OUTCOMES BEYOND PERFORMANCE

CORPORATE GOVERNANCE PRINCIPLES

United States of America

Hermes EOS
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For professional investors only

www.hermes-investment.com

HERMES
INVESTMENT MANAGEMENT

CORPORATE PURPOSE AND HERMES RESPONSIBLE OWNERSHIP PRINCIPLES

Companies aim to provide goods and services for customers and society at a competitive quality and price in a financially sound manner. This can only be achieved sustainably if they create and preserve value over time, not only for their shareholders but also for stakeholders, civil society and the environment. Our expectation, therefore, is that companies should be run not only for the 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 a secure future for themselves and their families.

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.

INTRODUCTION

Hermes EOS believes, as a representative of responsible long-term shareholders, that the interests of its clients should be aligned with the separate roles of company management and boards. All parties should seek to improve the company's long-term performance sustainably, and thereby its value to its long-term share owners, while respecting the interests of other stakeholders. We strive to foster a collaborative and constructive dialogue with companies. If necessary, we request change that we believe would be helpful.

Shareholders have over the last few years secured additional rights to enable them to hold boards of directors to account. We have supported these developments as we firmly believe that the additional rights can serve to improve the dialogue between companies and shareholders, including minority shareholders. This enhanced dialogue will generally mean that the exercise of these newly afforded shareholder rights will likely be unnecessary.

In July 2016, the Commonsense Corporate Governance Principles were published. Their publication demonstrates how far corporate governance has evolved in the US during the past few years. We are pleased that they have been updated in 2018 and we look forward to the further evolution of the principles, just as our corporate governance principles have developed over time. We have also become an endorser of the Investor Stewardship Group and its Framework for US Stewardship and Governance. However, our principles go further than the Commonsense Principles and the Framework in a number of areas. We look forward to continued healthy debate on governance matters with company directors, management and other investors on the many areas on which we would like to see continued progress.

In this sprit, these US corporate governance principles are intended to help boards of US companies address the longer-term issues they should consider when performing their decision-control role.

OVERARCHING PRINCIPLE

Importance of board and shareholder engagement

Dialogue between boards and committed long-term shareholders on long-term strategy and capital allocation, corporate governance and risk management, and on environmental and social risks and opportunities is essential. Through this exchange of views and improved mutual understanding, shareholders are better able to hold companies to account and are in a better position to attempt to influence, if necessary, the boards of companies in which they are invested. Our experience has shown that constructive engagement between shareholders and directors, based on relationships of trust, can lead to improved performance. In turn this should lead to increased value, as well as mitigating the risk of value destruction or damage to the company's reputation. Independent chairs, lead independent directors, other non-executive directors, and in particular board committee chairs should be available for meetings and teleconferences with long-term shareholders as an essential part of their responsibilities. Developing relationships with long-term shareholders can also be valuable to boards, particularly during corporate actions, downturns or times of crisis. We therefore expect boards to welcome more and better quality engagement between long-term investors and independent directors on matters for which they are responsible.

OTHER PRINCIPLES

While each company has a unique business model, circumstances and board composition, there are governance issues public companies in the US should consider:

THE BOARD

Ethical leadership

The board must set the tone from the top, demand the highest ethical standards and drive the expectations and values of the organization. This is to ensure that the culture is one in which bad behavior cannot thrive anywhere. It means that the company, every employee and any other individual associated with it seeks always to do the right thing and are supported to do so. This means that the necessary processes exist to provide the best possible environment for this to happen.

Ethical leadership includes but goes beyond compliance. The board must be able to take soundings from throughout the organization to satisfy themselves that the company has the highest ethical standards. It must ensure that management constantly develops and maintains processes to enable it to do so. We therefore seek to engage with companies where we judge that there may be shortcomings in the ethical leadership from the board or insufficient oversight of, management of, or reporting on ethics, culture and compliance.

[1] The Hermes Responsible Ownership principles can be found at: https://www.hermes-investment.com/ukw/wp-content/uploads/sites/80/2018/03/final-responsible-ownership-principles-2018.pdf

Board responsibilities

Boards should comprise a substantial majority of independent directors with an appropriate balance of relevant experience and expertise. These directors ought to have the ability to represent the interests of all shareholders, with a focus on the long term. They should provide support and, where necessary, a robust challenge to management.

