OUTCOMES BEYOND PERFORMANCE

CORPORATE GOVERNANCE PRINCIPLES

Germany

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For professional investors only

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HERMES EOS

CORPORATE PURPOSE AND HERMES RESPONSIBLE OWNERSHIP PRINCIPLES

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. 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] These principles provide our views on corporate purpose and other issues that we believe are important for companies globally.

SUPPORT FOR THE GERMAN CORPORATE GOVERNANCE CODE

We welcome the recommendations of the February 2017 version of the German Corporate Governance Code[2]. We encourage companies to fully comply with the Code, while recognising that good governance cannot be guaranteed merely by adherence to its principles and recommendations. We therefore urge companies to consider carefully how best to apply the principles and spirit of the Code to their own circumstances and clearly communicate to shareholders the rationale behind their chosen approach. In our German Corporate Governance Principles, we set out in more detail the key elements of corporate governance that guide our approach to stewardship in Germany. These sometimes go further than the current provisions of the German Corporate Governance Code.

SUPERVISORY BOARD (AUFSICHTSRAT)

Composition of the supervisory board

It is of fundamental importance that the supervisory board comprises members with a diverse range of competencies, knowledge and experience to enable it to discharge its duties and responsibilities effectively. A sufficient number of truly independent board members with these attributes is required to achieve this outcome. Due to the inclusion of employee representatives on them, we would like to see supervisory boards in German companies to be at least one-third composed of independent non-executive members. Excluding the employee representatives, we would like to see a higher level of independence of at least 50% of the remaining directors.

It is important that supervisory board members are chosen on the basis of their ability to carry out their responsibilities in a way that helps to ensure the long-term success of the company, including sustained value creation. To that effect, we welcome the Code's recommendation (5.5.1) and reiteration of the German Stock Corporation Act that all supervisory board members are bound by the company's best interests rather than by their personal interests or the interests of a particular stakeholder group. This should be read in the context of the guidance provided in the Code's foreword: "[It is] the obligation of the Management and the Supervisory Boards to ensure the continued existence of the enterprise and its sustainable creation of value in line with the principles of the social market economy (in the company's best interests)." The supervisory board as a whole and each director individually must be mindful of these responsibilities in the performance of their duties. Evaluation of the supervisory board's effectiveness should consider how to alleviate the challenge of infrequent meetings of a large body with members with different viewpoints. It is possible that non-independent directors could feel greater pressure to represent the interests of particular stakeholder groups than those of the company. Each director and the supervisory board as a whole must be mindful of this risk. The chair has a vital role in working with the directors to mitigate this risk.

Employee representation

We recognise the value that employee representatives can bring to the supervisory board through their experience and expertise, particularly if they are employees of the company concerned. They also bring a wide range of perspectives, including on issues such as executive remuneration and human resource management. However, employee representation at the supervisory board level is one of the reasons why supervisory boards tend to be large. This is likely to reduce their efficiency and effectiveness and the board, led by the chair, should put in place measures to prevent this. We also note that the German system of co-determination provides only employees based in Germany with the opportunity of representation at the supervisory board level and reserves a number of board seats for trade union officials also based in the country. This is difficult to justify as employees from other countries are likely to be disenfranchised. We understand that a number of publicly listed German companies that have converted their legal status to societas Europaea have chosen to do so at least partly to address concerns related to the German system of co-determination. However, we discourage companies from converting their legal status solely on the grounds of avoiding employee representation on the supervisory board.

Investor dialogue with the supervisory board

We support the Code's requirement that chairs of supervisory boards should be available for investor dialogue (paragraph 5.2). Our expectations of the format and content of communication between supervisory boards and investors are shaped by the Guiding Principles for the Dialogue between Investors and German Supervisory boards[3] which we developed in collaboration with key stakeholders. We encourage companies to refer to these guiding principles, which outline key features of this dialogue such as participants, content and format.

