CARBON REPORT

Hermes strategy and approach

December 2018

For professional investors only

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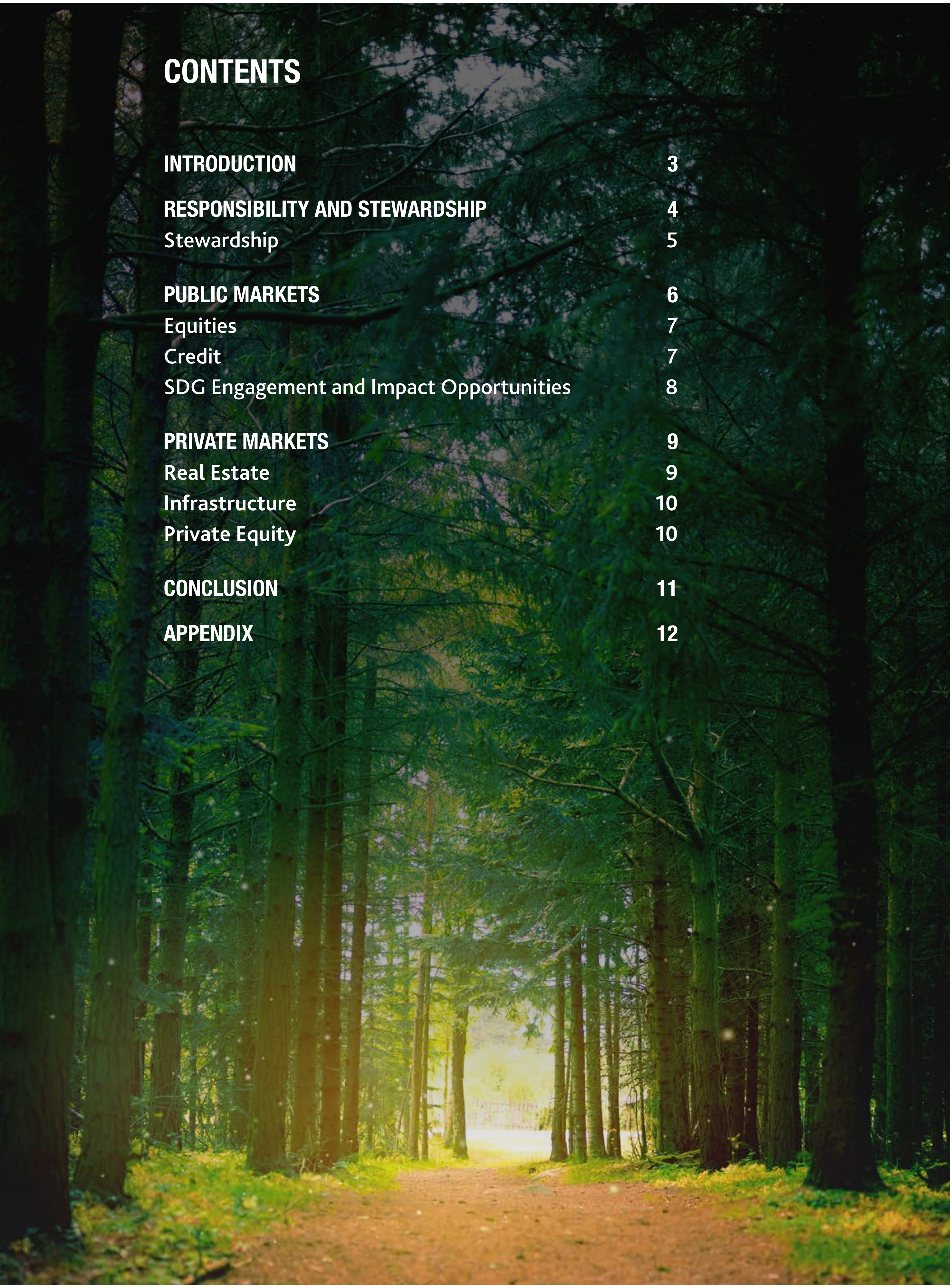
INVESTMENT MANAGEMENT



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INTRODUCTION

Climate change is an increasingly important investment theme and it is becoming clear that there is no dichotomy between pursuing the best long-term financial gain and pursuing ESG. At the start of October, the Intergovernmental Panel on Climate Change (IPCC) published an alarming report on how we must limit the atmosphere warming to just 1.5°C above industrial levels or risk a cataclysmic environmental catastrophe.

Despite the report's stark warning, current estimates highlight that we are currently on course for 3.1-3.7°C increase unless we drastically change our industrial and commercial habits. Many people don't accept that doing good is good business, but for long-term success, that is what you have to do. Do investors fully take on board the effects of climate change? No. But are they starting to understand that climate change has pretty profound financial impacts? Yes. Investors also need to be taking account of the risk to the financial system of stranded assets. We know they have substantial long-term impacts both to the financial system and the real world.

This is a bottom-up trend – citizens are taking carbon risk more seriously than investors or governments. The power of the people's action is forcing change, as is evidenced by the revolution on plastic which occurred in 2018 driven by a marked shift in consumer attitudes. This is a people's movement driven by their understanding of how it affects their lives.