The board and risk management

As part of their decision-control function, we expect directors to become highly knowledgeable about the company's strategy and most important risks. Directors must satisfy themselves that the executive team is managing these risks well, before ratifying management decisions and before making board-reserved decisions, such as CEO or chair selection. We believe board oversight is crucial in defining a company's risk appetite, encouraging the right level and type of risk and in discouraging undue risk-taking. This is particularly important when considering long-term factors, such as reputation and license to operate that affect a company's reputation, prospects and therefore value. Boards should provide meaningful disclosure about how they fulfil their risk oversight role. This disclosure should include the decision processes and factors the board and its relevant committees use to ensure an ethical approach to business and how they identify and manage risk. This should include descriptions of a high quality internal and external audit program. This can provide reassurance to investors about the financial statements and internal controls.

As a result of the requirements on the audit committee set by Sarbanes-Oxley and related regulations, we believe that this committee has limited capacity to oversee strategic risk areas alongside its core audit committee function. Where oversight of long-term capital allocation, cyber-security risk, key stakeholder risk, data privacy risk, environmental risk, or other material risk areas is tasked to the audit committee, we will question the companies corporate governance guidelines, and consider asking the board to think about how best to perform these important risk and strategy oversight functions.

Director independence

When considering the independence of individual directors, particularly those who sit on mandated board committees, companies should go beyond the definitions of independence set by the NASDAQ and NYSE stock exchanges. An independent director:

- Will have no direct material relationship with the company, other directors or its executives, which includes interlocking board memberships, including those of not-for-profits;
- Will not favor any single or group of shareholders, even if affiliated with or appointed by one or more shareholders; and
- Will not have sat on the board for such a long time, particularly with other directors, as to compromise his or her independence of mind and ability to hold management to account on behalf of shareholders.

We do not have strict rules for mandatory retirement age or maximum tenure and believe that detailed knowledge and experience of a company can be helpful. However, boards with a cadre of long-serving directors, including those with service at related companies or other links to each other, can indicate an over-familiarity and insufficient challenge to management or other directors. We expect a board to explain cogently the reasons for the continuing appointment of such directors and how the appearance of possible lack of independence is managed and mitigated, particularly when there are two or more directors who have served on the board together for more than 10 years. Where we see ostensibly over long tenure and no obvious program to refresh the board with suitably qualified directors, we may recommend voting against some directors, including the chair of the nomination and governance committee.

Board evaluation, diversity and succession

Boards should regularly evaluate their own performance, that of their committees and of each director. We encourage boards to periodically use independent outside consultants to help them obtain the best insights on how boards and individual directors can improve their performance. Boards should disclose how they conduct these evaluations which should cover, as well as performance, composition and structure and their future needs.

Boards of directors ought to have robust succession plans in place that provide for orderly refreshment of their members. These succession plans should be accompanied by thorough disclosures articulating how skill-sets, experience and other attributes contribute to the board's strategic needs and are matched, if applicable, to the specific roles or needs of the board.

We expect the board to report on how the attributes of directors and the board as a whole are assessed including the frequency of this assessment. Providing a matrix of board members' attributes may be helpful in this regard. While difficult to disclose, boards should also take account of directors' characters and personal style. For example a board should have members who can provide inspirational leadership and others who have the ability to execute and follow up a decision. Directors should be prepared to discuss how the board interacts when engaging with shareholders. When planning for succession or refreshment, a board should be mindful of the strategy and the diverse nature of the company's activities, and should consider employees, customers, communities and other stakeholders.

Most boards lack sufficient diversity to reflect the markets and communities in which they operate and should address this by acknowledging the issue and taking positive action to improve board diversity and diversity disclosure. Boards should therefore consider the skill sets, experience and age, gender, background, ethnicity, nationality, and veteran status, as well as other characteristics, of possible candidates. We expect to see an absolute minimum of 20% female directors as a first step towards gender equality on boards and elsewhere in organisations. We also expect to see overall diversity by other measures such as nationality and ethnicity to be at least 30% as boards and organizations work towards being much more reflective of their communities, customers and society. Where we perceive insufficient diversity of gender or ethnicity on a board we may oppose the election of the chair of the governance or nomination committee or the lead director and will normally do so if these minimal requirements are not met.

