OUTCOMES BEYOND PERFORMANCE

CORPORATE GOVERNANCE PRINCIPLES

Australia

Hermes EOS
September 2018

For professional investors only

www.hermes-investment.com

HERMES INVESTMENT MANAGEMENT

COMPANY PURPOSE

Companies aim to provide goods and services for customers and society at a competitive quality and price. This can only be achieved sustainably if they create and preserve value over time, not only for their shareholders but also for all stakeholders, society and the environment. Our expectation, therefore, is that companies should be run not only for shareholders, but should also have a wider purpose that benefits society. In turn, this supports the needs of savers and pensioners, who rely on sustainable returns from their investments, to provide them and their families with a secure future.

This document should be read in conjunction with the Hermes Responsible Ownership Principles[1]. They provide our views on corporate purpose and other issues that we believe are important for companies globally.

SUPPORT FOR THE AUSTRALIAN STOCK EXCHANGE CORPORATE GOVERNANCE COUNCIL'S PRINCIPLES AND RECOMMENDATIONS

We generally support the recommendations of the ASX Corporate Governance Council's Principles and Recommendations. We encourage companies to apply the Principles and Recommendations and, if they do not, to fully explain their reasons.

We have explained our thinking below on certain issues which we regard as particularly important for Australian companies, and we also highlight issues where we think Australian companies should go beyond the Principles and Recommendations.

BOARD COMPOSITION

Board independence and risk oversight

Boards of directors should comprise a substantial majority of independent directors with an appropriate balance of relevant experience and expertise. These directors should have the ability to represent the best interests of all shareholders, while having regard to other stakeholders. They should have a long-term focus, provide support and have the ability to challenge management when necessary. In addition, they should have oversight of the company's strategy and risk management.

As part of their oversight function, we expect directors to become highly knowledgeable about the company's strategy and most important risks. Directors must be satisfied that the executive team is managing these risks well. We believe the board's oversight of risk is crucial in defining a company's risk appetite, encouraging the right level and type of risk taken and discouraging undue risk-taking. This is particularly important when considering long-term factors, such as reputation and licence to operate. Boards should provide meaningful disclosure about how they fulfil their risk oversight role. This should include how the board and its committees ensure a good quality internal and external audit programme that can provide reassurance to investors about the company's financial statements and internal controls, and describe how the board oversees the identification and management of risks.

When considering the independence of individual directors, particularly those who sit on board committees, companies should follow the guidance of the ASX Corporate Governance Council's Principles and Recommendations. We do not have strict rules for retirement as a result of age or maximum tenure, and believe that detailed knowledge and experience of a company can be helpful. However, boards including a significant number of long-serving directors, including those with service at related companies or other links to each other, could lack objectivity. Wherever we see a group of directors that has served together for a prolonged period, particularly in the absence of obvious refreshment plans, we expect the board to cogently explain the reasons for the continuing appointment of those directors, and how this apparent lack of independence is managed and mitigated. If we see what appears to be overlong tenure and no obvious programme for renewing the board with suitably qualified directors, we may recommend voting against some directors, including the chair of the nomination and governance committee.

Succession planning

We believe that good succession planning at board and senior management level is essential for safeguarding long-term value for any organisation. It should involve contingency planning for the sudden loss of key personnel, as well as planning for foreseeable change, for example retirement.

Diversity

We believe that boards should seek diversity in its broadest sense, taking into account the company's long-term strategic direction, business model, employees, customers, suppliers and geographic footprint. We support the goal that boards, together with all levels of management, should broadly reflect the diversity of society. As members of the 30% Club, we believe that boards should already have achieved a minimum of 30% female representation or be able to demonstrate credible plans for achieving this goal in the near future. We therefore supported the proposed amendments to the third edition of the ASX Corporate Governance Council's Principles and Recommendations, requiring listed entities to set an objective of not less than 30% female representation in the composition of the board. We also welcome Recommendation 2.2 of the Principles and Recommendations, which states that companies should "have and disclose a board skills matrix setting out the mix of skills and diversity that the board currently has or is looking to achieve in its membership."