While environmental, social and governance (ESG) investment has been largely driven by activists – and we at Hermes not only count ourselves in that number but as one of the vanguards leading the charge – it has taken years to bring these ideas into the mainstream. We factor ESG issues into our investment and engagement decisions. A lot of investors look at ESG factors almost as an overlay – they make an investment decision and then look at the other data and try to tick a box to say it's OK. We differentiate ourselves because we understand that taking into account all these factors is part and parcel of the decision-making process. It is evident that others are now moving in the same direction.

It is crucial to invest for the long term. When you invest for retirement, you have a 30-year time horizon. What happens in one quarter doesn't matter. If you have a decades-long time horizon, factors that are not seen as important over the short term become really crucial. If your factory is located on a riverbank and water levels rise; if your factory needs inputs that will be subject to a carbon price; if it is reliant on high-carbon technology, your company is going to be affected. If your company is deeply carbon-oriented, how will you retain your social licence to operate over the next 10-15 years?

> Society clearly cares more than it did about the long-term effects of climate change on the environment and society. As society moves, it expects institutions to follow suit.

This is all about the momentum that is changing society's consumer habits. The process has already started and it is going to be big. Society clearly cares more than it did about the long-term effects of climate change on the environment and society. As society moves, it expects institutions to follow suit. We are going to see a profound shift in what people buy and how – this shift is coming soon, and at a pace.

As responsible investors – and by which, we mean responsible not just to the planet, but to our own customers, too – it is imperative that we are stewards of capital. We need to talk to and engage with the companies in our portfolios about their plans to adapt to changing consumer demands.

There is popular demand for this change – it makes sense financially, morally and as a long-term investment.

Saker Nusseibeh
CEO, Hermes Investment Management

RESPONSIBILITY AND STEWARDSHIP

Climate change is one of the most pressing risks for our clients and they are becoming increasingly aware of it. Many of them are universal owners, so they are broadly exposed to physical risks such as rising sea levels and drought, as well as transition risks such as stricter emissions regulations. All of these factors can affect profitability and the viability of business models.

We believe that the role of the fund manager is not only to pick stocks to see what the returns might be, but also to be a good owner of these stocks. The stewardship that fund managers do is crucial.

The implications of climate change for investor decisions will differ sector by sector. The automotive and utility sectors, for example, both have significant value which is at risk from the transition to a more sustainable economy, but also significant opportunities – from electric vehicles and renewable energy respectively. The speed at which these new technologies come down their cost curves always surprises people. If you get the ROI rate consistent with a low-carbon transition, investors will pile in.

By contrast, the oil and gas sector will be one of the hardest-hit. Even if an oil company can achieve an economic return, it might not be in beneficiaries' interests if it worsens climate change and this creates a strong pressure on policy-makers to clamp down on the industry. "No company in the world wants to shrink, but in a low-carbon world, there are very few value-creating opportunities for the oil companies," points out Leon Kamhi, Head of Responsibility.

Carbon Tracker says that since 2010, the European utility industry has written down $150 billion of value and the sector is 20% down, with potentially more at risk. "Ten years ago, it was hard to see how it would get on to the fund manager's horizon, but now it's there," Kamhi adds. "This is real now and other high-carbon sectors – and those who invest in them – can see what could happen."

$150b

of value the European utility industry has written down since 2010 according to Carbon Tracker.

However, despite its growing popularity, divestment is not the answer. It does not reduce the level of carbon emitted, as long as others are investing. We need to engage with these companies to ensure they are on the right track to reduce emissions and help achieve the 1.5°C target.

Engagement must be incisive. As engagers, we must become more effective at finding information that can really challenge what they are doing. We should be saying: "Your emissions per unit are far higher than your peers, please explain."

At Hermes, we have senior people doing our engagement. A number of our competitors have corporate governance people who are not really connected to what is going on within the business doing it instead. Our engagement and fund manager teams talk to each other so we engage as investors, not as an NGO.

Climate change is happening, and we need to make the transition to a low-carbon economy, so how do we do that cost efficiently? One thing we need to do is advocate for better policy.

We are starting to see some encouraging developments. Good progress is also being made on fiduciary duty. The European Union is introducing a Sustainable Finance Package, requiring funds to be more transparent on how they invest sustainably as a first step to strengthening fiduciary obligations. The aim is to use the financial system to direct capital towards more sustainable outcomes. If the package goes through, it will start to sift the wheat from the chaff and we will see who is really taking their fiduciary obligations on ESG issues seriously.

The UK has been very clear that it will uphold its climate ambitions, regardless of what happens with Brexit.

The UK is introducing new rules requiring pension fund trustees to explain their approach to managing ESG and climate risks through investment strategies. "In practice, investing in the climate transition, in addition to complying with the evolving definitions of fiduciary duties and the pressure of central banks, enables investors to capture a wealth of growth opportunities in the low carbon and circular economies," says Tatiana Bosteels, Director of Responsibility for Private Markets.

The UK has been very clear that it will uphold its climate ambitions, regardless of what happens with Brexit. We have also been working with China's climate taskforce, which has taken up the Taskforce on Climate-related Financial Disclosures (TCFD) recommendations. China's Ministry of Finance is recently focusing on how China can gain from climate opportunities.

However, says Ingrid Holmes, Head of Policy and Advocacy, "what policy started, technology and changing consumer preferences will finish." You can see this in both the vehicle market, where electric vehicles are gaining traction, and in energy infrastructure, where, for the first time, wind and solar costs are comparable with existing gas power plants in Germany.