Combined chair/CEO roles

A significant and growing number of US companies have an independent chair and separate CEO. We encourage this structure as it is likely to be a more effective governance arrangement at most companies than combining the roles. We believe the chair should manage the board and the CEO should manage the business. Combining these functions can confuse these very different roles and responsibilities, which require very different attributes, and overly concentrate power in one person, creating not only problems with oversight, but also with accountability and ultimately succession.

We expect the board to explain how it has decided on the leadership structure of the company, when it was last reviewed, when it will next be considered and the factors it will take into account in its next review.

We urge companies that continue to have a combined chair/CEO to appoint an independent chair, to improve the effectiveness of board debates and accountability to shareholders. While we recognize that it may appear difficult to make changes in with regard to an already combined CEO/chair role, our expectation is that no later than upon the succession of the CEO, the board should split the roles and appoints an independent chair. We re-emphasize our belief that both CEO and chair succession is harder to manage, and therefore riskier, when these distinct roles are combined.

We are concerned about incoming CEOs that wish to be appointed chair. We understand that this is the prevailing model in the US. However, there is growing evidence to show that humble leaders are more effective[2] and we welcome the boards and CEOs who seek to enshrine less power in one individual with the risk that this entails.

We are also concerned by the position of executive chair. By its nature, the role is executive and therefore not independent. We do not see the role of leading the board as normally being a full-time responsibility. Therefore we fear the division of responsibility between the executive chair and the CEO is unclear, accountability can become blurred and risk can unnecessarily increase. These concerns are exacerbated when the chair, even if non-executive, is a former CEO of the company as this may make it harder for the board to scrutinize and challenge decisions made by the chair in the past. We are therefore likely to support shareholder proposals advocating for an independent chair.

Where the roles are combined, we may, on a case-by-case basis, support boards where one individual holds both roles, providing a permanent lead independent director is appointed and that person has not only the right character and skills, in our judgment, for the role, but has the following defined powers.

The Lead Independent Director

The powers of the lead independent director, in the absence of an independent chair, ought to include:

- The ability to call a special meeting of the board of directors or the independent directors at any time, at any place and for any purpose, including to consider the removal of the chair/CEO from one or both positions. Regular in-camera board sessions of only independent directors helps to ensure that the independent directors can act effectively as a body to both advise and to control the decisions of management.
- Consulting individually with the chair of the board, CEO and committee chairs on the topics and schedules of the meetings of the board and committees and approve such schedules to assure that there is sufficient time for preparation and discussion of all agenda items
- Presiding over meetings when the CEO is conflicted or absent
- Guiding full board consideration of the appointments, evaluations and succession of the CEO, the board and its committees
- Meeting one-to-one with the CEO after every regularly scheduled board meeting
- Guiding the annual self-assessment of the full board including the CEO
- Engaging with significant long-term shareholders at their request
- Issuing a letter or statement in the proxy describing how the board has operated during the year.

The company should state that the powers and role of the lead independent director are near-equivalent to that of an independent chair and explain why the person holding the position is the best candidate for the role and why the CEO still needs to be the chair.

From time to time, we request meetings with company chairs or lead independent directors. Meeting shareholders is an essential role of the directors. Where this access is unreasonably denied, we find it difficult to support some annual meeting agenda items, including the re-election of those board members.

EXECUTIVE COMPENSATION

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 private response to our views. However, pay practice within companies rarely reflects our discussions on our pay principles.[3] Our current thinking on executive pay can be summarized 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. Compensation reports must explain how alignment with long-term shareholders is achieved.

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.

[2] Please see https://www.wsj.com/articles/the-best-bosses-are-humble-bosses-1539092123 which contains links to a number of research papers.
[3] https://www.hermes-investment.com/wp-content/uploads/2017/09/Remuneration-Principles-Clarifying-Expectations.pdf

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 far 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.

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 compensation. 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.

