Public Engagement Report

ROAD TO NOWHERE
Why car manufacturers need to accelerate away from fossil fuels

Federated Hermes
EOS

www.hermes-investment.com
For professional investors only

This report contains a summary of the stewardship activities undertaken by EOS on behalf of its clients. It covers significant themes that have informed some of our intensive engagements with companies in Q1 2021. The report also provides information on voting recommendations and the steps we have taken to promote global best practices, improvements in public policy, and collaborative work with long-term investors and their representatives.

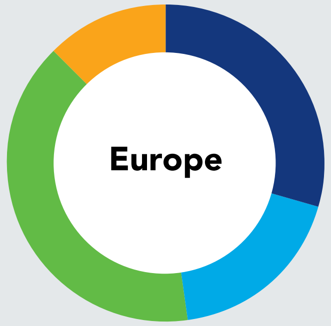
Table of contents

Engagement by region

Over the last quarter we engaged with 582 companies on 1,734 environmental, social, governance and business strategy issues and objectives. Our holistic approach to engagement means that we typically engage with companies on more than one topic simultaneously.

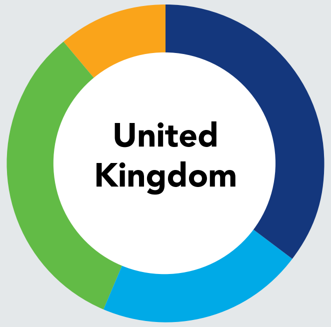
We engaged with 582 companies over the last quarter.

- Environmental **30.1%**
- Social and Ethical **20.2%**
- Governance **34.5%**
- Strategy, Risk and Communication **15.2%**



We engaged with 144 companies over the last quarter.

- Environmental **29.6%**
- Social and Ethical **18.3%**
- Governance **39.7%**
- Strategy, Risk and Communication **12.4%**



We engaged with 46 companies over the last quarter.

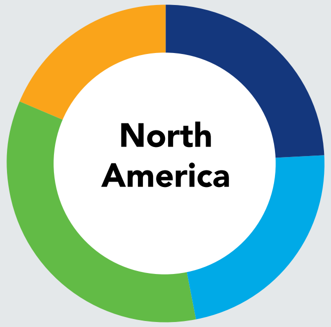
- Environmental **35.5%**
- Social and Ethical **21.0%**
- Governance **32.6%**
- Strategy, Risk and Communication **10.9%**

We engaged with 107 companies over the last quarter.

- Environmental **39.4%**
- Social and Ethical **13.7%**
- Governance **29.5%**
- Strategy, Risk and Communication **17.4%**

We engaged with 57 companies over the last quarter.

- Environmental **36.8%**
- Social and Ethical **24.3%**
- Governance **30.9%**
- Strategy, Risk and Communication **8.1%**



We engaged with 219 companies over the last quarter.

- Environmental **24.3%**
- Social and Ethical **22.8%**
- Governance **34.5%**
- Strategy, Risk and Communication **18.4%**

We engaged with 9 companies over the last quarter.

- Environmental **85.7%**
- Governance **7.1%**
- Strategy, Risk and Communication **7.1%**

Engagement by theme

A summary of the 1,734 issues and objectives on which we engaged with companies over the last quarter is shown below.

Environmental topics featured in 30% of our engagements over the last quarter.

- Climate Change **81.6%**
- Forestry and Land Use **5.4%**
- Pollution and Waste Management **9.6%**
- Supply Chain Management **1.3%**
- Water **2.1%**

Social and Ethical topics featured in 20% of our engagements over the last quarter.

- Bribery and Corruption **1.7%**
- Conduct and Culture **12.3%**
- Diversity **24.3%**
- Human Capital Management **23.1%**
- Human Rights **30.0%**
- Labour Rights **6.6%**
- Tax **2.0%**

Governance topics featured in 35% of our engagements over the last quarter.

- Board Diversity, Skills and Experience **22.9%**
- Board Independence **16.6%**
- Executive Remuneration **42.0%**
- Shareholder Protection and Rights **14.0%**
- Succession Planning **4.5%**

Strategy, Risk and Communication topics featured in 15% of our engagements over the last quarter.

- Audit and Accounting **6.4%**
- Business Strategy **38.6%**
- Cyber Security **1.9%**
- Integrated Reporting and Other Disclosure **28.8%**
- Risk Management **24.2%**

Stuck in second gear

Car manufacturers may appear to be complying with EU emissions standards, but a canny use of offsets and loopholes is masking sluggish progress towards Paris Agreement goals. How are we engaging with the sector to accelerate the transition from fossil fuels to electric vehicles? By Claire Milhench.

Setting the scene

The top 10 automotive groups account for 90% of EU-wide auto emissions and hold the keys to change. Yet a Federated Hermes analysis[1] identified erratic progress towards Paris Agreement-alignment, with car makers exploiting exemptions and loopholes within the EU's regulatory framework. As a result, overall emissions have risen not fallen. Meanwhile, due to air quality concerns, several EU countries are now introducing complete bans on internal combustion engine (ICE) vehicles by 2030. Faster adoption of battery electric vehicles must be a priority for auto companies, alongside a plan to retrain the millions of workers skilled in ICE technology, to deliver a just transition to a net-zero economy.

For further information, please contact:

Roland Bosch
Theme lead: Risk management
roland.bosch@hermes-investment.com

Sachi Suzuki
Sector lead: Transportation
sachi.suzuki@hermes-investment.com

In the US car market, gas-guzzling sports utility vehicles (SUVs) and outsized pickup trucks are popular models, reflecting the fact that gasoline is cheap. In parts of Europe, higher taxes on fossil fuels mean that smaller, more economical models have tended to have the edge. But things are changing – and not for the better.

An investigation by the Badvertising campaign[2] found that SUVs now make up 40% of new cars sold in the UK, while in 2019, over 150,000 new cars sold in the UK were too large to fit into a standard parking space. A bigger car means higher carbon emissions, because it requires more fuel to propel a heavier vehicle. Despite this, car manufacturers trumpet their green credentials with aspirational advertising of hybrid vehicles driving along empty roads through lush, green landscapes. So what's really going on?

Part of the problem is that manufacturers continue to produce and sell cars with high-emitting profiles and then push these heavier, more lucrative options, so that people are encouraged to buy vehicles bigger than they need.

In an attempt to bring the auto sector into alignment with the Paris Agreement and curb carbon emissions, in 2020 the EU implemented a target of 95 gCO_2/km across manufacturer fleets. This applies to all cars sold into the EU, so also impacts US and Asian manufacturers such as Ford and Toyota.

[1] https://www.hermes-investment.com/ukw/wp-content/uploads/2021/02/fhi-backfire-on-emmisions-responsibility-office-0221.pdf
[2] https://www.badverts.org/the-problem

However, an analysis of the 2019 data by the international business of Federated Hermes in the report *Backfire on Emissions* showed that while most manufacturers looked likely to meet EU regulatory targets and thus avoid hefty fines, much of this was due to the extensive use of short-term enablers such as electric vehicle offset schemes, and the exclusion of the 5% most-polluting vehicles.

Aside from the pollution legacy, there are concerns that the EU's existing regulatory enablers are encouraging a sluggish transition strategy from car manufacturers.

Percentage of fleet whose emissions fall in the below groupings (0 g/km, 0-95, 95-110, 110-130, 130-150, and ≥150).

OWNER	AVERAGE EMISSIONS	0-95	95-110	110-130	130-150	≥ 150
Volkswagen Group	124.34	1.73	11.42	35.72	23.66	27.04
PSA Group	114.87	4.48	25.73	44.98	17.28	7.39
Renault-Nissan Alliance	117.44	2.39	13.64	40.51	24.41	17.76
Hyundai	123.55	2.6	11.59	40.15	22.57	21.55
BMW Group	126.91	3.61	3.94	37.46	29.37	25.28
Daimler	137.36	1.89	3.99	19.95	21.44	52.31
Ford	130.97	2.53	14.03	31.07	20.12	32.24
FCA Group	130.83	0.5	5.77	28.87	24.88	39.99
Toyota	99.76	26.34	19.82	17.07	23.79	12.9
Geely	132.51	9.63	0.31	18.71	29.28	42.07

Source: European Environment Agency, as of December 2020. Data until 2018 is final, 2019 is provisional. Analysis undertaken by Federated Hermes.

According to our analysis, in 2019, petrol passenger cars accounted for 63% of sales and diesel cars 32%, while battery electric (BEV) and hybrids (including PHEV) were at 1% and 2% respectively. By December 2020, battery electric and plug-in hybrids had leapt to 23% of new sales[3], but the average lifespan of vehicles is around 12 years, so the overall pollution legacy of new petrol and diesel cars is significant. There is a strong argument that car companies and consumers need to transition much faster.

Disorderly transition

Aside from the pollution legacy, there are concerns that the EU's existing regulatory enablers are encouraging a sluggish transition strategy from car manufacturers. There are 3.7 million car industry employees across the EU, and they will need to be reskilled, or they will bear the brunt of a disorderly transition. There is also a need to roll out charging points and other supportive infrastructure to enable rapid consumer take-up of electric vehicles. The removal of loopholes would force companies to make the necessary changes sooner rather than later.

Unfortunately, patent filings on EVs indicate that some companies are not spending enough on R&D. The EU is targeting much lower carbon emissions, suggesting that companies need to ramp up their EV production. For example, a 59g CO_2/km target would require EVs to make up 47% of the EU fleet.

Meanwhile, governments in Europe and Asia have announced dates for the total phase-out of sales of new ICE vehicles. The UK, Netherlands, Ireland, and Sweden have a 2030 phase-out date, while China and Japan have set a 2035 date. Norway, which has strongly incentivised EVs through tax breaks, smashed through 50% of new sales in 2020, a global record.[4] It is hoping to end sales of ICE vehicles by 2025.

A quick guide to electric vehicles

Hybrid vehicle – The battery charges while the motorist drives, by using regenerative braking energy and the internal combustion engine (ICE), but when this charge is used up the car reverts to fossil fuel propulsion.

Plug-in hybrid electric vehicle (PHEV) – The motorist can charge the vehicle by plugging it into a special socket, but the batteries have a limited range, with petrol or diesel fuel acting as the fall back.

Battery electric vehicle (BEV) – Fully electric-driven, so the battery's range is critical.

Fuel cell electric vehicles – Electricity fuels an electric motor, but this is produced using a fuel cell powered by hydrogen.