Stewardship

Through Hermes EOS, our stewardship service, which is one of the largest in the world, we represent £359.0bn assets and we engage with over 500 of the world's largest companies each year.

One of the biggest developments in stewardship this year has been the advent of Climate Action 100+, a five-year investor initiative "to engage systemically important greenhouse gas emitters and other companies across the global economy that have significant opportunities to drive the clean energy transition and help achieve the goals of the Paris Agreement", which was launched in December 2017.

To date, 310 investors with more than $32 trillion in assets under management – including Hermes – have signed on to the initiative, which focuses on the top 100 systemically most important emitters, who are responsible for about 80% of total emissions.

Climate Action 100+

310
investors – including Hermes

$32t
in assets under management

Focus on:

TOP 100
most important emitters

80%
of total emissions created

The breadth of our stewardship activities means that we are particularly active in the initiative, leading on 28 companies, including BP, Centrica, Rolls Royce and AngloAmerican. There are three dimensions to our engagement – how the board is managing the risks of climate change, the level of action being taken to limit emissions to well below 2°C and how well the company is disclosing its management and action to investors.

We look for disclosure in relation to the Task Force on Climate-related Financial Disclosures (TCFD) recommendations. The TCFD is starting to gain traction, with more and more companies signing up to it. TCFD shifts the focus of climate risk disclosure from the company's impact on the environment (e.g. emissions) to the impact of reducing emissions on the company's business model and value. It also requires disclosures in a company's principal financial statements. The quality of responses differs, but they are evolving. It is new, it is different and there are challenges in in how to respond, but it is a good unifier that is harmonising responses.

When it comes to governance, the big issue is lobbying. "There is a significant gap between the chorus of support at high level for all these initiatives and what happens further down the chain in organisations, where environmental initiatives still get quite a lot of pushbacks," says Holmes.

We aim to bring all companies up to best practice through engagement.

Some sectors are better than others – in mining, Rio Tinto and BHP Billiton have produced reports on their own lobbying and that of the Mining Council of Australia, while BHP Billiton has pulled out of the World Coal Association over its stance on climate change. It is an example that could be heeded by the automotive sector, which has been on the defensive since the diesel-gate scandal and is struggling with the current conflicts over the Corporate Average Fuel Economy (CAFE) fuel efficiency standards in the US.

"We aim to bring all companies up to best practice through engagement. Shell is a good example – we have been asking them for their long-term strategy on climate change. It now has a strategy to decarbonise the energy it supplies which appears quite ambitious. Our focus now is to see how the company implements this, with disclosure of its targets and metrics." says Bruce Duguid, Head of Stewardship at Hermes EOS. "BP appears to be in a different place, with best practices in operational emissions management, but a less clear strategy over the long term. We now need to see how it ensures all its investments are compatible with the goals of the Paris Agreement."

"Climate Action 100+ is just one example of how stewardship on climate change has grown up to take a more forceful, more muscular approach through collaborative engagement across different sectors and geographies," says Duguid. "Outside of Climate Action 100+, we have been engaging with key players in financial services such as HSBC and Standard Chartered to limit their exposure to carbon risks."

PUBLIC MARKETS

"Most investors are now aware of climate change and acknowledge what the big issues are," says Eoin Murray, Head of Investment. "In RFPs now, we are getting requests for information about ESG issues, sustainability and climate change in a way that wasn't happening a few years ago, but I don't see them acting on the key risks. There has been lots of disclosure but very little action."

There is still complacency around the timing. People talk about meeting the Paris goals by 2030. It still feels like a long way off, so the attitude seems to be: "We don't have to act today." But the closer we get to 2030 without doing enough, the greater the changes we will have to make.

Asset price dislocation will increase, particularly for those entities in danger of becoming stranded assets, which is anything to do with fossil fuels. The energy mix will still contain a fair chunk of fossil fuel assets by 2030, but to meet the targets, the proportion has to fall from what we have today. And it's going to be more abrupt than the gradual evolution that people expect.

The oil majors, for example, can choose the discount rate they apply to their decommissioning costs according to accepted accounting practices. They accept a huge discount rate that implies their current costs are close to zero. "I don't think investors are really acknowledging this," Murray says. "They should be pushing the big oil companies and saying; 'This is unacceptable, and the discount rate bears no relation to reality'."

The requirement to cut carbon will hit other sectors such as automotive, cement and mineral extraction, where there is still a belief that it will be a while before serious issues will affect them.

But in many sectors, companies take climate more seriously than their investors. The current investor mindset is mostly so short term that the key issues are back of mind.

One encouraging sign is that green bonds are really starting to take off. Now that there are well-established principles, investors are becoming more comfortable that the risk of greenwashing has gone.

Key to a successful transition, is the development of low carbon technologies and products which are able to competitively substitute existing solutions with superior quality and at a lower cost. Happily, this is beginning to happen. Examples include solar and wind power becoming competitive for a number of applications in the Utilities' sector and electric vehicles in the Automotive sector.

One encouraging sign is that green bonds are starting to take off. Now that there are well-established principles, investors are becoming more comfortable that the risk of greenwashing has gone. A huge amount of non-financial corporate debt has to be rolled over by 2021-22 and if a good chunk of that goes green, then this market will be huge.