[1] https://www.hermes-investment.com/ukw/wp-content/uploads/sites/80/2018/03/final-responsible-ownership-principles-2018.pdf
[2] The German Corporate Governance Code is under review at the time of publication. The review is to be completed in early 2019 and we are providing our input in the consultation process.

Election/re-election of supervisory board members

The election and re-election of supervisory board members is the principal mechanism for shareholders to hold them to account. To ensure individual accountability, it is international best-practice that members of the supervisory board are (re)elected individually. The Code's recommendation that appointments to the supervisory board should be made on an individual basis (paragraph 5.4.3) therefore needs to be followed without exception.

We believe that there should be repercussions when shareholders do not strongly support the discharge of a supervisory board member. Whenever a member of the supervisory board has lost the confidence of a significant percentage of shareholders, he or she should, as a minimum, not be permitted to be chair or vice chair of the supervisory board or a member of any of its committees. Any supervisory board member, whose discharge was not unequivocally supported during his or her tenure, should generally not be proposed to shareholders for re-election. In these instances, we encourage companies to engage with investors well in advance of the next annual general meeting (Hauptversammlung) to discuss the nomination process and candidates. In addition, we expect the board to communicate its response to any shareholder proposals filed with respect to appointments ahead of the annual general meeting.

Removal of supervisory board members

The right to remove the shareholder-elected members of the supervisory board, although rarely used and rightly regarded as a last resort, acts as an important reminder to the board that it is ultimately accountable to the shareholders. However, to be effective, the possibility of removal must be realistic. As such, we expect it to be possible for a simple majority of shareholders at a shareholder meeting to remove members of the supervisory board.

Appointment period of supervisory board members

We would welcome a recommendation in the Code to the effect that appointments of supervisory board members should not exceed three years. However, we recognise that very occasionally there may be good reasons for longer appointment periods and will consider this issue pragmatically, provided that the company discloses the reasons well and engages meaningfully on the specific reasons. This recommendation recognises that company-specific experience, knowledge and regular board refreshment are essential to the effective functioning of supervisory boards. Good succession planning at the supervisory board is an important safeguard to the continued success and long-term value for any organisation.

Supervisory board – cooling-off periods

It used to be widespread practice in Germany that the chair of the management board became chair of the supervisory board after retiring from day-to-day management. There may be a case for appointing a successful former chair of the management board to the supervisory board, not least because he or she will have an in-depth knowledge of the company. However, the roles of chair of the supervisory board and chair of the management board, as well as the competencies, knowledge and experience required for these posts, differ significantly. In addition to conflicts of interest that may arise, the two roles typically are best served by individuals with different characteristics. The supervisory board chair plays a vital oversight, challenge and mentoring role, which is different from the executive function of the management board chair. We therefore believe that as a general rule the chair of the management board should not become supervisory board chair and, for similar reasons, not become a member of the audit committee either. By adopting this approach, potential for conflicts of interest is reduced. These may otherwise arise where a supervisory board chair has to lead a review of decisions taken during, or issues that relate to, his or her tenure on the management board. Instead, a successful former chair of the management board could be proposed for election as an ordinary member of the supervisory board.

We generally welcome the Code's recommendation (5.4.4) that all other members of the management board should not become supervisory board members within two years of leaving the executive office at the company. This is consistent with Section 100.II of the German Stock Corporation Act, according to which a member of the management team is not allowed to become a member of the supervisory board until two years after his or her retirement from any management position. However, we believe that the mandatory waiting period of two years as stipulated by law may occasionally lead to the loss of valuable experience and relevant knowledge from the supervisory board, potentially resulting in the diminishing rather than a strengthening of the board's efficiency. The global financial crisis has shown that company-specific knowledge and sector experience are of high importance for the overall efficiency of supervisory boards.

