal provides clients with access to all of this information and more and our monthly EOSi Highlights calls expand on our work with companies, themes and sectors.

Named individual in relation to stewardship matters

Leon Kamhi (Head of Responsibility)

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Biography details for each Hermes EOS engagement professional are included on our [website](#) along with contact details for directors of Hermes EOS.

HERMES INVESTMENT MANAGEMENT

We are an asset manager with a difference. We believe that, while our primary purpose is to help savers and beneficiaries by providing world class active investment management and stewardship services, our role goes further. We believe we have a duty to deliver holistic returns – outcomes for our clients that go far beyond the financial – and consider the impact our decisions have on society, the environment and the wider world.

Our goal is to help people invest better, retire better and create a better society for all.

Our investment solutions include:

Private markets

Infrastructure, private debt, private equity, commercial and residential real estate

High active share equities

Asia, global emerging markets, Europe, US, global, and small and mid cap

Credit

Absolute return, global high yield, multi strategy, global investment grade, real estate debt and direct lending

Multi asset

Multi asset inflation

Stewardship

Active engagement, advocacy, intelligent voting and sustainable development

Offices

London | New York | Singapore

For more information, visit www.hermes-investment.com or connect with us on social media:   

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