At the same time, the nature of capital markets is changing. The influence of public markets is weaker and private capital is stronger. Companies can stay private for much longer, particularly those that generate large amounts of cash – they don't need markets in the same way that their predecessors did. It takes away the burden and costs of public reporting but it also means that many of the drivers for climate action will come from the private equity and private debt markets.

Equities

The Paris Agreement really raised awareness amongst businesses of what they could and should be doing around carbon. It's a more high-profile issue now and there is increased transparency and increased measurement from companies, thanks in part to TCFD.

"At the start of the year we enhanced our ESG Dashboard to include more indicators on climate risks and opportunities in companies. We identify companies which are actively integrating environmental considerations within their business strategies. We expect these improving companies to become more carbon efficient over time: the portfolio's footprint is about 25-30% less than the benchmark," says Louise Dudley, Portfolio Manager, Global Equities. "We know that companies with improving ESG standards tend to perform better in the long run. Improving ESG can deliver financial outperformance."

Many boards are still just not thinking in this way which makes it even harder to get data. The link to returns is not as strong for environmental issues as it is for social and governance because of lack of quality data. Companies need to measure their carbon footprint, how it is changing and start to set targets.

Hermes is developing a suite of tools to measure and understand the risks in our portfolios and in individual companies. Our Carbon Tool enhances understanding of the issue by integrating our engagement and stewardship information. It helps identify not just where the risks are, but also how we are engaging to reduce a company's carbon footprint and exposure to stricter regulations – and, critically, whether we are being successful in our engagement.

The tool allows fund managers to assess their fund's carbon performance, carbon risk, and corresponding engagements with investee companies in a comprehensive manner. The tool is also the source for enhanced client reporting to demonstrate how ESG and engagement is being credibly integrated into the firm's fund and stewardship offerings.

The carbon tool assesses and integrates the following three key elements, making it a cutting-edge approach in evaluating the impact that investment funds have on the environment:

Measuring the carbon risk of an investment fund relative to its benchmark and of listed companies relative to their peers, including Scope 1, Scope 2, and Scope 3 emissions

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

Our new tools will better demonstrate to clients how ESG and engagement is being deeply integrated into our investment and stewardship offerings... combined with our engagement intelligence, the carbon tool is powerful in delivering real-time and specific carbon information to fund managers and engagers alike.

Dr Michael Viehs, Associate Director, Responsibility, says, "the carbon tool helps our fund managers to more effectively take into account information about specific carbon risk and thereby enhance their investment decisions. Assessing carbon risk helps to identify investment opportunities and threats to value, and helps to begin or intensify engagements that can reduce the risk of holding exposed companies."

High-quality ESG information enables fund managers and engagers to perform effectively and improve communications with clients and their beneficiaries. Our new tools will better demonstrate to clients how ESG and engagement is being deeply integrated into our investment and stewardship offerings. Moreover, combined with our engagement intelligence, the carbon tool is powerful in delivering real-time and specific carbon information to fund managers and engagers alike.

Credit

ESG analysis is fully baked into our investment process because we see no separation between ESG factors and credit risk. Using Hermes' QESG tool, along with the results of analyst research and the efforts of our engagement team, we seek to understand how climate risks can translate into credit risk.

If that research throws up something material and we believe a company is open to engagement, we encourage them to reduce environmental impact as a path to building a sustainable business that will support the expansion of enterprise value. We're happy to invest in companies that score poorly from an ESG perspective if they're trying to turn their business around.

From our perspective, there is not that much of a difference between credit and equity investors when it comes to engagement or risk assessment. Both long-term equity investors and credit investors want to put their money into long-term, successful, sustainable businesses.

Mitch Reznick, Co-Head of Credit, says, "although engagement by bondholders is a relatively new development for companies, we believe the right to engage is predicated on being a financial stakeholder in a company, rather than the security you hold. Our needs as debt holders substantially overlap with long-term equity holders. It is important that companies serve all of their stakeholders".

SDG Engagement and Impact Opportunities

The UN Sustainable Development Goals (SDGs) were not initially intended to be a tool for investors. Nonetheless, we have two approaches to linking the SDGs to investing. The SDG Engagement fund aims to help meet the goals by engaging with companies to improve in relation to the goals, while the Impact Opportunities fund invests in companies that are well-placed to profit from activities that will help meet the goals.

The SDG Engagement fund uses the 17 Sustainable Development Goals – including Climate Action – as a framework for investing. We mapped the SDGs back to sectors in the MSCI indices, so we know when we look at a company what the SDG touchpoints will be. We deal with many companies in the "old economy", where there is typically more work to do than in new economy tech firms.

The SDG Engagement fund uses the 17 Sustainable Development Goals – including Climate Action – as a framework for investing.

"We don't invest in companies that already perform well in relation to the Goals, we buy into companies that we think we can help to improve, for example, gender equality, labour conditions or carbon emissions," says Hamish Galpin, Head of Small and Mid-cap Equities.

Hermes engages on climate issues, but there is a problem with the lack of data in small and mid-cap companies. A number of our investments screen poorly, but when you look deeper, you discover they are very well-run. You have to do your due diligence properly and look at every company individually, because the data is often not there or it is out of date.

