OUTCOMES BEYOND PERFORMANCE

PUBLIC ENGAGEMENT REPORT

A common thread: promoting decent work in the supply chain

Q2 2019

HERMES EOS

www.hermes-investment.com

This report contains a summary of the stewardship activities undertaken by Hermes EOS on behalf of its clients. It covers significant themes that have informed some of our intensive engagements with companies in Q2 2019. 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 other long-term shareholders.

This report has been written and edited by Claire Milhench, Communications & Content Manager, Hermes EOS

ENGAGEMENT BY REGION

Over the last quarter we engaged with 656 companies on 1,400 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 656 companies over the last quarter.

- Environmental **16.1%**
- Social and Ethical **15.9%**
- Governance **54.5%**
- Strategy, Risk and Communication **13.5%**

We engaged with 112 companies over the last quarter.

- Environmental **14.8%**
- Social and Ethical **16.1%**
- Governance **53.5%**
- Strategy, Risk and Communication **15.7%**

We engaged with 114 companies over the last quarter.

- Environmental **15.5%**
- Social and Ethical **20.0%**
- Governance **54.1%**
- Strategy, Risk and Communication **10.5%**

We engaged with 109 companies over the last quarter.

- Environmental **18.8%**
- Social and Ethical **13.4%**
- Governance **53.1%**
- Strategy, Risk and Communication **14.7%**

We engaged with 87 companies over the last quarter.

- Environmental **19.0%**
- Social and Ethical **15.0%**
- Governance **49.0%**
- Strategy, Risk and Communication **17.0%**

We engaged with 232 companies over the last quarter.

- Environmental **14.7%**
- Social and Ethical **15.5%**
- Governance **57.8%**
- Strategy, Risk and Communication **12.0%**

We engaged with 2 companies over the last quarter.

- Environmental **50.0%**
- Social and Ethical **50.0%**

ENGAGEMENT BY THEME

A summary of the 1,400 issues and objectives on which we engaged with companies over the last quarter is shown below.

Environmental topics featured in 16.1% of our engagements over the last quarter.

- Climate Change **72.6%**
- Forestry and Land Use **4.4%**
- Pollution and Waste Management **12.4%**
- Supply Chain Management **5.3%**
- Water **5.3%**

Social and Ethical topics featured in 15.9% of our engagements over the last quarter.

- Bribery and Corruption **4.5%**
- Conduct and Culture **13.1%**
- Diversity **30.2%**
- Human Capital Management **19.8%**
- Human Rights **22.1%**
- Labour Rights **6.8%**
- Tax **3.6%**

Governance topics featured in 54.5% of our engagements over the last quarter.

- Board Diversity, Skills and Experience **21.8%**
- Board Independence **15.6%**
- Executive Remuneration **43.4%**
- Shareholder Protection and Rights **16.6%**
- Succession Planning **2.6%**

Strategy, Risk and Communication topics featured in 13.5% of our engagements over the last quarter.

- Audit and Accounting **12.7%**
- Business Strategy **31.2%**
- Cyber Security **4.8%**
- Integrated Reporting and Other Disclosure **32.8%**
- Risk Management **18.5%**

ANOTHER DAY, ANOTHER DOLLAR?

Advancing human rights in the supply chain

Many companies rely on global supply chains to access labour in low-cost regions. But the fragmented and opaque nature of these chains heightens the risk of human rights abuses, and progress to improve working conditions has been slow. What can investors do to address this complex and challenging issue? By Hannah Shoesmith.

Setting the scene

A 2019 report by the NGO Human Rights Watch identified brands' poor sourcing and purchasing practices as a "huge part of the root cause for rampant labour abuses in apparel factories"[1]. The International Labour Organization (ILO), the Ethical Trading Initiative (ETI) and Oxfam have also identified this link across many industries[2]. Until this link is addressed, they argue, human rights abuses will persist. The ILO estimates that there are 40 million modern slaves globally, of which 25 million are in forced labour. Some 152 million children aged between five and 17 work, predominately in agriculture, services and industry[3].

Companies have tried to enshrine decent, safe and fair working conditions in codes of conduct, against which they carry out factory audits. However, there is a growing consensus that these compliance programmes have failed to identify and address the root causes of exploitative working conditions, such as sweatshops, bonded labour and poverty wages.

For further information, please contact:

Hannah Shoesmith
hannah.shoesmith@hermes-investment.com

The ILO estimates there are:

40M
modern slaves globally

25M
in forced labour

[1]https://www.hrw.org/report/2019/04/23/paying-bus-ticket-and-expecting-fly/how-apparel-brand-purchasing-practices-drive
[2]https://www.ethicaltrade.org/sites/default/files/shared_resources/Business%20models%20%26%20labour%20standards.pdf
https://www.ilo.org/wcmsp5/groups/public/---ed_protect/---protrav/---travail/documents/publication/wcms_556336.pdf
https://policy-practice.oxfam.org.uk/publications/ripe-for-change-ending-human-suffering-in-supermarket-supply-chains-620418
[3]https://www.ilo.org/global/about-the-ilo/newsroom/news/WCMS_574717/lang--en/index.htm

The power of social media to shine a spotlight on murky practices in far-flung lands means that consumer awareness of worker exploitation has grown in recent years, putting companies under pressure to improve supply chain transparency. Emerging human rights litigation is also focusing corporate minds with new legislation presenting financial and reputational risks for brands that fail to get to grips with this apparently intractable problem.

The Australian Modern Slavery Act (2018), France's Duty of Vigilance (2017) and the Dutch child labour due diligence law (2019) all represent attempts to tackle the root causes of labour exploitation. Meanwhile, following a review of the UK's Modern Slavery Act, in June 2019 Prime Minister Theresa May announced initial measures to strengthen the Act. Companies are also being held to account through the United Nations Guiding Principles on Business and Human Rights (UNGPs, 2011) and its reporting framework, launched in 2015.

However, keeping sight of supply chains is just the first challenge for companies, many of which have highly fragmented, hyperflexible, seasonally varying chains, with blind spots caused by unauthorised sub-contracting.

When companies do carry out due diligence of the supply chain, it tends to be focused on policy-driven, top-down auditing activities. At best these identify symptoms but fail to address the root causes of exploitative working conditions. There have been many media reports of factories or farms involved in human rights abuses even where these have been audited and 'approved' by retailers and their consultants[4].

"Businesses have spent millions on CSR programmes. Despite this significant investment, labour conditions for workers and farmers at the end of the global supply chains have not improved significantly."
Source: ETI

Companies have acknowledged these failings. As far back as 2012 footwear manufacturer Nike said: "We have learned that monitoring does not bring about sustainable change. Often, it only reinforces a pattern of hiding problems."[5] In 2016 a report into corporate leadership on modern slavery found that of 71 leading retailers in the UK, 77% believed there was a likelihood of modern slavery occurring at some stage in their supply chains[6]. This implies new forms of monitoring and other approaches are required in order to make a meaningful difference. For example, some companies have turned to blockchain solutions to help map and monitor supply chains such as a collaboration with Thai Union shrimp farms, Diginex and the Mekong Club, a Hong Kong-based NGO, using the Verifik8 data analytics platform[7].

Of 71 leading UK retailers:

77% believed there was a likelihood of modern slavery occuring in their supply chains

However, although some retailers and brands accept there are prevailing human rights abuses in their supply chains, despite codes of conduct and auditing, very few address this in their sustainability reports. There is a lack of information about how to identify salient human rights risks when carrying out due diligence, and then to provide lasting remedy.

