DELIVERING HOLISTIC RETURNS

Strategy and approach to acting as a responsible owner, investor and firm

2019

For professional investors only

www.hermes-investment.com
A MISSION TO DELIVER OUTCOMES BEYOND PERFORMANCE

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

We recognise that as fiduciaries, entrusted with the savings of millions of individuals, we have responsibilities which go beyond those defined in any contract – these are to our clients and their ultimate beneficiaries. We have these responsibilities because our decisions will have impacts on the world in which beneficiaries live and work today as well as the one in which they will retire into tomorrow. Our goal is to help people invest better, retire better and to create a better society for all.

In order to deliver the needs of our pension saving beneficiaries we are cognisant of our commitment to clients to deliver superior risk-adjusted investment returns within the terms of our mandate. We also understand that the way we achieve these financial returns will have a wider impact and will consequentially likely impact upon the real value of their retirement incomes. These factors, while more difficult to quantify and measure, will be significant to beneficiaries’ ultimate quality of life and cost of living.

It is this understanding that informs our belief that we have a duty to consider the longer-term risks and opportunities when investing. This means extra work in analysing companies, understanding externalities, governance practices, environmental impacts, treatment of workforces and the influence of operations on local communities. It also means using our influence to improve the behaviour of those companies in which we have invested; the operations of the assets that we directly manage; and advocating for systematic improvements to the financial system in which we participate.

Achieving this mission will mean putting the interests of our clients and their ultimate beneficiaries front and centre of all that what we do. This is a commitment that all Hermes employees are committed to and is embodied in our Pledge of Responsibility.

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**Sustainable companies and assets**
- Delivering valued goods and services affordably

**Societal benefits**
- Promotion of employee and community benefits and rights

**Environmental benefits**
- Efficient use of world’s physical and economic resources

**Strong risk-adjusted financial returns**
DELIVERING HOLISTIC RETURNS SPANS FOUR MUTUALLY REINFORCING STRANDS OF ACTIVITY

The scale and focus of our active ownership and investment activities allows us to bring the full force of ESG awareness and engagement to our investment decisions. Not only does successful engagement help appraise the actual level of ESG or other risk, if successful, it helps to mitigate it. In turn, our engagement and investment teams are able to focus on the risks and indeed opportunities which are most relevant and material.

Having a focus on responsible investing, responsible ownership and policy advocacy across all of our strategies, while also behaving responsibly as a firm, is integral to delivering holistic returns.

We aim to be ‘ESG aware’ and actively incorporate relevant considerations into our investment processes across all strategies and asset classes.

We aim to be active, engaged and responsible owners of those companies and assets in which we are invested and those we directly manage.

We engage with and encourage regulators and standard setters globally to intervene to correct market distortions and ensure that the financial system operates in the interests of its ultimate asset owners.

We aim, as a firm, to meet the expectations that we have of others. Each of us individually has a responsibility to lead by example and act ethically and with integrity.

Four mutually reinforcing strands of activity

- ESG-aware investments
- Active ownership and management
- Advocating in beneficiaries’ interest
- Behaving as a responsible business
We believe that a responsible investment approach encompasses systematic consideration of a range of non-financial factors alongside more traditional financial analysis of cash-flows and P/E ratios. It involves the incorporation of longer-term risk factors including a company’s relationship with its stakeholders as well as its impact, through both its operations and the products and services it offers, on the environment and wider society. It also necessitates recognising the importance of the long-term health and stability of the markets in which we invest. It is only through this holistic analysis of the risks, return and impact characteristics of a company that it is possible to deliver the holistic returns to which we aspire.

Importantly, our analysis, which is illustrated below, needs to be a dynamic process which necessitates going beyond the use of external ESG ratings and undertaking fundamental company research and utilising insights gleaned from engaging with company boards and management. The feedback loop from our engagements with companies is an essential component of our investment approach. The exercise of stewardship must we believe lie at the heart of any long-term investment programme – it represents a willingness to engage with firm management to seek change that will benefit shareholders over a long horizon. Engagement is no quick fix, of course, and only those shareholders that stay the course will usually get to enjoy the full benefits of active engagement.

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**300 Club: Investment industry transformation**
- Promotion of global carbon price; Integrated reporting for sustainable businesses
- Raising governance standards in both public and private companies

**Promulgation of Stewardship codes**
- Diversity and inclusion including within investment industry

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**ESG Data Awareness**
- Proprietary ESG tools; fundamental bottom-up research; engagement feedback; place-making
- ESG due diligence; Systematic assessment and tracking of ESG risks
- Acquisition risk-assessments; performance monitoring; sustainability benchmarks
- Systematic ESG due-diligence; detailed ESG KPIs and information rights

**ESG Risk Management and Engagement**
- Comprehensive company engagement programme
- Manager and company engagement
- Sustainability requirements for refurbishments; manager, community and tenant engagement
- Direct investment, engagement with management teams and active management

**Responsible Investment and Impact**
- Customised ESG and explicit Impact funds
- Dedicated environmental innovation fund
- Focus on rental income and yield value added from green investment
- Investments in wind farms, solar energy and energy efficiency
It would be inaccurate to consider any one set of ESG factors to be exhaustive, as the implications of “non-financial” influences on an investment’s long-term prospects continually evolve and are influenced by both industry, geography and asset class.

Corporate governance

Our research has demonstrated that sound corporate governance is the universal bedrock of risk management.

Good corporate governance encompasses a vast range of aspects, in particular the effective oversight of management and company strategy, along with the protection of minority interests, and balancing the competing priorities of different stakeholders against a duty to promote the organisation’s long-term success.

Our equity, infrastructure and credit teams in particular assess ownership structures, management credibility and the corporate governance and behaviour of companies. We are mindful that governance standards vary by market although they generally tend to be higher in developed than emerging markets, with well-developed company law and corporate governance codes accompanied by protections for minority shareholders, liquid secondary markets and typically dispersed shareholder rights. However, this generalisation is shifting as many Asian countries in particular recognise the benefits of raising governance standards across their markets. We are mindful of the importance of transparency and legitimacy in public-facing infrastructure investments which provide an essential service.

Environmental

We believe that companies are exposed to many environmental costs and, for investors, environmental externalities generated by a company are likely to impact their portfolios in another place or time.

We are mindful of companies’ approach to the use of natural resources as well as their impact on the environment; these same considerations are equally if not more important in relation to our real estate and infrastructure investments.

The responses of governments and corporations to climate change in particular will create winners and losers and materially impact both investment returns and society. For this reason, climate change is a critical element of our broader strategy to integrate ESG factors and stewardship into all of our funds. Consideration of carbon risk, where relevant, informs our idea generation, investment decisions and risk monitoring and our approach is set out in more detail within our annual carbon risk report.

Social

We recognise that companies are not abstract entities but are composed of people and operate within communities.

It is self-evident therefore that companies have responsibilities towards those individuals whom they employ as well as the communities in which they operate; both are rich sources of capital for a company, but they need to be managed with integrity.

The observance of basic human and labour rights, developing the full potential and productivity of human capital and effectively combating bribery and corruption are essential for the long-term sustainability of companies and ultimately maintaining their license to operate.

A minimal firm-wide exclusion policy

Hermes operates a firm-wide exclusion policy with respect to pure-play cluster munitions companies and manufacturers of anti-personnel land mines. This exclusion list is reviewed quarterly by our Responsibility Working Group. Additionally we have a range of formal and informal broader exclusion policies in place for particular funds and for individual clients.

Implicit within our mission is also a recognition that the investment decisions we make will have impacts wider than the returns they generate. As a result, we question a company’s purpose, how and where it generates its profits and whether these come at the expense of externally imposed costs. The answers to these questions inform our investment decisions. Each of our investment teams has the flexibility to form their own judgements based upon their own detailed analysis. However, each team is expected to have documented their considerations and be able to justify any investment decision both internally to our Portfolio Review Committee and, importantly, to clients.