Compensation, human capital management and culture

Boards need to ensure that they effectively oversee human capital management policies and practices at companies to ensure that management is instilling and embedding the desired culture across the whole organization and into its value chain. We are increasingly of the view that current compensation practices play little positive role in embedding cultural norms and expectations. Indeed misaligned compensation within companies and within the investment chain is largely responsible for the short-termism that afflicts most publicly traded companies. Moreover, the perception is that executive compensation is not only higher but is subject to different rules from how pay is structured elsewhere in companies. This disproportionality is damaging to the companies' license to operate and to their long-term performance. We expect compensation committees and boards to consider these two factors in their decision-making and for CEOs and senior management to be mindful of them when considering their own pay and those of others within the organization.

We believe that companies should develop coherent philosophies for how they pay their workforce, including the elimination of any gender or ethnic background pay gap, as well as how they provide rights to their workers and treat them with dignity and respect. Companies should also go beyond this to find ways to develop the potential of their workers to help ensure the long term success of the company. Companies should provide data and metrics to demonstrate their commitment in this area.

Share buy-backs

We believe that regular dividend payments are normally a better way to return cash to shareholders than share buybacks.

We are also concerned about the hidden cost of compensation through the dilution of outside shareholders and managing this dilution by share buy-backs, often at too high prices. Moreover, metrics such as return on equity and earnings per share can be flattered or even managed by share buy-backs.

Companies need to clearly disclose:

- The effect of share buy-backs on their compensation plans and how the result of their plans would differ without taking buy-backs into account and the adjustments made by the compensation committee as a result of the buy-backs or other changes to the capital structure;
- How the board decides on buy-backs in addition to other long term capital allocation choices; and
- Whether such buybacks are directly or indirectly financed by debt and how this effects the future risk profile of the company.

Advisory vote on compensation

The compensation committee should be directly accountable to shareholders through an annual advisory vote on compensation. This vote should lead to improved dialogue between compensation committees and investors. Companies that consult shareholders on pay practices on a regular basis are, in our view, better able to reflect the views of their shareholders on compensation. We expect clear disclosure on how a company's compensation policy and practice meet the compensation principles we have outlined above. Where companies decline to address shareholder concerns following a significant level of shareholder dissent, we may be forced to register concerns about pay by voting against compensation committee members.

Special One-Time Retention Schemes: boards that make special retention awards to CEOs are, in our view, showing a potential material weakness in their succession planning role. Such awards may likely lead us not to support the re-election of certain directors, such as the chairs of the nominating and governance committees, the compensation committee or the independent chair or lead independent director.

SHAREHOLDER RIGHTS

Shareholder meetings

We view the annual meeting process as a valuable discipline. Its notice provisions, relative infrequency, voice given to minority and individual shareholders all help to protect important shareholder rights while also reinforcing the separation of the governance roles of management, the board, and shareholders. We welcome how new technology can assist in the administration of shareholder meetings. However, we do not believe that shareholder meetings should be held virtually at the expense of a physical meeting. We will oppose any changes to annual meetings that in our opinion diminish shareholder rights.

Majority voting

It is our belief that electing directors is a fundamental shareholder right. We prefer for shareholders to have the opportunity to vote either for or against directors, instead of going through the more cumbersome process whereby the shareholder right to determine who is elected to the board is passed to the other directors under director resignation policies. We are pleased that a significant and growing number of US companies have adopted some form of majority voting, thus increasing accountability to their shareholders. We urge companies to adopt a full majority vote standard, with exceptions limited to narrowly defined legal and regulatory requirements, such as the need for financial expertise on certain board committees. Where a director does not receive majority support and is asked to remain on the board, the company should publicly commit to expediting a search for a replacement director and for the director to resign as soon as possible following the new appointment.

Multiple-class share structures

Multiple class share structures disenfranchise minority shareholders and often increase the power of one shareholder for a disproportionate financial stake. We encourage issuers with multiple-class share structures to adopt sunset provisions that put in place the concept of one-share one-vote. We advocate initial public offerings of companies with single class structures that provide a level playing field for investors. We normally recommend voting against the chair of the governance committee where multiple-class share structures are in place.

