CORPORATE GOVERNANCE PRINCIPLES

Taiwan

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For professional investors only

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EOS

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 other stakeholders, society and the environment. Given this relationship, our overriding expectation, therefore, is that companies should be run not only for shareholders, but also with 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.

INTRODUCTION

We are signatories to and therefore support Taiwan's Stewardship Principles for Institutional Investors launched in June 2016. It is a framework to encourage a fruitful dialogue between institutional investors and companies, for the long term benefit of all stakeholders. The July 2018 revision of the Taiwan Company Act also supports improved relations between companies and shareholders.

The Financial Supervisory Commission has provided companies with voluntary guidance in the Corporate Governance Roadmap (2018-2020) with its five action plans to support companies to embrace and implement corporate governance improvements. We encourage companies in Taiwan to comply with both the spirit and practice of these recommendations. However, these do not cover all issues we regard as important for good corporate governance practices and we therefore outline additional issues and expectations in our principles to assist Taiwanese companies and their directors in understanding our views.

BOARD OF DIRECTORS

Composition and independence

We place a strong emphasis on the overall balance in the composition of the board. The board should comprise members with a diverse range of attributes, competencies, knowledge and experience to enable it to discharge its duties and responsibilities effectively. These include leadership skills, decision-making expertise, and the necessary characteristics and independence, to be able to effectively challenge and hold executive management to account.

We therefore encourage companies, regardless of their size in capital as stipulated by company law, to go beyond the Security and Exchange Act's requirement of two independent directors representing no less than one fifth of board seats, which became fully effective for all companies in 2017.

Similarly, we recommend that companies have an audit and a remuneration committee chaired by an independent director with an independent majority, or ideally entirely composed of independent directors.

The positions of CEO and chair should be separate as these two roles have different responsibilities which require very different attributes. In addition, combining these roles can unduly concentrate power, creating issues with oversight, accountability and succession. The chair should ideally be independent and non-executive, but if the company is able to provide sufficient justification for having an executive chair, we would prefer that he or she be independent on appointment. In cases where the positions of CEO and chair are combined, we expect a strong lead independent director who can demonstrate leadership in consolidating the voice of other independent directors, and care and diligence in safeguarding the interests of minority shareholders. We encourage companies to disclose the powers and responsibilities of the lead independent director.

We are also concerned if directors appear overcommitted. We regard a director as possibly over-committed if he or she has more than five directorships of public companies. When appointing directors, the company should disclose clearly to shareholders the director's other commitments.

We encourage companies to have effective mechanisms for assessing board performance, director independence and the quality of each director's contribution as well as that of each committee and the board as a whole. This will assist the refreshment of the board as the needs of the company evolve. It can also help to prevent excessive tenures and assist the process of replacing poorly performing directors or those whose skills are no longer required. We recommend boards question the true independence of directors with material connections with the company or prolonged tenures, regardless of their qualities and provide shareholder with confirmation of long-serving directors independence. We view any tenure in excess of nine years as potentially detrimental to independence, particularly when there is a group of directors with similarly extended tenure.

Diversity

Boards are most effective when they have access to knowledge and experience from a wide range of backgrounds that are relevant to the long-term strategic direction and geographic footprint of the company. While we respect the knowledge and skills of independent directors with academic or local government background, we recommend considering a wider pool of candidates with senior executive and international experience, as a wide variety of viewpoints and perspectives is likely to result in a better quality of debate and therefore decision making. Boards that have too much commonality of background run the risk of groupthink and complacency, both clear signs of governance failure.

We believe that boards should take account of diversity in its broadest sense, including gender, nationality and ethnicity, even in markets where the population is fairly homogenous. This is even more important for companies with a large global footprint. Skills, experience, character and other attributes will also be considered when assessing possible candidates for the board and other senior positions.

Global efforts to improve gender equality and emerging initiatives to promote women's progression in other Asian markets are ongoing. We encourage companies to have at least two female directors on the board as a step toward improved gender balance. Where there is an under-representation of women on the board, in comparison with the market average, we expect companies to develop a gender diversity target and to set a timescale to achieve it.

Shareholder Engagement

Dialogue between boards and serious, committed long-term shareholders on strategy, finance, corporate governance and risk management – including the management of risks and opportunities stemming from environmental and social issues – is essential. Through this exchange of views, shareholders can better comprehend, and if necessary, attempt to influence the boards of companies in which they invest, developing relationships of trust based on an improved mutual understanding. Our experience has shown that constructive engagement between shareholders and directors in these areas can lead to improvements in the governance, performance and value of companies. Conversely, lack of engagement can lead to increased risk.

