Corporate Governance Principles

The Association of Southeast Asian Nations

Our expectations of ASEAN-listed companies

EOS at Federated Hermes
2021

Federated Hermes

www.hermes-investment.com
For professional investors only

Introduction

EOS at Federated Hermes represents a broad range of long-term investors, who seek to be active stewards and owners of their beneficiaries' assets, including the shares or debt of the companies in which they invest. EOS engages with these companies around the world to promote long-term, sustainable returns. These Principles express our expectations of companies across a number of important governance, environmental and social topics. More detail on our expectations, particularly on environmental and social topics, can be found in our public, annually updated Engagement Plan[1].

The Association of Southeast Asian Nations (ASEAN) cover the following markets: Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam. Since it is a diverse group of countries at different stages of development on environmental, social and governance topics (ESG), we will be flexible in our approach towards applying the principles. Where possible, we will highlight the relevance of local corporate governance codes that provide relevant frameworks to guide the application of our principles.

Stewardship and engagement

Investors must also act as responsible stewards and promote long-term value through constructive engagement with companies and their directors. All substantive correspondence from institutional investors should be shared promptly with all board members. Our experience has shown that dialogue between companies and committed, long-term investors on strategy, finance, risk management and material ESG issues can improve the governance, performance and value of companies. Developing relationships of trust with long-term shareholders can be invaluable for boards, and we expect chairs and independent directors to make themselves available for engagement.

We expect companies to engage with long-term investors across a range of asset classes, including different types of corporate debt, in addition to their shareholders. Companies should now recognise that debt investor expectations have similarly aligned expectations to long-term shareholders in relation to governance, long-term strategy, capital allocation and environmental and social matters. Debt investors now expect accountability and constructive dialogue on opportunities and risks which might enhance or impair earnings or cashflow.

At EOS, our model is to provide stewardship on behalf of a collective of investors – mainly pension funds and other long-term, institutional investors from around the world. We engage with investee companies on matters material to long-term value, encompassing ESG and strategic topics, and make voting recommendations on resolutions at shareholder meetings. This collective model aims to make the engagement process more efficient and effective, for companies and investors, by

[1] The latest public version of the EOS Engagement Plan can be found at: www.hermes-investment.com/stewardship/eos-library

pooling resources and assets. We also aim to reduce potential conflicts of interest through a collective focus on long-term, sustainable value, shaped with input and agreement from our clients.

Company purpose and leadership

It is our strong belief that companies can only create and preserve long-term value for investors if they provide goods and services that sustainably solve societal needs.

To achieve this, we expect companies to be guided by a purpose that serves not only shareholders, but also other stakeholders, society and the environment. This helps protect the long-term interests of the savers and pensioners – current and future – invested in companies, who require sustainable financial returns and an economy, society and environment which can provide a secure future.

A clear and meaningful business purpose should enable business leaders to identify the right things to do in the short term, in order to fulfil their purpose over the long term. This is critical in a time of crisis – such as that caused by the coronavirus pandemic in 2020 – when difficult trade-offs may be required, particularly between shorter-term financial returns and maintaining strong relationships with key stakeholders, including government, the workforce, customers and supply chains[2].

Companies need to be able to rationalise and explain their decisions affecting key stakeholders. This includes the most difficult decisions, such as redundancies, but also how they allocate capital, including dividend payments and share buybacks.

We expect boards to consider capital allocation in the context of a company's purpose and long-term strategy. We are concerned that buybacks may be chosen to improve the share price or other related metrics over the short term, but are not always the best use of capital to support the creation of long-term, sustainable value.

Endorsement of local code

We encourage companies either to at least comply with the code of corporate governance in the respective markets or to fully explain their reasons for non-compliance. In Malaysia, we expect companies to adopt the comprehend, apply and report (CARE) approach and develop policies and action plans if they are unable to meet corporate governance standards. We recommend that companies assess any recurring explanations to identify whether they continue to be fit for purpose. In addition, we discourage companies from using boilerplate explanations, or viewing explanations as a tick-box exercise. Instead, we encourage companies to use disclosure to create internal debate about the effectiveness of their governance arrangements and to provide meaningful explanations of how their board ensures the highest possible levels of governance. We expect clear and thorough explanations that reflect the changing circumstances faced by the company over the reporting period,

[2] We expand on our expectations of companies in responding to coronavirus in more detail in our open letter to CEOs: https://www.hermes-investment.com/ukw/eos-insight/eos/stewardship-during-and-after-the-pandemic/

especially when it comes to explaining board structures and composition that deviate from best practice.