Shareholders' right to call special meetings

In other jurisdictions, including Canada and the UK, shareholders representing 5% of the outstanding issue are entitled to call a special meeting. This is an appropriate threshold that strikes the right balance between ensuring that such meetings are not called capriciously and still being practicable for shareholders to exercise. We accept that this right is significantly restricted in the US at the moment and are therefore will support 10% special meeting threshold as an appropriate level in the interim. As we do so, we highlight that shareholders who successfully request special meetings still need to obtain the requisite majority vote at the special meeting itself to effect change. We note that even in jurisdictions where the right to call meetings with 5% of the shares exists, such meetings are rarely convened. Providing the right for shareholders to call special meetings at a reasonable level of aggregate ownership demonstrates that the board is committed to open and trusting shareholder relations and increases director accountability to shareholders.

Shareholder proposals

We encourage boards to engage with serious, committed long-term shareholders, including ourselves as a representative of our clients. Where boards interact in an engaged manner with shareholders on issues that affect the long-term value of companies, we see less need to file or support shareholder resolutions.

We consider proposals on a pragmatic basis, reviewing each proposal in its company-specific context and considering the extent to which the issue in question has been managed, usually in the case of larger businesses, following dialogue with the company on the issues arising from the proposal. In our experience, shareholder proposals can be a catalyst for related dialogue with issuers and we thus avail ourselves of these opportunities, where appropriate, whether or not we support the resolution.

We expect boards to take and disclose action addressing the issues raised by shareholder proposals which receive significant support or 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 and not understanding its obligations to shareholders.

Proxy access

Shareholders in other jurisdictions may nominate director candidates on the board's slate. While proxy access in the US is increasing, the lack of universal adoption contributes to the often transactional and defensive nature of corporate governance and of board-shareholder dialogue. This situation and can lead to costly, distracting and divisive proxy contests.

We are therefore delighted that in 2015, proxy access began to be widely adopted. We are pleased that most large US companies have introduced this reform. We encourage all companies to voluntarily implement the necessary by-laws and governance changes to enact the right of shareholder access to the director nomination portion of the proxy statement. Shareholders owning 3% of the outstanding shares for at least three years, with no limit on the number of investors that make up this 3%, should be able to nominate up to 25% of the board, as originally proposed by the SEC. This high threshold presents a significant hurdle to short-term shareholders attempting to nominate candidates to the board on their own. Moreover, any candidate put forward for election should be voted on by all shareholders.

We note that this developing standard in the US is still weaker than the rights that shareholders enjoy in nearly all developed markets. We do not expect boards to implement by-law provisions that make the use of the right of proxy access even more difficult or cumbersome. Furthermore, we do not want to see restrictions on shareholders aggregating holdings, on share retention requirements after any election, on share lending when there is reasonable right of recall, nor on the compensation of director nominees (provided it is fully disclosed). We also do not expect to see onerous restrictions on previously nominated candidates that failed to win a majority of votes cast to prevent them from being nominated again. While boards should protect companies from the use of proxy access to gain creeping control, different groups of shareholders should have the right to nominate director candidates without restrictions beyond the reasonable thresholds we support. We are therefore likely to support enhanced proxy access shareholder proposals that are substantially in line with our principles even if they do not yet have the support of a majority of institutional investors. We are also likely to oppose the election of the governance committee chair or the lead director if boards propose proxy access that make the use of proxy access more difficult than what we believe is appropriate.

As experience has shown, we do not expect proxy access to be used often. However, we believe that its existence will help make boards more accountable and more responsive to dialogue with their long-term shareholders.

SOCIAL, ETHICAL AND ENVIRONMENTAL RESPONSIBILITY

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 and anti-bribery and corruption

We expect companies to have best practice anti-bribery and anti-corruption policies and processes in place and robust compliance mechanisms to enforce them. We expect the board to oversee the anti-bribery and corruption controls and to ensure that the necessary organizational measures exist to provide the best possible defense against corruption. Organizational controls are however insufficient on their own and the board must ensure that the company has the highest ethical standards and the culture is one in which corruption or other unethical behavior cannot thrive. We seek to engage with companies where we judge there may not be effective oversight of, management of, or reporting on anti-bribery and corruption, including where we have concerns about the culture and behavior that exists in the organization.