Committees of the supervisory board

We expect companies to establish three committees – audit, nomination and remuneration – and that these should consist of at least three members. We therefore support the Code's recommendations on supervisory board committees (5.3.1 – 5.3.3). The satisfaction of independence criteria for these committees is essential for them to fulfil their intended function. Therefore, we may recommend to vote against the (re)election of the non-independent shareholder representatives, serving on a particular committee. If there are no shareholder representatives up for election, we may vote against the discharge of the supervisory board.

Audit committees - We welcome the Code's recommendations regarding the skill set of the audit committee chair. We agree that the chair of the audit committee should be independent, therefore be neither a former member of the management board nor the chair of the supervisory board. (paragraph 5.3.2). We also strongly believe that the audit committee should not be chaired by a representative of a major shareholder. The chair of the audit committee should be a financial expert, with specific experience in accounting and internal control.

[3] https://www.ey.com/Publication/vwLUAssets/ey-buiding-principles-for-the-dialogue-between-investors-and-german-supervisory-boards/$FILE/ey-buiding-principles-for-the-dialogue-between-investors-and-german-supervisory-boards.pdf

Given the potential for conflicts of interest, we further believe that all members of the audit committee should be demonstrably independent directors with the relevant competencies, knowledge and experience.

Nomination committees - We support the Code's recommendations on nomination committees (5.3.3). We believe that nomination committees should consist of a majority of independent members and should not be chaired by a representative of a major shareholder. We strongly encourage German companies to involve shareholders in corporate governance decisions, such as the nomination of candidates for election to the supervisory board. While we recognise the legal and practical limits to this, there are a number of mechanisms, such as a consultation of shareholders on the criteria, which should be taken into consideration when assessing the composition of the supervisory board and be compatible with the relevant German law.

Remuneration committees - We strongly encourage companies to establish a remuneration committee. We expect the remuneration committee to ensure that remuneration structures and practices are relevant to the company's businesses and support the long-term creation and preservation of value. To that effect, we would like to see a provision in the Code which specifically recommends that companies set up a remuneration committee. We believe that the majority of remuneration committee members should be demonstrably independent. In particular, the chair of the remuneration committee should be independent and not a former member of the≈management board.

Corporate governance committees - Companies which set up corporate governance or shareholder relations committees to monitor business relations and transactions between them and companies controlled or associated with their major shareholders should ensure that the purpose of these committees is reflected in their composition, terms of reference and reporting. These committees are meant to be a corporate governance safeguard mechanism, principally for outside shareholders. They should thus be composed of demonstrably independent members and also have terms of reference that ensure that business relations and transactions with all the relevant entities related to major shareholders are monitored and reported in a meaningful way to outside shareholders at least on an annual basis.

Attendance and commitment supervisory board members

At present, the Code does not contain a recommendation on the number of external board appointments a supervisory board member is allowed to hold. However, we view it as essential that each supervisory board member is able to dedicate sufficient time and commitment to the fulfilment of his or her role.

Therefore, we welcome the recommendation in the Code (5.4.1) that the supervisory board should ensure when proposing new board members, that the candidate will be able to dedicate sufficient time to his or her board duties. In practice, we are concerned that this recommendation does not account for the varying time requirements of board positions, which can rapidly and significantly fluctuate in line with changing company circumstances. It would be more effective to recommend a limit on supervisory board memberships, with companies providing specific explanations when they do not want to comply with the provision for a director.

We therefore strongly encourage a recommendation in the Code on the number of supervisory board positions. We believe that an individual should hold no more than five supervisory board or similar positions and fewer than this is in very large complex organisations particularly if the director has committee responsibilities. Furthermore, we recommend that chief executives do not hold more than one chair position or two non-executive directorships in a large company.

Evaluation of the supervisory board

The Code's recommendation to regularly evaluate supervisory board efficiency (5.6) has encouraged more and better practice in this area. We would like to see the Code also suggest externally-conducted board evaluations on a regular basis and more comprehensive reporting on the results and actions arising from them.