Board effectiveness and composition

Boards should ensure they comprise members with strong and diverse skills, experience, perspectives and psychological attributes, as well as sufficient independence and strength of character to challenge, as well as advise and support executive management teams. They should ensure membership of the board is frequently reviewed and refreshed, and that directors are elected and re-elected by shareholders on a regular basis to ensure accountability. Biographies for all directors should be provided to shareholders, indicating which are considered independent and the value that they bring to the board. This should be accompanied by an analysis of how the board as a whole displays the necessary skills, independence, diversity and other attributes to meet the company's evolving needs.

Chair/CEO separation

In line with codes of corporate governance in Singapore, Malaysia, the Philippines and Thailand, we expect the separation of the roles of chair and chief executive. The division of responsibilities between the chair and chief executive should be clearly established and set out in writing. We may recommend voting against the election or re-election of a combined chair and CEO, executive chair or the promotion of a former CEO to chair unless: it is a temporary arrangement with a published, time-bound transition plan; the company can present a compelling justification for the move such as the sudden loss of the CEO due to illness or through resignation or otherwise a lack of alternative candidates; the appointment is balanced by the presence of independent and effective non-executive directors including a lead or senior independent director with the skills and character to challenge the chair so that no one individual has overriding powers of decision; or the appointment is of a CEO to the role of chair and the candidate has spent at least two years not employed by the company between such roles.

Independence and tenure

On all boards, we expect a strong core of independent directors, including an appointed lead independent director, to ensure that all stakeholder interests are protected, to exercise objective judgement and, if necessary, to act as agents for change. This group should play an import role in guiding the boards' decision making and in the recruitment of directors. It should be empowered to meet independently, including before and after board meetings, and should do so in practice. It should be granted unfettered access to members of management, information and resources as required.

Ensuring sufficient levels of independence is particularly important for founder-led companies, those with executive chairs, significant shareholder representatives on the board (which we believe can be useful and justified, provided minority shareholder interests are protected) or strong management representation on the board. In their disclosures, companies should clearly state which directors they consider to be

independent and the criteria for determining this. We expect at least one third of the board of directors to be independent. If the chair is non-independent (in Singapore and Thailand) and if companies are included in the FTSE Bursa Malaysia Top 100 Index or with at least MYR2bn market capitalisation in Malaysia, we expect at least a simple majority composition of independence for the entire board which we define as over 50%.

We consider the overall composition of boards and recognise the value that long-serving directors can contribute. However, too many directors serving concurrently can increase the risk of groupthink and complacency. We expect a healthy mixture of tenures on boards, including regular board refreshments.

Companies should provide a rationale for nominating candidates, taking into account concerns that investors might reasonably have. These might include: independence and tenure, particularly when directors have been on the board for more than nine years; if they have been on the board with a group of directors for a long time; or if a director's capacity to fulfil his or her obligations may be perceived to be declining.

Committees

We expect companies in the ASEAN region to have nomination committees that are at least majority independent, chaired by an independent director. We expect the highest level of independent representation on the boards and committees of all listed companies, including listed subsidiaries or companies with controlling shareholders, to ensure an appropriate level of accountability to minority shareholders among the directors.

Board evaluations

We advocate board evaluations. The board should adopt the best practice of conducting such an evaluation at least every three years with a skilled and independent facilitator. Such externally facilitated evaluation should supplement the annual evaluation conducted by the board, ideally led by the independent director.

Director attendance and commitment

We expect board directors to be able to devote sufficient time to fulfil their duties, including to build and maintain a good understanding of the company and to fully absorb and be able to challenge the information presented to them by management. As a broad guideline, we do not support directors holding more than five directorships at public companies and in this context we consider a non-executive chair role to be roughly equivalent to two directorships.

Whether a director may be over-committed depends on a range of factors beyond the number of other roles they hold, including the size and complexity of the company and additional responsibilities, such as being a committee chair. We consider that certain industries such as banking (due to its business model and regulatory complexity) and multi-site operating companies such as international mining (due to the need for site visits) require more time commitment. We expect companies to encourage their executives to take on non-executive roles outside their own group

companies to assist in their development, bring current experience to boards and build a pipeline of future board directors. However, we do not expect executives to hold more than one non-executive role. This applies to directorships in both commercial and non-profit making institutions. We may make an exception if these organisations are part of a conglomerate, but we expect companies to be able to explain any conflicts of interest that may exist due to multiple directorships in subsidiaries, the competing objectives that might be present, and clarification on how director remuneration is calculated for these multiple roles.

