

OUTCOMES
BEYOND
PERFORMANCE }

ENGAGEMENT OBJECTIVES & PLAN

2018-2020



Public version

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HERMES
EOS

Hermes EOS – our approach to engagement

Hermes EOS is one of the largest stewardship resources of any fund manager in the world. This team of engagement and voting specialists enables pension funds and other longer-term institutional investors to meet their fiduciary responsibilities and be more active owners of companies. Hermes EOS helps improve the capacity of shareholders as responsible owners of the assets in which they invest and to incorporate longer-term sustainability and risk management issues into their ownership policies and practices. Its activities are based on the premise that companies with informed and involved shareholders are more likely to achieve superior long-term performance than those without. Engagements may relate to the financial performance, strategic plans and risk management of companies or environmental, social and governance issues.

We work on behalf of over 40 long-term investors from 10 countries who entrust us with the stewardship of £336 billion / \$455 billion / €379 billion of assets (as at 31 December 2017) invested in over 10,000 companies worldwide.

Our stewardship services cover the following areas:

- **Corporate engagement** – engagement with companies that form part of the public equity and corporate fixed income holdings of our clients to seek positive change for the mutual benefit of our clients, the companies we engage with and the societies in which they operate.
- **Public policy & market best practice engagement** – engagement with legislators, regulators, industry bodies and other standard-setters to help shape the environment in which companies and their investors operate.
- **Intelligent voting** – voting recommendations that are, where practicable, engagement-led and involve communicating with company management and boards around the vote to ensure recommendations are well-informed and include engagement insights.
- **Portfolio screening** – we provide a quarterly screening service to identify companies which are in or near breach of international norms and conventions to assist with the identification of higher-risk companies in the investment portfolios of our clients.
- **Advisory services** – we work with our clients to develop their responsible ownership policies, drawing on our extensive experience and expertise to help develop their stewardship strategies.

Our 26-person team includes industry executives, senior strategists, corporate governance and climate change experts, accountants, ex-fund managers and former bankers and lawyers. The depth and breadth of this resource reflect our philosophy that stewardship activities require an integrated and skilled approach. Intervention at senior management and board director level should be carried out by individuals with the right skills, experience and credibility. Making realistic and achievable demands of companies, informed by significant hands-on experience of business management and strategy-setting, is critical to the success of our engagements.

Hermes EOS focuses its resources on corporate, public policy and best practice engagements which have the potential to add – or protect – the most long-term market value for its clients’ holdings and safeguard their reputation.

Engagement objectives

The core client objectives which we seek to influence through our engagement work are to support long-term sustainable economic growth and value-creation through:

- **Environment** – improved management and disclosure of the risks arising from climate change in support of the goals of the Paris Agreement to limit climate change to below 2°C; sustainable levels of consumption of natural resources including water, land-use and materials, building a circular economy over time; and control of pollution of air, land and water to below harmful levels.
- **Social & ethical** – respect for basic human rights including those of indigenous communities, eradication of slave and child labour, provision of fundamental services and protection of privacy; improvements in human capital management including the protection of labour rights and development of a more diverse and inclusive workforce; and the development of an appropriate corporate culture resulting in more ethical conduct, including the elimination of bribery and corruption.
- **Corporate governance** – improvement of the governance of companies through better board composition and effectiveness, including more diverse and independent boards, the alignment of executive remuneration with the creation of long-term value, and the protection and enhancement of shareholder rights.
- **Strategy, risk and communications** – the clear articulation of a company’s purpose, supported by a long-term sustainable business model and strategy, robust risk management practices and transparent disclosure of reliable information that is sufficient for investors and wider stakeholders to make informed decisions on long-term investment.
- **Stewardship** – more active ownership by investors to support a global financial system that acts in the interests of ultimate beneficiaries, rather than their various agents, including greater levels of market engagement, voting on all shareholdings and working collectively in support of shared goals.

This agenda supports the delivery of holistic returns – outcomes for our clients that go far beyond the financial, impacting on the social fabric, the environment and the wider world, helping people invest better, retire better and create a better society for all.

Engagement progress in 2017

During 2017, we engaged with 659 companies, covering 1,704 identified objectives or issues, and making progress on 38% of all objectives contained within in our engagement plan.