Companies also fail to articulate their own role and responsibility in implementing real change in the way they purchase, despite the fact it is broadly accepted that certain purchasing practices have a negative impact on working conditions. Such practices include changing or cancelling orders at the last minute, providing insufficient lead times, demanding prices that do not meet production costs, and post-production discounts[8].

Despite this negative outlook, there are more targeted interventions that can help to address the major social challenges in the supply chain, and it is these that investors should be focusing on, rather than traditional approaches to disclosure.

[4] For example, the Tazreen factory fire in Bangladesh 2012, Rana Plaza Bangladesh factory collapse in 2013, Thai shrimps supply chain in 2014.
[5] https://purpose-cms-production01.s3.amazonaws.com/wp-content/uploads/2018/05/14214952/Nike_FY10-11_CR_report.pdf page 30
[6] https://www.ethicaltrade.org/sites/default/files/shared_resources/corporate_leadership_on_modern_slavery_summary_0.pdf
[7] https://themekongclub.org/2019/03/04/diginex-and-the-mekong-club-join-forces-with-verifik8-and-british-government-to-pilot-blockchain-project/
[8] https://www.dieh.dk/dyn/Normal/3/23/Normal_Content/file/1272/1504712428/guide-to-buying-responsibly-lower.pdf
https://www.ilo.org/travail/info/fs/WCMS_556336/lang--en/index.htm

The challenge for investors

Given these challenges, there is a growing discourse around which questions investors should be asking and if audits are getting to the real issues.

The disclosure of a company's environmental, social and governance (ESG) data and metrics is the most common way that companies provide investors with the information they need to make informed decisions, and this data is growing fast. According to a 2018 KPMG survey, Asian companies reporting on ESG issues jumped from 49% in 2011 to 78% in 2017.[9]

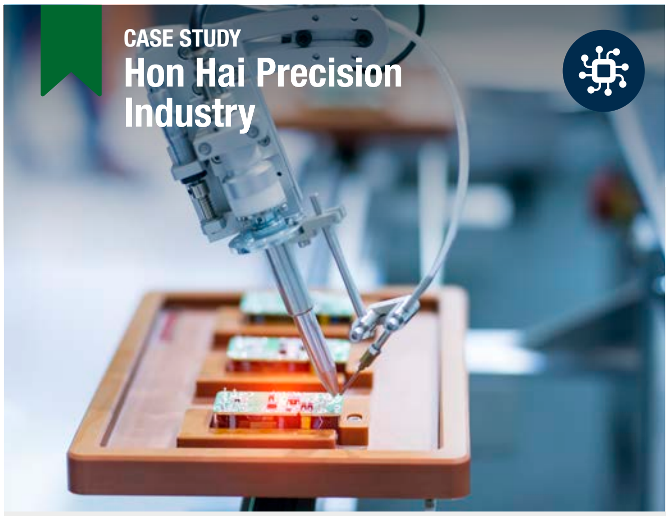
78% of Asian companies reported on ESG issues in 2017

Yet the sheer abundance of data and benchmarks makes it difficult for investors to focus on the most material risks and opportunities for companies. In addition, the benchmarks do not always agree: The Wall Street Journal reported in September 2018[10] that electric car manufacturer Tesla had been rated best (MSCI), worst (FTSE) and average (Sustainalytics) for ESG issues depending on the approach of each agency.

Hermes EOS balances this data, such as information about materiality from the Sustainability Accounting Standards Board, with our own internal processes to identify key engagement opportunities with companies. Over the past decade we have engaged on hundreds of supply chain human rights topics, across mining, consumer goods, oil and gas, pharmaceuticals, technology and financial services sectors. Our supply chain work connects our activities in developed and developing markets and our global reach allows us to leverage engagement synergies that arise from these supplier and customer relationships, such as with Apple and its largest supplier, Hon Hai.

What can investors do?

Investors have an important role to play in encouraging companies to move beyond a focus on minimum compliance standards to address some of the challenges identified above. There are also certain key themes on which investors can engage to demonstrate more meaningful approaches to supply chain human rights.



In 2010, a number of workers at a Hon Hai plant committed suicide, and reports emerged of exploitative working conditions. Over six years we engaged with the company on its response. We gained insights into an independent investigation, raised concerns with the chair at the AGM, visited facilities to speak with workers including union representatives, and requested that the company progress with its worker health and wellbeing programme.

1 Forced Labour and Modern Slavery

Migrant workers are particularly vulnerable to forced labour. Risks include hefty upfront recruitment fees paid by prospective employees, which can lead to debt bondage, the retention of passports by employers, squalid living conditions and excessive, forced overtime. However, it is not only migrant workers who may face forced labour conditions. Forced and excessive overtime, curtailment of freedom of movement and debt bondage can all take place with local workers too, with women particularly at risk.

Investors can engage with companies on activities to identify forced labour and modern slavery indicators in their supply chains.[11] It is extremely unlikely that traditional, announced audits will uncover these. Companies should commit to ensuring workers do not pay for jobs. Working with collaborative organisations such as Stronger Together in the UK, which has developed a responsible recruitment toolkit, and engaging with local NGOs to build intelligence about freedom of movement and exploitative conditions, is more likely to uncover concerns.

An example of our current engagement on this topic is with US home improvement supplies retailer Home Depot, and its approach to managing prison and forced labour risks in the lower tiers of its supply chain.

[9] https://assets.kpmg/content/dam/kpmg/xx/pdf/2017/10/executive-summary-the-kpmg-survey-of-corporate-responsibility-reporting-2017.pdf
[10] https://www.wsj.com/articles/is-tesla-or-exxon-more-sustainable-it-depends-whom-you-ask-1537199931
[11] https://www.ilo.org/wcmsp5/groups/public/---ed_norm/---declaration/documents/publication/wcms_203832.pdf
[12] https://www.ilo.org/wcmsp5/groups/public/---ed_norm/---ipec/documents/publication/wcms_653987.pdf

2 Child Labour

"Zero tolerance" of child labour in supply chains is one of the most established aspects of retailers' social compliance programmes. Sustainable Development Goal 8.7 aims to end child labour in all its forms by 2025. Yet it is a persistent problem. The seasonal and informal nature of many supply chains, such as in agriculture, the lack of decent work for adults and insufficient provision of education mean that parents have no choice but to bring or send children to work.[12]

Companies often cite zero-tolerance policies and audits that have not identified child labourers. However, children and young people continue to be exploited in supply chains and it is unlikely that many supply chains are totally child-labour free. Investors can encourage companies to disclose where they have identified child labourers and what they have done about it.

"While reliable numbers are difficult to come by, it is safe to say that the issue of child labour in supply chains extends to most sectors and most regions of the world."

Source: ILO

This should include key steps such as those outlined in the Children's Rights and Business Principles guidance from Unicef, the UN Global Compact and Save the Children.[13] Emphasis should be placed on providing proper rehabilitation for the child and the family involved, but also on identifying the root cause. This can be a complex task that requires careful stakeholder engagement, such as with government representatives, local NGOs and community leaders, to understand the reasons for the child labour and identify long-term, sustainable solutions. Companies should also be encouraged to implement an ongoing process to map child labour risk and develop partnerships with local experts to provide support.