Effectiveness

Measurable aspects of boards, such as those outlined above, are important but insufficient indicators of a board's functionality. While we welcome improvements to disclosure of these around the world, ticking all the good governance boxes does not necessarily translate into good governance, as demonstrated by continuing large-scale corporate failures.

Engagement between investors and board directors provides a valuable opportunity to more deeply assess how well a board is functioning. Our white paper, *Guiding Principles for an Effective Board*[3], highlights the factors that we consider to be most important in determining board effectiveness, focusing on the human, relational, and behavioural elements that are more difficult to assess.

Succession planning

Effective succession planning at board and senior management level is essential for safeguarding the ability of companies to deliver long-term returns. It should involve contingency planning for the sudden loss of key personnel, as well as planning for foreseeable change such as impending retirement. It should include consideration of the diversity of skills, experience and other attributes required at board and senior management level.

Overseen by the board, senior management should create a pipeline of suitable candidates from within the organisation to become senior managers and executive directors. Similarly, the board should identify suitable candidates for independent directors.

Diversity and inclusion

As well as the intuitive, social case that companies should embrace diversity and realise its benefits through inclusive cultures, there is a growing body of evidence supporting the link between more diverse company leadership and financial performance[4], including a 2020 study from McKinsey which found that companies with executive teams ranking in the top quartile for ethnic diversity were 36% more likely to have above-market profitability than their less diverse peers. McKinsey also noted

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[3] https://www.hermes-investment.com/wp-content/uploads/2020/04/guiding-principles-for-an-effective-board-april-2020.pdf

[4] For example, The 30% Club has compiled a list of studies examining the benefits of gender diversity https://30percentclub.org/initiatives/investor-group

that companies that already saw diversity and inclusion as a strength were likely to leverage this to bounce back from the pandemic more quickly[5].

Boards should seek diversity in its broadest sense to support high quality debate and decision making. Considering diversity of skills, experience, networks, psychological attributes and demographics (including gender, ethnicity, nationality, sexual orientation and age) will equip the board to effectively serve the company and its stakeholders.

Diverse perspectives throughout an organisation are also likely to more accurately reflect employees, customers, and suppliers across the company's geographic footprint. As such, we support the aspiration all levels of management and the wider workforce, should broadly reflect the diversity of society, including in the company's core functions, such as operations and sales.

We expect boards and management teams to monitor key indicators to assess the composition of the workforce and how the company's culture supports inclusivity. Where diversity is found to be lacking – for example, the under-representation of women or ethnic minorities in leadership positions or elsewhere across the organisation – we expect companies to develop time-based targets and initiatives to address it. We expect them to carefully consider how these targets and initiatives can take into account the convergence of different dimensions of diversity and support those facing combined challenges, for example, the promotion of women of colour to leadership roles.

Racial or ethnic inequity

ASEAN is an ethnically diverse region. For example, Indonesia alone has 1,300 recognised ethnic groups, as such, when considering the definition of race and ethnic minorities, we need to be particularly sensitive to cultural contexts in different markets.

We welcome the steps taken by companies around the world to acknowledge and commit to addressing racial or ethnic inequity, in the workforce and beyond. We expect these to be followed up with concrete steps and actions.

We believe many companies, including our own, have much more to do to address this urgent problem. We seek to learn from those companies that are taking a lead. But even those leading companies are only beginning to address the problem. Those which, like us, are only beginning or accelerating the journey must do so without further delay.

As a start, we expect companies to:

1. Discuss how they define and consider the inclusion of minorities within their organisation in terms of ethnicity, religion and language and how diversity reflects their key stakeholders, namely customers, employees and suppliers.

[5] https://www.mckinsey.com/featured-insights/diversity-and-inclusion/diversity-wins-how-inclusion-matters

2. Commit to a thorough review of the company's actions to date to identify where it may be perpetuating racial or ethnic inequity and where there are opportunities to make a positive contribution to racial or ethnic equity. They should include: the company's culture and workforce; products, services and customer practices[6]; actions with suppliers; contributions to public policy and other societal actions, such as support for community initiatives; and seeking and acting on feedback from employees, customers, suppliers and other stakeholders, including independent external experts.