As a general rule, we prefer to engage with companies rather than exclude them from our investible universes. In our view, successful engagements can reduce the risks to shareholders, unlock value and reap benefits to wider society.

A spectrum of impactful products

Encouragingly, there is an ever greater awareness among both businesses and investors of the need to create a sustainable and resilient world, combined with a recognition that this can enhance, not detract from, long term portfolio returns. The interest in long-term sustainability is indicative of a transformation in opinion on the role of ESG considerations in investment approaches.

The UN Sustainable Development Goals (SDGs) have provided a framework for governments, but also for companies and indeed investors. All parties are recognising their responsibility for helping achieve these ambitious goals and in so doing overcoming those challenges, not just to a company’s own sustainability but ultimately the planet’s.
Encouragingly, a new generation of literate consumers is emerging. This generation want their goods to be made responsibly, by a company that treats its workers properly, with a supply chain that protects worker safety. As we live in an ever more transparent and connected world, poor practice is now readily exposed. These same expectations are being translated to investment products, we have noted that the expectations of our clients, and importantly their underlying savers, has rightly grown significantly in recent years.

One evident result of the SDGs has been the growth of interest in impact investing specifically and more broadly in the impact of company actions and investment decisions. This trend towards delivering what we describe as holistic returns is hugely welcome.

Impact investing as a specific strategy goes beyond best-in-class ESG practices. The three key concepts that traditional impact investing brings to the public domain are: intentionality, the intention of an investor to exert a positive social or environmental impact; additionality, fulfilling a good cause beyond the provision of private capital; and measurement, being accountable and transparent in reporting on the financial, social and environmental performance of investments. Implementing these concepts is challenging enough in private markets, but it is even more onerous in public markets.

This focus on the delivery of additional and measurable societal benefits that will endure is one that is increasingly at the heart of our approach to investing. Long-term thinking and understanding and measuring the impacts – positive and negative – that all businesses have on society and the environment, are important aspects of investment success. This reflects the complex, interrelated nature of the ecosystem in which we operate as investors and our responsibility for sustaining that system for future generations.

While we adopt an approach of being aware of the ESG issues and external impacts generated by our companies and assets across our fund offerings, we have also developed products which are more explicitly and systematically geared towards investing in the best ESG performing stocks or towards delivering a net positive societal impact.

<table>
<thead>
<tr>
<th>Responsible investing spectrum</th>
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</thead>
<tbody>
<tr>
<td>&quot;Traditional&quot; investing</td>
</tr>
<tr>
<td>Limited to no focus on ESG matters at a stock or macro level</td>
</tr>
<tr>
<td>Investment objective is characterised as pursuing maximum short-term financial returns</td>
</tr>
<tr>
<td>Various funds have exclusion lists</td>
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</tbody>
</table>
ESG and engagement integration in public markets

The case for ESG in both equities and credit

We have undertaken – and continue to undertake – research in order to understand the relationship between ESG factors and company performance. Our analysis demonstrates a clear case for ESG integration in both public equities and credit.

Each of our equity and credit investment teams have their own approach to incorporating ESG in the context of their particular strategy and investment universe. Consistent is:

1. **Clear vision**
   - a consistent belief that ESG and engagement integration enhances investment decisions and is good for our beneficiaries

2. **Direct accountability**
   - investment teams are provided with research, tools and support but are ultimately responsible for integrating ESG considerations and engagement insights within their processes

3. **Fundamental research**
   - we go beyond external ratings and produce high-quality ESG analyses

4. **Engagement insights**
   - our investment and stewardship teams collaborate to make the most out of the synergy between the two activities

5. **Sharing across teams**
   - there is regular formal and informal sharing of insights to foster debate and innovation

6. **Clarity on materiality**
   - we produce research on what does and does not matter in order that teams can focus on what is material

7. **The big picture**
   - there is an awareness of the wider impact of companies on society and the environment

Our equity and credit teams employ a long-term investment philosophy (whether value- or growth-oriented) and a process that involves focusing on business fundamentals and long-term franchise value. ESG considerations feature throughout the investment process and a number of proprietary tools supplement the investment team’s processes to enhance their fundamental analysis and result in better investment decisions.

ESG investing: finding value in governance and social factors

In our latest study, *ESG investing: a social uprising*, which analysed correlations between companies with high ESG scores and shareholder returns from 31 December 2008 to 30 June 2018, we found that companies with good or improving environmental, social or governance characteristics have on average outperformed companies with negative characteristics. This is being driven by the strength of their corporate governance and, for the first time since our investigation began in 2014, social metrics. The impact of the environmental considerations is not statistically significant.

As with our previous research, we found no evidence that companies with attractive environmental characteristics have tended to underperform. Investors can therefore integrate environmental considerations into their portfolios without fear of them detracting from performance. Contrary to our previous study, the result for the social factor is statistically meaningful: companies with good or improving social characteristics have tended to outperform their lower-ranked peers on average by 15bps per month from 31 December 2008 to 30 June 2018. Meanwhile, the study also reinforced our earlier finding of a robust link between underperforming firms and poor governance. But this has weakened since 2016 (from 30bps to 24bps per month), reflecting the narrow leadership of the US stock market, which has been dominated by the FAANGs – Facebook, Amazon, Apple, Netflix and Google, now Alphabet – in recent times.

**ESG value is driven by corporate governance and social characteristics**

Average monthly dispersion in total returns between companies in top decile and lowest decile on environmental, social and governance scores from 31 December 2008 to 30 June 2018.

Source: Hermes Investment Management as at 30 June 2018.
Pricing ESG risk in credit markets

To analyse credit risks with greater precision, we developed a pricing model to capture the influence of ESG factors on credit spreads by using the QESG score – our proprietary measure of ESG risk. By regressing these values against the spreads of credit default swaps (CDS) instruments – which provide the purest reflection of credit risk – we were able to determine the nature and strength of the relationship between the ESG risks captured by the QESG scores and credit spreads. After expanding our research, our latest analysis, Pricing ESG risk: reinforcing our conviction, showed a convincing relationship between ESG risk and credit spreads, manifesting as an ESG-risk curve.

The relationship between implied CDS spreads and QESG Scores

<table>
<thead>
<tr>
<th>QESG Score</th>
<th>CDS Spread</th>
</tr>
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<tbody>
<tr>
<td>170</td>
<td></td>
</tr>
<tr>
<td>150</td>
<td></td>
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<tr>
<td>130</td>
<td></td>
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<td>110</td>
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<tr>
<td>90</td>
<td></td>
</tr>
<tr>
<td>70</td>
<td></td>
</tr>
</tbody>
</table>

Source: Hermes. For illustrative purposes only.

Proprietary tools

In addition to making use of best-in-class third party research provided by ISS, MSCI, Sustainalytics, Trucost, and others, our investment teams incorporate ESG factors into their investment process by using a range of in-house proprietary tools which include:

a) ESG Dashboard

The ESG Dashboard was developed by Hermes Global Equities in conjunction with our in-house engagement experts, Hermes EOS. It is used by investment teams across Hermes, enabling analysts and portfolio managers to easily incorporate ESG analysis into their stock-picking processes and, importantly, to flag stock-specific sustainability risks.

The Dashboard provides a concise digest of the ever-increasing amount of data on ESG risks. As well as incorporating a wide range of research from leading providers – Sustainalytics, Trucost, Bloomberg, MSCI, FactSet, ISS and CDP – the report includes proprietary information from Hermes EOS on voting and engagement.

A valuable component of the Dashboard is the QESG score, a ranking applied to each company, based on the information collated. This score not only captures how well a company manages ESG risk, but also the trend in this exposure. It can act as an early indicator of changing ESG risks, thereby alerting analysts and portfolio managers to potential issues and opportunities. The QESG score also assesses a company’s ESG metrics compared to its peers and, crucially, how its ESG profile is changing.