We engage with Swiss food and drink company Nestlé on cocoa supply chain and child labour risks. The company has developed local partnerships with NGOs and local government, as well as an industry initiative. We encourage the company to disclose its progress on its activities to address the root causes of child labour in cocoa plantations.

3 Living Wages and Purchasing Practices

Most retailers and brands have a commitment to paying a living wage. However, there is little consensus about how a living wage should be calculated, although the Global Living Wage Coalition is making progress. The reality is that minimum wages are frequently not paid, capturing workers in a cycle of poverty, which leads to other human rights abuses such as debt bondage or child labour. In a survey of over 1,450 suppliers in 87 countries by the ILO and the joint ETIs, 39% of suppliers reported accepting orders below the production cost, struggling to pay workers as a result.[14]

An awareness of companies' roles in driving down labour standards has developed into a debate about business models and purchasing practices. Increasingly, businesses are acknowledging the role they have to play in improving their own procurement in order to enhance working conditions, but many have made only incremental progress.

In 2012, allegations were made about poor working conditions at palm oil plantations supplying Kuala Lumpur Kepong, a Malaysian palm oil company. Over the past seven years Hermes EOS has engaged with the company on how it can strengthen its due diligence, identify any further concerns, and remedy these.

The company has worked with a local NGO to carry out assessments and developed follow-up actions. These include addressing modern slavery indicators such as access to passports for migrant workers and eliminating recruitment agency fees. In 2018, the company updated its labour standards commitments and agreed a non-compliance protocol with one of its most critical stakeholders – the NGO that made the original allegations. The company is currently setting up an internal taskforce focused on labour standards chaired by its head of plantations.

The WEST Principles – Worker Engagement Supported by Technology – are a collaboration between technology providers, employers, NGOs, industry and subject matter experts. The aim is to develop principles to maximise the impact of technology to identify and address the risk of abuse and exploitation of workers in global supply chains.

[13]https://www.unglobalcompact.org/docs/issues_doc/human_rights/CRBP/Childrens_Rights_and_Business_Principles.pdf
[14]https://www.ilo.org/wcmsp5/groups/public/---ed_protect/---protrav/---travail/documents/publication/wcms_556336.pdf

In order to improve labour standards and drastically reduce human rights abuses, workers must be a key source of information and take part in developing solutions.

Investors can engage with companies on how to adapt their practices to take account of this. For example, they can provide better forecasting to help suppliers plan production, by factoring in realistic lead times for product launches and by ringfencing wages in negotiations. Buying and sourcing teams should be evaluated against these activities as well as more traditional measures, such as intake margin. Investors can also ask companies if they have considered collective action with other brands and retailers on living wages, such as through ACT on Living Wages, or if they have considered taking part in Better Buying,[15] an industry-wide approach to improving buying practices.

We have been in discussion with fashion retailer H&M about ensuring supply chain living wages and how it will use its collaboration with ACT on Living Wages to help empower workers to collectively bargain on wages and working conditions.

4 Worker Voice

In order to improve labour standards and drastically reduce human rights abuses, workers must be a key source of information and take part in developing solutions. For too long, corporate auditing programmes have failed to include genuine worker feedback. There have been some attempts to improve worker interviews, but workers do not feel secure enough to share details about exploitation and many are even coached on the answers to give to auditors.

In 2016, an NGO uncovered sexual exploitation of female factory workers in the Bangalore supply chains of British retailers through interviews with employees. These were carried out away from the workplace by female members of the NGO team, and not through worker interviews as part of the many factory audits carried out by customers.[16]

Union-based collective bargaining should be available to factory workers but too often this is restricted. Investors can seek to understand how companies support suppliers that allow workers a meaningful mechanism of worker and management dialogue. In addition, investors can ask companies how they are putting workers at the centre of their own due diligence work and finding trusted ways to receive genuine and regular feedback, such as using apps on workers' smart phones.

Our engagement with sportswear manufacturer Adidas includes worker grievances and the development of hotlines and worker voice technology, which will be extended to all strategic suppliers by 2020.

5 Gender-Specific Issues

Women and girls working in supply chains are more vulnerable to exploitation and may not be able to access their workplace rights or voice their grievances due to their social status. An average of 68% of the global apparel sector workforce is female.[17] Women are also concentrated in the lowest paid, least secure roles across the agri-food sector.[18]

39%
of suppliers surveyed reported accepting orders below the production cost

68%
of the global apparel sector workforce is female

Investors should expect companies to articulate how they are incorporating gender-specific issues into their supply chain human rights due diligence. In particular, they should say how it features in their consideration of saliency, how they develop worker engagement approaches that are designed to address gendered human rights risks, and how they design remediation programmes to improve working conditions for women specifically.

Next steps

Human capital management and human rights remain high priority topics in our engagement plan and this list of key themes is by no means exhaustive. More traditional topics such as worker health and safety are sadly still relevant today. However, investors can harness their influence to encourage companies to consider and disclose how they address these persistent challenges with more innovative, holistic solutions, whilst continuing to educate themselves through collaboration with key stakeholders and site visits.

[15] https://betterbuying.org/
[16] https://www.sistersforchange.org.uk/2018/06/20/eliminating-violence-against-women-at-work/
[17] https://www.ilo.org/wcmsp5/groups/public/@ed_dialogue/@sector/documents/publication/wcms_300463.pdf
[18] https://policy-practice.oxfam.org.uk/publications/ripe-for-change-ending-human-suffering-in-supermarket-supply-chains-620418

COMING OF AGE:
15 years of stewardship with Hermes EOS

In the 15 years since Hermes EOS was launched, stewardship has travelled from the fringes to the mainstream, with the benefits of engaging with companies on environmental, social and governance (ESG) risks and opportunities now more widely recognised by investors and regulators.

Setting the scene

Stewardship is in our DNA. More than just voting shareholdings at annual meetings, stewardship includes screening, monitoring and engaging with companies on matters that impact long-term value creation, such as strategy, capital structure, performance, risk, corporate governance and culture, and material environmental and social issues. But the road to mainstream acceptance has been far from smooth.

For further information, please contact:

Hans-Christoph Hirt
Hans-Christoph.Hirt@hermes-investment.com

Sustainable investing and stewardship are now considered must-haves for any asset manager keen to attract long-term investors, but 15 years ago, serious practitioners were few and far between.

Back then, engagement was underused and underdeveloped – screening and divestment were easier if asset managers wanted to burnish their responsible investment credentials. But for long-term institutional investors with large equity allocations, such as Hermes Investment Management's then owner, the BT Pension Scheme (BTPS), this was less than ideal.

Hermes had taken some early steps in stewardship through a dedicated corporate governance team and concentrated Focus Funds, which identified companies with governance issues and sought to improve them. Seeing the success of this approach mainly in the UK, BTPS strongly encouraged Hermes to scale this up and engage systematically with key holdings around the world.

Serendipitously, another large pension fund sought our help on stewardship around the same time. Hermes recognised that providing such a service for clients who shared the same values and aims would support the development of a team of the right size and calibre to make a meaningful impact with companies globally.

A dedicated engagement team was set up, and as Hermes Investment Management was named after the messenger of the gods, the name EOS was chosen after the rosy-fingered goddess of the dawn, while also standing for Equity Ownership Services.

Like any start-up, the early days were challenging at times, with late nights during AGM season for staff trying to make considered voting recommendations at a growing number of companies. EOS was also quite UK-centric, a far cry from the global reach it would later achieve.