   Start collecting, as a minimum, data on the ethnic composition of the workforce by seniority. We encourage companies to at least annually, publish these and other relevant data, including pay gaps/ratios, with a narrative explanation of what the figures mean and a brief, timebound, action plan to address shortfalls. Data should be used internally to prompt further investigations so that underlying drivers can be understood and acted on. Many companies will have a global footprint with a workforce spread over different geographies. In markets where data collection is restricted by law, companies should find alternative ways of monitoring their diversity and inclusion efforts. This could for example include anonymous staff satisfaction and engagement surveys.

Gender equality

Advancing gender equality in company leadership and throughout organisations also remains critically important, with many companies around the world still falling far short of equal representation. We continue our global support for initiatives like The 30% Club, which advocate for companies to achieve a minimum of 30% female representation on boards and in leadership populations.

We perform our assessment of diversity at both board and management levels to ensure that the leadership team has a suitable combination of talents. We expect boards to be comprised of at least 20% women by 2021, 25% by 2025 and 30% by 2030. We may recommend a vote against the chair of the nomination committee (or if the company does not have a nomination committee, we may recommend a vote against the chair of the board), if the company fails to demonstrate that a credible plan has been put in place to meet these expectations. In cases where a company is founder and/or family-owned or dominated, with over 25% in share ownership, we may still recommend a vote against the chair of the nomination committee. We may also do the same in cases where the nomination chair is also an executive and a representative of a major shareholder.

In addition to gender diversity on the board, we expect companies to be able to articulate how they are growing the executive pipeline of female talent and disclose relevant key performance indicators (KPIs) with time-bound targets supportive of gender equality.

[6] For example: products, services or practices that intentionally or unintentionally create or sustain racial inequity (e.g. banks' lending practices to people of colour), perpetuate racist stereotypes or group supremacy (e.g. the representation of different groups in marketing).

Improving the representation of women should not be considered in isolation from other dimensions of diversity and, particularly, ethnic diversity. We welcome the integration of targets for representation of people of colour and for women by The 30% Club in the UK, for example, that boards should include at least one person of colour and that half of these board seats should go to women of colour.

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 aligning properly with the core long-term objectives of companies.

We are concerned that the models common in markets like the US and the UK, which gear the majority of pay towards performance-based pay, may have been well-intentioned but have produced damaging, unintended consequences such as escalating quantum and encouraging short-termism or financial engineering. Other markets around the world where pay is more restrained are at risk of importing these poor practices.

We consider a key risk to be focusing the majority of pay on achieving performance targets which can be difficult to define and set with the right degree of rigour. These risk heavily incentivising executives to hit targets over relatively short time frames, regardless of whether these actions are best aligned to long-term, sustainable returns to shareholders and other stakeholders. This is particularly the case with schemes that disproportionally focus on increasing the share price through heavy weighting to total shareholder returns metrics. We also generally do not support the use of share options, which can introduce similar risks of short-termism, too much focus on the share price, and which do not encourage long-term ownership of stock. However, we may allow flexibility for companies in the region which are at the beginning of their journey to increase the proportion of variable pay relative to their below industry average fixed pay.

The pandemic in 2020 has served as a reminder of the limitations of pay schemes reliant on stock options or performance-based incentives schemes as share price and limited visibility of the future meant boards in most industries have struggled to set meaningful targets in light of the disruption caused by the pandemic. Meanwhile the ensuing rally in markets may lead to underserved windfall gains under various share scheme incentive schemes.

We continue to make the case for switching to simpler pay schemes aligned to long-term success and the desired culture in the organisation, based on fixed pay and long-term time-restricted stock, with an emphasis on long-term share ownership for executives.

We expand on our views on executive pay in our paper, *Remuneration Principles: Clarifying Expectations*[7].

They can be summarised as follows:

1. Simplicity: Pay should be simple; for example, fixed pay (mix of cash and long-term shares) plus a single incentive scheme (an annual bonus).
2. Alignment: Pay should be aligned to long-term strategy and the desired corporate culture, incentivising long-term value creation, including wider social and environmental outcomes. Where metrics and targets are used in incentive pay, they should reflect strategic goals, rather than focus attention on total shareholder return, stock price appreciation or earnings per share.
3. Shareholding: Management should become long-term stakeholders in the company's success through substantial shareholdings. Significant shareholding requirements should remain in place for at least two years following departure from the company.
4. Accountability: Pay outcomes should reflect outcomes for long-term investors and take account of falls in company value or reputation. The board should intervene and apply discretion whenever formulaic outcomes do not achieve this. The potential pay outcomes under a policy should be rigorously scenario tested in advance, with a cap on the total possible pay published, to help reduce the risk of unintended consequences.
5. Stewardship: Pay outcomes should be communicable to all stakeholders, including employees and the public. Boards should take into account wider workforce pay practices and ratios when judging the appropriateness of pay opportunities and outcomes. Boards should then write to employees each year explaining the outcomes of executive pay and the alignment to long-term value, and the company's strategy and purpose. Companies and investors should regularly discuss strategy, long-term performance and the link to executive pay.