We are being well received by companies we have invested in because matters of sustainability have gone from being something they ought to consider to something they have to consider. It requires new information systems to be put in place to capture data – there can be great initiatives at operational level that head office knows little about because the data is just not being collected.

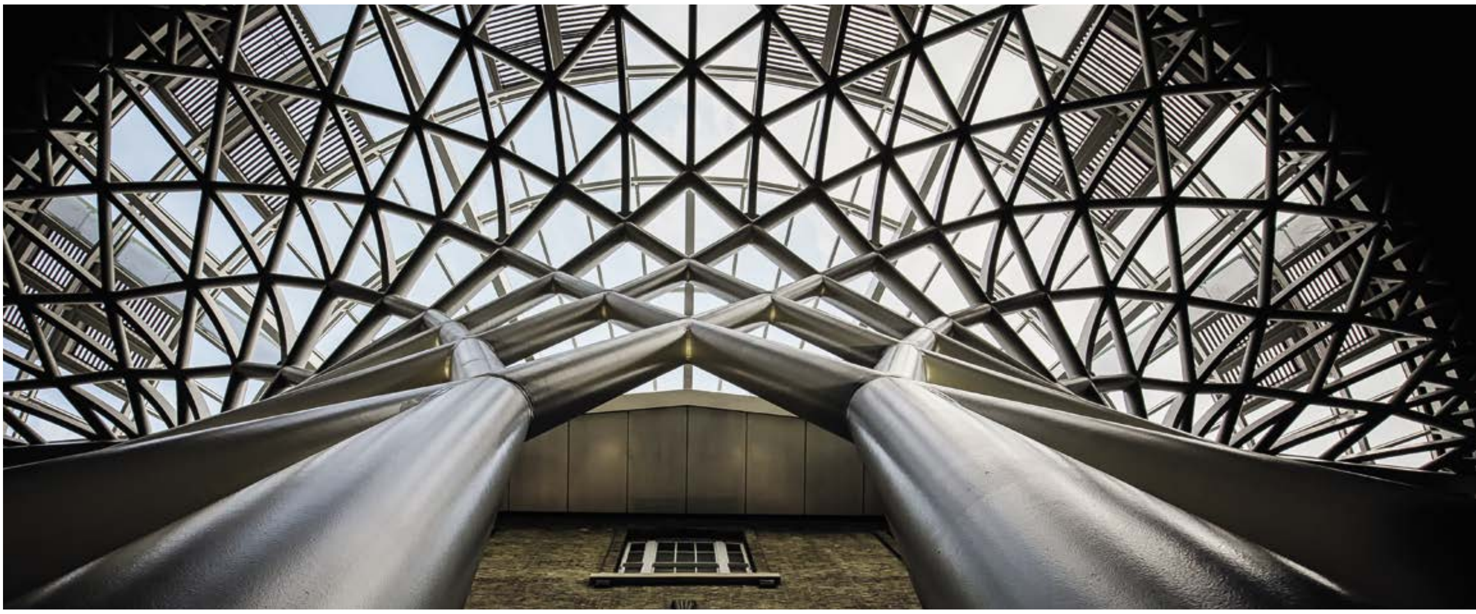
While companies sometimes begrudge the resources they have to commit to implementing sustainability measures, we are happy for them to do so because it will make them better companies in the long run. "We are the ultimate patient capitalists – we will take a 5-7-year view to achieve our goals," says Galpin.

The Impact Opportunities strategy aims to increase prosperity in society through sustainable impact investing and companies, linked to at least one SDG. We have now translated the SDGs into a framework that has allowed us to invest. At present, we have 29 companies in the portfolio and while none of them are perfect, we want to work with them to drive down their negative externalities.

It took us some time to work out our taxonomy, but we have come up with nine investment themes – Water, Health and Wellbeing, Financial Inclusion, Education, Energy Transition, Future Mobility, Food Security, Circular Economy and Impact Enablers. There is quite a high bar for getting in the portfolio, it has to involve a positive product or service and there has to be an explicit timeline.

Ørsted, the Danish energy group, is a great example of a company involved in energy transition – oil, gas and coal were core to its business model until a few years ago but when it listed in 2016, it made an explicit commitment to become a 100% renewable energy company.

The financial risk at stake if you're on the wrong side of the climate change trade is increasing, as illustrated by the way that carbon prices have shot up this year. At the same time, there are opportunities for companies that provide solutions to the problem. "A great many people limit their focus on carbon to transport and energy, and ignore other huge carbon generators such as agriculture, but food security, for example, is a theme where there are companies that are interesting from an energy transition point of view," says Tim Crockford, Portfolio Manager, Impact Opportunities.



PRIVATE MARKETS

"Private markets are more tangible than public markets – you can touch and feel what you invest in," says Chris Taylor, Head of Private Markets. Climate risks don't just sit in one box, they interact with other changes that are happening at the same time, such as the impact of technology, urbanisation, globalisation and demographic lifestyle changes. "To deal with these complexities, we take a very disciplined approach to measuring factors such as energy and water consumption, and we have specific tools to reduce those inputs," he adds.

Hermes thinks about long-term thematic effects on demand in a holistic sense. It's about how people's lives are changing, how they are affected by environmental risks. That translates into investing in everything from ships to offices to infrastructure. We add value by actively managing.