Initially the focus was on key corporate governance issues – board composition, independence, skill-sets and dynamics, and remuneration. Beyond the UK, companies were less receptive to dialogue with investors. So in these early years, Hermes EOS built credibility overseas by publishing country-specific local corporate governance principles.

There were some significant hurdles to overcome. The concept of stewardship was in its infancy, and many mainstream investors were yet to be convinced of the value of engagement. Meanwhile, companies were often unused to board-level dialogue with investors on long-term issues and could be resistant or unhelpful.

But changes were afoot. A major report published in 2004 under the auspices of the UN Global Compact, *Who Cares Wins: Connecting Financial Markets to a Changing World*, coined the term ESG and promulgated the notion that environmental, social and governance factors should be incorporated into investment.

The UN then invited a group of the world's largest institutional investors to develop the Principles for Responsible Investment (PRI), launched in 2006. Hermes was on board as a founding signatory and chaired the working group that drafted the principles. The PRI would help to promote the idea that shareholders should play an active role in their investments. But a catalyst to drive real change was needed – and investors would not have long to wait.

There were some significant hurdles to overcome. The concept of stewardship was in its infancy, and many mainstream investors were yet to be convinced of the value of engagement.

CASE STUDY

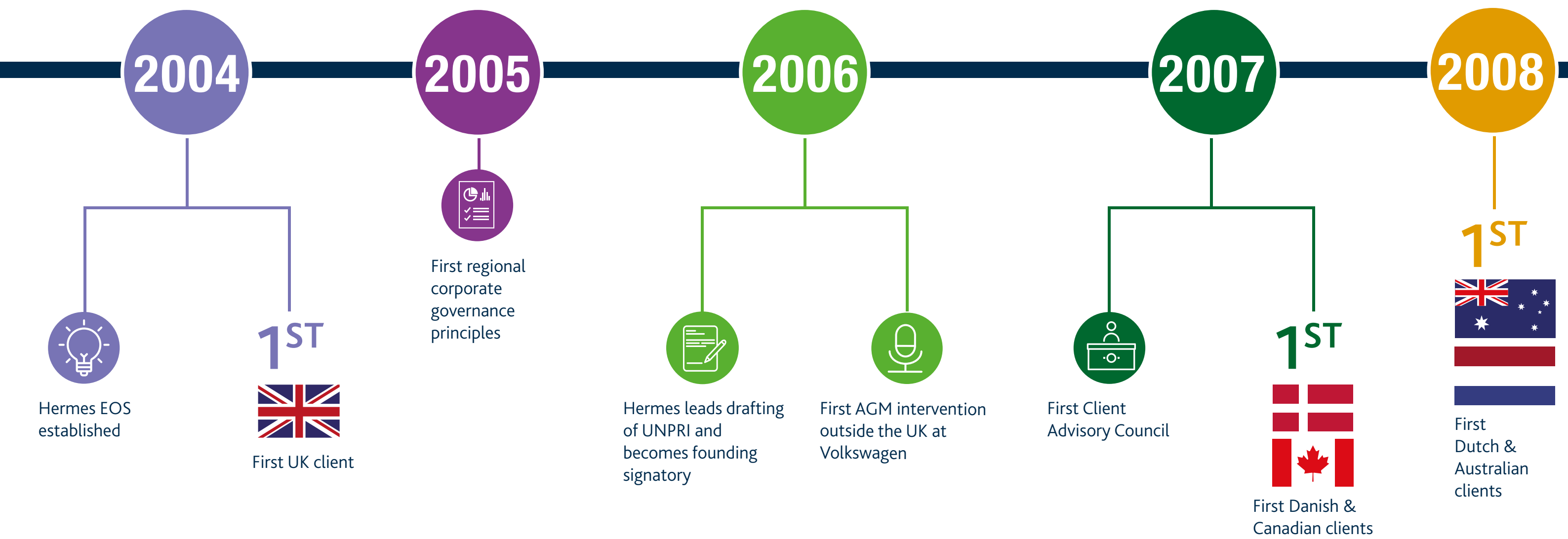
Volkswagen

German AGMs can be huge affairs, held in vast, draughty conference centres and sometimes judged more by the quality of their sausages than the quality of their speeches. Hermes EOS would disrupt this staid world with interventions at car-maker Volkswagen's 2006 and 2007 AGMs when we challenged supervisory board chair Ferdinand Piech and chief executive Martin Winterkorn.

The aim was to highlight problems with the company's corporate governance, stemming from an unusual ownership structure and a culture driven by a dominant chair supported by family shareholdings. We kept up the pressure over the years, raising concerns about the effectiveness of VW's supervisory board due to its limited independence, but there was not enough support from other institutional investors to trigger meaningful change.

Things came to a head with the Dieselgate scandal in 2015, when Volkswagen was revealed to have systematically cheated in diesel emissions tests. The company suffered huge reputational and financial damage, the CEO resigned, and Volkswagen had to pay some $30 billion in fines, civil damages and restitution.[1]

In our view, the company's culture and the failings of the supervisory board to monitor senior management and hold them to account, enabled the emissions deception to unfold and remain undetected for years. Four years on from Dieselgate, we still need to see tangible and credible evidence of improving governance and culture. On the positive side, Volkswagen has made a strategic decision to become a leader in electric vehicles and is aiming to be carbon neutral in its operations and products by 2050.



Lessons learnt

The financial meltdown triggered by the sub-prime crisis in 2007-8 forced market participants to rethink their approach.

Investors and companies had little time to debate the finer points of stewardship in the thick of the crisis as everyone scrambled to put out the fire, but once the smoke had cleared, asset-owners asked what they needed to do to avoid such painful losses again. In the UK, the Stewardship Code, launched in 2010, was one response to the crisis. The main aim was to encourage institutional investors to engage on corporate governance on behalf of their underlying beneficiaries. This included ensuring effective risk management and reining in excessive pay and misaligned incentives in management remuneration.

During this difficult period, the Hermes executive team provided vital support to EOS. We relaunched our Responsible Ownership Principles in 2010, setting out how we discharged our responsibilities, so that companies would understand what to expect in an engagement. We also developed a milestone system to track our progress in engagements, signed the UK Stewardship Code, and after an intensive engagement, led a proxy fight in Germany at semiconductor manufacturer Infineon. That engagement established an important principle in Germany that supervisory boards should involve investors in the nomination process in a meaningful way.