	# of companies engaged	# of issues and objectives engaged	# of objectives engaged	# of objectives completed	% of objectives with progress	# of interactions per company
Engagement programme	387	1354	659	80	38%	3
Other companies	272	350	20	5	34%	1
Grand Total	659	1704	679	85		

Corporate engagement objectives & progress 2017



In addition to 1,545 interactions (including meetings, phone calls and letters) with companies we also had 190 interactions with regulators, standard-setters and other third parties in the pursuit of public policy and market best practice objectives.

Engagement themes for 2018-20



¹ Includes tax and bribery & corruption.
² Includes diversity & inclusion.
³ Includes cyber security.

The following are the themes we address in our engagement plan, covering issues in the areas of environmental, social, corporate governance, and strategy, risk management and communication. We have included some objectives which exemplify those we pursue both at individual companies and to improve public policy and market best practice. The objectives set at individual companies are tailored to their particular circumstances and will typically be of broader scope than can be included in this short summary of our engagement plan.

Environmental themes

Climate change

Climate change concerns investors for two reasons. The first is transition risk and potential consequential litigation, as regulation and disruptive technologies drive the move to a low-carbon economy. Transition risk is more likely to hit poorly prepared companies in exposed sectors. The second reason is the physical risk of climate change, which threatens societal wellbeing and the growth and stability of the global economy. The UN Paris Agreement clearly sets the public policy goal to limit global warming as a result of climate change to 2°C or lower.

Corporate engagement – Our focus is on aiding companies to manage the risks and opportunities arising from climate change. Our core objectives include appropriate board-level oversight, strategic risk and opportunity appraisal, and target setting. We also ask companies to manage the physical risks arising from climate change.

Public policy & best practice – We will support the Climate Action 100+ collaborative engagement initiative by acting as engagement lead for a range of companies in different regions. We seek to improve the quality of wider investor engagement on climate change by contributing to collaborative engagements with some of the largest international responsible investment organisations, including the PRI.

Natural resource efficiency

Natural resource efficiency covers water, food, timber and land use, as well as commodities and minerals, including fossil fuels, iron ore and precious and rare earth metals. This theme is important to investors, as much of the global economy is dependent upon the continuing supply of natural resources, while current levels of consumption of some commodities are unsustainable. It is estimated that 52% of the world’s population could be at risk due to water stress by 2050.

Corporate engagement – Our focus is on water stress, circular economy initiatives, and sustainable food and agriculture. Our core objectives include encouraging companies to adopt leadership roles in managing water demand, and pressing for smart product design, the use of biodegradable or renewable materials and for recycling and reuse campaigns. We will also encourage companies to develop a long-term, sustainable food sourcing strategy.

Public policy & best practice – We will continue to support the CDP Water initiative and seek to promote improved market engagement on water stress. We will support and help develop sustainable agriculture-related accreditation standards and work with civil society groups to advance market best practices, such as the Roundtable on Sustainable Palm Oil.



Pollution

Pollution management covers nuclear contamination, toxic substance management and spill control. Toxic substances include nitrogen and sulphur oxides (NO_x, SO_x) and small particulates, and spills include oil, chemical pollutants and antimicrobials. Pollution continues to grow as an investor concern globally, as governments increase regulations. In the UK, for example, the new air quality plan for nitrogen dioxide (NO₂) proposed that conventional petrol and diesel cars be banned by 2040.

Corporate engagement – Our focus is on pressing companies to reduce pollution and encouraging financial institutions to factor pollution into their lending decisions. Our core objectives include companies adopting robust nuclear risk management policies and processes, best practice toxic substance management, and the development of catastrophe risk management plans and emergency response systems which cover spills.

Public policy & best practice – We will support a range of initiatives to control pollution. For example, we will engage with the EU on auto emissions management policies and press for public policy support for testing regimes reflective of real-life driving conditions.

Social themes



Conduct, culture & ethics

Culture generally manifests itself in corporate conduct and in the behaviour of employees. Unethical cultures can engender conduct issues such as mis-selling practices, the poor treatment of customers, business compliance issues, misleading reporting, aggressive tax planning strategies and bribery and corruption. These practices can damage stakeholder relationships and brand reputation, and lead to legal liabilities and financial costs.