Real Estate

Climate change is having a huge impact on investors in land and real estate. It has been an issue for many years, but recently it has accelerated dramatically. An obvious recent example is in Florida, which has some of the most expensive real estate in the world, but was also one of the areas most affected by Hurricane Irma last year. Land values in locations like that have not recovered and they are unlikely to do so. The same is true in a number of other parts of the world.

There is growing pressure on real estate investors to say how they are managing these risks as the impacts of climate change become more evident. Asset owners are asking about managers' climate management approach in relation to their own fiduciary duty.

"Our clients are changing their behaviour and so are our occupiers," says Tatiana Bosteels, Director Responsibility for Private Markets. "Climate change is increasing the rate of obsolescence of assets. Long-term analysis of issues such as replacement costs and land value is what protects you. Due diligence is really important to ascertain the risks and opportunities."

We try to anticipate the way people will want to work, live and play in an area. Kings Cross is a good example, with 67 acres of superb infrastructure that provides an opportunity to create a community that is engaged, socially inclusive and has heritage and culture.

We don't buy green buildings per se, but when we acquire a property, we are explicit about making sure it is future-proofed for environment and climate risks. When we look at the risk profile of an asset, the fund manager will be explicit about issues like functional obsolescence, flood risk, solar gain and energy consumption.

"We're moving away from thinking about buildings to an increased focus on 'places'," says Ben Sanderson, Director of Fund Management. "It's an opportunity to bring together climate and environment risk with the other drivers of future performance. There is a danger of thinking about climate and environment in isolation."

We try to anticipate the way people will want to work, live and play in an area. Kings Cross is a good example, with 67 acres of superb infrastructure that provides an opportunity to create a community that is engaged, socially inclusive and has heritage and culture. There is an Arts College at its heart and a mosaic of different uses that contribute to a sustainable place. We have been able to create new buildings there because of the propensity of global capital to move to places that attract talent.

We're replicating what we've done at Kings Cross in Leeds and Manchester. And other cities around the world, such as Boston, New York and Sydney see it as an exemplar. We're looking to deploy capital responsibly, so we work in collaboration with the public sector, as well as with best-in-class property developers such as MEPC and Argent. They are a key differentiator for our business.

24.9%

annualised internal rate of return for Kings Cross from December 2010.

"We have a responsibility to our beneficiaries to contribute to making better places where they can retire," Chris Taylor says. However, this approach is good business, too. The annualised internal rate of return for Kings Cross from December 2010 is 24.9% and we can also start to measure our impact on society at large. "This is the way to sustain superior risk-adjusted returns," he adds.

Infrastructure

"Infrastructure clients are generally looking for long duration, low volatility and low risk returns. We typically invest in assets that provide essential services – they tend to have very long lives, to be capital intensive and, by nature, they are often monopolies," says Peter Hofbauer, Head of Infrastructure.

Sustainability is important to enable businesses to deliver that essential service over a long period of time, often over multiple generations. Climate change is one of the key macro factors to consider over this long investment horizon. Infrastructure includes transport- and energy-related sectors, which have historically used and generated significant amounts of carbon and have a broader environmental impact.

The TCFD recommendations have changed the way people disclose emissions, as has the GRESB (Global Real Estate Sustainability Benchmark) Infrastructure Assessment.

20%

of our portfolio is composed of renewable investments.

The most significant opportunity in infrastructure globally over the last few years has been renewable energy and the change to networks that the switch to renewables requires – and that is likely to continue for a significant period of time. Almost 20% of our portfolio is composed of renewable investments. The majority of markets still rely on government subsidies relative to carbon fuels, but reforms to the EU carbon trading system and technological improvements in wind and solar is resulting in increased deployment of subsidy free renewables in some European markets.

Environmental issues such as climate change are disrupting almost all sectors and, consequently, catalyse large and compelling investment opportunities.

We don't exclude any assets but we wouldn't consider investing in, for example, a coal-fired power station. That's because we don't feel it has positive investment characteristics over a long period of time and we wouldn't see it as sustainable.

With the increased focus on carbon reporting, we have reviewed our own portfolio for Scope 1 and 2 emissions as well as emissions avoided by investing in areas such as renewable assets. Under the TCFD recommendations, we measure our weighted average carbon intensity and, on a net basis, our portfolio avoids more emissions than it makes because of the renewable assets in our portfolio.