Diversity and inclusion

The boards should ensure that diversity and inclusion is effective across the company. Where there is an under-representation of women or ethnic minorities on the executive committee or in senior positions, we expect companies to develop diversity and inclusion targets and set timescales to achieve them. We encourage boards to monitor key indicators such as employee surveys, staff turnover, recruitment and promotion and pay ratios by category of employee. Boards should hold management to account on progress on diversity and inclusion and ensure that targets reflect the values and aspirations of the organization.

Climate change

Climate change is a systematic 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.

Because of the systematic 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 matters on its board agenda at least annually, and that it and senior management engages with outside 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 organizations of which they are members or from other organizations 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 organization 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 disclosure recommendations in full, as they apply to their industry. 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 disclose their strategic options for a net zero emission world. In addition, we expect companies, especially those in sectors where climate risks are the most material to demonstrate clearly that they are managing both their current and 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, and how climate risk is reflected in the cost of capital deployed to high emission or high physical risk borrowers and insureds.

UN Sustainable Development Goals

We expect companies to assess the relevance of each UN Sustainable Development Goal (SDG) 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.

Human Rights

Licenses 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.

Tax

We expect companies to:

- Comply with all tax laws and regulations in all countries of operation;
- Recognize 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 license to operate in all jurisdictions in which they have a presence; and
- Disclose the taxes paid by or collected by them in each country.

Lobbying and political or charitable contributions

The election of public officials, the enactment of laws and the establishment or changing of regulations affect all stakeholders. Corporations, as legal persons, are free to contribute to political efforts, to support charitable causes, and to lobby regulators and legislators within the bounds of directors' business judgment. The broad stakeholder effect of these efforts and expenditures demand good quality disclosure. While some corporations argue that such activity is a source of competitive advantage, we argue that this should be explained as should the possible reputational risk associated with the activity.

We encourage companies to provide reasonable disclosures in their mainstream reporting of their approach to major public policy issues affecting them. This should include details of their direct political and lobbying contributions and activities. The reputational risks associated with such practices call for investors to scrutinize this expenditure of financial and other resources better in order to assess their material impact. We expect web-based reporting that is easy to find and navigate and provides aggregate totals of political and lobbing donations, with click-through access to more granular reporting, including the amount of each expenditure and the identity of the payee for that expenditure. Reports should provide details on the expenses designed to influence legislation, elections and campaigns supporting (or opposing) candidates for public office. We also expect companies to describe why these activities are in the best interest of their shareholders and most important stakeholders and how it is an appropriate use of the funds of shareholders and other resources.

Moreover, we expect the disclosure on the governance responsibility regarding such expenditures. It should describe the various levels of responsibility for oversight from board level downwards, how the authorization process for donations works, taking account of the benefits and costs, including reputational risk, as well as monetary thresholds and other considerations for approval at each level. The disclosure should outline what factors are considered and how they are assessed in making the decision. If there is a tiered approval process, this should be explained in full. It should also demonstrate how decisions are monitored by management, and ultimately the board, and what happens if the board disagrees with the decisions made under the policy.

We also expect disclosure on how companies manage their relationships with trade associations and other third-party lobbying organizations. While we understand that companies and membership organizations do not always agree on policy or other matters, companies need to ensure that they have robust methods in place for assessing the cost and benefit of memberships and processes to influence the policy decision-making of such organizations. These should be disclosed in the same manner that we have specified for political contributions and lobbying expenditures. Moreover, companies should be transparent about their internal escalation process to influence a trade association to change its position or to determine whether to continue membership. Fundamentally we need to be reassured that the expenditures and activities within a third party lobbying organization are aligned with the long-term interests of our clients and the stated public policy positions of the companies of which they are shareholders. We therefore expect companies to describe their governance approach to both direct and third party lobbying in similar details to that of their political activities.

Where the disclosure and governance of these issues appears to be lacking, we are likely to support shareholder proposals supporting increased reporting and disclosure.

Above all, political and lobbying activities should be linked to the company's purpose and strategic objectives.

A similar approach applies to charitable activities and donations. The company should be able to show that its giving is linked to an underlying purpose, including supporting and nurturing the desired culture among its staff. The company should scrutinize its charitable activities and donations and be particularly mindful that any contributions to charities associated with directors or their families should be disclosed justified through this lens.

HERMES
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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

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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:

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