$60BN
fines and compensation paid by BP for Deepwater Horizon explosion

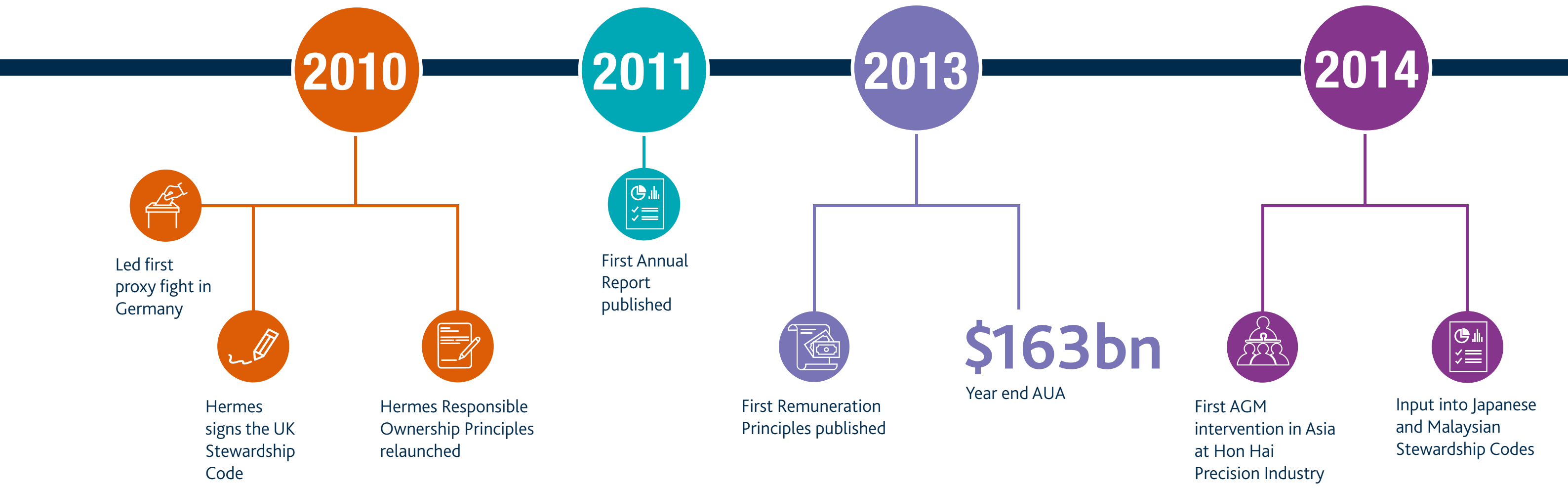
2010
UK Stewardship Code launched

The main aim was to encourage institutional investors to engage on corporate governance on behalf of their underlying beneficiaries.

We also engaged with BP following the Deepwater Horizon explosion and oil spill at the Macondo Prospect in 2010, which killed 11 workers and resulted in the biggest environmental disaster in US history.[2] The total cost of fines and compensation paid by BP would run to over $60 billion.[3]

Prior to the explosion, we had identified that the health and safety function within BP was becoming excessively decentralised and were concerned that lessons learnt in one operation were not being applied across the whole group. After the accident we stepped up our engagement, not only at BP, but across the industry, focusing on how companies should respond to catastrophic oil spills, and what improvements should be made to risk management processes to minimise the likelihood of such incidents reoccurring.

[1] https://uk.reuters.com/article/uk-volkswagen-emissions/vws-dieselgate-bill-hits-30-billion-after-another-charge-idUKKCN1C40RN
[2] https://www.theguardian.com/environment/2012/nov/28/epa-suspends-bp-oil-spill
[3] https://eu.usatoday.com/story/money/2016/07/14/bp-deepwater-horizon-costs/87087056/



Shareholder rebellions

By 2012, some investors had grown tired of company executives receiving massive pay packets regardless of performance.

With many investors still nursing losses in the wake of the global financial crisis it was seen as disproportionate, and in some cases, a reward for failure. Investors began voting against some of these enormous pay-outs in what was characterised as the shareholder spring – for example, there was a 59% vote against the board remuneration policies at advertising agency WPP in protest against the 60% rise in total pay for CEO Sir Martin Sorrell[4,5] in a year when the share price fell.

Reflecting this concern, we developed our remuneration principles with the help of other investors and major companies. We also became more active outside Europe, speaking in front of some 14,000 people at Walmart's 2013 shareholder meeting to call for an independent chair.[6] On the back of our engagement, Walmart arranged for us to visit clothing factories in Bangladesh, where retailers and brands were under pressure over labour standards and safety in their supply chains in the wake of the Rana Plaza tragedy.

Advertising agency WPP

59%
vote against the board remuneration policies

60%
rise in total pay for CEO... in a year when the share price fell

With the stewardship tide lapping at the shores of Asia, we gave input into new Malaysian and Japanese Stewardship Codes.

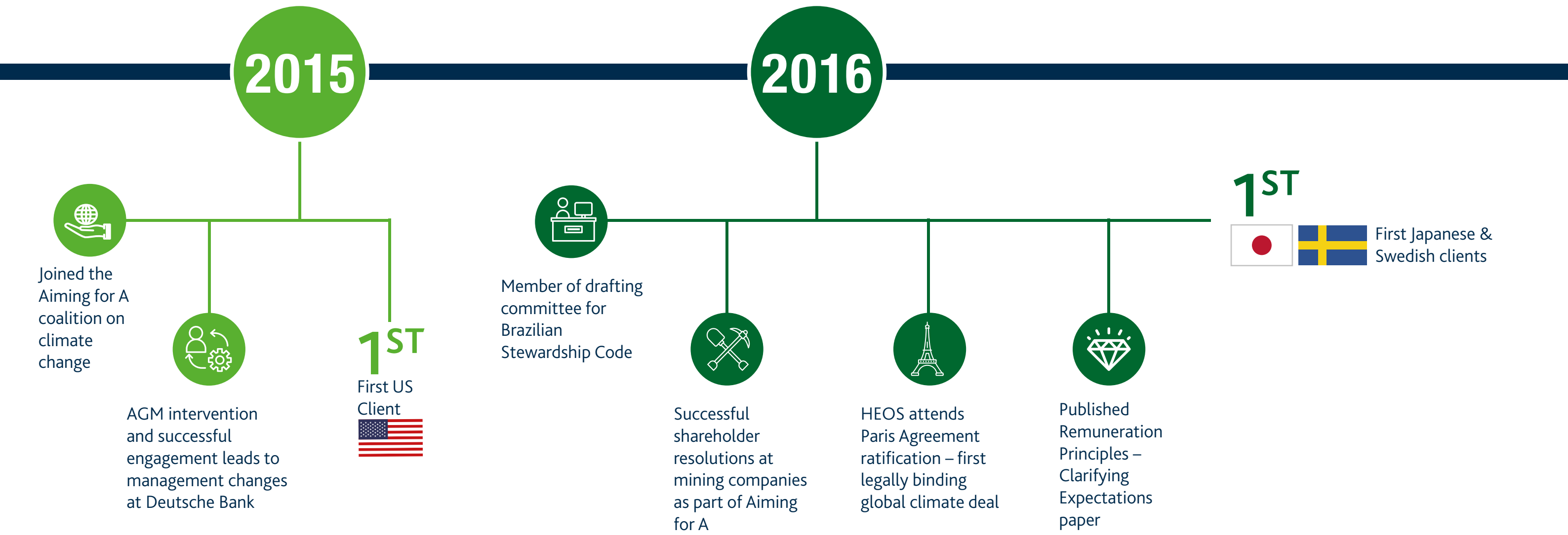
With the stewardship tide lapping at the shores of Asia, we gave input into new Malaysian and Japanese Stewardship Codes. And in 2014, with social issues rising up the investor agenda, we made our first Asian AGM intervention at Hon Hai Precision Industry, better known as Foxconn.

This Taiwanese electronics manufacturer, which makes products for Western consumer goods companies, had seen a spate of suicides at its factories, and reports emerged alleging poor labour practices. Following intensive engagement with Hon Hai on human capital management over several years, including a site visit and meetings at the company's headquarters, we went to Taipei on behalf of a group of investors owning around 2.3% of the company, to deliver a statement at the AGM. After further engagement, the company would make some progress on labour issues, and in early 2017, a third-party research firm took Foxconn off its controversial companies list.