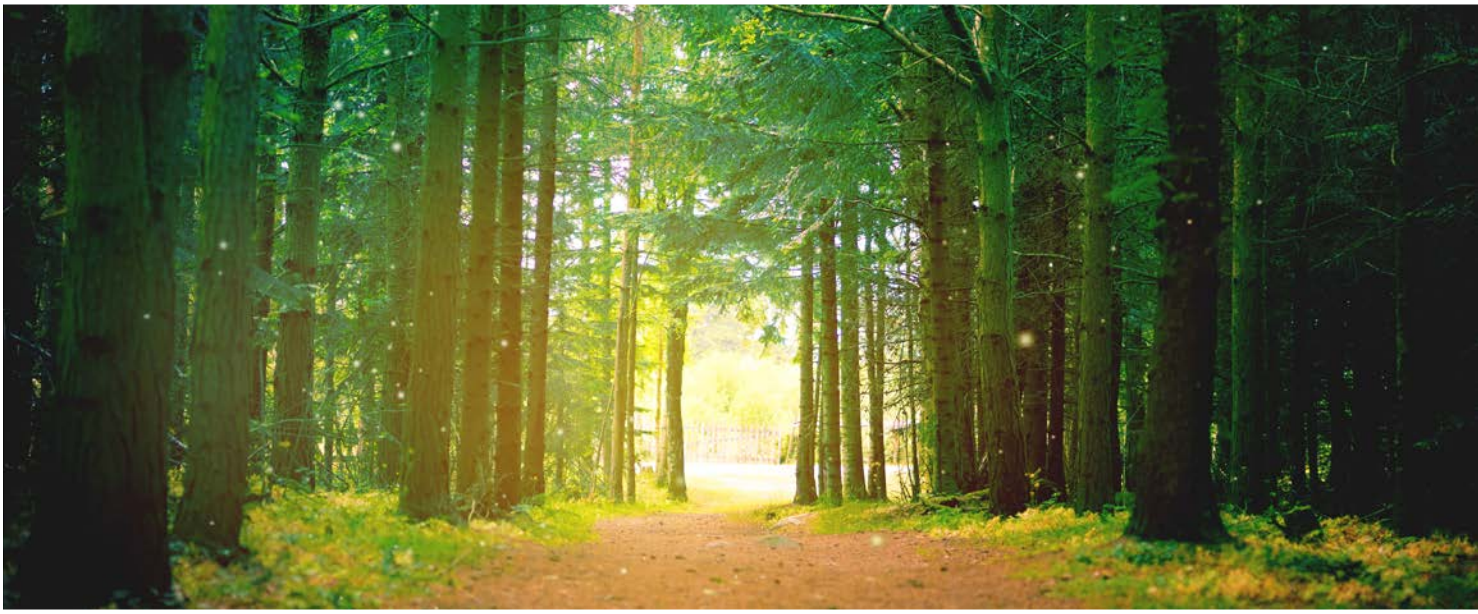
The greatest challenge in the last few years has been getting clarity around the fact that sustainable investing, including consideration of carbon emission, isn't necessarily inconsistent with achieving a fair return on investment. The two are not mutually exclusive – you can make sustainable investments that have a positive impact on the environment and the quality of life of beneficiaries and still achieve an appropriate return.

Private Equity

Our investment strategy lends itself well to growth opportunities arising from the innovation needed to deliver a low-carbon economy. We invest on a globally unconstrained basis, focusing on the regions, themes, sectors and companies that we believe present the most attractive opportunities.

Elias Korosis, Partner, Hermes GPE, said, "Sustainability is fast becoming a core part of a multi-trillion thematic opportunity, alongside technological innovation, consumer behaviour shifts and the catch-up in emerging markets, which private equity can address in a more concentrated, pure-play way."

It's a theme that is cutting across most traditional sectors: Environmental issues such as climate change are disrupting almost all sectors and, consequently, catalyse large and compelling investment opportunities. This is driven by actors at all levels, whether it is consumers directly opting for more sustainable products, companies looking ahead and capturing opportunities that innovation brings to them, and governments under pressure to modernise their policies, when less taxing (costly) and polluting alternatives are in place. We are actively partnering with companies and funds which seek to take advantage of this mega-trend.



CONCLUSION

Climate change is fast becoming a central theme for investors, both in terms of the risks it creates for the companies we invest in and the opportunities it provides for companies that can help the transition to a low-carbon economy.

"The financial case for acting is becoming ever-clearer. Companies that aren't thinking about how to adapt to the low-carbon economy are at risk of being left with stranded assets, while those that are offering solutions are really well-placed to thrive," says Saker Nusseibeh, Chief Executive.

You don't need to be investing in the best-performing companies, either. There is significant value – to investors and to society at large – to be gained from buying into companies or assets that have poor ESG performance and making them better. There is plenty of evidence that companies that perform better on ESG issues provide better financial returns.

"However, to bring about change, real, positive change, investors need to engage with the companies they own – and that engagement has to be precise and constructive about how firms can improve. In some instances, investors need to work together in their engagement efforts, through initiatives such as Climate Action 100+ and the Investors Agenda" says Nusseibeh.

Moreover to ensure that their engagement is as well-informed as possible, they need high-quality, relevant data so they know how companies are performing against their peers. Initiatives such as the TCFD are helping to improve company disclosure and instruments such as our Carbon Tool are helping to join the dots between problem areas in a portfolio and the engagement that is being done to address those issues.

This type of popularist movement is bigger than anything we have seen before, and has the power to unite – rather than divide – society.

The direction of travel towards a low-carbon economy is clear, driven by a whole range of factors, including a firming of the scientific consensus highlighted by the Intergovernmental Panel on Climate Change, regulatory initiatives such as the EU's reform of its carbon market, high-level targets such as the SDGs, and strengthening consumer sentiment.

Nusseibeh concludes, "This type of popularist movement is bigger than anything we have seen before, and has the power to unite – rather than divide – society. Investors must ensure that they, and the companies they invest in, are on the right road."

APPENDIX: PROGRESS AGAINST HERMES CLIMATE TARGETS

The carbon risk and opportunities management activities we are implementing cover our public equities and credit, private real estate and infrastructure assets, representing **USD 41bn AUM as of 31 Aug 2018, or 90% of our AUM**.