The latest version of the Dashboard was released in January 2018.
A clearer view of the Hermes ESG Dashboard

### ESG Performance

<table>
<thead>
<tr>
<th>Environment</th>
<th>Social</th>
<th>Governance</th>
</tr>
</thead>
<tbody>
<tr>
<td>QE Score %</td>
<td>▼ 52 (58)</td>
<td>▲ 76 (69)</td>
</tr>
<tr>
<td>QE Peer Median %</td>
<td>▼ 60 (67)</td>
<td>▼ 60 (62)</td>
</tr>
<tr>
<td>Sustainalytics Rating (%)</td>
<td>▼ 79</td>
<td>▼ 70</td>
</tr>
<tr>
<td>MSCI Score (%)</td>
<td>▼ 69</td>
<td>▼ 49</td>
</tr>
<tr>
<td>BBG Disclosure (%)</td>
<td>▼ 62</td>
<td>▼ 60</td>
</tr>
<tr>
<td>Impact Ratio (%)</td>
<td>▼ 0.33</td>
<td>▼ Y</td>
</tr>
<tr>
<td>Carbon Footprint (t/$m)</td>
<td>▼ 18</td>
<td>▼ Y</td>
</tr>
<tr>
<td>Trucost Waste ($m)</td>
<td>▼ 14</td>
<td>▼ Y</td>
</tr>
<tr>
<td>Trucost Water Abstraction 1</td>
<td>▼ 67</td>
<td>▼ Y</td>
</tr>
<tr>
<td>Trucost Disclosure (%)</td>
<td>▲ 100</td>
<td>▲ Y</td>
</tr>
<tr>
<td>CO2 Intensity ($)</td>
<td>▼ 0</td>
<td>▼ Y</td>
</tr>
<tr>
<td>CDP Performance Score</td>
<td>Band A-</td>
<td></td>
</tr>
<tr>
<td>Water Score</td>
<td>2</td>
<td></td>
</tr>
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</table>

### QESG Score %

- ▼ 66 (71)

Source: Hermes. For illustrative purposes only.

### At a glance: some key elements of the Portfolio Snapshot

#### ESG Performance

- **Source E S G ESG**
  - QESG: ▼ 103% ▼ 104% ▼ 105% ▼ 104%
  - SA: ▼ 101% ▼ 102% ▼ 100% ▼ 101%
  - MSCI: ▼ 96% ▼ 110% ▼ 105% ▼ 104%

Green > = 110% Amber: (90%-110%) Red <90%

### Controversies Relative to Benchmark

<table>
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<th>Sources</th>
<th>SA E S G Total</th>
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<tr>
<td>1/2/3</td>
<td>92% 93% 80% 93%</td>
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<tr>
<td>4/5</td>
<td>0% 36% 16% 27%</td>
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Source: Hermes. For illustrative purposes only.

### Engagement as % of AUM

- 75%

### b) Portfolio Snapshot

The Portfolio Snapshot allows us to observe the aggregate ESG risks across our portfolios relative to their respective benchmarks. It also examines ESG ratings and controversies and identifies contingent risks. Our portfolio managers use this tool to evaluate a strategy’s ESG performance over time, by providing information on the carbon intensity of the portfolio and our voting choices relative to the benchmark. In addition, it provides insights into engagement: the companies we are engaging with; the ESG themes we are engaging on; and the progress we have made on current engagements.

### At a glance: some key elements of the Portfolio Snapshot

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### c) Carbon Tool

The Hermes Carbon Tool, launched in 2018, enables fund managers and engagees to identify carbon risks in listed investment portfolios and specific companies that are or might become more exposed to carbon risks in the future. Importantly, the tool incorporates our stewardship activity and intelligence and is able to identify companies that are priorities for engagement and their progress against objectives.

This tool evaluates the impact that investment funds have on the climate by:

- Measuring the carbon risk and footprint of an investment fund relative to its benchmark as well as listed companies relative to their peers, including Scope 1, Scope 2, and Scope 3 emissions.
- Calculating the value at risk for an investment fund according to different carbon pricing and policy scenarios.
- Identifying companies with which carbon-focused engagement should be initiated or intensified.
- Gauging the level of carbon risk being engaged on within portfolios – and the progress achieved.
Stewardship insights

We believe that ESG-aware investors should not rely on data alone, as it is often backward looking and updated infrequently and at a time lag. As such, active ownership is an important pillar of our investment approach. The voting and engagement activities of our stewardship team can promote positive change within companies, unlocking hidden value and also providing a forward-looking view of ESG and broader performance that can lead to opportunities.

Independent oversight

All of our investment activity is supported by our dedicated Investment Office and Responsibility Office both of which report directly to our CEO.

The Investment Office provides a robust and transparent risk framework. On a look back, real time, and forward-looking basis the team actively monitors fund risk and helps to deliver sustainable risk-adjusted alpha, while acting as an early warning system to identify potential problem areas. It has overall responsibility for the consistency of performance and thus ensures that investment teams stay true to their processes, this includes oversight of ESG and engagement integration.

Our Responsibility Office is tasked with coordinating and supporting the development of our policies and their subsequent integration across our funds and stewardship services. Regular meetings are held between the team and portfolio managers at which ESG issues relevant to the specific strategies – whether specific or market level – are discussed.

Long-term reporting

We recognise that over the short-term volatility can dominate manager skill. As we are long-term investors and pride ourselves on our desire to incorporate longer-term risk and opportunity factors within our investment processes, we emphasise the longer-term when reporting our investment performance to clients.

In addition, we explain how ESG issues relating to individual stocks have informed our investment decisions and detail our voting and engagement activity.
ESG and engagement integration in private markets

We have over 30 years’ experience of investing in private markets. In these asset classes the materiality of ESG issues can be much more significant but, due to the lack of publicly available information, it may be more difficult to assess. It is investments in ‘real-assets’ however, which can be most tangible to the lives of underlying beneficiaries.

Real estate

We believe that a responsible approach to real estate investment is the only strategy that both protects and enhances the value of our clients’ assets, now and into the future. Through Responsible Property Investment we aim to increase the quality of the buildings, improve energy efficiency, minimise pollution, enhance lives for occupants and help improve the quality of life in the communities in which our buildings exist. We set out our expectations clearly and subsequently measure and monitor performance closely. This approach increases the value of properties, retains tenants, reduces vacancy periods, lowers operating costs and ultimately generates stronger income for investors.

We integrate responsibility principles across our investment and asset management processes, including: investment, development, property management, and occupier and community engagement. We have created a range of dedicated tools and procedures to help deliver on our Responsible Property Investment ambitions, and we continue to work with the real estate industry to develop tools and methods to that effect.

Investing responsibly: it is important that sustainability risks within a portfolio are assessed at the acquisition stage. This is crucial to the early identification of mitigation actions ensuring that the portfolio is future proofed. We carry out a sustainability due diligence for new acquisitions of prospective assets. Working with our investment teams this enables us to identify cost effective environmental improvements required and the impacts on refurbishment budgets. These risks are then integrated into our discounted cash flow analysis. To continue to understand the risk, we also carry out regular regulatory risk assessments of our standing portfolio against European and UK medium and long-term policy requirements.

Our approach encompasses:

Risk management
Fiduciary duty to manage risks from regulatory pressure and market changes and investment acumen to build on opportunities

Future proofing
Assessing sustainability risks at acquisition and through an asset’s lifecycle, identifying mitigation strategies to future proof and enhance the value of the portfolio

Valuing sustainability
Working with valuation professionals and adopting internal investment models to integrate RPI considerations in the assessment of value

Sustainability benchmarks
Developing dedicated sustainability benchmarking and reporting tools to improve management and the monitoring of funds’ sustainability performance

<table>
<thead>
<tr>
<th>Sustainability due diligence for new acquisitions</th>
<th>Strategic and operational sustainability benchmarking of our funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulatory risk assessment of standing portfolio</td>
<td>Active data management systems of utilities and waste</td>
</tr>
<tr>
<td>Active engagement on our indirect and international investments</td>
<td>On-going monitoring of performance with continuous feedback between property managers, asset managers and sustainability experts</td>
</tr>
<tr>
<td>Minimum sustainability requirements for refurbishments and developments</td>
<td>Stringent risk and safety requirements and supporting tools</td>
</tr>
<tr>
<td>Dedicated responsible property management guidelines for our directly managed assets</td>
<td>Community and occupier engagement programmes</td>
</tr>
</tbody>
</table>
Wellington Place in Leeds city centre is an economic and social hub

Town Square is now one of the largest public open spaces in Leeds.