[3] MarketMonitor-EU-jan2021.pdf (theicct.org)
[4] https://www.theguardian.com/environment/2021/jan/05/electric-cars-record-market-share-norway

Our engagement approach

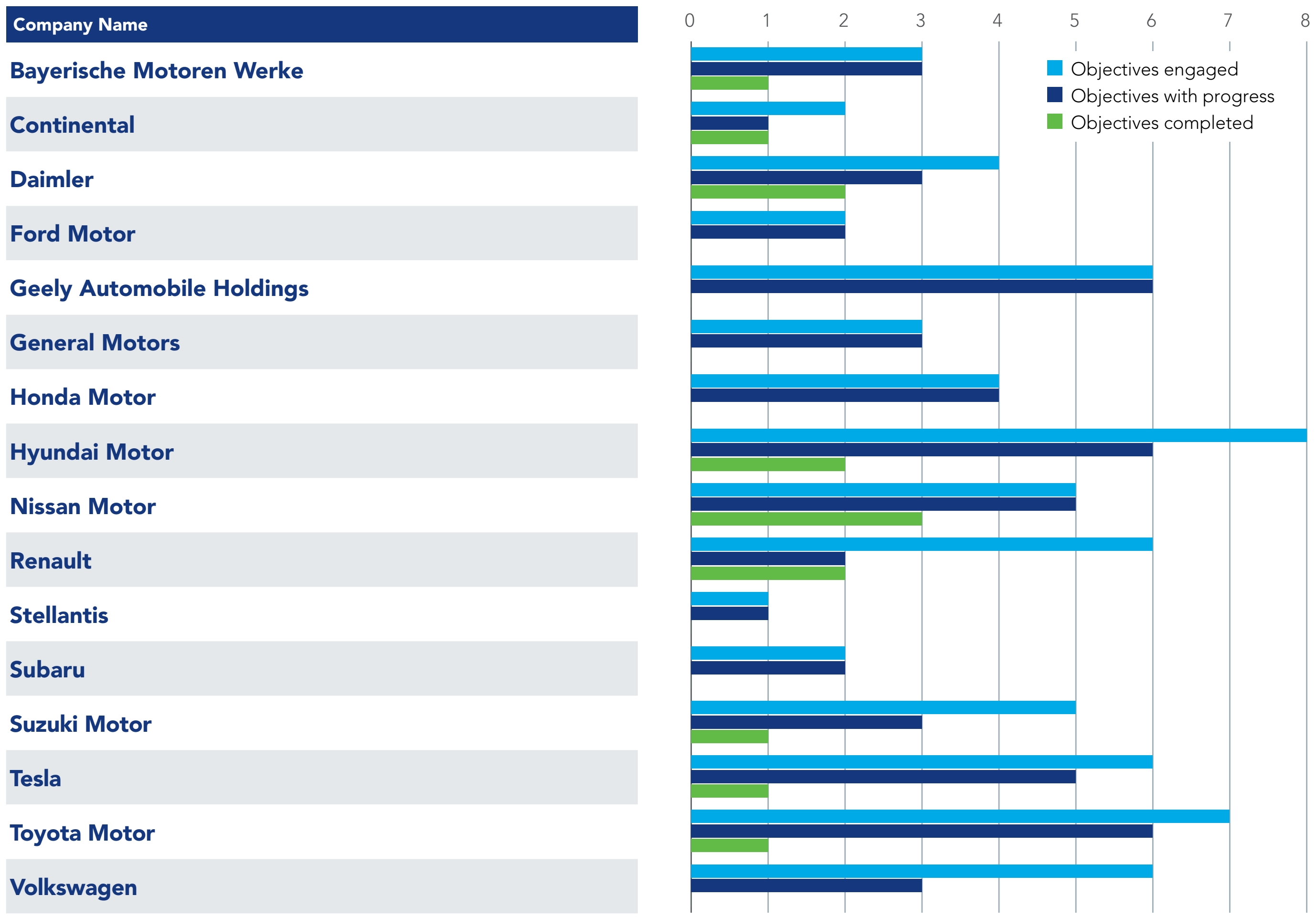
These looming deadlines will require a shift in gears if car companies are to make it to the finish line in time. While light hybrids can be a reasonable bridging technology, 100% penetration of BEVs is needed by 2030 ideally, and 2035 at the latest. Unfortunately hybrids tend to be larger than non-hybrids on average and are less attractive in terms of lowering emissions than one might assume. There is a risk that companies waste time and money developing and investing in hybrid technologies that do not perform as well in the real world as is claimed or fall foul of tighter policy come 2030. It would make more sense to leapfrog hybrids and go fully electric with fast and furious adoption of BEVs. To get there, companies must not only invest in R&D, they must commit sizeable capex to reconfiguring production lines, and change their approach to marketing and sales.

Some companies – such as Daimler in 2019, and Nissan in January 2021 – have already announced a net-zero target for 2050, including Scope 3 carbon emissions. As part of this effort, by the early 2030s every new Nissan vehicle offering in its key markets will be electrified.[5] It will also include end-of-life vehicle recycling or reuse.

The picture elsewhere is less encouraging. Historical data show that incremental improvement to ICE technology – or even hybrid technology – is unlikely to deliver the scale and pace of emissions reductions needed from the auto industry. To highlight this, we wrote to several leading car manufacturers, including BMW, Stellantis, Daimler, Renault, Toyota, Geely, Hyundai, and Ford.

In our letters, we challenged companies on the fact that vehicle weights have been increasing, pointing out what this means for legacy emissions. We asked about their decarbonisation and capital allocation strategies, and queried any tilts towards PHEVs, when BEVs must take the lion's share of the market to ensure that emissions targets are hit. We said we were sceptical that investment in a hybrid-to-BEV technology transition pathway over five to 10 years would deliver the most attractive return on shareholder capital, given the relatively short time period before all such vehicles would need to be fully electric.

There is a risk that companies waste time and money developing and investing in hybrid technologies that do not perform as well in the real world as is claimed or fall foul of tighter policy come 2030.



Source: EOS data, January 2019 – March 2021

[5] https://global.nissannews.com/en/releases/release-18e8181d3a7c563be5e62225a70c61b2-nissan-sets-carbon-neutral-goal-for-2050

We are also participating in the Climate Action 100+ (CA100+) Net Zero Benchmark Initiative, where we are the Daimler lead and BMW co-lead. Investors working through CA100+ are seeking more robust and comparable information on how companies are realigning their business strategies and operations with the goals of the Paris Agreement, and a net zero emissions future.

Accordingly, the net zero benchmark builds on the TCFD recommendations, with more guidance on the specific company actions and disclosures that are most relevant to investors' decisions. These include analysis of elements such as a just transition for affected auto workers so that no one is left behind, climate policy support and capital alignment, targets and goals, the company's decarbonisation strategy, plus assessments of its reporting and governance.

As part of this engagement, in September 2020 we sent letters to Daimler and BMW explaining the benchmarking initiative. We asked them to make or reconfirm a commitment to achieving net zero emissions by 2050 or sooner, with medium-term targets or goals consistent with a global reduction in emissions of 45% by 2030, relative to 2010 levels.

We asked them to make or reconfirm a commitment to achieving net zero emissions by 2050 or sooner, with medium-term targets or goals consistent with a global reduction in emissions of

45% by 2030, relative to 2010 levels.

An analysis of company alignment with these indicators was conducted by CA100+ in collaboration with the Transition Pathway Initiative. The company scorecards, published on March 22, reveal that Volkswagen and Daimler were the highest-ranked auto companies, while Fiat Chrysler Automobiles (now Stellantis) was a laggard. However, the scores do not tell the whole story, as they are mostly an indicator of how much information a company has disclosed. It is possible to earn a high score, but not be closely aligned to the Paris Agreement goals.[6]

We are now using the detailed analysis and benchmark scorecards to inform our engagements with car manufacturers, and in the months ahead we will urge the laggards to put their foot to the floor and pick up the pace.

[6] https://www.climateaction100.org/progress/net-zero-company-benchmark/

CASE STUDY

Daimler

Daimler is one of the world's largest manufacturers of premium passenger cars and commercial vehicles. We have a long history of engaging with Daimler, extending back to 2007 and covering a wide range of ESG issues.

Since 2010, we have been engaging on climate change, aiming to achieve a roadmap for alternative technologies and sustainable vehicle models aligned to international climate goals.

In 2018, we took on the lead role of engaging with Daimler as part of the collaborative initiative Climate Action 100+, intensifying engagement through a series of meetings with the supervisory board chair and company executives.

We challenged the company to articulate its mobility strategy more clearly and requested more ambitious emissions reduction targets aligned with the Paris Agreement goals.

We also raised concerns with the chair about the apparent misalignment between the company's position supporting the Paris Agreement and the positions of its third-party member industry associations, which openly lobbied against more ambitious 2030 vehicle emissions reduction targets in Europe.

Carbon neutral production

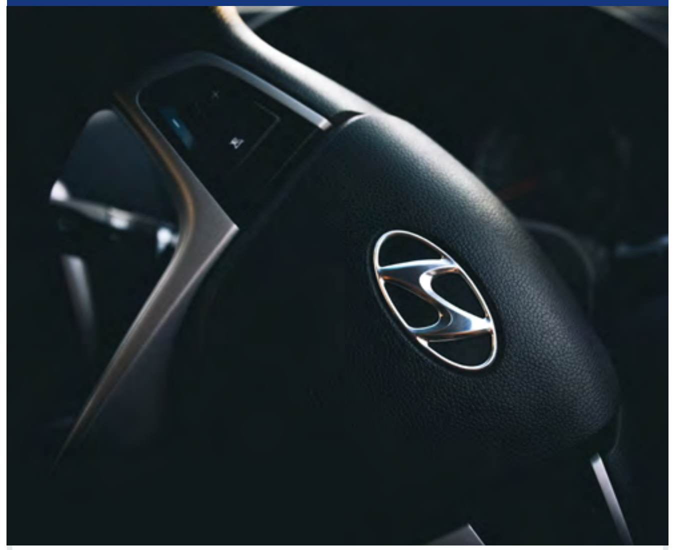
In May 2019, a week before its annual shareholder meeting, the company announced its "Ambition2039" strategy, outlining its plans for a transition to a low carbon business model. The strategy set targets for carbon neutral production, and specified that all Mercedes-Benz passenger vehicles sold must be carbon neutral in both manufacturing and use by 2039, aligned with our request.

In our speech at the 2019 shareholder meeting, we welcomed the progress Daimler had made. We also stressed the need for Daimler to ensure alignment between its own support for ambitious climate policies and the positions of its membership industry associations. In statements from both the supervisory board chair and CEO, the company acknowledged the importance of aligning corporate lobbying with the Paris Agreement.

Roland Bosch
Theme lead: Risk management

CASE STUDY

Hyundai Motor



South Korea's Hyundai Motor is one of the world's largest vehicle manufacturers, with over 50% of its sales overseas.

In 2017 we raised our concerns about the apparent weakness in the company's sustainability performance, particularly the carbon intensity of its vehicles, as revealed in a report published by the non-profit organisation CDP. We introduced it to CDP and following this, the company acknowledged that its performance could be improved.

It then shared its improvement plans, including around catching up with Japanese peers who had invested earlier and more decisively in green technologies, and enhancing its communications around this. With little initial improvement, we continued to question vehicle sustainability performance over the next three years, including meeting with the independent chair in 2018.

Hyundai Motor has now made good progress in improving the sustainability of its vehicles, launching a number of lower emissions models including IONIQ, offered as a hybrid, a plug-in hybrid and a fully electric vehicle, and KONA Electric, the first fully electric compact SUV.

The company is also accelerating the development and promotion of hydrogen fuel cell vehicles and plans to increase its sustainable vehicle models from approximately 3.8% to 20% of total sales by 2025.

Sachi Suzuki
Sector lead: Transportation

Electric dreams

Range anxiety is often cited as one of the main factors preventing greater consumer take-up of all-electric vehicles. No one wants to be stranded far from home. So why aren't we seeing a rapid roll-out of charging infrastructure?

Even if companies scale up their production of EVs to meet countries' 2030 ICE sales ban deadlines, another question remains – will motorists be able to find a place to charge them? Although charging points have popped up at kerbside in some major cities, they are still few and far between.

Electric-charging infrastructure must be rolled out faster at work, home and across business premises if mass adoption by 2030 is the goal. Electricity grid capacity will need to be expanded to accommodate this. We are seeing some announcements, such as that made by the UK government to invest over £500m in growing the EV infrastructure, but much more needs to be done.