We are not yet taking the position of automatically opposing all pay models that do not align to our principles. However, we set various guidelines and thresholds in our voting policies which seek to improve market practice and encourage closer alignment with our principles. These are tailored to the context of each market.

Protection of shareholder rights

We rigorously defend shareholder rights on behalf of institutional investors, including the right to receive good quality corporate reporting and material information on a timely basis, to propose shareholder resolutions and to vote at shareholder meetings.

[7] https://www.hermes-investment.com/wp-content/uploads/2018/10/remuneration-principles-clarifying-expectations.pdf. The principles contained in this paper are global in nature, but some of the specific references to structures are more applicable to certain markets such as the UK.

We support a single share class structure, with one share one vote, and oppose any measures that deviate from this.

Share issuance without pre-emptive rights

In Malaysia (effective until 31 December 2021; 10% afterwards), Singapore and Thailand, companies can seek authority to issue up to 20% issued share capital other than as a rights issue under the general issuance mandate. Companies may repurchase up to 10% of issued share capital per year and sometimes seek authority to reissue all repurchased shares under the share reissuance mandate.

While we respect the flexibility that companies require in managing their share capital, they rarely fully use the general share issuance allocation that they seek for shareholder approvals at AGMs. We therefore strongly recommend a self-imposed target for general share issuance, including reissuance of shares, of 5% as best practice, and no more than 10% of the shares in issue. These should be issued at no more than a small discount, with 10% as the absolute maximum discount. In addition, we recommend that the company clearly discloses: the rationale for the placement and the number and percentages of issued shares issued in earlier placings; whether the funds from those placings have been used as intended; the discount at which the shares were issued; and details of the actual placements, including criteria for selecting these, in the proxy materials to keep shareholders adequately informed.

Hybrid or virtual shareholder meetings

Annual general meetings and other shareholder meetings are an important part of the governance process for companies. They provide a forum for shareholders to hear directly from the company about its performance and to challenge directors on important topics, bringing transparency and accountability to shareholders.

We believe dialogue between shareholders and the board is enhanced by the in-person meeting format: it presents the opportunity to make points to the whole board, not just to one or two directors; the ability to ask questions spontaneously and to build on the questions asked by others is valuable; it is more difficult for directors to avoid difficult questions or topics; and directors must provide answers in a public forum and, accordingly, be accountable for them.

We may accept meetings to be convened in a hybrid format – where shareholders have the option to join the meeting via an online platform or to join in person, provided all shareholder rights are protected or enhanced. Online participation should be a supplement to, not a replacement for in-person participation and companies must ensure that this is not used to suppress dialogue or otherwise reduce opportunities for shareholder participation that would have been available at an in-person only meeting.

We do not generally support virtual-only meetings unless these are a temporary solution in response to restrictions on in-person gatherings prompted by the pandemic. In those cases, we expect a clear commitment to return to in-person or

hybrid meetings as soon as restrictions allow and for all shareholder rights to be protected.

Shareholder resolutions

We support the selective use of shareholder resolutions as a useful tool for communicating investor concerns and priorities or the assertion of shareholder rights, and as a supplement to or escalation of direct engagement with companies. When considering whether or not to support resolutions, we consider factors including: whether the proposal promotes long-term shareholders' interests; what the company is already doing or has committed to do; the nature and motivations of the filers, if known; and what potential impacts – positive and negative – the proposal could have on the company if implemented.

Social, ethical and environmental responsibility

Taking a responsible and long-term approach to social, environmental and ethical issues is critical to the creation and preservation of long-term value, and should be reflected in the company's purpose, strategy and culture. Companies must identify and disclose the most material social and environmental issues for the company and its significant stakeholders. They must seek to address the associated risks and opportunities through their core business strategy and value proposition, rather than through adjacent initiatives which can feature in traditional corporate social responsibility programmes.