- The 20-acre site – originally part of Leeds Central railway station, which closed in 1967 – was converted into a green space in 2009. Since then, we have worked in earnest with developer MEPC to create a vibrant and sustainable mixed-use urban centre.
- Today, the development is a valuable and well-used community asset, providing attractive employment opportunities and housing in modern, high-quality properties as well as green spaces.
- A major new feature of public realm, Tower Square, was opened in 2016. It is anchored by an 1850s Grade III-listed lifting tower, which harnessed steam power to hoist railway wagons from the oil passenger line to the goods yard.
- Bringing together businesses and the local community, the diverse and numerous well-being and community initiatives throughout Wellington Place embody the philosophy of the development.

Infrastructure

Few asset classes are as necessary, or significant, to the daily lives of individuals as infrastructure. We believe therefore that a strong focus on responsible investment is particularly important for infrastructure assets given their long term, public service nature.

Their tangible societal impact magnifies the need for sustainability to be embedded within corporate governance models in order to ensure there is effective consideration of environmental impact and conservation and strong stakeholder relationships – quality of service, value for money and ensuring affordability for customers are essential to maintain the social license of many infrastructure assets. Successful infrastructure investment we believe requires a commitment to long-term partnerships and proactive, positive engagement with key stakeholders including the community, regulators, government, relevant representative bodies, customers, co-investment partners and investors.

Our experienced team targets long-term investments (20+ years), with a strong emphasis on governance and positive alignment with stakeholders. We aim to work with like-minded investment partners, including institutions and pension schemes with similar investment horizons and shared values. We target significant stakes, with sufficient governance rights (either alone or in partnership) to exert influence at board and/or shareholder level, including board representation and influence over key shareholder matters.

Our approach systemises the assessment and management of ESG risks and opportunities during the investment lifecycle, from due diligence through to exit. These considerations are fully integrated into the day-to-day activities and processes which are implemented by all members of the Infrastructure team and overseen by an Infrastructure Investment Committee.

As in public markets, we take an active ownership approach, seeking to both improve performance and mitigate identified risks through engagement with companies via board and shareholder interactions. In addition, we are very engaged with regulators and industry groups on relevant matters, in particular pressing for a raising of the floor with respect to the governance of critical public interest infrastructure assets.
Our investment in Eurostar is illustrative of our commitment to environmentally sustainable transport. Not only does a Eurostar journey emit 90% less carbon than the equivalent short-haul flight, Eurostar’s commitment to further reducing its impact on the environment is embodied in its “Tread Lightly” programme:

- Less than 1% of Eurostar’s waste from its UK offices, stations and depot is sent to landfill;
- 90% of the water used to clean Eurostar trains is recycled;
- Recycling rates at St Pancras station have increased more than three-fold annual, with 79% of waste now recycled – up from 26% in 2017;
- Former Eurostar power cars, business dress uniforms and train blankets are donated to museums and charities rather than disposed of;
- Eurostar’s latest fleet of e320 trains include energy efficient lighting, recyclable fixtures and fittings, interior decoration created exclusively using water-based and eco-friendly paints and lacquers;
- All meals on board are created with the principles of sustainability and responsible sourcing in mind; and
- Eurostar set a new science-based target in early 2018 to increase its energy efficiency: it aims to reduce energy used by trains by 5% by 2020; introduce alternatives to fossil fuels on all trains by 2030; reduce plastics by 50% by 2020; and reduce the use of paper tickets.
ESG and engagement in private equity

In private equity too, we have and continue to embrace ESG in our selection of funds (General Partners) and our direct investments. In addition to the moral imperative, we adopt this approach because we think long term and believe the outlook for portfolio companies will be greatly enhanced through active engagement and management of ESG-related risks and opportunities.

The overarching objective of the Hermes Private Equity ESG framework is to ensure that material ESG risks and opportunities, whether they be at a macro, industry or company specific level are identified and effectively managed. To that end, we undertake due diligence on all potential General Partners and direct investments as an integral part of our wider due diligence process. Where our assessment identifies a concern then a plan to address the matter must be in place before any investment decision would be confirmed.

As in public equities, we seek to adopt a ‘positive engagement’ mindset rather than a policy of ‘screening out’ based on ESG performance. The ESG assessment is therefore viewed as an opportunity to de-risk and identify additional opportunities, rather than an obstacle to progressing a deal; indeed, ESG laggards often offer the greatest opportunity to add value. We believe there is significant scope for private equity investors to add value through effective ESG engagement, for example in relation to:

- **Operational improvements**: initiatives designed to enhance efficiency, improve stakeholder relationships and strengthen governance all hold the potential to positively impact financial performance

- **Accessing new opportunities**: improving staff welfare and instilling a future-proof outlook will help to boost innovation and create opportunities as new markets emerge and existing sectors transition

- **Exit outlook**: prospective acquirers will place greater onus on the ESG credentials of target companies

- **Exit pricing**: the sustainability of business models, as well as the presence of ESG-related risks and opportunities, are likely to impact exit metrics

6 stage process

<table>
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<th>GP commitment and capabilities</th>
<th>Deal process</th>
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Since our establishment in 1983, we have believed our responsibilities as investors do not stop with a decision to buy or sell a stock, instead, we must act as engaged owners of the companies in which we are invested and the assets that we manage. This means engaging in constructive dialogue and taking action where necessary through our ownership rights.

Private assets
Infrastructure
Across our infrastructure investments we have a range of ownership stakes which stretch from 100%, to joint control, to a significant minority stake. In each case, our ownership grants us certain rights which we seek to exercise in a responsible fashion. We recognise that good governance is the foundation for effective consideration and management of social and environmental matters. Ensuring that environmental, social and governance considerations are prioritised by company boards and shareholders, not only improves the management of long-term risks and opportunities, but enhances broader stakeholder relationships, making a positive and meaningful contribution to the wider society.

Throughout the life of an investment, the Hermes Infrastructure team is actively involved in its monitoring and management through regular engagement with management, co-investors and other stakeholders. Our principal objectives are to preserve capital value by effective risk management. Where appropriate, and without compromising effective risk management, opportunities will be taken to enhance performance. This is undertaken in a manner that:

- Promotes systems, processes and procedures that encourage proactive consideration of environmental, social and governance matters, avoid tick-box exercises, effectively monitor outcomes and facilitate innovation
- Recognises and is sensitive to the public service nature of infrastructure investment and the reputation of investors
- Is supportive of management teams whilst maintaining appropriate distance to avoid compromising accountability
- Promotes a ‘beyond compliance’ culture with regard to environmental, social and governance matters

We are acutely aware that the governance structures of privately owned infrastructure assets come with their own set of issues. Boards are typically large, not as diverse as might be desirable and with individual directors often required to act in two capacities – as a company director and as a representative of their appointing shareholder. Recognising these tensions have the potential to relegate long-term stakeholder and other ESG issues down the agenda, we have focused on promoting corporate governance structures that mitigate this risk and allow for the holistic integration of stakeholder and public interest matters into board strategy and decision making.

Direct management of real-estate assets
In situations where we directly manage real-estate assets, we are committed to acting consistently and clearly as stewards of the assets we own. Where we are an indirect owner through a joint venture and with third-party funds we act as stewards of the assets through engagement with the fund’s governance structures.

Managing directly-owned real estate assets responsibly:
In our direct real estate funds, we believe that active management delivers stronger returns. A growing preference from owners and occupiers for buildings with better environmental performance will lead to those assets experiencing higher net income growth due to lower depreciation and operational costs.