According to the EU Green Deal, to achieve climate neutrality, a 90% reduction in transport emissions is needed by 2050. This strategy should be implemented with a socially responsible approach to preserve jobs and reskill workers, in line with the principles of a just transition to a low-carbon economy.

With utility companies, we advocate for a faster roll out of charging points, but the policy framework is critical. To this end, we have informed policymakers, regulators, and industry associations of the Net Zero Company Benchmark expectations to galvanise the support needed.

In February 2021 we responded to the EU's public consultation on the revision of CO_2 emissions standards for cars and vans. We recommended the removal of the regulatory enablers for auto companies that give them the leeway to continue selling high emission vehicles.

We also want to see vehicle tax reform to penalise consumers that buy highly polluting vehicles. Aside from motorists' fears about running out of charge – which experts say are overdone – cost is the other major barrier preventing mass switching to EVs. Norway has turbo-powered EV sales by offering tax breaks to make electric cars cheaper.[7] Germany has also joined forces with car companies to fund grants for BEVs to drive up demand. By contrast, the UK government has frozen fuel duty on petrol and diesel since 2010.[8]

[7] https://www.theguardian.com/environment/2021/jan/22/electric-vehicles-close-to-tipping-point-of-mass-adoption
[8] Why are the Tories putting up the wrong taxes? | Financial Times (ft.com)

Engaging on human rights risks in Xinjiang

Investors are increasingly concerned about the detailed and credible reports of alleged human rights abuses of ethnic minorities in the Xinjiang Uyghur Autonomous Region (XUAR). How do we engage on this important issue, particularly in high-risk sectors such as textiles, construction, and agriculture?

Setting the scene

In March 2020, the Australian Strategic Policy Institute (ASPI) published a report linking alleged human rights abuses of the Uyghurs and other ethnic minority citizens from the far west region of Xinjiang to global businesses. The report listed 82 global brands as customers of factories where Uyghurs were allegedly being forced to work. The Chinese government has repeatedly denied any ill treatment, despite growing expert reports and witness testimony. The US government has imposed sanctions on certain goods imported from the region and issued a 'business advisory'[1] cautioning companies about the risks of value chain links to entities that engage in human rights abuses in the XUAR and elsewhere in China. Other Western governments have also responded strongly.

Reports of human rights abuses in the XUAR have been growing over the last 18 months, with governments around the world condemning the situation. The US, Canadian and Dutch governments have declared the situation a genocide and at the end of April 2021, British MPs unanimously approved a motion also describing the Uyghurs' plight as genocide. Previously, the British government had issued a statement describing the scale and severity of the alleged human rights violations of Uyghurs in Xinjiang as "painting a truly harrowing picture"[2].

In March 2021, the European Union, the US, Canada and the UK issued sanctions on what the UK referred to as "perpetrators of gross human rights violations in Xinjiang"[3]. The Biden administration reiterated the US view that the situation in XUAR could be considered a genocide[4].

Concerns have intensified since the report *Uyghurs for sale*[5], published by ASPI in March 2020, which provided detailed allegations of human rights abuses taking place in the XUAR, via mass internment and surveillance, but also at factories linked to the supply chains of global businesses. The report set out evidence that an estimated 80,000 Uyghurs had been transferred to work in Chinese factories, some directly from detention centres, as part of a state-sponsored labour scheme. This was the most thorough report to date making direct connections with global businesses.

The report set out evidence that an estimated
80,000
Uyghurs had been transferred to work in Chinese factories, some directly from detention centres, as part of a state-sponsored labour scheme.

[1] 'Xinjiang Supply Chain Business Advisory – United States Department of State
[2] Human rights violations in Xinjiang and the government's response: Foreign Secretary's statement – GOV.UK (www.gov.uk)
[3] https://www.gov.uk/government/news/uk-sanctions-perpetrators-of-gross-human-rights-violations-in-xinjiang-alongside-eu-canada-and-us
[4] https://www.state.gov/reports/2020-country-reports-on-human-rights-practices/
[5] Uyghurs for sale | Australian Strategic Policy Institute | ASPI

The Chinese government has denied any use of forced labour from Xinjiang and claims that participation in labour transfer programmes is voluntary. Officials also initially denied the presence of the centres, but given the increasing number of satellite images showing expanding sites, they now refer to the detention centres as vocational training centres that do not infringe on human rights.

However, testimonies have mounted from former diplomats and former detainees who have managed to leave the region or the factories. These include witness statements of forced sterilisation and mass rape in the region[6,7], and indications of forced labour at Chinese factories[8]. Credible reports have also been released from NGOs, the UN and other international experts. As these concerns have grown, getting access to the region to verify the situation has become almost impossible. The Chinese government continues to place severe restrictions on reporters. China has publicly stated its support for the UN's human rights chief, Michelle Bachelet, to visit Xinjiang in order to carry out an independent and comprehensive assessment of the human rights situation there, but the visit has yet to take place.

In January 2021 the US government announced a ban on all imports of cotton or tomatoes from the region.

Human rights are a priority engagement theme for EOS at Federated Hermes. Aside from the moral case for respecting human rights, we believe that understanding how a company manages human rights can demonstrate its broader corporate culture and approach to enterprise risk management. This can affect a company's reputation and social licence to operate and its ability to generate long-term sustainable value.

The United Nations Guiding Principles on Business and Human Rights (UNGPs) outline the corporate duty to respect human rights, seeking to identify, mitigate and prevent human rights impacts, from a rights holder as well as a business perspective.

Links to global business and government responses

In addition to the potential transfers of forced labour to factories throughout China, which can then feed into global supply chains, according to international trade data, XUAR is in the top 20 exporting regions of China[9]. In 2019 it exported over US$17bn worth of goods internationally, including textiles, footwear, and apparel. The Xinjiang region accounts for over 80% of cotton production in China and Chinese cotton makes up approximately 20% of the global supply.

Throughout 2020, the US Departments of Commerce and Treasury[10] issued sanctions on government entities and companies implicated in the alleged abuses and the Department of Homeland Security[11] issued "withhold release orders" on products from Xinjiang companies and a detention centre. In January 2021 the US government announced a ban on all imports of cotton or tomatoes from the region.

Blacklisted firms cannot buy goods and technology from US companies without US government approval. Although US sanctions escalated the issue for many companies, the risks of not addressing this could be severe for individuals and businesses, regardless of sanctions. This is due to potential lawsuits and legal risks associated with gross human rights abuses; material risks stemming from the seizure of goods and the ending of business relationships; and reputational risks from negative media coverage, the filing of OECD National Contact Point complaints[12], and being subject to third-party investigations.

The UK and Canadian governments have imposed trade restrictions with the XUAR[13] and the UK government introduced financial penalties for businesses that do not comply with the Modern Slavery Act[14]. In addition, the Australian parliament is considering a bill to ban imports from the XUAR[15].

Human rights are a priority engagement theme for EOS at Federated Hermes.

[6] China cuts Uighur births with IUDs, abortion, sterilization (apnews.com)
[7] 'Their goal is to destroy everyone': Uighur camp detainees allege systematic rape – BBC News
[8] Uyghurs for sale | Australian Strategic Policy Institute | ASPI
[9] Xingjiang Uygur Autonomous Region | OEC – The Observatory of Economic Complexity
[10] Treasury Sanctions Chinese Entity and Officials Pursuant to Global Magnitsky Human Rights Executive Order | U.S. Department of the Treasury
[11] DHS Cracks Down on Goods Produced by China's State-Sponsored Forced Labor | Homeland Security
[12] Governments that have committed to the Organisation for Economic Co-operation and Development's responsible business guidelines are required to set up a 'national contact point' tasked with furthering the effectiveness of the guidelines. One aspect of this is the opportunity to file a complaint about a multi-national enterprise not meeting the guidelines for responsible business conduct.
[13] UK and Canada announce new trade and business measures directed at products from Xinjiang | Canada | Global law firm | Norton Rose Fulbright
[14] UK Government announces business measures over Xinjiang human rights abuses – GOV.UK (www.gov.uk)
[15] https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Foreign_Affairs_Defence_and_Trade/UyghurForcedLabourBill

Our engagement approach

In high-risk circumstances, companies and their investors have a responsibility to carry out heightened due diligence of human rights impacts within their operations and supply chains.

Following the ASPI report, we wrote to 65 companies that were mentioned in it. In our letter we asked three things from the companies:

1. To ensure immediate action is taken to assess the risk of forced labour for the XUAR.
2. To ensure any assessment or due diligence is conducted with a lens to the potential difference of treatment of workers based on ethnicity.
3. To update us on how they might be collaborating or engaging with peers and multi-stakeholder initiatives to better understand the scale of the issue.

We received a variety of responses, including:

- Details of work being carried out to ensure transparency of supply chains.
- Initiation of collaborative work, for example with the Fair Labor Association and Responsible Business Association.
- Instigation of specific investigations in supply chains.

One of the most progressive responses came from a fashion retailer, which confirmed that it had no Tier 1 or 2 production in Xinjiang, and had stopped sourcing cotton from Xinjiang after the Better Cotton Initiative suspended its licensing of cotton from the region in April 2020. The company also contacted all its suppliers in China highlighting that labour programmes where ethnic minority workers were taken to work in factories in China were regarded as forced labour. Subsequently, the company concluded that there was a heightened risk, and as a consequence it ended its business relationship with a mill in another province, which was owned by a yarn producer mentioned in the report.

After this initial outreach we conducted further analysis of newly-released NGO and expert reports, parliamentary inquiries, and US sanctions, resulting in identification of three high-risk sectors for involvement in this issue:

1. Apparel and textiles – as the region produces 80% of all Chinese cotton, which makes up around a fifth of the world's cotton.
2. Construction – companies providing machinery to develop detention centres.
3. Agriculture – businesses linked to farming, harvesting, or distributing produce from the region.

CASE STUDY

The US farming machinery manufacturer

We engaged with one US manufacturer of farming machinery to learn how the US sanctions had impacted the company. We asked how it would comply with the sanctions and how it applied its human rights policy to customers and the use of its products, as its policy only referred to oversight of human rights in the supply chain. The company said that it would comply with sanctions but was still working through how to address the issue of conducting due diligence on its customers.

We followed up by sharing resources on how to approach human rights in high risk areas, including sharing the UN Guiding Principles reporting framework. We sought clarity on how the company would expand its human rights policy to include customers and product use, and how it would disassociate responsibly from business relationships potentially connected to a region.

So far, we have held discussions or plan to hold discussions in the near future with **34** companies.

Beyond sectors, we identified that any organisation with production or manufacturing in China would be exposed to a high risk of the transfer of forced labour, and Chinese technology companies were also reviewed for allegations of potential links to mass surveillance.

We reviewed all the relevant companies in our engagement programme from these sectors to determine if there was already a relevant issue or objective, or whether to develop dialogue for engagers to raise the issue. So far, we have held discussions or plan to hold discussions in the near future with 34 companies.

For example, we engaged with Walt Disney, which attracted criticism from British politicians for filming parts of its live action version of Mulan in Xinjiang province, and listing Chinese authorities in the credits.[16,17] We welcomed the company's intention to continue incorporating checks and ensuring a robust evaluation of its internal processes and human rights-related risks throughout production. It highlighted the challenge of consistently implementing its ethical culture across its complex multinational operating footprint. It acknowledged the importance of setting the tone from the top.