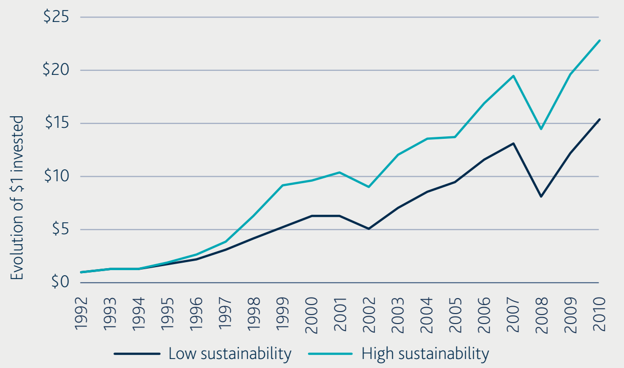
However, adoption of stewardship remained low across the asset management industry, and generally under-resourced. This was despite the fact that several academic studies had emerged showing that engagement on ESG issues reduced risk and enhanced returns.

Supportive data would help to erode some of the scepticism towards engagement and convinced more pension funds that stewardship made sense from a financial perspective, not just an ethical standpoint.

[4] https://www.theguardian.com/media/2012/jun/13/wpp-shareholders-vote-against-sorrell-pay
[5] https://www.ft.com/content/045ca646-b547-11e1-ab92-00144feabdc0
[6] https://www.ft.com/content/ef4ac8c8-cf94-11e2-a050-00144feab7de

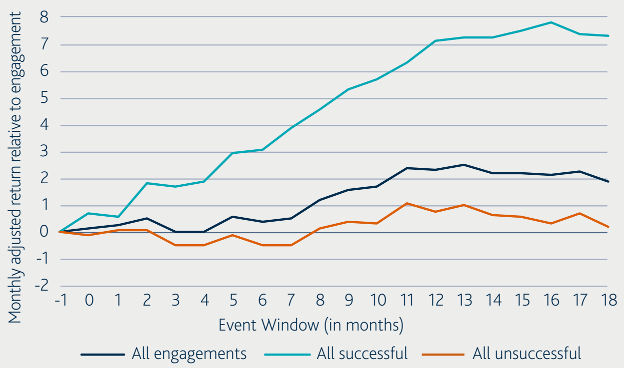


'High Sustainability' firms generate higher returns over the long term



Source: A 2014 study by Eccles, Ioannou, and Serafeim investigated the effect of corporate sustainability on organisational processes and performance using a matched sample of 180 US companies
High sustainability companies = those that voluntarily adopted sustainability policies by 1993. Low sustainability companies = those that adopted almost none of these policies

Engagement linked to enhanced financial performance



Source: A 2012 study by Elroy Dimsona, Oğuzhan Karakaşb, and Xi Lic analysed an extensive database of corporate social responsibility engagements with US public companies over 1999–2009 addressing environmental, social, and governance concerns. Engagements are followed by a one-year abnormal return that averages +1.8%, comprising +4.4% for successful and zero for unsuccessful engagements.

Past performance is not a reliable indicator of future results.

Building momentum

The upsurge in interest from asset owners meant that companies had to pay attention. Institutional investors were now working collaboratively to move the needle at companies and the momentum was building to a point where ESG engagement was poised to enter the mainstream.

Nowhere was this clearer than in environmental risk, where the increasingly dire warnings from scientists about climate change had become impossible to ignore. The Paris Agreement of 2015 served notice that companies could not continue with "business as usual" – this was unsustainable.

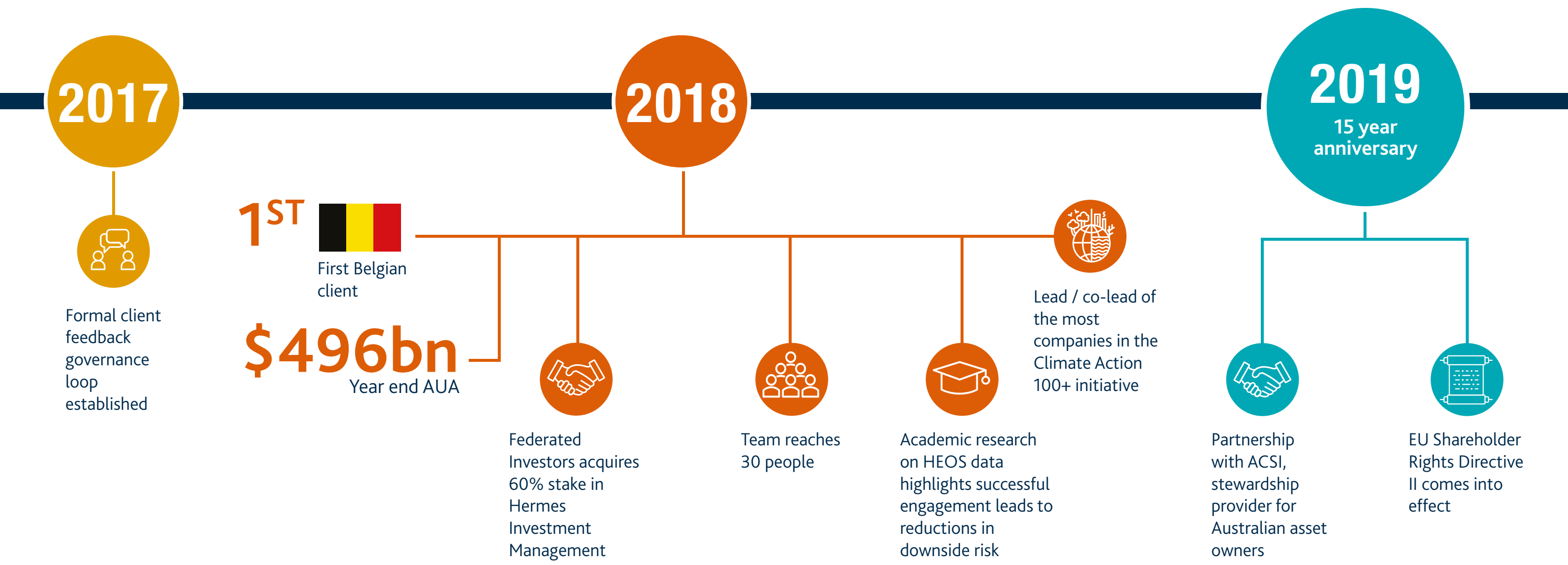
Early successes included the Aiming for A coalition, which Hermes EOS joined in 2015. Through engagement, we helped to co-ordinate shareholder resolutions calling for more transparency over climate change risks and opportunities at the 2016 AGMs of miners Anglo American, Glencore and Rio Tinto. These resolutions, which were developed through collaborative engagement, were supported by the companies' boards and passed by a majority of investors, creating new momentum for action on climate change in the mining industry.

$8TN
of assets backed the Anglo American resolution

95%+
of the votes in favour

For example, investors responsible for more than $8 trillion backed the Anglo American resolution, including four out of 10 of the world's largest pension funds, with over 95% of the votes in favour.[7] The company went on to set science-based targets to reduce its own emissions, with a goal to establish carbon neutral mining over the long term.