Board committees

We expect boards to establish formal, independently chaired, audit, remuneration and nomination committees. The audit committee should be fully independent, and the remuneration and nomination committees should have a majority of independent directors. If this is not the case, companies should explain how they manage potential conflicts of interest in respect of audit, remuneration and nomination.

[1] https://www.hermes-investment.com/ukw/wp-content/uploads/sites/80/2018/03/final-responsible-ownership-principles-2018.pdf

Combined chair/CEO

We believe that boards should have an independent chair, whose role is to manage the board, and a separate CEO, who manages the business. Combining the roles can confuse these responsibilities and overly concentrate power in one person, creating not only problems with oversight but also with accountability and ultimately succession.

We urge companies that continue to have a combined chair/CEO to consider appointing an independent chair to improve the effectiveness of board debates and accountability to shareholders. While we recognise that it may appear difficult to change this arrangement, our expectation is that on the appointment of a new CEO, the board should split the roles and appoint an independent chair, for approval by shareholders at the next AGM. We note that succession is harder to manage, and therefore riskier, when the roles of the CEO and chair are combined.

We may, on a case-by-case basis, support boards where one individual takes on both roles. However, in such cases, a permanent lead independent director or deputy chair should be appointed – one with the necessary characteristics and skills, who also has important and clearly defined powers. These should include a significant role in establishing the board's information requirements, meeting schedules and agendas, with regard to board and CEO evaluation, and succession planning, and the right to meet shareholders without management present. This helps to ensure that the independent directors can act effectively as a body to advise and to oversee management. We expect the board to explain how it has decided on the leadership structure of the company and the factors it will take into account at its next review.

From time to time, we request meetings with company or committee chairs or lead independent directors. Meeting shareholders is a key part of the roles of these individuals. Where this access is unreasonably denied, we are unlikely to support the re-election of those board members.

EXECUTIVE REMUNERATION

We are increasingly concerned that executive remuneration structures and practices around the world are not fit for purpose, neither serving long-term investors nor, in many cases, aligning properly with the core long-term objectives of companies.

Therefore we continue to hold many discussions on reforming pay with remuneration committee members, executives, human resource professionals, remuneration consultants and other investors around the world. We are often encouraged by their response to our views. However, pay practice within companies rarely reflects our discussions on our pay principles[2]. Our current thinking on executive pay can be summarised as follows:

Simplicity: pay schemes should be clear and understandable for investors as well as executives. Pay structures should be much simpler and less leveraged than they are at present, for example taking the form of a single incentive scheme and lower variable and total possible pay.

Shareholding: the executive management team should make material investments in the company's shares and become long-term stakeholders in the company's success. Significant shareholding requirements for directors should remain in place for a specific period of time following departure from the company, with no share sales allowed for at least one year.

Alignment and quantum: pay should be aligned to the long-term success of the company and the desired corporate culture, and is likely to be best achieved through long-term share ownership. Pay is often too high and pay schemes often seem to pay out significant sums which conflict with many shareholders' and other stakeholders' views of performance. Boards should be able to justify to investors, the workforce and the public the rationale for the CEO's and the most senior management's pay, taking account of the pay of the wider workforce. If they are not able to do so, directors should use their discretion to adjust actual or potential pay downwards. The rules of pay schemes should support this. Remuneration reports must explain how alignment with long-term shareholders is achieved.

Accountability: remuneration committees should use discretion to ensure that pay properly reflects business performance. Pay should reflect outcomes for long-term investors and take account of any decrease in the value of, or drop in the reputation of the company. Remuneration committees should take a more robust view on pay, using their judgement and being accountable for their decisions. They should avoid paying more than is necessary and not place too much reliance on existing practice and benchmarking which help to perpetuate many of the problems that we seek to address. The potential outcomes of a pay policy should be rigorously scenario tested with a cap on the total possible pay published in advance, to help reduce the risk of unintended consequences.

Stewardship: companies and investors should regularly discuss strategy, long-term performance and the link to executive remuneration. Executives should be encouraged to achieve strategic goals, rather than focus attention on total shareholder return or stock price appreciation. They should take account of the company's effect on key stakeholders.