As part of our engagements, we ask companies to:

1. Be more specific about what due diligence they have carried out to determine if there is an adverse impact related to forced labour in or from the XUAR in their value chains (to trace or map their supply chains and customers, carry out well designed and meaningful audits of factories in China or investigations);
2. Explain how the company is connected; and
3. Outline what action can be taken to respect human rights to the greatest extent possible given the circumstances, especially given that the provision of remedy in this case is generally seen as highly improbable.

We support the Investor Alliance for Human Rights' practical guidance for investors[18] on this subject and in particular the advice on remedy (that is, compensating for any harms identified). Expert advice[19] suggests that it is almost impossible to achieve any form of remedy in this environment. For many businesses therefore the challenge is to assess how they can responsibly cease to be connected to the human rights abuse. This may involve responsibly disengaging from business relationships, ensuring consideration of how to give notice, reasonably reducing any impact on employees, and honouring payments for contracts to which the company has already committed.

EOS has also joined the Investor Alliance for Human Rights' collaborative engagement on this topic. Through this initiative, EOS will collaborate on engagement with 15 companies, in addition to our own engagements with other companies in our own programme. The first step in this collaborative engagement was to send letters to the companies requesting further dialogue.

Engagement on this subject is unsurprisingly sensitive, particularly with Chinese companies, while foreign companies are concerned about potential Chinese consumer boycotts. Only one Chinese company has so far spoken to us about the allegations of mass surveillance and how it can implement governance and risk management measures to ensure that data from individual users is not shared with the government.

Many companies have referred to specific investigations or collaboration with multi-stakeholder initiatives. One company confirmed that it would comply with all US sanctions for XUAR and was planning responsible disassociation from the region.

With each company we engage, we will continue to focus on the need for heightened due diligence on this high-risk subject. We encourage companies to align with the UNGPs and to move beyond policy statements towards transparent actions and disclosure of the outcomes of their work. As with all our human rights engagements, we seek to encourage companies to include potentially affected stakeholders, their representatives, and experts when designing due diligence and the provision of remedy.

Engaging on these issues is undoubtedly difficult. However, we maintain our commitment to this priority theme as a stewardship service provider, and with the conviction that companies that invest in positive social outcomes are more likely to create and preserve long-term holistic value.

With each company we engage, we will continue to focus on the need for heightened due diligence on this high-risk subject.

[16] https://www.cbr.com/mulan-disney-xinjiang-criticisms-from-british-politicians/
[17] https://edition.cnn.com/2020/09/11/media/disney-mulan-xinjiang-intl-hnk/index.html
[18] Human Rights Risks in Xinjiang Uyghur Autonomous Region – Practical Guidance for Investors | Investor Alliance for Human Rights (investorsforhumanrights.org)
[19] See remedy chapter on page 16: https://investorsforhumanrights.org/sites/default/files/attachments/2020-08/InvestorGuidanceonHRRisksXinjiang08.03.20.pdf

Access all areas

The pandemic forced many companies to hold virtual shareholder meetings in 2020 – while these worked well in some cases, we also saw some troubling practices. But if such meetings are conducted properly this year, they can support investor stewardship, rather than eroding shareholder rights.

Setting the scene

In 2020 the pandemic created a divergence in practices as companies took their annual shareholder meetings virtual. In many cases shareholder-board interactions diminished and shareholder rights were eroded. However, technological advances mean that virtual or hybrid meetings can support and broaden shareholder participation if they are conducted well. For example, shareholders no longer need to travel long distances to put questions to board members in person.

For further information, please contact:

Andy Jones
Theme lead: Stewardship
andy.jones@hermes.investment.com

Government-imposed bans on large gatherings in 2020 not only prevented summer music festivals and major sporting events from going ahead – companies were also forced to rethink their annual shareholder meetings. While some companies and regulators responded quickly and embraced the latest technology – improving shareholder access via live online virtual meetings – others used the opportunity to shut down debate by controlling the Q&A session, or worse, held their meetings behind closed doors.

The annual meeting is an important part of corporate governance and shareholder democracy, but its value could be far higher. For companies, the annual meeting is the opportunity to present to, discuss with, meet, and hear from a broad base of shareholders. It plays a key role in keeping shareholders engaged with the company and renewing support for management and the board.

It is the primary annual event for shareholders to understand the stewardship of their company, the personalities running the business, and an opportunity to hold them to account. It is also the main or only time investors can address many of a company's board members and hear questions from other shareholders.

Unfortunately in recent years we have seen boards paraphrasing questions or statements and giving uninformative or boilerplate responses to shareholder questions. This trend was noticeable even before the coronavirus sped around the world.

Improving shareholder meeting participation

1. The internationalisation of share ownership restricts physical attendance for a large segment of the shareholder base due to the travel burden. Attending virtually instead of flying to another country keeps carbon emissions down.
2. Given the increase in active ownership and stewardship by investors, and the growing demands on boards and management to engage with a broader set of shareholders, annual meetings are an important forum in the year for engagement with shareholders.
3. There are increasing expectations under stewardship codes and related regulation for asset owners to make use of their shareholder rights, in particular voting, along with greater public scrutiny on voting decisions. This can be informed by the discussion at annual meetings.
4. The rise in the number of shareholder-filed resolutions means that annual meetings are an important opportunity to hear from both the proponent and the board on the item raised.

Responding to Covid-19 restrictions

Although regulatory guidance on annual meetings was unclear or restrictive at the height of the pandemic's first wave, some companies took the opportunity to have limited or no engagement between shareholders and the board. Where companies did put alternative live engagement options in place, these favoured larger institutional shareholders rather than retail investors.

While there were positive examples, such as Deutsche Bank, which delivered its virtual meeting via a live webcast, we also saw some troubling practices.

In Switzerland, some companies, such as LafargeHolcim, did not provide any mechanism for a Q&A at the annual meeting or through an alternative forum.

In the UK, some meetings were held behind closed doors with no broadcast. One example was Barclays, where we raised our concerns about the impact on shareholder rights with the company secretary.

Although the virtual format allowed us to intervene at more meetings – 'attending' 22 meetings versus nine the previous year – we often had to pre-submit the questions, as live engagement was not possible. This was the case at UK insurance company Aviva where we asked a question on alignment of its strategy with the Paris Agreement, and at Swiss luxury goods manufacturer Richemont where we asked for a rotation of the auditor and an external evaluation of the board.

At other meetings we asked questions about worker rights and safety during the pandemic. However, pre-submitting questions could yield indifferent results – for example, one UK aerospace company read out its answers via video, but did not provide any substantive detail, and there was no option for shareholders to interact with board members.

In the US, many annual meetings lasted less than an hour, some of which was taken up with presentations. We were particularly disappointed that pharmaceutical company AbbVie ended its virtual meeting after less than half an hour, choosing not to address the question we had submitted on the grounds that it had run out of time.

This year Swiss company ABB held its meeting behind closed doors[1], giving no opportunity for a live Q&A with the board, whilst others in the same market, such as Novartis, provided this.[2]

Although regulatory guidance on annual meetings was unclear or restrictive at the height of the pandemic's first wave, some companies took the opportunity to have limited or no engagement between shareholders and the board.

Good practice principles

We want to see annual meetings protected as an important mechanism of stewardship, board-shareholder engagement, and board accountability. It is vital that good practice standards, fairness, order, integrity, and shareholder rights are upheld across markets. This transparency and accountability benefits stakeholders far beyond the attending shareholders.

Reflecting on our experiences and observations in 2020, we have defined a set of good practice principles that cover virtual, hybrid and physical meetings and apply to most countries. These aim to maximise the value of the meeting for both company and shareholder.

[1] https://new.abb.com/news/detail/74906/notice-of-abbs-annual-general-meeting-on-march-25-2021
[2] https://www.novartis.com/sites/www.novartis.com/files/2021-novartis-agm-notice.pdf

1. Format of attendance

We believe hybrid meetings are the optimal structure, combining the benefits of both physical and virtual formats. For example, physical attendance facilitates an important accountability/escalation point that is likely to be more immediate and effective than a mediated interaction via an online platform. Virtual attendance enables broad access from an international shareholder base who may need to vote or attend multiple meetings in a day. It also reduces the travel requirements, and the associated costs and carbon emissions.

The procedures and protocol for the meeting should be published in advance, including rules on the selection and ordering of questions, and how the company will respond to questions that are not answered live or in advance.

The annual meeting should have a dedicated area on the company website to which shareholders can refer before, during and after the meeting. This should be updated to include a record of vote results and any statements or actions by the company in response to material dissent.

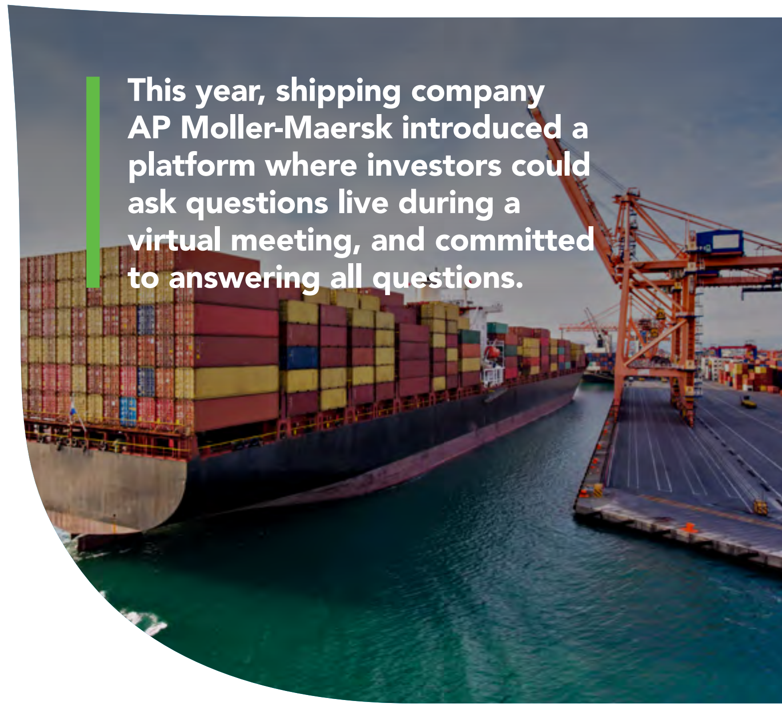
Virtual attendance enables broad access from an international shareholder base who may need to vote or attend multiple meetings in a day. It also reduces the travel requirements, and the associated costs and carbon emissions.

Under Germany's Covid-19 Act, German companies held virtual shareholder meetings in 2020, and gave shareholders the opportunity to submit questions ahead of the meeting. For example, at Deutsche Bank, we submitted questions on the lack of gender diversity on the management board, strategy implementation and risk oversight – particularly with regard to non-financial risks – and sustainability. We then joined the meeting via a live video stream.

Revisions to the German rules in October 2020 mean that it is now a legal requirement for management to answer all questions that are submitted ahead of a virtual-only meeting. The earlier rules, devised at the height of the first wave in March 2020, gave management a choice over whether and how to answer.[3]

Revisions to the German rules in October 2020 mean that it is now a legal requirement for management to answer all questions that are submitted ahead of a virtual-only meeting.