Diversity

We believe that boards should seek diversity in the broadest sense, taking into account a company's long-term strategic direction, business model, suppliers, employees, customers and geographic footprint. We expect that supervisory and management boards, together with all levels of management, should broadly reflect the diversity of society, including across dimensions such as age, race and gender. As members of the 30% Club of Investors, we believe that supervisory and management boards should achieve a minimum of 30% female representation and, if not, set out plans to reach that target by 2020 as a first step to gender equality. As we approach 2020 we expect companies to demonstrate progress towards this target. We will seek a dialogue with companies, where new appointments do not show sufficient progression towards this target and may recommend a vote against directors' appointment from 2020 onwards.

MANAGEMENT BOARD (VORSTAND)

Appointment period of management board members

We favour contract periods for members of the management board of significantly less than the legal maximum of five years. Five-year periods not only reduce the accountability of management board members but may also lead to significant liabilities for the company if the appointment is terminated before expiry of the contract. We also welcome the cap that is recommended with regard to the termination of contracts in change of control situations, even though this leaves scope for generous pay-offs. We find it particularly difficult to support initial appointments to the management board for periods of more than three years, since they may prove costly if they need to be terminated prior to expiry.

There should be repercussions whenever shareholders do not strongly support the discharge of a management board member. If a member of the management board has lost the confidence of a significant percentage of shareholders, the supervisory board should consider whether, as a minimum, refreshment of the management board is required.

The remuneration committee should seek to reduce contract lengths and contractual severance payments and explain the reasons if they are not lower than the Code recommends.

REMUNERATION (VERGÜTUNG)

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[4]. 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.

Supervisory board remuneration

We note that the Code allows members of the supervisory board to receive performance-related as well as fixed remuneration (5.4.6).

Participation by supervisory board members in performance-related pay or incentive plans is likely to align their financial interests too closely with those of management board members and senior executives. We therefore will almost always oppose any such arrangements. If used, we encourage companies to explain fully the design of performance related remuneration plans for supervisory board members, in particular how they ensure that these plans do not create conflicts of interest.

To encourage share ownership by supervisory board members and thus ensure a clear alignment of their interests with those of shareholders, we would like to see a majority of their remuneration paid in shares which should be held for at least four years and at least one year after the director's departure from the supervisory board.

Management board remuneration

Important concerns regarding the remuneration of management board members include: the quantum of remuneration; no clear alignment with the company's long-term success; payments despite serious misconduct and/or missed targets; unjustified termination payments; and the complexity or lack of transparency of remuneration policy or systems, as they are referred to in Germany. As a result, the regulation governing management board member remuneration has increased considerably in recent years.

We welcome the output of the working group initiated by Hermes EOS which has developed guidelines for sustainable management board remuneration systems in German listed companies, published in July 2018. The guidelines build on the principles of the Code and best practice examples and provide guidance for the design of remuneration policies, reporting and investor engagement. They represent a[5] compromise between different stakeholders, as well as more ambitious suggestions that we strongly support, even though the guidelines do not go as far as the Hermes pay principles described earlier.

[4] https://www.hermes-investment.com/wp-content/uploads/2017/09/Remuneration-Principles-Clarifying-Expectations.pdf
[5] http://www.guidelines-executivecompensation.de/wp-content/uploads/2018/08/Leitlinien_EN_Web.pdf

Design

Remuneration packages should be designed to promote the long-term success of the company. The supervisory board should formulate management board remuneration principles that guide the board in its decision making process to incentivise sustainable success and reflect the objectives of important stakeholders of the company.

The objective of any remuneration scheme should thus be to align the interests of executives with those of long-term shareholders by linking a substantial part of their variable remuneration to the company's performance over at least three years and to the underlying returns earned by shareholders over this period.

To foster simplicity, the remuneration system should be applied to all with the same structure applied to all employees. Further, remuneration systems should be based on no more than three pillars (fixed salary, annual variable remuneration and multi-year remuneration).