Corporate engagement – Our focus is on the prevention of business ethics risks and on the challenges faced by companies when trying to embed values – for example through the influence of leadership ('tone from the top') – and assess culture effectively. Core objectives include evidence of a customer-centric culture, the implementation of strong anti-bribery and corruption programmes, and a responsible tax planning strategy.

Public policy & best practice – We encourage the enactment of strong anti-bribery and corruption legislation. We support industry initiatives which, for example, press governments to amend tax regulations to restrict opportunities to shift profits off-shore, such as the OECD's Base Erosion and Profit Shifting Initiative.



Human capital management

Human capital management involves the good management of a diverse workforce in order to obtain the best possible long-term performance. This includes putting in place appropriate hiring policies and processes to ensure employee retention and engagement, health and wellbeing and appropriate training. Numerous studies support the value-creation potential of a diverse workforce.

Corporate engagement – Our focus is on a call to action on wider diversity, and respect for all labour rights. Core objectives include credible plans to achieve minimum diversity targets appropriate to each geography, to engage with poor performers on the newly disclosed pay gap in the UK, and to encourage payment of at least the minimum wage and/or living wage, depending on jurisdiction.

Public policy & best practice – We advocate the benefits of diversity in public debate and support government-backed initiatives to increase executive management diversity. We encourage hard and soft regulation on improved human capital management and labour rights disclosures.



Human rights

Human rights cover child and slave labour, indigenous rights and self-determination, and basic rights such as life without torture, no imprisonment without charge, access to medicine, nutrition, finance, personal security and data privacy. Respect for human rights is a priority on the investor agenda as it reflects a company's wider corporate culture, business ethics and enterprise risk management, each of which is essential to the creation and preservation of long-term value.

Corporate engagement – Our focus is on improving human rights management and product safety, and reducing child and slave labour. In order to achieve this, our core objectives include encouraging companies to apply the UN Guiding Principles – especially if their products and services are exposed to use in disputed and indigenous regions – and to use appropriate technology to create a more transparent supply chain.

Public policy & best practice – We promote new best practices in responsible raw materials sourcing in supply chain management, such as the Responsible Business Alliance. We will also participate in the sustainable protein supply chain to improve access to nutrition.

Corporate governance themes



Board composition & effectiveness

Board composition & effectiveness includes the following needs: external and independent evaluation of boards, diversity of board members, a mix of skills and attributes, independent directors to challenge management, systematic succession planning, a separate chair and CEO, and effective committees. These sub-themes concern investors as there is strong evidence that, for example, the decision-making of boards is improved by diversity of board members in terms of gender, age, background, networks, nationality and ethnicity.

Corporate engagement – Our focus is on encouraging boards to adopt policies and actions that are conducive to good decision making and long-term quality. The extent of progress on board composition differs materially by geography. Our core objectives in the UK, as a developed market, include to increase the percentage of women on boards to 33% by 2020, to improve diversity based on ethnicity as well as a balance of skills, experience, background and personal attributes, and oppose over-committed directors. In emerging and developing markets, we seek to increase independence on boards.

Public policy & best practice – We will support further development and effective implementation of the UK Corporate Governance and Stewardship Codes. In Japan, we will continue to talk to the Financial Services Agency (FSA) on board composition, including promoting diversity and more external directors. To encourage better board composition and corporate governance in the US, we endorse initiatives such as the Investor Stewardship Group.

Executive remuneration

We believe that well-structured remuneration can be an important ingredient in delivering long-term business success. Pay structures are a critical tool for aligning the activities of management with a company's purpose, strategy and performance. Despite, and potentially because of, efforts to control the tension between executives' interests and those of other stakeholders, in a number of markets executive pay has become complex and excessive, while arguably failing to align or motivate.

Corporate engagement – Our focus is on the implementation of the Hermes Remuneration Principles. Specific objectives vary according to local market practices and company issues. Examples include the simplification of remuneration schemes, reduction of variable to fixed pay ratios, increasing the focus of metrics on strategic goals, increased executive shareholdings and the establishment of a clear link between pay and performance.

Public policy & best practice – We will contribute to the development of pay practices across the world. For example, we have set up an initiative with the goal of developing guiding principles for best practices in executive remuneration for German companies. We also continue to promote more widespread investment industry consensus for the adoption of Hermes' Remuneration Principles in the local context, with a particular focus on simplified remuneration schemes. In emerging markets, we seek to engage on improving transparency on executive remuneration.