[7] https://blueandgreentomorrow.com/environment/overwhelming-support-mining-climate-resolutions/
[8] https://insideclimatenews.org/news/31052017/exxon-shareholder-climate-change-disclosure-resolution-approved



Building momentum

2015
The Paris Agreement reached

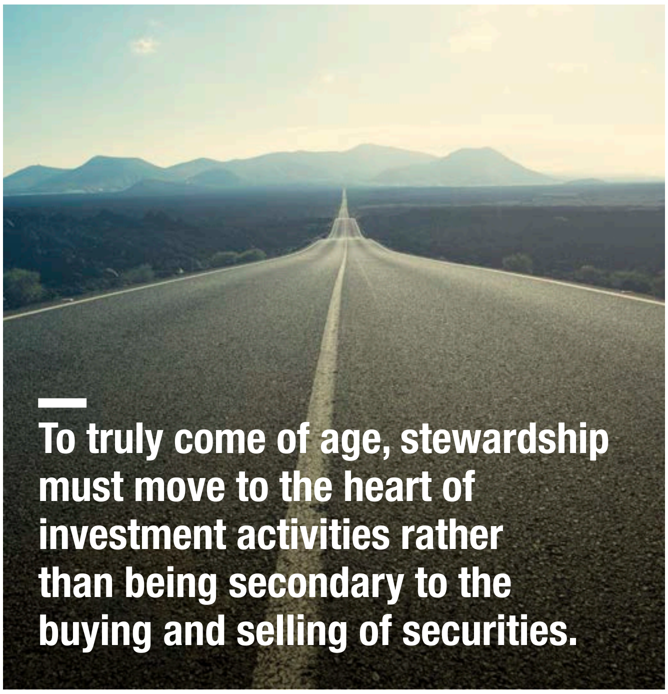
$33TN+
in assets backing the Climate Action 100+ initiative

There was another important milestone in 2017 when ExxonMobil shareholders voted 62% in favour of a resolution that we co-filed, requesting that the oil giant report on the impacts of climate change to its business, despite stiff opposition from management.[8] This followed a similar shareholder proposal at Chevron in 2016, where we were the lead co-filer, which received 41% support.

Climate Action 100+, an even bigger investor-led initiative focusing on the systemically most important greenhouse gas emitters, is another example of how stewardship has evolved. With over US$33 trillion in assets backing the initiative, companies are now engaging with investors about the long-term risks to their businesses posed by climate change, and the need to act, as well as improve their governance and disclosure.

Hermes EOS is leading or co-leading on 27 of the 160 companies in the initiative, garnering 99% support for a shareholder resolution at BP's 2019 AGM, which asked the oil giant to set out how its strategy is consistent with the goals of the Paris Agreement.

On the governance agenda, change was also taking place in the US, frequently led by the use of shareholder resolutions. This has resulted in improvements to 'proxy access', which in the US means shareholders can now put their own nominees forward for a director's position on the board's slate, avoiding costly and divisive proxy contests.



To truly come of age, stewardship must move to the heart of investment activities rather than being secondary to the buying and selling of securities.

Greater transparency

Greater focus and awareness at the asset owner and beneficiary level prompted a push for more transparency around engagements.

At EOS, that led to the development of a detailed engagement plan, with companies and themes chosen in a systematic way. To formulate the plan, we consult stewardship clients about their priorities and the most material issues on which we need to engage companies. The plan helps us stay on track and ensures our efforts are focused where they can have the most impact.

We disclose the results of our activities through our company case studies and other reporting, and advocate for the adoption of best practice and improved standards through our public policy work. Although engagement mainly takes place behind closed doors in order to preserve trust and ensure a frank dialogue with companies, we have helped shift expectations on disclosure.

In lockstep, we have seen an increase in the size and importance of ESG and responsible investing teams at our clients and across the industry. Stewardship now has many champions ready to fight its corner, with PRI signatories mustering almost $90 trillion in assets under management.

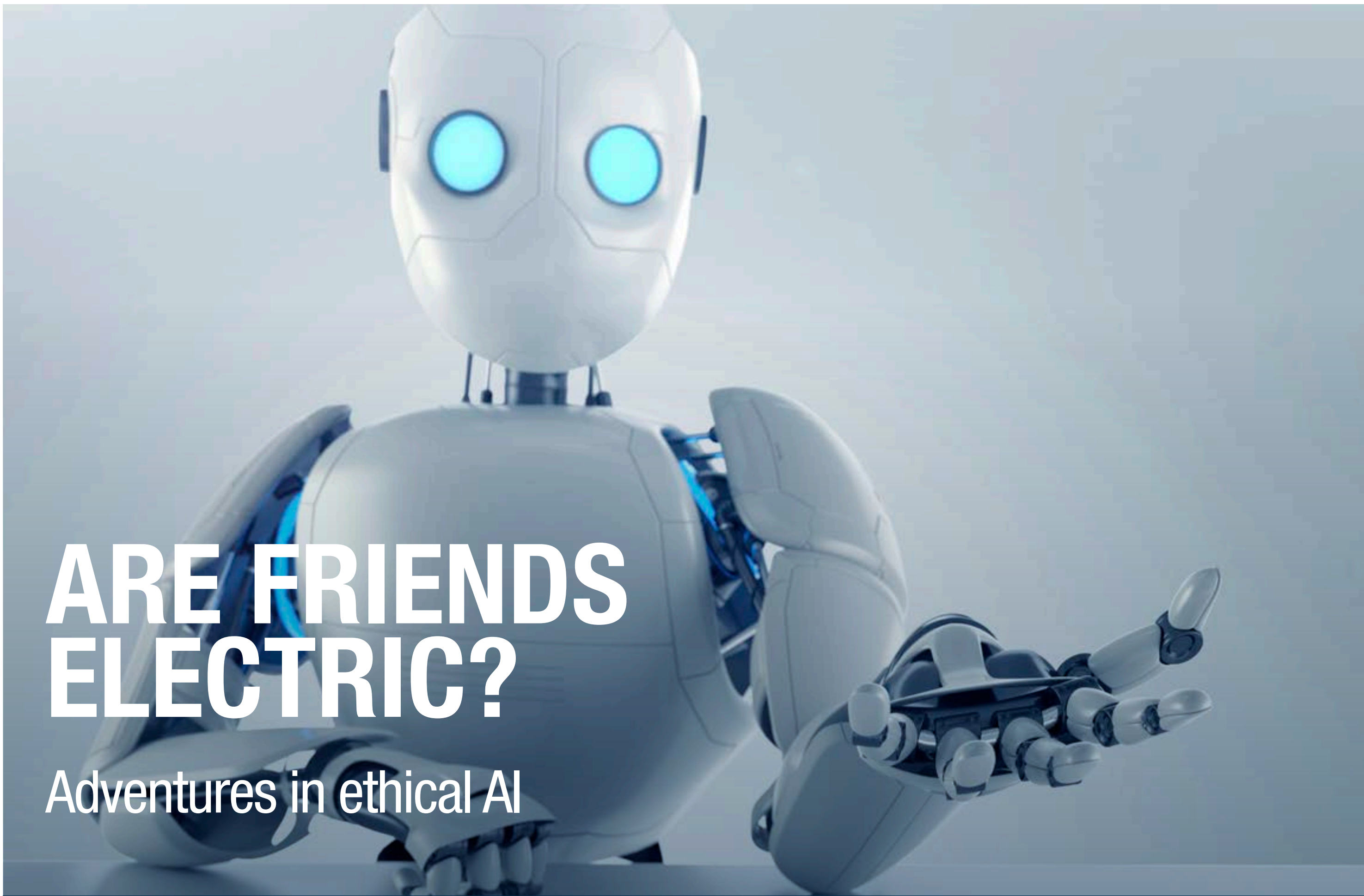
In the US, we have seen a greater willingness from companies to engage, partly driven by demand from investors and partly by a recognition that good corporate governance is the bedrock of more sustainable growth. And in Europe, the resources devoted to active ownership are only expected to increase with the implementation of the EU's updated Shareholder Rights Directive. The UN's Sustainable Development Goals (SDGs) and the recommendations of the Task Force for Climate-Related Financial Disclosures (TCFD), which apply to both investors and companies, provide an additional impetus to investors to engage on a wider range of societal and environmental challenges.