[3] https://www.gibsondunn.com/2020-year-end-german-law-update/
[4] https://investor.maersk.com/shareholder-services/annual-meeting
[5] https://www.novonordisk.com/investors/agm-divider/annual-general-meeting-2021.html



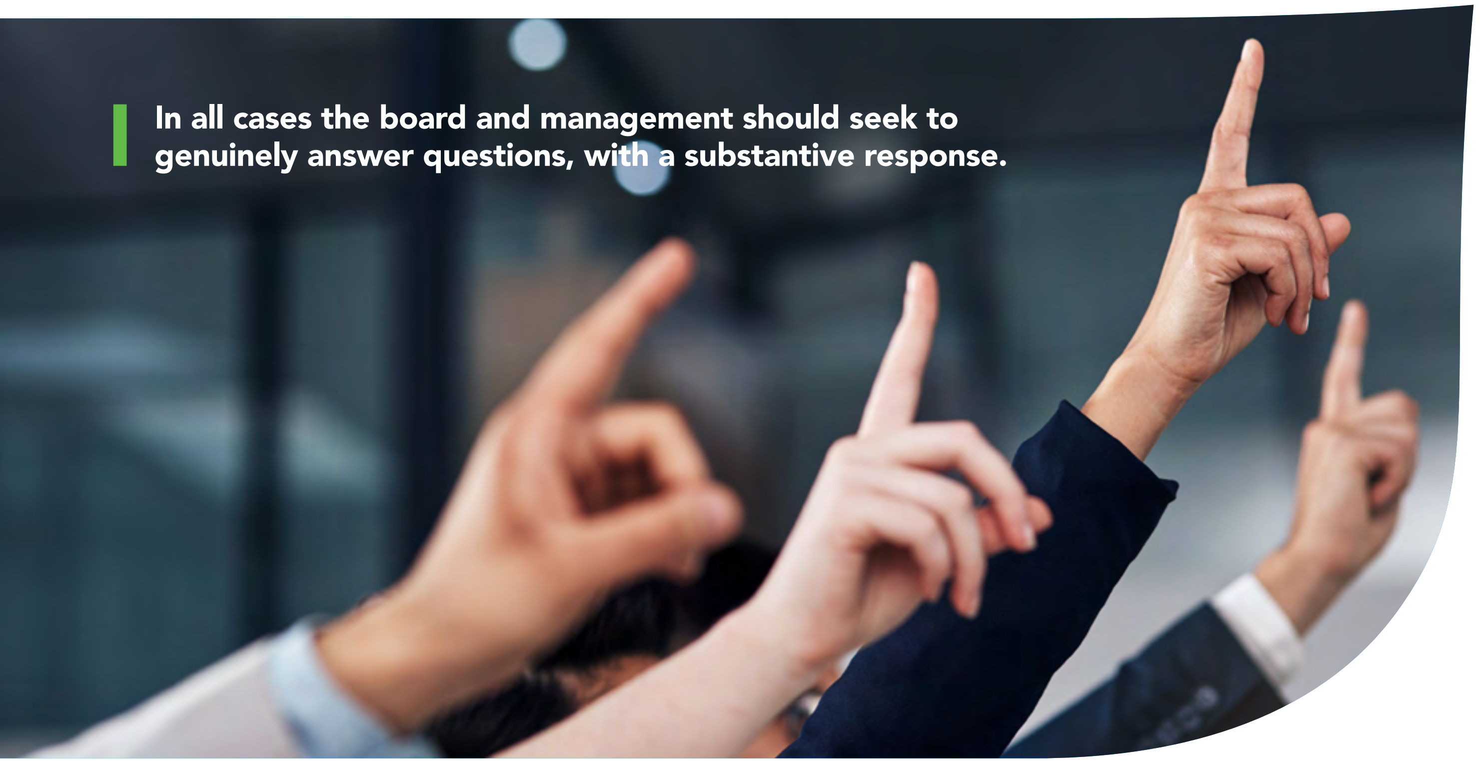
2. The virtual experience

The experience for virtual attendees should mirror that for physical attendees as closely as possible. This includes:

- A video platform, with an audio line also available.
- A live video-feed of the full board, with a close up of the chair (or other director chairing the meeting if the chair is not independent) and CEO when they are speaking.
- The ability to ask questions live to the board, ideally orally rather than in writing.
- If questions are to be submitted in advance, visibility of the list of all submitted questions and the order in which they will be answered.

This year, shipping company AP Moller-Maersk introduced a platform where investors could ask questions live during a virtual meeting, and committed to answering all questions. In the event of a time crunch, it said it would publish any unanswered questions and its responses on its website.[4]

Danish pharmaceutical company Novo Nordisk also held a virtual-only meeting in 2021 due to the ongoing pandemic – the first time it did so. Shareholders could submit questions in advance and during the meeting via an app and the company committed to responding to all relevant questions. If it could not answer them during the meeting, it said the answers would be posted on its website within two weeks. The meeting was also recorded and made available on its website.[5]



In all cases the board and management should seek to genuinely answer questions, with a substantive response.

3. Company attendance, presiding and presentation

All board members and top executives should attend the meeting and be available for answering questions. This enables more complete responses. Unfortunately, even before the pandemic, some companies failed in this regard. For example, Alphabet's CEO and president did not even attend the 2019 shareholder meeting.

The meeting should be presided over by the chair, or an independent director if the chair is not independent. This is so that the director leading the representation of minority shareholders on the board leads the meeting, and also to avoid management answering questions on corporate governance.

Management and the board should present on progress against company strategy, including ESG-related issues, as well as financial performance. The chair of each board committee should present on its actions of the prior year, its conclusion on the state of the company in its area of focus, and the focus areas of the committee for the next year.

4. Q&A

We support the shareholder right for any shareholder or proxy attending to speak at the meeting. In all cases the board and management should seek to genuinely answer questions, with a substantive response. Shareholders should be able to challenge the board where this is not the case and ask for more detail and clarification. In recent years we have seen a decline in the willingness to provide meaningful and insightful responses and we will call this out where observed.

The proponents of shareholder resolutions should have the opportunity to present their proposals and be given at least 10 minutes in which to do so. This time should be in addition to any minimum time allotted for general Q&A.

Where there is a time limit to a live Q&A session, any questions submitted before the end of the day should also be answered on the annual meeting website within three working days of the meeting. Questions and answers, including those answered in writing, should be included in a published full transcript of the meeting.

In the German market, we attended the Siemens Energy 2021 shareholder meeting which ran for eight hours. We raised eight questions that were read out in full and the company made a good effort to give detailed answers to all the questions that were submitted ahead of the meeting.

Meanwhile Swiss company Novartis offered a virtual speakers' desk, where investors could pre-submit questions. The board responded to all the submitted questions at the meeting.

Voting season 2021

As the 2021 voting season continues, we will take note of which companies embrace open and constructive dialogue with shareholders. We will identify those companies that fall short of our expectations and consider our approach to future voting recommendations. We will highlight the good examples and the worst performers, while working with market authorities in different countries to promote best practice, as we recognise that part of the solution must come through clear regulatory guidance.

It is still early days for these new meeting formats, and some companies need to evolve their approach. However, there is much value for companies, shareholders, and other stakeholders in quality interactions at a well-run meeting. Ultimately, if executed the right way, going virtual or using a hybrid meeting format could enhance access for all, and maintain or even improve shareholder rights.

Company engagement highlights

A selection of short company case studies highlighting areas where we have completed objectives or can demonstrate significant progress.

Overview

Our approach to engagement is holistic and wide-ranging. Discussions range across many key areas, including business strategy and risk management, which includes environmental, social, and ethical risks. Structural governance issues are a priority too. In many cases, there is minimal external pressure on the business to change. Much of our work, therefore, is focused on encouraging management to make necessary improvements.

The majority of our successes stem from our ability to see things from the perspective of the business with which we are engaging. Presenting ESG issues such as climate change or board effectiveness as risks to the company's strategic positioning puts things solidly into context for management. These short company engagement updates highlight areas where we have recently completed objectives or can demonstrate significant progress, following several years of engagement.

JPMorgan Chase & Co

Engagement theme: Lead independent director succession

Lead engager: Diana Glassman

Following over six years of engagement with US investment bank JPMorgan Chase on the succession of its lead independent director, it announced a new lead independent director in 2020. As part of our ongoing engagement with the bank, we met a board member in 2014 to raise our concerns about the notable absence of the lead independent director – the former CEO of Exxon – from the stakeholder outreach programme. We questioned whether he was the right individual to serve in such a role.

We met the audit committee chair in Q3 2014, who, we inferred, was the de facto lead director. We requested meetings with other directors repeatedly over the next few years to better understand board dynamics and we were pleased to finally meet the lead independent director in Q4 2018. While this was a positive meeting, plans for his succession remained an urgent concern considering his regressive views on ESG issues, especially climate change, combined with his long tenure.

In its April 2020 proxy statement, the bank announced its intention to begin the formal process for identifying a successor. In Q3 2020, the board announced that the independent directors had unanimously nominated a new lead independent director, effective from 1 January 2021. The former lead independent director formally resigned from the board at the end of 2020. We expect the new appointee to promote a higher degree of engagement and alignment with investors, regulators and other relevant stakeholders.

Nissan Motor

Engagement theme: Business strategy

Lead engager: Sachi Suzuki

This Japanese car manufacturer's relationship with its large shareholder and Alliance partner France's Renault appeared precarious after the arrest and departure of its then executive chair Carlos Ghosn in late 2018, who was also the chair and CEO of Renault. In July 2019, we wrote to the board of Nissan and raised our concerns. We noted that the automotive industry was facing major disruption and voiced our concerns about the apparent weakening of trust between Nissan and Renault. We highlighted that the two parties should rebuild their trust in each other and reach an agreement to ensure the sustainability of the Alliance. We made some specific recommendations including the publication of a statement about the future of the Alliance.

In May 2020, the Alliance published a statement, highlighting the new cooperation model to support member companies' competitiveness and profitability, and detailing how this would be done through the "leader-follower scheme". In our meeting with senior executives in 2020 we gained assurance that the statement aimed to clarify that the Alliance is not political, which some may have previously suspected. We will continue to monitor developments and engage on other issues including fleet emissions reduction and human rights in the cobalt supply chain.

Phillips 66

Engagement theme: Health and safety disclosures

Lead engager: Diana Glassman

As part of our ongoing dialogue with US oil company Phillips 66, we initiated engagement on enhancing the qualitative disclosures for its health and safety programmes in a call with its policy and sustainability manager in Q1 2019. The programmes include its 10 Life Saving Rules (LSR), "stop work" authority for all workers, and analysing the root causes of incidents. To complement this, we suggested that the company disclose how its safety policies and procedures work in practice and highlight its internal awards and good examples of safety from its programmes.

In Q2 2018, the company published a video which features its employees discussing the value and success of its LSR. Following a majority shareholder vote at its 2020 annual meeting calling for disclosure on the public health risks of expanding petrochemical operations in flood-prone areas, Chevron Philips Chemical, a joint venture 50% owned by Phillips 66, published disclosure on its identification and management of physical risks from climate change. We will continue to encourage it to explicitly address the public health risks of expanding its operations in the Gulf of Mexico.

We welcomed further enhancements to the company's health and safety disclosures in its 2020 sustainability report, and more frequent updates to its website. These included: its participation on community advisory panels and local emergency planning committees; social risk assessments and auditing; supply chain safety auditing; recognition it has received from local and national health and safety organisations; detailed disclosure on its policies and management systems around health and safety; and case studies on its ongoing projects related to health and safety. We continue to engage on further improvements to its reporting, encouraging disclosure of performance targets for its sustainability programmes.