Moreover, additional benefits from green buildings arise from increasing demand – good air quality and high levels of daylight have been shown to reduce absenteeism, improve productivity and concentration, reduce stress levels and achieve an overall increase in wellbeing. Enabling long retention rates and less voids affecting our investment performance. For these reasons, on our directly managed funds, we integrate environmental and social issues into our active asset management strategy on each of the investment phases of the building life cycle:

- Refurbishment tools
- Active management
- Investing in communities and
- Working with occupiers

Improving the value and performance of legacy buildings has been a key part of the Hermes RPI strategy. We have tailored guides and minimum sustainability requirements for refurbishments and developments to capture environmental and health improvement potentials at this crucial step of the building life cycle.

Setting a clear intention to deliver specific objectives since 2006, we have maintained a number of environmental, social and governance targets throughout all of our investment processes. To deliver on these, an integrated sustainability management system helps deliver minimum environmental performance requirements and targets as part of property management processes.

We make investment in community programmes to deliver mutual social and community benefits, as a key element of place making. We also establish a constructive dialogue with occupiers and have engagement activities to respond to their needs to strengthen the sustainability performance of our buildings. We have monthly and quarterly review meetings with the contracted property managers in order to ensure that environmental, health & safety and regulatory compliance requirements are being carried out in line with current legislative requirements and their contractual terms.
Our view of the benefits of good human capital management, including the provision of fair living wages, robust health & safety practices and investment in training and development programmes, is consistent across assets. For this reason, we took the decision in 2016 to include anti-slavery clauses in any new or renewed property management service agreement.

In addition, we take an active role in public policy and sector engagement to promote acceptance and implementation of responsible investment principles across the real estate industry. This ensures sector-wide tools are developed enabling industry comparison and better monitoring of funds’ performance.

Our dedicated tools include:

- **Responsible Refurbishment and Development**: tailored guides and minimum sustainability requirements for refurbishments and developments
- **Active property management**: an integrated sustainability management system
- **Working with occupiers**: green lease clauses since 2008 and active tenant engagement programmes
- **Community Engagement**: dedicated community engagement tools and awards

**Company Engagement**

The Hermes Responsible Ownership Principles first published in 2002 have been long-standing and aim to create a common understanding between company boards, managers and owners. The Principles convey our expectations of listed companies and similarly what these companies can expect from us as owners. The expectations which are set out are derived from Hermes’ extensive experience as an active and engaged shareholder and as such these principles underpin the manner in which we fulfil our stewardship responsibilities beyond public companies.

In addition to the Hermes Responsible Ownership Principles we have developed specific corporate governance principles for many countries and regions in order to address particular local issues and nuances. We believe that, by being clear with companies about what we expect, we can create a better framework for communication and dialogue with boards and management. This should contribute to better management of companies and ultimately their long-term success, which, in turn, will lead to wider benefits to society and for our clients’ beneficiaries.

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**Key elements of responsible stewardship**

| Monitoring | Active monitoring of issues to assess whether trends in ESG performance are positive or negative. Resources are allocated to those we deem have the most material risk. |
| Engagement | Engage with asset directors and senior management teams to promote and achieve beneficial change relating to risk management, governance, sustainability and business strategy. Personal, board-level interactions substantially increase the chances of effective engagement success. |
| Voting | Using our voting rights as investors in a considered and intelligent manner in order to manage long-term risks and promote positive change. |
| Stewardship codes | Hermes is a formal founding signatory of many Stewardship Codes globally as well as an active contributor and supporter of the development of many others. |

1 Research Report: Talk is not cheap – The role of interpersonal communication as a success factor of engagements on ESG matters, Prof. Dr Michael Wolff, Dr. Laura Jacoby & Hüügen Coskun, September 2017
Our stewardship team boasts one of the largest stewardship resources globally, composed of an effective group of highly and diversely skilled, multi-national professionals, all committed to influencing leading businesses on governance and sustainability matters. Consistent issues tend to include those around minority shareholder rights, executive remuneration, corporate transparency, labour and human rights and environmental impacts.

Our engagements with companies will normally focus on those matters which are relevant to the longer-term strategic success of the company and typically involves senior face-to-face interactions. Generally, our engagement activity becomes more active where we believe engagement will lead, from a value or risk perspective, to a more sustainable and successful company.

Our approach is complementary to and supportive of wider efforts to promote prosperity, while protecting the planet. In particular, the many environmental and social themes of our engagement plan are well aligned with the Sustainable Development Goals and support each of the goals either directly or indirectly.

**Escalation**

We escalate the intensity of an engagement activity over time, depending on the nature of the challenges each company faces and the attitude of the board towards our dialogue. Some engagements may involve just one or two meetings; others are more complex and will entail multiple meetings with management and board members over several years, as well as letters to the board and collaboration with other investors. Such activity often requires persistence. Helpfully our long-term perspective enables us to persist with these difficult and time-consuming engagements.

Making realistic and realisable demands of companies, informed by significant hands-on experience of business management and strategy setting is critical to the success of our engagements. With all engagements, we seek to build a strong relationship with the company and are willing to be patient, remaining focused on the achievement of goals which are directed towards long-term success. Any change we encourage a board or management team to make through the exercise of voting rights or engagement will be with the intent of improving a company’s long-term performance.

Measuring and monitoring progress on engagements is carried out by setting clear engagement objectives and systematically measuring milestone progress. We consistently review the progress we are making against these objectives utilising a system that we have designed for managing and tracking our engagement activities.

**Collaboration**

We very much recognise the benefits of working with like-minded peers to advocate for change at particular companies as well as at a broader market level. Indeed, the primary concept of Hermes’ stewardship service is to provide a mechanism for like-minded institutional investors to pool their resources and in so doing create a stronger and more effective stewardship voice.

Where there are shared objectives – in particular the promotion of long-term sustainable value – we use both formal forums and other more informal links which we have globally to work collaboratively with other investors on an ad hoc and on an ongoing basis. We are proud to be an active participant in, and indeed be a founding member of many associations of investors; not least among these are the Principles for Responsible Investment, Climate Action 100+ and the International Corporate Governance Network.

**Voting**

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

Our regional corporate governance principles provide a clear and transparent framework for our voting policy and we manage our voting via a partnership with proxy advisory firm ISS. While we have developed our own best practice regional principles which are based on local market standards, we benefit from the additional research and vote processing service ISS provide. The research received from ISS is however, only one of several inputs that we utilise in reaching a judgement and making voting recommendations to clients.
We generally seek to support and work with management resolving any concerns outside of the AGM cycle. Where however, we do consider voting against or abstaining on management resolutions or voting in favour of shareholder resolutions opposed by management, and recommending as such to voting clients, we will whenever practicable contact the company before the meeting to discuss our concerns, thus ensuring that we are making a fully informed decision. If we vote against, or recommend voting against management recommendations, on any matter we will inform the company after the meeting of our reasons for so doing and engage for relevant changes at the company.

We publish our voting disclosure one quarter in arrears. In doing so, we are transparently accountable that our dialogue with companies around voting issues is not compromised.

Hermes is particularly mindful of its position as a fiduciary for its clients and seeks always to act in their best interests. Accordingly, we take all reasonable steps to identify conflicts of interest and maintain and operate arrangements to prevent such conflicts from giving rise to a material risk of damage to the interests of any of our clients. The Hermes pledge is intended to express the commitment of each of us individually to put the interests of our clients and their beneficiaries at the heart of what we do including the management of conflicts of interest fairly between all parties.