We expect boards and management to have oversight of material sustainability issues and to be accountable to shareholders for effectively managing the associated risks and opportunities. Boards should consider the issues in this section, although the list is not exhaustive.

UN Sustainable Development Goals

We support the UN Sustainable Development Goals (SDGs) and believe that the private sector has an important role to play in achieving them by 2030. Companies should assess the relevance of each SDG, identifying those that they can make a direct contribution to, and incorporate the most material SDGs into their strategies. We encourage companies to go beyond highlighting any SDG that the company could be connected to and to be purposeful in selecting those which it intends to make an active, direct contribution to, including through the allocation of resources and setting targets. We urge companies to report on their approach to the SDGs and to engage with its shareholders and civil society on how best to contribute to the SDGs.

Climate change

The breakdown of the climate is a systemic risk to the value of our clients' portfolios, due to the economic and political consequences, as well as the physical impacts of climate change.

We strongly support the goal of the 2015 Paris Agreement – to limit global warming to well below 2°C and pursue efforts to reach 1.5°C of warming – and expect companies

to publicly do the same, as well as ensuring any third party organisations they support or are members of, such as trade bodies or lobbying organisations, are aligned to achieving this.

We urge companies not already doing so to:

- Establish strong governance of the risks and opportunities presented by climate change. Boards should ensure that climate change is included on the board agenda at least annually. We recommend that the board and senior management engage with outside experts who can advise on strategic risks and opportunities that climate change presents, including challenging the company's approach if necessary.
- Set science-based targets to reduce greenhouse gas emissions in line with the goals of the Paris Agreement. This should include consideration of Scope 3 emissions associated with a company's supply chain or use of products or an explanation where this is not the case.
- Integrate climate change into the forward-looking strategy for the company. This includes conducting scenario analysis to establish the potential financial and other impacts of climate change on the business at different levels of warming.
- Adopt the framework set out by the Task Force on Climate-related Financial Disclosures for the management and reporting of climate-related risks and opportunities.

We support the work of The Transition Pathway Initiative (TPI), which assesses companies' management of greenhouse gas emissions and risks and opportunities related to the transition to a low-carbon economy. It also assesses how companies' current and future carbon performance might compare to the international targets and national pledges made as part of the Paris Agreement. Company ratings can be accessed via the publicly available TPI tool[8]. We will consider recommending voting against the chair of the board or other responsible directors of companies which we do not believe to have demonstrated sufficient management of climate risks, for example, those scoring below a Level 3 management rating from TPI.

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. Boards should ensure robust governance processes are in place to identify misalignments. Where these are identified, all available avenues to influence these third parties should be used to encourage effective action on climate change in line with the Paris Agreement. The company should be transparent on this governance procedure, actions taken to reduce or eliminate this misalignment and any progress seen, in line with the Institutional Investors Group on Climate Change Investor Expectations on Corporate Lobbying on Climate Policy. Ultimately the board should be prepared to cease membership where misalignment persists without

[8] http://www.lse.ac.uk/GranthamInstitute/tpi/the-toolkit/

progress. Companies should also proactively support and advocate for positive action to mitigate climate change risks in their spheres of influence.

Companies should ensure that climate-related risks are integrated into financial reports and accounts. The auditors should consider company relevant climate and energy related financial risks and assumptions, future plans (e.g. capital allocation, M&A, capital projects), compliance with laws and regulations and determine whether those risks are adequately disclosed in the financial statements.

Biodiversity

Companies in many sectors are dependent on biodiversity and ecosystem services, including the supply of clean water, the availability of raw materials, and the existence of healthy soils. Company operations and supply chains also have extensive impacts on terrestrial, marine and freshwater biodiversity. There is also an important connection between biodiversity and human health, with the coronavirus pandemic highlighting the increased risk of transmission of viruses from animals to humans resulting from exploitation of wildlife and habitat destruction[9].

Companies must acknowledge the centrality of nature to their continued success and take responsibility for ensuring that their activities do not directly or indirectly negatively impact biodiversity. To protect valuable ecosystems and habitats, companies should prioritise eliminating deforestation from their supply chains and helping farmers transition to more regenerative forms of agriculture. Where feasible, we will expect companies to demonstrate a net positive impact on biodiversity.

Resource efficiency – circular economy

As the global population and consumption levels continue to rise, it is vital to find ways to use resources more efficiently, to tackle environmental challenges such as climate change; pollution to air, water and land; and soil erosion and loss of biodiversity. We expect companies to strive for the most efficient use of resources possible, and to consider how they can introduce circular economy approaches to their business model and operations.