LafargeHolcim

Engagement theme: Climate change

Lead engager: Andy Jones

We became the Climate Action 100+ co-lead, alongside Ethos, for European cement company LafargeHolcim at the end of 2017. In 2018, following a presentation on the company's climate strategy, we encouraged the setting of targets with a stringent level of assurance. In 2019 we wrote to the chair of the board with our requests on climate action, including developing and externally assuring science-based emission reduction targets, and linking these to executive remuneration. Later in 2019 we met the chair of the board and the new executive-level chief sustainability officer (CSO) at the company's offices near Zurich. We were pleased to hear that a 'below 2°C' target had been submitted to the Science-Based Targets initiative (SBTi) but questioned whether it could be aligned to a more ambitious pathway. We again requested that the target be incorporated into executive remuneration.

At the end of the year the company announced that the target had been approved by the SBTi. In 2020 we continued to encourage a raising of the ambition to alignment with a well below two degrees or 1.5-degree pathway. We welcomed the inclusion of the carbon reduction target as one of three metrics in a substantially weighted ESG section of the executive long-term incentive plan. In September 2020 the company signed the Business Ambition for 1.5°C pledge, announced intermediate targets approved by the SBTi in alignment with a net zero pathway and announced a partnership with SBTi to develop a 1.5°C roadmap for cement. In a meeting with the chair and CSO in the same month we commended the company on its new commitment and progress on climate action.

Shinhan Financial Group

Engagement theme: Board composition

Lead engager: Jaime Gornsztejn

We have been engaging with South Korea's Shinhan Financial Group on board gender diversity since 2018. Although the company has had women on the board in the past, more recently the board composition lacked female representation. In our engagement, the company argued that it applies diverse criteria for director appointments, but we highlighted the need to demonstrate its understanding of the importance of gender diversity, particularly in the South Korean context.

We welcomed the positive steps taken during the engagement in 2019, especially the disclosure of the number of female candidates shortlisted for board positions and the initiatives to promote executive female talent within the company. At the 2020 annual shareholder meeting, we were pleased with the nomination and election of a woman to the board and continue to encourage further progress.

BHP

Engagement theme: Climate change

Lead engager: Jaime Gornsztejn

We have long engaged with BHP on climate change, but our engagement as a member of Climate Action 100+ on BHP's climate change mitigation plan and its contribution to the achievement of the Paris Agreement goals commenced in 2019. BHP proactively sought our input in various meetings with the sustainability team in 2019 and 2020, as it developed its medium-term carbon emissions reduction target. We emphasised the importance of using science-based targets and discussed decarbonisation options, mainly diesel replacement, the use of renewable energy and how to secure a stable and reliable supply. Although we acknowledged that 20% of emissions may be hard to abate with available or prospective technologies, we said that the use of offsets should be kept to a minimum and independently overseen.

In Q3 2020, the company announced its Scopes 1 and 2 carbon emissions reduction target of 30% by 2030 relative to 2020, using the science-based absolute contraction method. We continue to engage on the plan for the reduction of Scope 3 emissions, particularly initiatives related to shipping and steel production.

SoftBank Group

Engagement theme: Board composition

Lead engager: Sachi Suzuki

In a call with the global head of investor relations at SoftBank Group in April 2019, we raised our concern about the lack of gender diversity, as well as the low level of independence on the board. The company said that many of the executive directors were from outside SoftBank Group as they represented firms in which it had invested and were able to bring in diverse views. We acknowledged this but argued that it was important that the board had more independent directors to protect minority stakeholder interests, not least because the founder – who owns approximately 20% of the company – is also the chair and CEO.

At the 2019 annual shareholder meeting, we recommended voting against the chair, to voice our concerns about these points, and reiterated our expectations. In the group call with the executive chair in February 2020, we were pleased to hear that the company was considering improving gender diversity and independence on the board. Shortly before the 2020 shareholder meeting, the company announced the appointment of two new independent director candidates, including a female candidate, which we firmly welcomed.

As we continued to press for a higher level of independence and female representation, SoftBank Group announced that four of its executive directors had stepped down from the board in November 2020. The board now consists of nine directors, four of whom are independent, a significant improvement, which we welcomed. We continue to seek increased gender diversity, while engaging on the special board system, a subset of directors who can vote on certain items as delegated by the main board.

Kinder Morgan

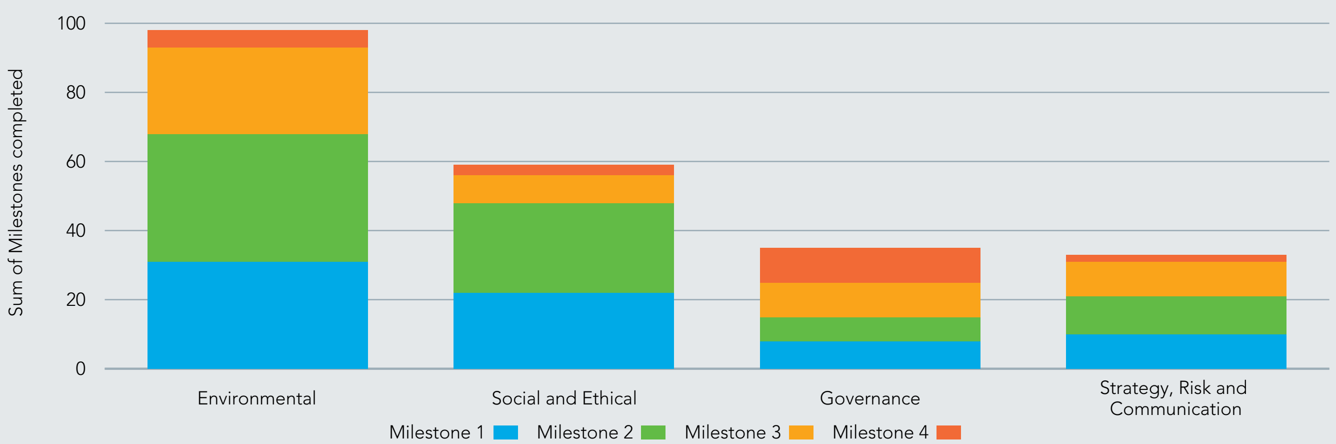
Engagement theme: Sustainability reporting and strategy

Lead engager: Diana Glassman

We initiated engagement with US energy infrastructure company Kinder Morgan on its sustainability reporting and greenhouse gas emissions in Q2 2016. In advance of its 2017 annual meeting, we expressed our support for all shareholder proposals, including an annual sustainability report and reporting on its methane emissions. While these proposals initially failed, they were proposed again in 2018. In a call with investor relations in Q2 2018, the company was reflecting on the majority support for climate-related resolutions and sustainability reporting, and a substantial vote for a methane management resolution at its 2018 annual meeting. It acknowledged our concerns that its pipeline development in Canada was becoming more difficult as a result of climate-related concerns. Kinder Morgan produced its first ESG report later that year, including methane emissions data.

As a founding member of ONE Future, a coalition of members across the natural gas value chain focused on policy and technical solutions for reducing industry-wide methane emissions, Kinder Morgan announced its commitment to achieving a methane emission intensity target of 0.31% across its natural gas transmission and storage operations by 2025. The actual emissions intensity for 2018 was 0.02%, far surpassing the target. However, it has only committed to start reporting company-wide Scopes 1 and 2 emissions in 2021 and has not yet addressed Scope 3. We will continue to engage on disclosing and setting a baseline with robust, Paris Agreement-aligned emissions targets for management of its greenhouse gas emissions.

Milestones completed by stage, Q1 2021



Source: EOS data

CASE STUDY

Pfizer

As part of our ongoing dialogue with US pharmaceutical company Pfizer, in 2017 we suggested to the corporate secretary that the company consider reporting in line with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). In 2019, we supported a shareholder proposal on enhanced lobbying disclosures. We reiterated our view during a meeting with the head of environment in 2020, as well as encouraging more ambitious carbon reduction targets.

We first raised concerns about diversity levels in 2018, encouraging goals for gender and ethnic minority representation and disclosure of detailed workforce composition data. We have also engaged on pricing and access for Pfizer's Covid-19 vaccine, and remain concerned that the company does not sufficiently recognise the risks from antimicrobial resistance (AMR).

The company has since published its first TCFD report and has committed to becoming carbon neutral across its operations by 2030. In early 2020 the company appointed two more female directors with diverse backgrounds in science and education, and civil society taking the total to four (33%).

This followed the setting of its first public goals in 2019, to increase female and ethnic minority representation at senior levels within the organisation. By 2025, it is aiming for 47% of vice president roles and above to be filled by women (globally) and 32% by minorities (US). In line with our expectations of US companies, Pfizer has also committed to publishing its government-submitted EEO-1 report on gender and ethnic minority composition data for the workforce, by level, in 2021.

We will continue to engage with Pfizer on its lobbying and political activity transparency, diversity, pricing and access commitments for its vaccine, particularly in developing markets, and on AMR.

Read our engagement case studies in full at
https://www.hermes-investment.com/ukw/eos-insight/eos/pfizer-case-study/

Katie Frame
Sector Lead: Pharmaceuticals and Healthcare

BLOG SPOTLIGHT

Raising the bar for stewardship

As we published our own Stewardship Report in Q1, Dr Hans-Christoph Hirt, head of EOS, examined the key challenges of the revised Stewardship Code, and asked whether it would be successful in raising the bar for stewardship across the industry.

The revised UK Stewardship Code is far more demanding for would-be signatories. The original Stewardship Code was criticised by Sir John Kingman in his December 2018 review of the Financial Reporting Council (FRC) as well-intentioned but "not effective in practice". Following a public consultation, to which we contributed, the FRC revised the Code and it is now beginning to assess the submissions it has received, to determine who has made the grade.

The revamped Code adopts a much wider and more ambitious definition of stewardship as: "the responsible allocation, management, and oversight of capital to create long-term value for clients and beneficiaries, leading to sustainable benefits for the economy, the environment and society". We were very supportive of such a definition in our contribution to the FRC's revision of the Code.

The FRC's feedback to the preliminary reporting submissions illustrated the challenge involved in satisfying all the requirements of the revised Code, as even some market participants with strong ESG credentials found this difficult. The Code expands stewardship across all asset classes and to investments outside the UK, with a change in approach from 'comply or explain' to 'apply and explain'. This is a real sea change, requiring a completely different level of reporting to the old boilerplate responses of the past.

There are new principles for service providers, setting out expectations on the role they play in supporting their clients in meeting their own stewardship responsibilities. Given this, EOS at Federated Hermes made its own application for the first time.

We hope that would-be signatories will engage wholeheartedly with the spirit of the Code, helping to raise the bar for stewardship across the investment industry and acting as a beacon for other markets.

Read the EOS Insights article in full and access the Stewardship Report at
Raising the bar for stewardship – UK Wholesale (hermes-investment.com).

Dr Hans-Christoph Hirt
Head of EOS

Public policy and best practice

EOS contributes to the development of policy and best practice on corporate governance, sustainability and shareholder rights to protect and enhance the value of its clients' investments over the long term.

Overview

We participate in debates on public policy matters to protect and enhance value for our clients by improving shareholder rights and boosting protection for minority shareholders.

This work extends across company law, which in many markets sets a basic foundation for shareholder rights; securities laws, which frame the operation of the markets and ensure that value creation is reflected for shareholders; and codes of best practice for governance and the management of key risks, as well as disclosure.

In addition to this work on a country specific basis, we address regulations with a global remit. Investment institutions are typically absent from public policy debates, even though they can have a profound impact on shareholder value. EOS seeks to fill this gap.

By playing a full role in shaping these standards, we can ensure that they work in the interests of shareholders instead of being moulded to the narrow interests of other market participants, which may differ markedly – particularly those of companies, lawyers and accounting firms, which tend to be more active than investors in these debates.