Shareholder protection and rights

Key areas of shareholder rights include: voting rights, disclosure of related party transactions, shareholders' ability to propose candidates for election to the board (proxy access), avoidance of poison pill arrangements which limit potential changes of control, and capital management protections to prevent the dilutive impact of new share issuance. Protecting and enhancing shareholder rights is critical to the long-term success of companies, in the interest of all stakeholders.

Corporate engagement – Our focus is to protect and enhance shareholder rights. Issues vary significantly by geographic market. Core objectives include defending pre-emption rights (UK), promotion of the one-share-one vote principle (Continental Europe), wider promotion of proxy access (North America), full disclosure and dismantling of cross-shareholdings (Developed Asia), and the implementation of transparent board nomination and election processes (emerging and developing markets).

Public policy & best practice – We will continue to engage with stock exchanges and regulators on their role in enforcing listing rules and promoting a framework that protects shareholder rights. We are active in systematically raising the subject of cross-shareholdings in Japan, for example with the Financial Services Authority (FSA), arguing our case that cross-shareholdings impede competition, are a non-efficient use of shareholder capital and ultimately impede effective stewardship.

Strategy, risk and communication themes

Business purpose & strategy

Boards should articulate a corporate purpose to deliver long-term, sustainable benefits to customers, acknowledging the needs of other stakeholders, and ensure that the company's culture, strategy and major decisions are guided by the corporate purpose. Meanwhile, the rate of technological change and disruptive technologies are increasing the need for companies to review long-term corporate strategy.

Corporate engagement – Our focus is on encouraging boards to articulate a purpose that provides a guide to strategy and how it enables sustainable business. Core objectives include articulation of a coherent corporate strategy, an explanation and justification of why a company is the best parent of each business it owns, and critical testing of all investment plans.

Public policy & best practice – We will continue to participate in the Statement of Significant Audiences and Materiality campaign, jointly supported by Harvard Business School professor Robert Eccles, where we have invited a pilot group of companies to identify their most significant stakeholders. We will also continue to contribute as a member of the advisory board of the Strategic Investor Initiative (SII) of the CEO coalition Committee Encouraging Corporate Philanthropy (CECP).

Corporate reporting

Corporate reporting includes the reporting of financial, strategic and business information. The audit process is vital to ensuring the integrity of company reporting on essential matters such as the solvency of the company, its prospects for longer term viability and its financial health more broadly. As corporate value has shifted from tangible to intangible assets, investors have required more integrated reporting of a company's holistic approach to value creation.

Corporate engagement – Our focus is on auditor independence, audit quality and integrated reporting. Core objectives include encouraging companies to put their audit out to tender more frequently, for audit committees to challenge auditors on significant judgements, and to press for systematic disclosure of a core set of ESG information.

Public policy & best practice – We will drive further improvements in audit and corporate reporting through collaboration with investors, practitioners, standard setters, and oversight bodies, and initiatives such as the Company Reporting and Auditing Group.

Risk management

An understanding of risks is vital to the good management of a company. High-profile business failures, such as BP's Deepwater Horizon oil spill in 2010 and the global financial crisis, have increased the attention paid to risk management. Digital technology is increasingly critical to a company's operations, giving rise to heightened cyber security risks.

Corporate engagement – Our focus is on the risk management framework and processes, with an emphasis on cyber security. Our core objectives include evidence the board has set the risk profile appropriately, integration of risk into strategy formation, a robust cyber security and data protection strategy, and measures to manage cyber security risks arising from third-party relationships.

Public policy & best practice – We are members of the PRI collaborative initiative on cyber security and will be leading engagements with a number of companies. We will also continue our dialogue with the UK's recently established National Cyber Security Centre to reflect the investor perspective and engage on regulation.

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, and small and mid cap

Credit

Absolute return, global high yield, multi strategy, global investment grade, real estate debt and direct lending

Multi asset

Multi asset inflation

Stewardship

Active engagement, advocacy, intelligent voting and sustainable development

Offices

London | New York | Singapore

Why Hermes EOS?

Hermes EOS enables institutional shareholders around the world to meet their fiduciary responsibilities and become active owners of public companies. Hermes EOS is based on the premise that companies with informed and involved shareholders are more likely to achieve superior long-term performance than those without.

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