Variable remuneration should be based on predominantly long-term focused corporate objectives to reflect the successful implementation of the company's strategy and the company's sustainable performance in comparison with its peers. Long-term company objectives derived from the company's strategy should include material sustainability parameters (e.g. innovation, environmental and social impact, corporate culture, customer service and employee satisfaction) alongside strategic and financial objectives. As part of longer-term, variable remuneration, malus and clawback provisions can help to reduce the misalignment of interests of executives with those of shareholders, as they will result in reduced payments in the event of breach of duty, misconduct and violations of material compliance and governance requirements.

We support the Code's recommendation to introduce a cap for overall remuneration, as well as a cap for all individual remuneration components (4.2.3). This allows an evaluation of remuneration over a variety of outcomes and ensures that payments are not unexpectedly higher than shareholders would expect, a feature that has been lacking at some companies in the past. Total remuneration is considered capped when all individual components of variable remuneration elements have an upper limit and include share price performance and pension contributions are only linked to fixed remuneration.

Management board members and senior executives should be required to invest in or be paid in shares and hold a significant amount of equity over the long term. Ownership of shares over the long term is the best form of alignment between executives and shareholders. We expect shareholdings of an absolute minimum of 300% of gross fixed salary for management board members or 500% of gross fixed salary for chief executive officers. Compliance processes to ensure contractually agreed share investments are legally permissible purchases should be put in place (e.g. by automatic purchases on pre-determined dates). Shares should be owned for a minimum period, with a proportion to be held post-employment.

Reporting

Remuneration policies should be disclosed annually so that shareholders can assess whether the interests of senior management have been aligned with their own. Furthermore, we encourage companies to prepare and publish detailed remuneration reports. These reports allow companies to articulate policies on remuneration and explain how they support strategic objectives. The reports should also explain the remuneration system and the resulting amounts of remuneration clearly and concisely, including the use of representative charts and tables, to show the performance metrics, explanations on the pay-for-performance relationship, the maximum achievable remuneration level – and under which conditions this can be achieved for each management board member. Further, the report should include underlying key performance indicators (KPIs) for every variable remuneration component, the target levels (threshold, target and maximum amounts), their weightings and the performance achieved against the targets for the last performance period at least on an ex post basis.

One-time payments, if exceptionally granted, should be transparent and adequately justified. The remuneration report should also state the factors that led the supervisory board to exercise any discretion. Increases in remuneration should be presented clearly and adequately justified, including peer comparisons.

Engagement

We promoted advisory votes on remuneration policies in our German Corporate Governance Principles for some time, even before the corresponding legal framework was introduced. We therefore support the advisory shareholder votes on executive pay. We also welcome the introduction of the amended EU Shareholder Rights Directive into German law, expected in mid-2019, which will make a binding say on pay vote an item on the AGM agenda at least every four years.

From our experience in other markets, regular constructive dialogue between the board and investors on remuneration and its role in long-term value creation and success of the company is of great importance, particularly in the event of material changes to the remuneration system. The dialogue should take place sufficiently in advance of the next AGM (generally no later than six months before the meeting) and before the remuneration committee has finalised its proposals. In addition, it should include shareholder advocacy groups representing retail investors and proxy advisors.

An advisory vote can be an important part of this interaction as it provides shareholders with an opportunity to formally express their opinion about the design and implementation of the remuneration policy. We therefore encourage German companies to provide shareholders with the opportunity to vote on their remuneration policy, particularly if there have been significant changes to the remuneration policy or if there was a significant number of votes against the policy in the previous year. In the event of around 25% or more vote against the remuneration proposal at the AGM, we expect remuneration committees to engage with investors on the most important elements of the remuneration system. This is even more important when the vote against the policy is even higher.