CA100+ Midstream Oil & Gas Working Group

Lead engager: Diana Glassman

We contributed to the Climate Action 100+ (CA100+) Midstream Oil & Gas Working Group's Investor Recommendations for a Net-Zero Aligned Strategy, which provides additional nuance to the CA100+ benchmark for North American midstream companies. The guidance for midstream companies lays out investor expectations regarding Scopes 1, 2 and 3 net-zero commitments by 2050 or sooner, targets, decarbonisation strategy, capital alignment, climate policy engagement, climate governance, just transition and TCFD disclosure. In developing these investor expectations, the Ceres midstream Oil and Gas Working Group built on the "top 10" asks we marshalled in a letter co-signed by 17 signatories that we sent to Kinder Morgan as co-leads of the Kinder Morgan CA100+ collaborative working group.

The guidance also incorporates EOS's perspective that midstream businesses should consider emissions from product transported and upstream sourced product, for example methane intensity. They should also adopt responsible customer/supplier practices related to water use, labour standards, and community impacts, and describe policies for dealing with indigenous peoples and relevant standards applied, such as Free, Prior, and Informed Consent and the UN Universal Declaration of Human Rights. CA100+ will now send the expectations to companies with North American midstream operations and EOS will leverage them across its engagement companies.

Finance for Biodiversity Pledge call

Lead engager: Sonya Likhtman

We had a call with the coordinators of the Finance for Biodiversity Pledge to share initial ideas about the focus and objectives for the engagement group. We discussed the importance of mapping existing initiatives and organisations to align efforts and avoid duplication. We shared views on how companies with material impacts on biodiversity could be identified, whether by sector or sub-theme. This task is challenging in the absence of a single metric, such as greenhouse gas emissions, that would enable comparison between different companies' biodiversity impacts.

We emphasised the importance of setting clear engagement goals so that companies understand the aims and requests of the collaborative engagement group. These are yet to be defined, although we suggested that there should be an emphasis on positive impacts as well as mitigating negative impacts.

Subsequently, we joined another call for signatories to discuss priorities for the different working groups and how the Finance for Biodiversity Pledge collaboration may be governed. It was a lively discussion and most signatories were highly engaged. The measurement and data group highlighted its initial thinking.

On behalf of the public policy group, we shared ideas about how signatories could create impact ahead of the COP 15 on biodiversity. The current thinking is to produce an open letter that urges parties to the Convention on Biological Diversity to agree on an ambitious post-2020 biodiversity framework. We can also use the letter to articulate areas where we think the draft framework can be improved. We discussed how this group should interact with existing organisations, especially whether the link to the Task Force for Nature-related Financial Disclosures (TNFD) working group should be stronger.

Supporting ATM Foundation's global Covid-19 response statement

Lead engager: Katie Frame

We signed up to a global statement coordinated by the Access to Medicine Foundation in support of an effective, fair, and equitable global response to Covid-19. The statement encourages world leaders in the G7, G20 and ACT-Accelerator Facilitation Council to finance the ACT-Accelerator in full, and to deploy adequate funding to ensure fair and equitable access to Covid-19 vaccines, medicines, and diagnostic tools globally.

The statement also recommends that governments and international organisations explore the feasibility of innovative finance mechanisms for national and global Covid-19 responses. These could be similar to the vaccine bonds issued by the International Finance Facility for Immunisation, or social bonds for Covid-19 programmes issued by individual or multiple governments.

In addition, through the statement we committed to working with the Access to Medicine Foundation on this issue and to engage with the healthcare companies in our programme

to promote industry actions supporting the mission and operations of the ACT-Accelerator. These actions might include cross-industry R&D partnerships, equitable pricing strategies and voluntary licensing agreements.

Presenting at Japanese METI-backed net-zero study group

Lead engager: Sachi Suzuki

We were invited to present at a study group on net-zero emissions supported by Japan's Ministry of Economy, Trade and Industry (METI) and attended by a large number of companies from different sectors. We shared our expectations for companies and what we want to see in the long term as well as the medium-to-short term. We also gave some examples of European companies considered to be leading in their respective sectors.

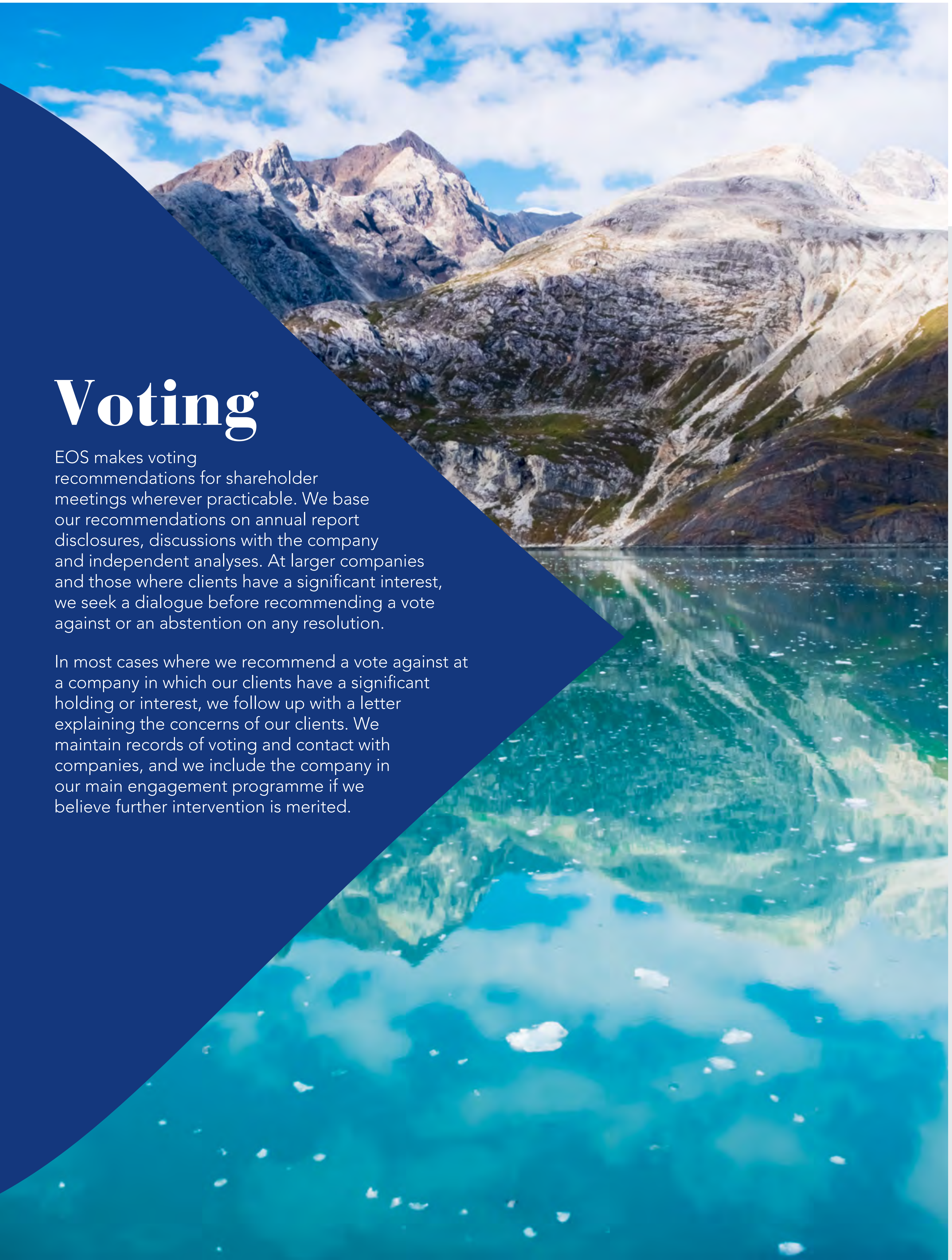
While we welcomed the commitments made by some Japanese companies to achieve carbon neutrality in 2050, following the government's announcement in late 2020, we encouraged companies to set a stretching and specific medium-term target and disclose a detailed roadmap including capex plans. We also emphasised our view that offsetting should be used as a last resort, given the apparent focus on carbon offsets as one of few viable options in achieving net zero. Lastly, we highlighted our expectations for more transparency around lobbying activities.

Biopharma sustainability roundtable discussion

Lead engager: Katie Frame

We participated in the third biopharma sustainability roundtable discussion with biopharma companies and investors to provide feedback on the results of the reporting methodology consultation. We expressed the need to consider ways to shift the thinking on disclosures in the sector, away from a culture of compliance, to a culture that strives for the highest ethical standards. Leading indicators should be used to assess culture, and qualitative disclosures made around the processes and learnings applied when cultural failures are identified.

We also said that the industry should shift towards setting more specific targets around diversity, based on a robust assessment of where issues may be occurring within an organisation. These targets should address issues related to inclusive culture, looking at retention, turnover and promotion rates by gender and ethnicity within different levels or business functions, for example.



Voting

EOS makes voting recommendations for shareholder meetings wherever practicable. We base our recommendations on annual report disclosures, discussions with the company and independent analyses. At larger companies and those where clients have a significant interest, we seek a dialogue before recommending a vote against or an abstention on any resolution.

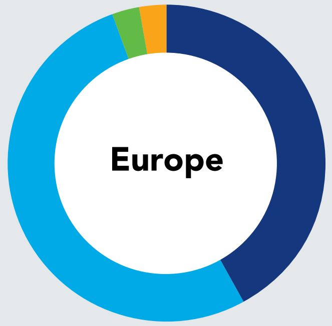
In most cases where we recommend a vote against at a company in which our clients have a significant holding or interest, we follow up with a letter explaining the concerns of our clients. We maintain records of voting and contact with companies, and we include the company in our main engagement programme if we believe further intervention is merited.

Voting overview

Over the last quarter we made voting recommendations at 1,940 meetings (16,997 resolutions). At 866 meetings we recommended opposing one or more resolutions. We recommended voting with management by exception at 27 meetings and abstaining at 14 meetings. We supported management on all resolutions at the remaining 1,033 meetings.

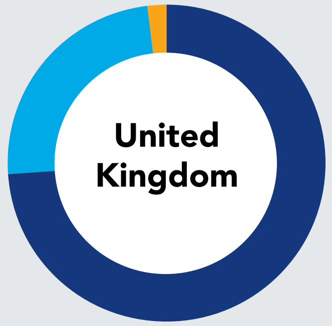
We made voting recommendations at **1,940** meetings (**16,997** resolutions) over the last quarter.

- Total meetings in favour **53.2%**
- Meetings against (or against AND abstain) **44.6%**
- Meetings abstained **0.7%**
- Meetings with management by exception **1.4%**



We made voting recommendations at **276** meetings (**4,280** resolutions) over the last quarter.

- Total meetings in favour **42.0%**
- Meetings against (or against AND abstain) **52.5%**
- Meetings abstained **2.9%**
- Meetings with management by exception **2.5%**

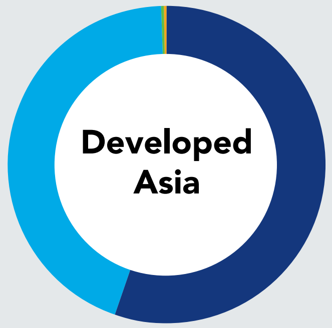


We made voting recommendations at **115** meetings (**1,169** resolutions) over the last quarter.