One highly visible example is the urgent need to reduce plastics consumption and waste. We expect companies in exposed sectors to develop strategies and set targets for the reduction of, and optimal and balanced use of plastics in products and packaging; to end reliance on single-use plastics wherever practicable; and to invest in developing more circular supply chains which consider the most sustainable use of plastics or alternative materials throughout their lifecycles.

In the face of looming resource scarcity, another example is the need to shift to more sustainable sources of food, including reliance on inefficient animal and livestock-based proteins. Boards in relevant sectors should consider the potential for healthy, sustainable foods, ingredients and agricultural practices, such as plant-rich dietary options, plant-based proteins, and animal proteins which do not exacerbate further

[9] https://www.hermes-investment.com/eos-insight/coronavirus/the-coronavirus-and-our-relationship-with-nature/

deforestation or fisheries depletion, and which avoid excessive use of antibiotics in rearing.

Human rights

We endorse the UN Guiding Principles (UNGPs) on Business and Human Rights and the UN Global Compact and expect companies to do the same. We expect companies to use the reporting framework of the UNGPs to disclose how they assess and manage human rights impacts related to their operations and supply chain. Companies should conduct regular human rights risk assessments and demonstrate effective human rights due diligence designed to identify, prevent, mitigate and account for how they address their impacts on human rights. They should prioritise their efforts on the salient human rights issues associated with their activities.

Companies' licences to operate are increasingly affected by reputational factors, including their approach to human rights. As a minimum, we expect companies to comply with all legal requirements, including, for example, the obligations of the UK Modern Slavery Act; and to respect all internationally recognised human rights.

Human capital management

For many companies, employees are one of their most valuable asset, yet it is often unclear from disclosure or engagement with boards how companies invest in or manage their people effectively. The pandemic has brought into focus the important role that motivated, engaged workforces with sufficient levels of investment can play in an organisation's successful response to crisis, as well as the responsibility companies have to act as responsible employers.

Companies should set strategies and supporting objectives for the management of their human capital which reflect the importance of employees to long-term value creation and are overseen by the board. We encourage companies to provide qualitative contextual information describing their approach, as well as annual disclosure of key performance indicators used to manage human capital.

We expect all companies to disclose the following as a minimum for human capital management:

- The number of people employed by the issuer, broken down by full-time and part-time employees along with contingent workers who produce its products or provide its services;
- Turnover or similar workforce stability metric; and,
- Workforce diversity data, concentrating on gender and, where possible, diversity of origins across different employment bands/employee levels.

Culture and ethical conduct

We expect companies to set and adhere to standards of ethical conduct through relevant policies and processes, including enforcing best practice anti-corruption and anti-bribery policies and processes. These should be overseen by the board with

robust action taken where issues are identified. This, combined with clear cultural expectations and organisational measures provide the best possible defence against corruption and other unethical behaviour.

Policies and processes cannot be fully effective without the right leadership. We expect the board not only to oversee the company's culture and conduct but also to set the tone from the top, to encourage the highest ethical standards, and to drive company values.

Tax

Companies should recognise the importance of taxation to the funding of public services on which they and their stakeholders rely, and pay their fair contribution. This has been particularly emphasised during the pandemic, in which all businesses have directly or indirectly benefitted from government action to support the economy.

Fair payment of tax, based on the intention of tax law and in proportion to the location of economic value generated, is an important pillar of a company's social licence to operate. We believe that companies that seek to aggressively minimise their tax payments will face increasing reputational and financial risks.

We expect companies to:

- Comply with the intention of tax laws and regulations in all countries of operation.
- Pay taxes in line with where economic value is generated.
- Publish a global tax policy describing their approach to tax risk, controls and oversight, including any material variations across the entity. This should include policy on corporate structuring in low tax jurisdictions, intra-group transactions and the use of tax incentives from public authorities. Companies should ensure that their tax policies and practices do not damage their social license to operate in all jurisdictions in which they have a presence.
- Disclose publicly the full extent of taxes paid or collected by them in each country. Reporting on each country should include the purpose of the local corporate entity along with comparable corporate data such as revenue, profit before tax and number of employees. Companies can use the Global Reporting Initiative Tax Standard as a framework for this disclosure.
- Boards to ensure they have sufficient oversight of tax policy, risk and controls in their committee work.