Hermes provides fund management and stewardship services to a large number of institutional investors, including a number of pension funds sponsored by corporations, governments and other organisations, as well as other asset managers. As a result, the following real or perceived conflicts may arise:

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

A specific Hermes stewardship conflicts of interest policy has been developed and is publicly available on our website. The stewardship conflicts policy outlines how in all of our activities we seek to promote the long-term success of the companies in which we and our clients have invested. This singular focus holds true in all circumstances. In those limited circumstances where a conflict over our approach to voting (aside from that directed by client specific policies) or engagement arises which is not able to be resolved through normal processes the matter is escalated to a stewardship escalation group which reports to an independent sub-committee of the Board. The group is guided in reaching its decisions by Hermes’ mission to delivering long-term holistic returns and if there is no majority view on the group then the Hermes CEO will make a final decision. All escalated instances are documented and reported to Hermes’ Risk and Compliance Committee – an independent sub-committee of the Hermes Fund Managers Limited Board.
We believe it is our responsibility to lead and participate in discussion and debate about the fiduciary responsibilities of institutional investors to their clients, their stakeholders and ultimately, society at large. In a similar vein, we have a proud history of leading thinking around corporate governance and the purpose and responsibilities of companies and their directors towards both their shareholders and wider stakeholders. Ultimately, it is our belief that the financial system should operate in the interests of its ultimate beneficiaries.

Companies and investors make decisions based on the economic signals surrounding them, such as the price of labour and materials and the cost of taxes. These are in turn informed by policy and regulation. In essence, public policy and regulation govern the markets in which we invest and instruct and shape our behaviours and the nature of our relationships with clients and investee companies.

Typically, savers – either directly or indirectly – have an interest in the whole of the economy that they live and work in and, as a result, knock-on effects which are not apparent when looking at a single investment often have profound cumulative effects on them in their totality. At present, however, we contend that the ability for capital markets to support the delivery of holistic returns is impeded by a number of market inefficiencies and indeed market failures which necessitate policy or regulatory intervention.

Repurposing the system so that it is better suited to delivering the needs of savers and supporting the delivery of the internationally agreed Sustainable Development Goals requires system-wide change. To that end, Hermes has a broad public policy engagement agenda directed towards promoting responsible investment and ownership practices and more pertinently advocating for a global financial system that operates in the interests of its ultimate beneficiaries. Our proposed measures for reform are essentially grouped into two distinct but inter-connected areas.

### Advocacy Aim Components

<table>
<thead>
<tr>
<th>Advocacy Aim</th>
<th>Components</th>
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<tr>
<td>A purposeful investment industry</td>
<td>Alignment and transparency of incentives and costs along the investment chain</td>
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<td></td>
<td>Holistic performance measurement and reporting</td>
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<td></td>
<td>Embed stewardship as a core function of equity markets with an explicit duty</td>
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<tr>
<td>Purposeful and sustainable assets</td>
<td>Saver representation within fund manager governance &amp; more aligned pay structures</td>
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<td></td>
<td>Enhanced corporate and asset disclosures</td>
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<tr>
<td></td>
<td>Accounting standards for holistic value</td>
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<td></td>
<td>Employee and stakeholder voice in corporate governance and reforms to executive pay</td>
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<td></td>
<td>Internalised environmental and societal costs while promoting a more circular economy</td>
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</tbody>
</table>

### Market inefficiencies and failures

- Industry structures and incentives result in the long-term interests of clients, and their beneficiaries, being diluted by the interests of intermediary agents.
- As a result of both explicit and implicit signals, the long-term success of companies and the interests of other stakeholders can be relegated below the maximisation of shorter-term profits.
- Economies under-invest in infrastructure and the development of future skills to their future detriment.
- Ultimately, unsustainable investments deliver economic returns today at the expense of future generations – external costs have not been internalised into companies’ profit and loss.

### Re-purposing the investment industry

The role the investment industry plays in the dispersal and allocation of capital is hugely important. However, despite growing markets and improving technology, the financial system too often fails to deliver on the needs of the end-users of the system. If the system undermines environmental and social values then it is introducing systemic risk, damaging its own legitimacy and more pertinently weakening long-term individual and aggregate returns to savers.

As our CEO argued in the Why Question, serving the interests of savers requires the investment industry to rethink the ‘why’ of investment. In turn, this should dictate ‘how’ to reconnect capital with its underlying purpose.

The Why Question

March 2017
We contend that a shift is needed in the thinking, measuring and reporting of holistic objectives and investment returns and considering whether capital markets are supporting the sustainable growth of the 'real' economy, delivering the retirement income savers need, providing the necessary social and physical infrastructure and supporting companies to invest and grow. In addition, reforms to fund governance structures and fund manager incentives along with further transparency of investment manager's costs and charges should help inform and reinforce more positive client relationships and better connect the financial world with the lives and futures of those whom on behalf it operates.

Create purposeful and sustainable assets:
Globally, public support for business is low in part fuelled by growing inequality in many countries and heightened job insecurity for large sections of populations. In addition, demographic shifts and finite resources together present challenges for sustainable global economic growth. Changing weather conditions as a result of climate change not only threaten agriculture, but labour productivity, human health, industry supply chains and energy systems. These present fundamental threats to the way many businesses currently operate while also presenting opportunities for others to innovate and flourish.

Importantly, an investor's ability to allocate capital towards those companies and assets best equipped to supporting the delivery of holistic value, and in turn the delivery of the Sustainable Development Goals, is dependent upon the availability of meaningful data. It is critical that companies and owners of real assets consider how sustainable their business models are and provide appropriate and meaningful disclosures so that capital can be efficiently allocated and invested. Presently, the quantity of relevant long-term orientated information is variable across jurisdictions and, where it is available, it is rarely of investment standard. There is a need for greater quality corporate information provided less often accompanied by a revisit of the way that a company's value is accounted for, including how it accounts for those costs which are externalised to society.

While we believe that there is no single silver bullet that will transform the way markets operate, we believe that a combination of measures could have a transformative impact, rebuilding trust and enabling the delivery of positive holistic returns for savers.

In addition to the thought-leadership work we do directly as a firm, we actively contribute to a wide variety of investor associations and collaborative initiatives. Of particular importance is the Principles for Responsible Investment (PRI) for which we chaired the drafting committee and became a founding signatory. In addition, our Chief Executive founded the 300 Club in 2011, an independent group of leading investment professionals from across the globe, in order to respond to an urgent need to raise uncomfortable and fundamental questions about the very foundations of the investment industry and investing. In addition to key industry trade associations, we are active members in a range of other responsible investment-focused organisations and initiatives.

An example of Hermes' participation to key initiatives

<table>
<thead>
<tr>
<th>Initiative</th>
<th>Details</th>
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<tbody>
<tr>
<td>300 Club</td>
<td>Founder of in 2011</td>
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<tr>
<td>Banking Standards Board</td>
<td>Board member since 2015</td>
</tr>
<tr>
<td>Better Buildings Partnership</td>
<td>Members since 2008</td>
</tr>
<tr>
<td>Climate 100 +</td>
<td>Member and co-lead for the European utilities sector</td>
</tr>
<tr>
<td>CDP</td>
<td>Investment member since inception 2015</td>
</tr>
<tr>
<td>CFA – Future of Finance Advisory Council</td>
<td>Since 2013</td>
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<tr>
<td>Council of Institutional Investors</td>
<td>Member – Corporate Governance Advisory Council</td>
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<tr>
<td>Eumedion</td>
<td>Member of their Investment Committee</td>
</tr>
<tr>
<td>Global Real Estate Sustainability Benchmark</td>
<td>Member of Real Estate Advisory Board since 2011</td>
</tr>
<tr>
<td>International Integrated Reporting Council</td>
<td>Council Member since 2011</td>
</tr>
<tr>
<td>International Corporate Governance Network</td>
<td>Board Governance Committee member</td>
</tr>
<tr>
<td>Institutional Investors Group on Climate Change</td>
<td>Chair of property working group</td>
</tr>
<tr>
<td></td>
<td>Member of policy working group</td>
</tr>
<tr>
<td>PRA/FCA Climate Financial Risk Forum</td>
<td>Chair of the Disclosures Working Group since 2019</td>
</tr>
<tr>
<td>Sustainability Accounting Standards Board</td>
<td>Member of the Investment Advisory Group</td>
</tr>
<tr>
<td>Principles for Responsible Investment</td>
<td>Founding signatory in 2006</td>
</tr>
<tr>
<td></td>
<td>Member of various Advisory Committees</td>
</tr>
<tr>
<td>UK Investor Forum</td>
<td>Since inception in 2016</td>
</tr>
<tr>
<td>UK Green Finance institute</td>
<td>Advisory Board Member</td>
</tr>
<tr>
<td>UN Environment Programme Finance Initiative</td>
<td>Global Steering Committee Member</td>
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<tr>
<td></td>
<td>Chair of UNEP FI Investment Committee</td>
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<tr>
<td></td>
<td>Positive Impact Working Group member</td>
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<tr>
<td>UN Global Compact</td>
<td>Joined in 2017</td>
</tr>
<tr>
<td>Willis Tower Watson’s Thinking Ahead Institute</td>
<td>Members since 2016</td>
</tr>
</tbody>
</table>
We are conscious that we should strive to meet the expectations that we have of others. In that, we are supported by our ownership structure and history.