- Total meetings in favour **73.9%**
- Meetings against (or against AND abstain) **24.3%**
- Meetings with management by exception **1.7%**

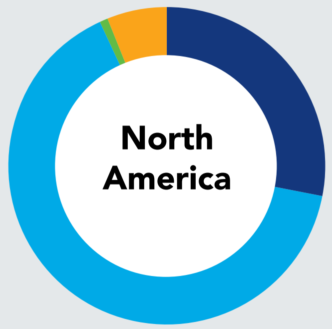
We made voting recommendations at **736** meetings (**5,390** resolutions) over the last quarter.

- Total meetings in favour **60.5%**
- Meetings against (or against AND abstain) **38.7%**
- Meetings abstained **0.4%**
- Meetings with management by exception **0.4%**



We made voting recommendations at **569** meetings (**4,179** resolutions) over the last quarter.

- Total meetings in favour **55.5%**
- Meetings against (or against AND abstain) **44.1%**
- Meetings abstained **0.2%**
- Meetings with management by exception **0.2%**



We made voting recommendations at **235** meetings (**1,955** resolutions) over the last quarter.

- Total meetings in favour **28.1%**
- Meetings against (or against AND abstain) **65.1%**
- Meetings abstained **0.9%**
- Meetings with management by exception **6.0%**

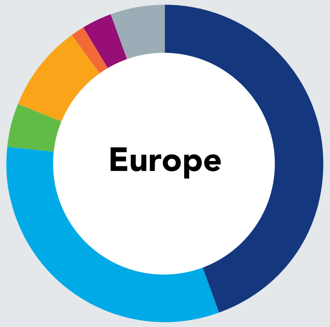
We made voting recommendations at **9** meetings (**24** resolutions) over the last quarter.

- Total meetings in favour **55.6%**
- Meetings against (or against AND abstain) **44.4%**

The issues on which we recommended voting against management or abstaining on resolutions are shown below.

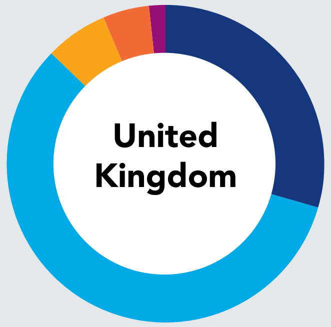
We recommended voting against or abstaining on **2,376** resolutions over the last quarter.

- Board structure **42.7%**
- Remuneration **24.7%**
- Shareholder resolution **3.4%**
- Capital structure and dividends **7.0%**
- Amend Articles **12.6%**
- Audit and Accounts **4.8%**
- Investment/MandA **0.4%**
- Poison Pill/Anti-Takeover Device **0.1%**
- Other **4.3%**



We recommended voting against or abstaining on **519** resolutions over the last quarter.

- Board structure **44.5%**
- Remuneration **32.2%**
- Shareholder resolution **4.6%**
- Capital structure and dividends **8.7%**
- Amend Articles **1.5%**
- Audit and Accounts **3.1%**
- Other **5.4%**

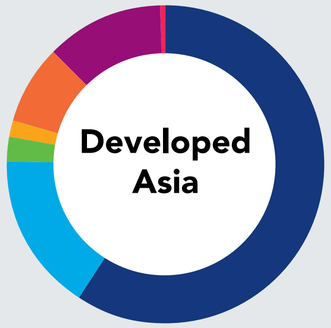


We recommended voting against or abstaining on **64** resolutions over the last quarter.

- Board structure **29.7%**
- Remuneration **57.8%**
- Capital structure and dividends **6.3%**
- Amend Articles **4.7%**
- Audit and Accounts **1.6%**

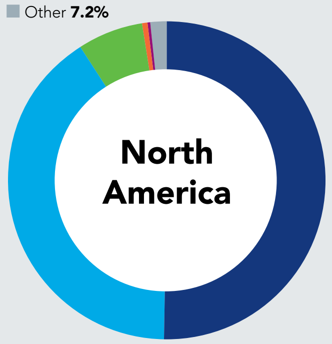
We recommended voting against or abstaining on **955** resolutions over the last quarter.

- Board structure **31.6%**
- Remuneration **16.2%**
- Shareholder resolution **2.3%**
- Capital structure and dividends **11.4%**
- Amend Articles **26.1%**
- Audit and Accounts **4.1%**
- Investment/MandA **0.9%**
- Poison Pill/Anti-Takeover Device **0.1%**
- Other **7.2%**



We recommended voting against or abstaining on **473** resolutions over the last quarter.

- Board structure **59.4%**
- Remuneration **16.1%**
- Shareholder resolution **2.5%**
- Capital structure and dividends **1.7%**
- Amend Articles **7.8%**
- Audit and Accounts **12.1%**
- Poison Pill/Anti-Takeover Device **0.4%**



We recommended voting against or abstaining on **360** resolutions over the last quarter.

- Board structure **50.3%**
- Remuneration **40.8%**
- Shareholder resolution **6.4%**
- Amend Articles **0.8%**
- Audit and Accounts **0.3%**
- Other **1.4%**

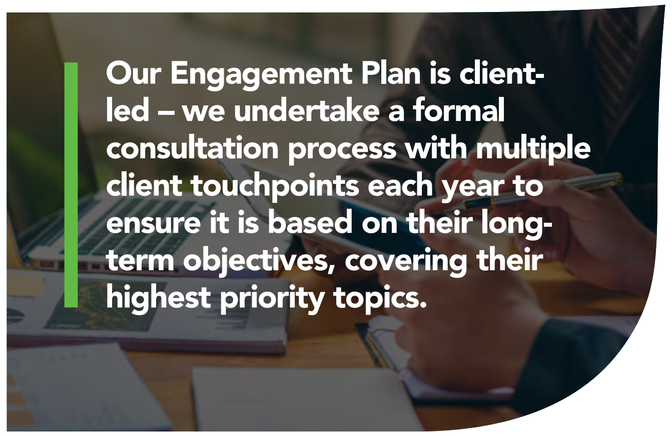
We recommended voting against or abstaining on **5** resolutions over the last quarter.

- Remuneration **80.0%**
- Capital structure and dividends **20.0%**

The EOS approach to engagement

EOS at Federated Hermes is a leading stewardship service provider. Our engagement activities enable long-term institutional investors to be more active owners of their assets, through dialogue with companies on environmental, social and governance issues.

We believe this is essential to build a global financial system that delivers improved long-term returns for investors, as well as better, more sustainable outcomes for society.



Our Engagement Plan is client-led – we undertake a formal consultation process with multiple client touchpoints each year to ensure it is based on their long-term objectives, covering their highest priority topics.

Our services

Engagement

We engage with companies that form part of the public equity and corporate fixed income holdings of our clients to seek positive change for our clients, the companies and the societies in which they operate.

Public policy

Engaging with legislators, regulators, industry bodies and other standard-setters to shape capital markets and the environment in which companies and investors can operate more sustainably.

Voting

We make recommendations that are, where practicable, engagement-led and involve communicating with company management and boards around the vote. This ensures that our rationale is understood by the company and that the recommendations are well-informed and lead to change where necessary.

Screening

We help our clients to fulfil their stewardship obligations by monitoring their portfolios to regularly identify companies that are in breach of, or near to breaching, international norms and conventions.

Advisory

We work with our clients to develop their responsible ownership policies, drawing on our extensive experience and expertise to advance their stewardship strategies.

The EOS advantage

- **Relationships and access** – Companies understand that EOS is working on behalf of pension funds and other large institutional investors, so it has significant leverage – representing assets under advice of US$1.5tn as at 31 March 2021. The team's skills, experience, languages, connections and cultural understanding equip them with the gravitas and credibility to access and maintain constructive relationships with company boards.
- **Client focus** – EOS pools the priorities of like-minded investors, and through consultation and feedback, determines the priorities of its Engagement Plan.
- **Tailored engagement** – EOS develops engagement strategies specific to each company, informed by its deep understanding across sectors, themes and markets. It seeks to address the most material ESG risks and opportunities, through a long-term, constructive, objectives-driven and continuous dialogue at the board and senior executive level, which has proven to be effective over time

EOS team

Engagement

Dr Hans-Christoph Hirt
Head of EOS

Joanne Beatty
Sector lead: Chemicals

Dr Emma Berntman
Sectors: Retail, Pharmaceuticals & Healthcare

Roland Bosch
Sector co-lead: Financial Services

Hanah Chang
Sectors: Transportation, Financial Services, Technology Hardware

George Clark
Voting and Engagement Support

Miguel CuUnjieng
Sectors: Financial Services, Oil & Gas, Technology

Emily DeMasi
Sector co-lead: Financial Services

Bruce Duguid
Head of Stewardship, EOS

Katie Frame
Sector lead: Pharmaceuticals & Healthcare

Yu-Ting Fu
Sector: Financial Services

Gage Giunta
Sectors: Financial Services, Oil & Gas, Technology

Diana Glassman
Sector lead: Technology Hardware
Sector co-lead: Oil & Gas

Tim Goodman
Sectors: Oil & Gas, Technology Software

Jaime Gornsztejn
Sector lead: Industrial & Capital Goods

Bram Houtenbos
Voting and Engagement Support

Laura Jernegan
Sectors: Financial Services, Pharmaceuticals & Healthcare

Andy Jones
Sector co-lead: Mining & Materials

Lisa Lange
Sectors: Transportation, Financial Services, Consumer Goods

Pauline Lecoursonnois
Sector lead: Consumer Goods

Sonya Likhtman
Sectors: Consumer Goods, Retail, Mining & Materials

Claire Milhench
Communications & Content

Ian Munroe
Voting and Engagement Support

James O'Halloran
Director of Business Management, EOS

Nick Pelosi
Sector co-lead: Mining & Materials

Hannah Shoesmith
Sector co-lead: Technology Software

Nick Spooner
Sector lead: Utilities
Sector co-lead: Oil & Gas

Sachi Suzuki
Sector lead: Transportation

Sarah Swartz
Sectors: Chemicals, Consumer Goods, Utilities

Velika Talyarkhan
Sector co-lead: Technology Software

Amy Wilson
Sector lead: Retail

Haonan Wu
Sectors: Transportation, Chemicals, Technology, Utilities

Michael Yamoah
Sectors: Technology, Retail, Consumer Goods, Pharmaceuticals & Healthcare

Tim Youmans
Sectors: Financial Services, Industrial & Capital Goods, Technology

Client Service and Business Development

Amy D'Eugenio
Head of Client Service and Business Development, EOS

Diego Anton
Client Service

Alexandra Danielsson
Client Service

Rochelle Giugni
Client Service and Business Development

Charlotte Judge
Communications & Marketing

Alice Musto
Client Service

Federated Hermes
EOS

Federated Hermes

Federated Hermes is a global leader in active, responsible investing.

Guided by our conviction that responsible investing is the best way to create long-term wealth, we provide specialised capabilities across equity, fixed income and private markets, multi-asset and liquidity management strategies, and world-leading stewardship.

Our goals are to help people invest and retire better, to help clients achieve better risk-adjusted returns, and to contribute to positive outcomes that benefit the wider world.

All activities previously carried out by Hermes now form the international business of Federated Hermes. Our brand has evolved, but we still offer the same distinct investment propositions and pioneering responsible investment and stewardship services for which we are renowned – in addition to important new strategies from the entire group.

Our investment and stewardship capabilities:

- **Active equities:** global and regional
- **Fixed income:** across regions, sectors and the yield curve
- **Liquidity:** solutions driven by four decades of experience
- **Private markets:** real estate, infrastructure, private equity and debt
- **Stewardship:** corporate engagement, proxy voting, policy advocacy

Why EOS?

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

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