We expect senior executives to willingly embrace these principles and, if they do not, for boards to consider the implications. Remuneration committees must take responsibility for the design, disclosure and dialogue on executive pay and we will hold them accountable for this.

Advisory vote on remuneration

The remuneration committee should be directly accountable through an advisory vote on remuneration. This vote should lead to improved communication between remuneration committees and investors. Companies that consult shareholders on pay practices on a regular basis are, in our view, better able to reflect their owners' views on remuneration. We expect clear disclosure on how a company's remuneration policy and practices meet the remuneration principles we have outlined above. When the remuneration report does not meet our expectations, we may also recommend a vote against the chair of the remuneration committee, or other committee members if he/she is not up for re-election.

[2] https://www.hermes-investment.com/wp-content/uploads/2017/09/Remuneration-Principles-Clarifying-Expectations.pdf

We support the 'two strikes' rule under which a company with a remuneration report receiving an 'against' vote of 25% or more of eligible votes cast at an AGM will see a separate conditional resolution (the 'spill resolution') at the subsequent AGM, allowing shareholders to vote in favour of a board spill if a second strike occurs. We expect companies which are subject to a first strike to respond appropriately to the concerns of investors. We will take account of any changes to remuneration practices as well as the broader interests of the company and its shareholders when deciding how to vote on board spill resolutions. Where we see insufficient action we are likely to recommend a vote against the re-election of the remuneration committee chair.

PROTECTION OF SHAREHOLDER RIGHTS

We rigorously seek protection of shareholder rights on behalf of asset owners, including the right to access information, propose resolutions and vote at shareholder meetings. We support a single share class structure and generally oppose any measures to increase the complexity of shareholding structures. We expect the unbundling of resolutions so that shareholders have the ability to vote distinctly on the general and enhanced authorities to issue shares as separate items on the agenda of shareholder meetings.

Dilution of shareholder ownership

We represent long-term share owners and strongly believe that the ownership interests of shareholders should be protected. We are therefore concerned about economic dilution through increases in a company's issued share capital that occurs by not offering all shareholders the right to participate in capital raisings.

ASX Listing Rules Chapter 7 dictates that each year a company may only issue more than 15% of its current issued share capital on a non-pro-rata basis if it has the specific permission of its shareholders. We strongly support mandatory dilution limits and believe that a lower limit, such as 5%, would be far more appropriate. We will generally recommend a vote against any resolutions requesting more than 15% dilution of existing shareholders, either in advance or retrospectively.

Related party transactions

We strongly encourage companies to establish board oversight and disclosure procedures requiring full transparency with regard to the direct and indirect interests of managers and directors. We therefore encourage companies to follow the guidance of the International Corporate Governance Network, which states that: "Every corporation should have a process for reviewing and monitoring any related party transaction. Typically, a committee of independent directors should review every related party transaction to determine whether such transaction is in the best interests of the corporation and if so, ensure that the terms of such transaction are fair to the corporation. The corporation should disclose details of all material related party transactions in the annual report of the corporation."

Shareholder proposals

We support the selective use of shareholder resolutions as a potentially useful tool for communicating investor concerns and priorities or the assertion of shareholder rights. Shareholder resolutions can be a powerful tool for expressing clearly the views of long-term shareholders in the context of the many short-term pressures on a company's board and management. Making constructive use of resolutions, and discussing them with directors, can help long-term shareholders maintain confidence in the board.

We expect boards to address the issues raised by shareholder proposals which receive significant support or where they are material to the company. In addition, we view any failure to implement a shareholder proposal that has received majority support as a clear indication of a board of directors not fulfilling its obligations to the owners of the company.

We support reform to the shareholder proposal filing process in Australia to make it easier to file proposals while providing protection from frivolous or vexatious filings, and to avoid changes to companies' constitutions.