Hermes was until 2019, 100% owned by one of the largest corporate pension funds in the UK, the BT Pension Scheme having been established by the scheme in 1983. With over 300,000 pensioners as our ultimate owners, we had a long history and strong culture of acting in the interests of long-term investors. In July 2018, Federated completed its acquisition of a majority stake in our business from the BT Pension Scheme. In contrast with recent consolidation activity in our industry, which has been defensive in nature, our partnership is motivated by a vastly different ambition.

In Hermes, Federated has a business with an established and growing presence in the UK, Europe and Asia. Our business is founded on a rich, client-centric heritage and expertise in investment and stewardship services. In Federated, Hermes has a stable majority shareholder with strong cash reserves and consistent revenues. We have access to the firm’s deep asset-management experience, sophisticated US distribution platform and insights gained from achieving long-term growth by serving investors’ interests first. Most importantly, both firms share similar values and cultural characteristics. Federated rightly perceives sustainable investing as one of the greatest long-term opportunities in asset management – especially in the US, where ESG integration and stewardship are beginning to take root. By collaborating to strengthen our investment propositions and distribution reach, we both see attractive prospects for success. Most importantly, it is our shared purpose of putting investors first that unites us on this journey.

A strong culture of responsibility

We are proud to have a strong culture of responsibility and aspire to both maintain and further foster a client-focused approach.

We are proud to have a strong culture of responsibility and aspire to both maintain and further foster a client-focused approach.

Additionally, we are committed to being open and transparent with our clients about how we manage their funds and in particular provide them with full transparency of any costs and charges in their fund.

Hermes behaviours

Through pay awards we look to ensure that those aspirations we articulate in the Hermes Pledge are reinforced. To that end, at performance reviews all Hermes staff are judged equally on their behaviours and on their technical performance.

Hermes has a set of behaviours innate to its culture that contribute to the success of the business; every employee has a responsibility to act in a way that upholds these core behaviours through their day-to-day activities.

Similarly, it is the responsibility of every leader and manager throughout Hermes to create an environment where all of our people can give their best, feel valued and be able to build upon their knowledge and skills.

Ensuring an alignment of interests

In order to reinforce the alignment of interests with our clients, senior investment managers notionally co-invest in the funds they manage, and their bonuses are linked to long-term performance. Our senior management also participates in a long-term incentive scheme which rewards the building of a sustainable and profitable business.
Coordinated approach with independent oversight

Ultimately, to achieve our objectives we look to create a thoughtful environment where orthodoxies are challenged in the way that we invest, in the way that we engage and in the way that we work. While the responsibility for implementing our approach resides with all Hermes personnel, we have a number of structures, teams and governance processes which ensure that across the firm we discharge our responsibilities in a consistent and effective manner.

- **Portfolio Review Committee**: our Investment Office which reports directly to our CEO, acts as an independent oversight body across all our investment teams. A key element of this is the monthly Portfolio Review Committee which monitors in detail the performance and risks with each fund and strategy and challenges investment teams.

- **Governance Committee**: comprised of senior representatives from the Investment Office, Responsibility Office, stewardship services, compliance and client services teams, the Governance Committee has three functions: it oversees the formulation and delivery of our engagement and voting policy for all of our equity funds; it acts as the escalation committee to resolve conflicts that arise, as governed by our stewardship conflicts of interest policy; and it monitors our engagement and voting activity.

- **Responsibility Working Group**: constituted of senior representatives from across the business and chaired by our Head of Responsibility who reports directly to our CEO, the Responsibility Working Group is charged with reviewing and recommending policy for decision by our Executive Committee in respect of all matters pertaining to the delivery of holistic returns.

- **Business Development Forum** approves the development of any new product based upon confirmation that it is aligned with our corporate objectives and responsibility agenda; products are reviewed annually to ensure the confirmation remains applicable and monitored by our Customer Outcomes Group.

- **Dedicated Responsibility Office** ensures that responsibility is embedded through the business. This extends to Hermes approach to its own governance and practices, as well as the integration of engagement and ESG factors into investment strategies and processes.

Board oversight

Hermes is majority owned by Federated Investors Inc, with a further 29.5% owned by the BTPS and 10.5% owned by Hermes Management. The chair and CEO roles are split, with an independent director appointed to the chair.

In line with good corporate governance practice, the board sets the company’s strategic aims, ensures that the necessary financial and human resources are in place for the company to meet its objectives and reviews and holds management accountable for performance within a framework of prudent and effective controls which enables risk to be assessed and managed. The board also sets the company’s values and standards and ensures that its obligations to its shareholders and others are understood and met.

Recognising the expectations for high standards of corporate reporting which we convey to companies, the Hermes annual report and accounts similarly aspires to be best-in-class, going above and beyond regulatory requirements to deliver an integrated report which provided detailed disclosures on a range of matters including CEO remuneration.

Good corporate citizens

In addition to our behaviours as individual employees and the delivery of strong investment performance for our clients, we also believe we should lead by example as a firm. Hermes strives therefore to make a difference, not only through our investment solutions, but in how we contribute to both the financial system and wider community. In evidence of our commitment, we are proud to have achieved the revised ISO 14001 in recognition of our efforts to manage our own operations as environmentally efficiently as we can.

Similarly, in recognition of the value of a diverse workforce and in particular the benefits of having a diversity of experience among senior management, we were a founding signatory to the Women in Finance Charter and have set ourselves firm-wide, board-level and senior-management-level gender diversity targets. In addition, Unity, our diversity and inclusion group, runs a timetable of events and workshops throughout each year, covering a wide range of diversity, inclusion and wellbeing topics with the specific aim of ‘promoting an open environment for people to be themselves’ in the workplace. Initiatives have included a Men’s Health and Wellbeing Day, addressing both physical and mental health issues; HerStory, a week-long event during which we celebrated the achievements of some of our talented female colleagues and took inspiration from a number of external female speakers, successful in predominantly male sectors, and Unconscious Bias Training to make people more cognisant of the biases we all have. Unity is also a firm supporter of Dementia Friends, recognising both the varying demands that staff may be facing in their home life and also the communal responsibility to create a more dementia-friendly society.

Our activities in the local community continue to be supported by our staff. These projects include a number of schools programmes focussing on reading and numeracy, social mobility and employability skills, renovating local schools and gardens, and supporting those more vulnerable in our immediate vicinity in recognition of the huge disparities in wealth on our doorstep.
Notable partnerships include:

- **Trees for Cities**
  Hermes offsets its operational carbon emissions by working with Trees for Cities. For every tonne of GHG emissions that we generate from our day-to-day operations and business travel, we purchase verified carbon offsets from Trees for Cities, which guarantees an equivalent amount of GHG emissions is reduced from the atmosphere.

- **Mosaic**
  Mosaic strives to inspire young people from poorer communities to realise their talents and potential. It also aims to rehabilitate young offenders in prison.

- **Business in the Community**
  Hermes is an active member of Business in the Community, the Prince of Wales’ responsible business network. Members of the network tackle a wide range of issues that are essential to building a fairer society and a more sustainable future.

- **East End Community Foundation (EECF)**
  The EECF has been dedicated to increasing opportunities for people living in London’s East End for 25 years. Hermes is working with them on a number of initiatives to help raise educational achievement, enhance employability and increase social cohesion.
RESPONSIBILITY IN ACTION: POLICIES AND ACTIVITIES

Responsibility is intertwined in the way we invest, manage our assets and behave as a business.