Transparency and reporting

We believe that the quality of narrative reporting reflects the board's strategic thinking, its line of sight into operations and how well it oversees the company. 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 each company reports in a way that allows investors to understand

the main risks that the board has identified for the business, along with how the company manages and mitigates them. This includes ESG, as well as financial and strategic, risks.

Audit

Shareholders in listed companies rely on the quality and robustness of the audited information those companies report to the market when making investment decisions, and when holding company management and boards to account. High quality and effective audits are vital to ensure the markets trust and have confidence in the information companies report.

Audits should provide assurance to shareholders that the financial statements present a prudent, true and fair view of the results, cash flow and financial position of a company. In recent years, we have seen a spate of business failures partly linked to poor quality audits. These high profile cases have raised questions about the quality, relevance and independence of audits, and strengthened calls for reform.

In addition, shareholders, regulators and other stakeholders have also increasingly focused on the role and performance of audit committees and how they discharge their duties. Beyond the oversight of the financial reporting process and the appointment and oversight of the external auditor, audit committees have important risk and compliance oversight responsibilities, as delegated by boards or as specified by laws or regulations.

Auditor rotation

Maintaining independent external assurance is a fundamental pillar of good stewardship and the fiduciary duty of a board of directors. Independence, and potentially audit quality, is at risk when the same assurance provider is maintained for long periods. Our experience is that simply rotating the audit partner is insufficient. Only by tendering the audit firm at regular intervals can auditor independence and quality be protected, in the interests of shareholders and other stakeholders. Auditor rotation can also add value with a fresh pair of eyes, fresh challenge and opinions. It will bring a new firm with a different approach and set of subject specialists.

Non-audit services and fees

As part of overseeing the external auditor, the audit committee must establish and enforce a policy on what non-audit services the company can procure from the external auditor. We pay close attention to these services and related fees to ensure that they do not compromise auditor independence, which could compromise the integrity of the audit. The non-audit fees should normally be substantially lower than the audit fee.

As a guideline, we do not expect non-audit fees to exceed 50% of audit fees in any given year. If this is exceeded, there should be a clear explanation as to why it was necessary for the auditor to provide these services (for example, for certain services such as reviewing interim reporting or performing due diligence on transactions) and how the independence and objectivity of the audit was assured. In these cases we

also expect the committee to take action to ensure this does not reoccur, either by tendering for a new audit firm or reallocating non-audit work to a different firm.

We recognise that audit quality cannot be ensured solely through regular rotation of external auditors or reducing conflicts caused by the payment of fees for non-audit work. We expect audit committee chairs and committee members to understand the organisation, challenge management and external and internal audit teams, and to follow best practice guidance when appointing audit firms, such as those we contributed to with the UK Investment Association[10]. Committee chairs and members should ensure they have sufficient time to fulfil their duties, which we expect to be significant, particularly for large, complex organisations. We expect companies in Malaysia and Thailand to establish an entirely independent audit committee in line with the market expectations, and encourage companies in the rest of the region to follow suit to uphold the highest standard of corporate governance.

Corporate actions

Most merger and acquisition transactions are not as successful as the acquiring party expects. When considering our voting recommendation on a commercial transaction, we will consider a range of factors, in the context of seeking to protect and promote long-term, sustainable value. The underlying expectation is that due process is followed, with information made available to shareholders. Considerations include:

- Consistency with strategy: whether the transaction is consistent with the prior stated strategic aims of the company or whether any change in strategy appears coherent and sensible.
- Risks and opportunities: the key risks and opportunities to the business from the transaction and the extent to which these appear to have been considered and managed. This includes factors such as cultural fit, human capital management implications and the post-transaction integration plan.
- Conflicts of interest: any conflicts of interest which may affect the alignment of the interests of directors or particular shareholders with those of long-term outside or minority shareholders. This includes considering whether the proposal is a related party transaction and, if so, whether appropriate disclosures and safeguards are in place; whether the transaction erodes any shareholder rights; and any potential conflict of interest concerning the directors' duty to act in the interests of shareholders, in particular, as these may arise from either existing or newly revised remuneration arrangements.
- Price: including whether any premium or discount to prevailing market share price is appropriate.

The board should form an independent committee to oversee any mergers or acquisitions, particularly when there are potential conflicts of interest for executives who stand to benefit financially from the transaction.

[10] https://www.ivis.co.uk/media/12498/Audit-tenders-guidelines.pdfv

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