MANAGEMENT OF ENVIRONMENTAL AND SOCIAL RISKS AND OPPORTUNITIES

Companies should effectively manage environmental and social factors that are relevant to their business, with a view to enhancing long-term sustainability. They should also disclose to shareholders on a regular basis how they identify and manage the relevant risks and provide evidence that these structures are effective. In addition, companies should clearly define board and senior management responsibilities for environmental and social issues. We believe that directors of companies are accountable to shareholders for the management of social, ethical and environmental risks and opportunities in the same way that they are accountable for the company's financial performance.

Ethical leadership

We expect companies to have best practice anti-corruption and anti-bribery policies and processes in place and robust compliance mechanisms to enforce them. However, these are not enough on their own. We expect the board to oversee the anti-bribery and corruption controls and – just as importantly – to set the tone from the top, to encourage the highest ethical standards, to drive the expectations and values of the organisation. This is to ensure that the culture is one in which corruption cannot thrive, and that the necessary organisational measures exist to provide the best possible defence against corruption. We may therefore seek to engage with companies where we judge the culture and values to be lacking or the effective oversight, management of, or reporting on anti-bribery and corruption to be insufficient.

Climate change

Climate change is a systemic risk to the value of the portfolios of our clients because of its economic and geopolitical consequences. We therefore support the goal of the 2015 Paris Agreement, which 195 countries signed up to, to limit global warming as a result of climate change, to well below 2°C. This historic commitment was helped by the intervention of companies globally, which publicly encouraged political action in the run-up to the Agreement.

Due to the systemic risk to the global economy, we expect every company to publicly support the Paris Agreement and to make this commitment a central tenet of its public policy and sustainability activity. In particular for companies whose value chain relies on significant energy usage or is exposed to the effects of climate change, the board should ensure that support for the Paris Agreement underpins the company's strategy. Every board should ensure that it has climate change on its board meeting schedules at least annually, and that it and senior management engage with experts who can advise them on the strategic risks and opportunities that climate change represents, and challenge the company's approach, if necessary.

We understand that companies may have different views on climate change from organisations of which they are members or from other organisations which they may be able to influence. Every board should make sure that the company uses all available avenues to influence these third parties, to encourage effective action on climate change in line with the Paris Agreement. Where a company and one of these third parties disagree on climate change, the company should explain publicly the action it has taken to argue for effective advocacy or action on climate change by that third party. It should also explain its reasons for continued participation in, funding or membership of the organisation despite this disagreement.

Task Force on Climate-related Financial Disclosures

We welcome the recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosures. We expect companies to adopt the recommendations in full. Companies should conduct scenario analysis to assess future transition and physical risks which will be brought about by climate change. As part of this scenario analysis, they should also identify and discuss their strategic options for a net zero emission world. In addition, we expect companies, especially those in sectors where climate risks are most material, to demonstrate clearly that they are managing both their current and possible future risks effectively. Furthermore, we expect companies to report on the opportunities presented by climate change. For instance, companies in the financial sector should report how they will help to finance the energy transition.

Human rights

Licences to operate are increasingly affected by the reputation of companies, including their performance on human rights. We support the UN Guiding Principles on Business and Human Rights and the UN Global Compact. We expect companies to use the reporting framework of the Guiding Principles to disclose how they manage human rights issues that are salient to their business.

UN Sustainable Development Goals

We expect companies to assess the relevance of each UN Sustainable Development Goal to their business and to consider how best to incorporate those which may be material into their business models and strategies. We urge companies to report on how they are responding to the SDGs and encourage them to participate with civil society on how best to support them.

Tax

We expect companies to:

- comply with all tax laws and regulations in all countries of operation;
- recognise the importance of taxation to the funding of good public services on which they and their stakeholders rely, and their commitment to pay their fair contribution;
- ensure that their tax policies and practices do not damage their social licence to operate in all jurisdictions in which they have a presence; and
- disclose the taxes paid by or collected by them in each country.

HERMES
INVESTMENT MANAGEMENT

OUTCOMES BEYOND PERFORMANCE

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, small and mid-cap and impact

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

Stewardship
Active engagement, advocacy, intelligent voting and sustainable development

Offices

London | New York | Singapore

Why Hermes EOS?

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.

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

EOS00250 0004771 10/18