<table>
<thead>
<tr>
<th>ESG aware investments</th>
<th>Active ownership and management</th>
<th>Advocacy</th>
<th>A responsible firm</th>
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Corporate Governance

An effective board
Companies should be headed by an effective board responsible for setting the strategy, direction and risk appetite of the company. Boards should comprise a diverse range of competencies, knowledge, perspectives and experiences to enable them to effectively carry out their duties and responsibilities.

Our research has demonstrated that corporate governance issues is commonly the most material of the ESG triumvirate – our proprietary QESG score is weighted towards governance factors and various board metrics are incorporated into our ESG dashboard such as board composition and the split of the CEO and Chair roles.

Across asset classes we engage with company boards on issues such as the level of board independence, skills and diversity and subsequently, we exercise our votes on such matters in an effort to ensure robust corporate governance structures and principles are implemented and applied.

We are active members of a plethora of groups worldwide promoting a high standard of corporate governance. In addition to responding to policy consultations we proactively advocate for change where we feel it necessary. For example, recognising that investor board representation in privately held infrastructure assets can present certain additional challenges, we have advocated for an enhanced corporate governance code to apply to essential infrastructure businesses.

The Hermes board is responsible for the governance of the organisation and ensuring its effective operation. The board is led by an independent chair and considers all stakeholders when establishing Hermes’ objectives. The board operates with majority independent Audit, Remuneration, Risk and Nomination committees and detailed disclosures are provided within our annual Integrated Annual Report and Accounts.

Pay aligned to long-term success
It is important that companies design and implement remuneration policies that adequately align management teams with the objective of achieving long-term sustainable business success.

We undertake rigorous assessments of company’s pay practices in order to gain reassurance that management are being incentivised to deliver long-term sustainable performance alignment with the interests of long-term shareholders.

In recent years we have roughly doubled our rate of opposition to remuneration proposals in certain markets and increased our engagement with chairs of remuneration committees in an effort to seek more acceptable remuneration structures and outcomes.

We regularly meet with policy makers and standard setters and respond to consultations in order to convey our views and influence the policy discourse. In 2016 we published Remuneration Principles: Clarifying Expectations in order to be clearer in our diagnosis of the problems and to advocate our proposed solutions.

We believe pay should support our purpose and align interests with clients and stakeholders. Accordingly, senior investment managers co-invest in the funds they manage, and their bonuses are linked to long-term performance. In addition our Remuneration Report details how our CEO’s pay is aligned with performed and illustrates the ratio of his pay to that of the average Hermes employee.
Corporate Governance

Culture
An increasingly critical role for boards and management teams is establishing and maintaining a corporate culture which leads to appropriate behaviours.

We complement our ESG ratings with a qualitative assessment which includes a view as to whether the board and CEO is setting the right tone from the top of the organisation and whether it is being reflected on the ground. This is particularly critical in certain sectors and with respect to highly acquisitive companies.

Culture generally manifests itself in corporate conduct and the behaviour of employees. Where the wrong culture and conduct exists, this can negatively affect stakeholder relationships, the reputation of a company and, in the worst cases, lead to fines and other costs. In our engagements with companies we challenge them to evidence their desired culture in their organisational structure, processes and controls.

In addition to pressing for enhanced levels of disclosure of workforce related metrics, we regularly speak at conferences and respond to consultations to emphasise the importance of corporate culture to long-term success. Additionally, our CEO is a board member of the Banking Standards Board which promotes high standards of behaviour and competence across the UK banking industry.

Responsibility, appropriate conduct and a principled approach to treating investors fairly, are integral to Hermes’ culture. This culture is underpinned by ‘Responsibility’, which is explicitly stated as one of Hermes’ core values and included in the Hermes Pledge. Individuals’ annual appraisals give equal emphasis to behaviours as technical performance.

Environmental

Climate change, water usage, pollution
Organisations need to ensure their operations take account of environmental constraints and the possible rising price of carbon or other factors where regulations are in place or are being considered.

We utilise data from various sources in order to understand a company’s exposure to risks arising from climate change. We look in particular at a company’s carbon footprint and sensitivity to different climate scenarios. We measure the carbon footprint of our portfolios to give us a better starting point to assess the best options to manage carbon risk in the context of our funds’ specific investment strategies.

We are committed to engaging with all of the highest emitting companies across each of our public markets portfolios in order to drive up disclosure levels, promote scenario testing and ensure operations are as energy efficient as is practicable. Additionally, we have actively managed down the energy efficiency of our real-estate assets for many years with detailed disclosures provided annually of performance against targets.

We are members of, among other initiatives, the Portfolio Decarbonisation Coalition, the Climate Change 100+ and the Institutional Investors Group on Climate Change. In our public policy engagement with the UK and European governments we call for a clear policy framework to enable the scaling up of low carbon and energy efficiency investments.

In addition to our ISO 14001 accreditation and in continuation of our corporate citizenship policy, we offset our own carbon emissions by partnering with Trees for Cities. We publish our carbon risk management strategy on an annual basis and in support of the FSB Taskforce for Climate-Related Financial Disclosures (TCFD) recommendations will be enhancing the level of relevant public disclosures we provide as a firm.
Social

Labour rights and human capital management

An organisation’s people and culture are fundamental to driving business performance. Good human capital management practices such as the provision of fair living wages, good health and safety practices and investment in training and development programmes are demonstrably linked to more stable and productive workforces and ultimately long-term value creation.

All our public markets investment teams have access to our ESG Dashboard and Portfolio Snapshot through which information on metrics such as employee turnover, health & safety performance and fatalities are provided. Investment teams supplement this information with company specific research utilising a range of sources to understand a company’s approach towards its workforce and any potential impact on, for example, productivity.

We encourage companies to enhance disclosures with respect to their workforce. In addition, we produce a Controversial Companies Report which highlights to clients companies which are considered as being in violation of internationally recognised guidelines such as the UN Global Compact’s principles on human and labour rights.

We have provided input into a number of best practice initiatives aimed at improving the level of corporate reporting to investors on human capital matters and continue to encourage hard and soft regulation on improved human capital management disclosures.

Our personnel, as our intellectual and human capital, are a fundamental component of our business. We are an accredited London Living Wage employer and signatory to the UN Global Compact. Our Modern Slavery statement details our commitment to running our business responsibly and during 2017 we rolled out unconscious bias training to all senior managers.

Community relations

Companies can provide positive economic impacts in the regions in which they operate through among other things job creation, payment of taxes and the provision of local infrastructure. There is increased scrutiny on the way organisations operate; as such they need to manage their relations with their local communities as it is their goodwill on which they are often dependent.

We are extremely cognisant that few asset classes are as necessary, or significant, to the daily lives of individuals as infrastructure. By their nature infrastructure businesses delivering essential services involve a broad range of different stakeholders including local communities. We believe that considering all stakeholders’ interests leads to the creation of greater and more sustainable value.

With our real estate developments, we endeavour to create places and communities where people want to work and live and play. Our community programmes and best practice tools aim to deliver social and community benefits, with a strong focus on skills and employment in line with local demand.

We challenge companies to pay an appropriate level of tax in the countries in which they operate, to that end, we have supported the Extractive Industries Transparency Initiative. Recognising the impact on local communities of certain businesses we work with the likes of the International Council on Mining and Metals to encourage companies to follow best practice on tailings management and pollution control.

We have a strong corporate citizenship programme that is focused on helping the communities in which we live and work. Our staff volunteer through our corporate programme or with other charities that are close to their hearts, taking part in lunchtime reading sessions with young people, renovating local schools and gardens, or supporting those more vulnerable within our immediate vicinity.
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, unconstrained, real estate debt and direct lending

Stewardship
Active engagement, advocacy, intelligent voting and sustainable development

Offices
London | Denmark | Dublin | Frankfurt | New York | Singapore

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

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