As part of our carbon risk approach and our commitment to The Montréal Carbon Pledge and the Portfolio Decarbonisation Coalition, in 2016 we set specific and measurable targets against which to monitor and measure progress. We monitor our performance using these indicators and assess performance against the relevant targets.

In line with our commitments under the Montréal Carbon Pledge, we aim to measure the carbon footprint of our investments across all relevant asset classes. This year we have measured the carbon footprint of our public equities, credit, infrastructure and real estate assets, representing 86% of our AUM as of Aug 2018. During 2016/17 we have made good progress in engaging with our private equity investments. The carbon footprint data is shared with clients included within a broader narrative on climate risks as one element of the story and is complemented by a deep analysis of carbon exposure, trends and scenarios aiming to paint the full story of companies and underlying progresses.

Hermes carbon Risk and Opportunity key performance indicators	Performance monitoring by indicators	2017 Performance
Awareness		
Level of carbon emissions attached to investments and expended in Hermes operations, yearly	This year we have measured the carbon emissions attached to Hermes operations and to our public equities, and real estate investments.	IN PROGRESS: 86% AUM covered. Hermes operations in 2017 – Trees for cities carbon offset: 1,102 tonnes CO_2e.
Percentage of assets under management (AUM) for which we measure the level of carbon emissions per USD invested and breakdown by holding, yearly	This year we have measured the carbon footprint of our public equities and real estate assets, representing **86% of our AUM as of August 2018.**	IN PROGRESS: 86% AUM, Public equities 100% AUM scope 1,2 and scope 3. Real estate directly managed assets representing 80% AUM scope 1,2. Infrastructure 98% AUM scope 1,2.
Listed equities and corporate credit:		
Carbon intensity per fund relative to benchmark in carbon emissions per USD invested	The carbon intensity per fund relative to the benchmark has been measured for 100% of listed equities. We are defining a process for credit markets.	IN PROGRESS: 100% of listed equity carbon emissions intensity measured.
Carbon intensity per fund relative to benchmark in carbon emissions per USD invested	The carbon intensity per fund relative to the benchmark has been measured for 100% of listed equities. We are defining a process for credit markets.	IN PROGRESS: 100% of listed equity carbon emissions intensity measured.

Hermes carbon Risk and Opportunity key performance indicators	Performance monitoring by indicators	2017 Performance
Active management *Real Estate:*		
Long-term carbon emissions reduction targets **1 – Reduce the absolute carbon emissions (tCO_2) by 40% for our landlord controlled directly managed portfolio (scopes 1&2) by 2020 from a 2006 baseline aligned with European carbon targets to 2020 and** **2 – Reduce the carbon intensity (tCO_2/m^2) for our landlord controlled directly managed portfolio (scopes 1 & 2) by 40% by 2020 from a 2006 baseline aligned with European carbon targets to 2020**	See real estate performance – RPI report 2018.	Target 1: NOT ACHIEVED: absolute carbon reductions (tCO_2) fallen by 4% in 2017 compared to 2006 baseline year. Target 2: OVERACHIEVED: carbon intensity relative to area (tCO_2/m^2) reduced by 66% in offices and by 52% in shopping centres by 2017 (target year 2020).
Annual operational targets **1 – to reduce by 5% year-on-year the absolute carbon emissions (tCO_2) of our standing portfolio, and our relative energy consumption (kWh/m^2)** **2 – to reduce by 5% year-on-year relative energy consumption (kWh/m^2) of our standing portfolio**	See real estate performance – RPI report 2018.	Target 1: OVERACHIEVED: Average of 8% operational absolute carbon emissions (tCO_2) reductions year-on-year for the last 8 years. Target 2: OVERACHIEVED: operational relative energy consumption (kWh/m^2) of standing portfolio reduced year-on-year for the last 8 years. 17% carbon reductions between 2016 and 2017.
Infrastructure:		
Assets with a climate risk plan as a % of assets under management (AUM) – ensure 100% AUM covered	We have carried engagement with 100% of assets on their climate risks management plans.	TARGET: 100% assets with climate plans. In Progress: 100% of assets engaged and progressing towards defining explicit climate risks and opportunity plan.
Engagement:		
Percentage of carbon in the portfolio being engaged upon	In public markets, we have engaged with 16% of the Scope 1/2/3 carbon emissions.	GOOD PROGRESS: Engagement with 16% of the Scope 1/2/3 carbon emissions. (2.2 $MtCO_2e$ vs 4.3 $MtCO_2e$).

HERMES INVESTMENT MANAGEMENT

OUTCOMES BEYOND PERFORMANCE

HERMES INVESTMENT MANAGEMENT

We are an asset manager with a difference. We believe that, while our primary purpose is to help savers and beneficiaries by providing world class active investment management and stewardship services, our role goes further. We believe we have a duty to deliver holistic returns – outcomes for our clients that go far beyond the financial – and consider the impact our decisions have on society, the environment and the wider world.

Our goal is to help people invest better, retire better and create a better society for all.

Our investment solutions include:

Private markets
Infrastructure, private debt, private equity, commercial and residential real estate

High active share equities
Asia, global emerging markets, Europe, US, global, small and mid-cap and impact

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

Stewardship
Active engagement, advocacy, intelligent voting and sustainable development

Offices

London | New York | Singapore | Denmark

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