Chairs and other non-executive directors, in particular board committee chairs, should make themselves available for meetings and teleconferences with minority shareholders, as an essential part of their responsibilities. Developing relationships of trust with long-term shareholders can be invaluable for boards. We therefore expect boards to welcome more and better quality engagement between long-term investors and directors, and for independent directors to participate in engagement.

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[1]. 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. Remuneration 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.

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.

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.

DISCLOSURE AND REPORTING

Meeting notification and proxy documents

For minority shareholders, the annual general meeting is a formal opportunity to obtain information about management's and the board's stewardship of their investments and, if necessary, to request clarification of any decisions taken during the year. The AGM is therefore an important accountability mechanism, and the communication in English of detailed information on all agenda items at least 30 days in advance of the meeting is a prerequisite for its effectiveness. All documents should be clearly displayed and accessible on the company's website.

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

Importance of good quality reporting

We believe that the quality of narrative reporting reflects the thought processes behind the board's strategy and indicates its ability to execute it. In addition, effective reporting means that engagement between share owners and boards is more productive. For this to be most useful, boards must report openly and transparently on the performance of the company and their stewardship of it over the year. It is essential that risk is reported in a way that allows investors to understand the main risks that the board has identified for the business and how the company manages and mitigates those. We encourage companies to move towards a more integrated reporting approach such as adopting the International Integrated Reporting Framework.

Auditor's quality and independence

Minority investors rely on the board to provide true and fair reporting of the company's performance and prospects. The external audit should provide significant assurance to outside investors. However, we have significant concerns about the quality of audit. We therefore rely on the audit committee to ensure that management prepares the financial statements and other disclosures to a rigorous standard and that the external audit is conducted to the highest possible quality. Where we have concerns about a company's performance or reporting that we believe the audit firm should have identified to the audit committee or to investors, we will consider not supporting the audit firm's reappointment and/or not recommending voting for audit committee members standing for re-election.

We consider that excessive payment of non-audit fees to the external auditor may compromise its independence. Although we acknowledge that the auditor may be well placed to provide urgent advice on taxation and transaction due diligence, or provide other consulting services, this should not happen on a regular basis and the non-audit fees should not exceed the audit fees. Where non-audit fees exceed audit fees on a regular basis, we may oppose the re-appointment of the auditor and the re-election of the chair of the audit committee.

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.

Business ethics and internal controls

Some companies in Taiwan have been associated with cases of unethical business practices including involvement in anti-money laundering, embezzlement, cybercrime, and insider trading. It is in the best interest of all companies to demonstrate high standards of ethics. We expect companies to have appropriate governance structures in place to counter bribery and corruption; such as best practice policies and processes, robust monitoring and independent compliance mechanisms. Further, 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 therefore seek to engage with companies where we consider the culture and values can benefit from effective oversight, management of, or more in-depth reporting on anti-bribery and corruption measures.

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.

Because of 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 (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 Capital Management

Employees are a company's most valuable asset. Businesses should therefore develop human capital management strategies and accompanying objectives that seek to maximise employee potential in order to maximise long-term value, through a positively engaged, committed and talented workforce. We encourage companies to provide qualitative contextual information describing their approach, as well as annual disclosure of the KPIs they use to manage their human capital. These should include the company's total number of employees, annual turnover and total recordable incident and lost time injury frequency rates.

DATA PRIVACY

We expect companies to establish and publish a data privacy policy that complies with associated rules and regulations, including but not limited to the EU General Data Protection Regulation (GDPR), which applies to global companies if EU subjects seek explanation from companies on how their personal data has been used. Companies should put in place process and escalation procedures to monitor the violation of data privacy policy. We seek evidence of ongoing effort to establish a culture of data protection, covering personal, customer and third party data.

CYBER SECURITY

All companies face data privacy and cyber security risks. We encourage companies to establish board expertise and oversight on matters related to information security, with a thorough understanding of the company's digital footprint. At least annually, the board should conduct a comprehensive review cyber security performance. Regular updates from staff and external advisers, and feedback on infrastructure security should also be provided to the board. There should be timely hardware and software updates to minimise the risk of virus attacks. When attacks do take place, there should be a comprehensive business continuity plan to address weaknesses identified for improvement. Companies should also proactively communicate to shareholders evidence of ongoing effort to establish a culture of cyber security awareness amongst all staff, including contractors.

TAX

We expect companies to comply with all tax laws and regulations in all countries of operation. Companies should 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. They should 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 | Denmark | Dublin | Frankfurt | 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.

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