REPORTING AND AUDITING

Reporting

We believe that the quality of reporting reflects how well the supervisory board oversees and the management board executes the company's strategy. Good quality reporting that is fair, balanced and reasonable supports engagement between shareowners and boards. Thus, boards must report openly and transparently on the performance of the company and their stewardship of it over the year, acknowledging the challenges, as well as the achievements, the state of the market and the competitive landscape. It is also fundamental 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 them.

Auditing

The audit process is vital to ensuring the integrity of company reporting on essential matters, such as the solvency of the company, its prospects for longer-term viability and its financial health. Audit committees play a critical role in overseeing this process and ensuring the quality of reporting to investors. They should therefore report on their main activities, the most important issues they have considered and how they ensure the quality of the audit on behalf of the company's owners. This should include the assessment of the quality and independence of the lead audit partner which can be affected by working too closely with the management board over time. Audit committees should pay particular attention to the reappointment of the lead audit partner after five years and discuss the quality of the audit team on an annual basis.

We support EU Regulation No 537/2014 on the specific requirements regarding the statutory audit of public interest entities. We believe that the tenure of the auditor should not exceed 10 years as we think that regular retendering should help to improve the independence and quality of the audit.

We do not believe that audits should be compromised by the firms carrying them out also receiving significant non-audit fees from companies within the group they are auditing. Consistent with EU regulation, we expect non-audit fees not to exceed 70% of the average of the audit fees over the previous three years. We expect companies to justify the amount of non-audit fees in the supervisory board section of the annual report by explaining why the auditor was best qualified to provide these services. While this is no panacea, we believe that this will help to protect the integrity of the audit.

Given our concerns about audit quality, we hold audit committee members responsible to ensure good quality audits. Further, we encourage companies to disclose the name of the lead audit partner responsible for carrying out the audit in the supervisory board section of the annual report.

SHAREHOLDER RIGHTS

We encourage German companies to involve shareholders in decisions concerning major corporate changes, such as major acquisitions, disposals or takeovers, even in situations where this is not required by German law or recommended by the Code.

Capital issuance requests

We are concerned about capital issuance requests from companies, especially requests to issue new capital without pre-emption rights for existing shareholders. We believe that pre-emption rights are an important safeguard for shareholders and their interests in the companies they invest in. Therefore, we generally do not support any proposal for capital issuance without pre-emption rights that would involve the issuance of additional capital of more than 10% of the already outstanding share capital even if there are pre-emptive rights. We do not generally support any capital issuance proposal which involves issuing more than 20% of the outstanding share capital. On a case-by-case basis, we might deviate from this, against the backdrop of, for example, a large, well- justified corporate transaction, such as an acquisition. However we note that many large acquisitions do not lead to the expected benefits and so we tend to be sceptical about their benefits.

Share repurchases

We generally do not support share repurchase programmes which allow companies to buy back shares for a price which exceeds the market price of the shares by more than 10%. We oppose the authorisation of share repurchase programmes whose validity exceeds 18 months or which allow companies to buy back more than 10% of the outstanding shares. On a case-by-case basis, we will evaluate whether we support such authorisations. We expect a company to provide a sound explanation for why it requires the authority to repurchase shares over a longer period than 18 months or more than 10% of the outstanding total.

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 their sustainability. They should also regularly disclose to shareholders how they identify and efficiently manage material risks and opportunities in these areas and provide evidence that the processes in place to do so are effective. Furthermore, companies should clearly define board and senior management responsibilities for environmental and social issues. Directors of companies should be accountable to shareholders for the management of material environmental and social risks, as over the long term these will affect the value and ability of companies to do business. We may seek to engage where we judge the oversight, management of, or reporting on environmental and social issues to be insufficient.

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 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.

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.

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 UN Guiding Principles Reporting Framework to disclose how they manage human rights issues that are salient to their business.

United Nations 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 encourage companies to report on how they support the SDGs and to engage with civil society to find out how best to respond to 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 of 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 | Denmark | Dublin | Frankfurt | New York | Singapore

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Hermes EOS

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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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