The road ahead

The dangers of ignoring poor corporate governance will always serve as a stark warning, but investors are increasingly focused on the climate crisis, with the toughest battles still ahead.

Short-termism remains a bugbear of markets, with some asset managers paying lip service to stewardship but reluctant to challenge companies effectively.

To truly come of age, stewardship must move to the heart of investment activities rather than being secondary to the buying and selling of securities. This will mean significant resourcing, and a shift in focus from policies and processes towards outcomes. Investors will want to see where stewardship is having the greatest impact, and who is really able to deliver results.



ARE FRIENDS ELECTRIC?

Adventures in ethical AI

Repeated failures by social media companies to regulate themselves have forced lawmakers to take a closer look at the algorithms underpinning our daily lives. So what does responsible artificial intelligence and data governance look like? And what should investors be asking for? By Claire Milhench.

Setting the scene

Artificial intelligence (AI) has the potential to be hugely disruptive for businesses and the economy, with both benefits and costs to society. AI already underpins many everyday transactions and interactions, from online shopping and following of current affairs, to navigating by using our smartphones. Such services may appear free to use, but concerns around loss of privacy, consumer manipulation and even the undermining of the democratic process, have grown. A failure by social media companies to manage these risks adequately has triggered big fines for some and is prompting regulators to look at the sector closely, with a view to imposing tighter controls.

For further information, please contact:

Christine Chow

christine.chow@hermes-investment.com

From the homicidal HAL 9000 in *2001: A Space Odyssey* to the world-ending Skynet in *The Terminator* movie franchise, we are all familiar with the nightmarish tropes of machine consciousness in science fiction. But the everyday reality of artificial intelligence is more insidious – AI is already here, operating under the radar, silently harvesting our data, often without our knowledge.

While AI has the potential to be a force for good, it can also be used in ways detrimental to society. AI can erode privacy by breaching consent laws and entrench inequality by reinforcing selection biases. There are also instances of over-reliance on AI to solve problems that require greater human intervention and oversight, such as monitoring the spread of harmful materials online.

For example, in March 2019, social media companies failed to prevent the livestreaming and reposting of the New Zealand mosque shootings in which 51 people died, because algorithms were not sophisticated enough to distinguish between real and fake violence.[1]

The ethical questions posed by embedding AI into all walks of life mean that regulators, consumers and investors need to become more sophisticated to identify the unintended consequences of its use. This is an issue that matters both from an investment perspective – because regulators may fine or break up companies that fail to police themselves – and from a societal perspective, because of the grave, long-lasting harms that can be done.

We are engaging with Facebook on a number of material governance and business model issues in light of the furore around how its platform works.

Concerns include a lack of control over the posting of content that is intended to mislead or is illegal, and the loss of privacy. We also have concerns that its business model continues to threaten its social licence to operate. In May 2019, Facebook signed up to the Christchurch Call to Action to tackle the spread of terrorist content online and introduced a "one-strike" policy for those who violate new livestreaming rules[5].

We have pushed for the company to be clearer on its strategy to extricate itself from the reputational, legal and regulatory issues it faces. There has been more investment in content governance but there is no clear coherent plan with objectives and milestones so that stakeholders can judge progress.

As a result of our concerns about the board and its response to the crisis at the company we recommended a vote against the lead director and the chair of the audit and risk committee. We also opposed this year's say-on-pay vote as a result of insufficient share ownership requirements and lack of a clawback policy. Finally we backed shareholder proposals concerning: abolishing the dual class structure; an independent chair; the election of directors by majority voting; gender pay gap reporting; and for a report concerning the content governance crisis, which would help to resolve in part our concerns about the company's response.

Tim Goodman

Chief concerns

Reflecting growing investor concerns, internet platforms attracted the most environmental and social shareholder proposals in two of the past three years in the US, according to a Goldman Sachs report.[2] These concerns cover a number of areas:

1 Data consent and loss of privacy

Data may be harvested online from individuals who have not given their express consent and then sold on to third parties. The most high-profile example of this is political consultancy Cambridge Analytica, which in 2018 was revealed to have harvested personal data from millions of people's Facebook profiles.[3] This data was then used to target voters. The backlash had significant financial and reputational consequences for the company. Italian authorities fined Facebook €10 million for misleading users over its data practices. Facebook's share price also suffered its biggest ever one-day drop in July 2018, wiping some $119 billion off its market value, after it revealed three million users in Europe had abandoned it in the wake of the scandal and the regulatory response.[4] Cambridge Analytica filed for insolvency and has ceased operations.

Investors are also concerned about the use of AI-powered facial recognition software by governments to target segments of a population.

The EU's General Data Protection Regulation (GDPR), which came into effect in May 2018, has significantly enhanced public awareness of data privacy as a human right. However, companies may not understand the extent to which it is applied. For example, many devices and applications still fail to provide users with simple, clear opt-outs, burying them in hidden sub-menus or warning that the application will not work without the user clicking "I Agree". This results in devices that may routinely eavesdrop on conversations without the user's express consent, ostensibly to "improve" the user experience, while location trackers monitor the user's every move.

Investors are also concerned about the use of AI-powered facial recognition software by governments to target segments of a population. For example, the US Congress highlighted the use of Hikvision's facial recognition software by the Chinese government (see case study), which has reportedly interned hundreds of thousands of the Uyghur ethnic minority population in massive "re-education" camps.[6,7,8] In May 2019, San Francisco became the first US city to ban the use of facial recognition software.[9]

[1] https://www.bbc.co.uk/news/technology-48276802
[2] https://research.gs.com/content/research/en/reports/2019/06/13/4d1dd803-400c-4abe-a2b6-bd9473026ca4.html
[3] https://www.theguardian.com/news/2018/mar/17/cambridge-analytica-facebook-influence-us-election
[4] https://www.theguardian.com/technology/2018/jul/26/facebook-market-cap-falls-109bn-dollars-after-growth-shock
[5] https://www.bbc.co.uk/news/technology-48276802
[6] https://www.wired.com/story/inside-chinas-massive-surveillance-operation/
[7] https://www.bbc.co.uk/news/resources/idt-sh/China_hidden_camps
[8] https://www.theguardian.com/world/2019/jan/11/if-you-enter-a-camp-you-never-come-out-inside-chinas-war-on-islam
[9] https://www.bbc.co.uk/news/technology-48276660

2 Loss of autonomy and consumer manipulation

Human autonomy or free will is in danger of being eroded as sophisticated AI algorithms are used to sell more consumer goods or drive repeat activity on social media so that tech firms – and the third parties who pay them – can gather more data. Users, who may include children or other vulnerable individuals, can find themselves spending more and more time on their devices, as the software has been designed to engender addictive behaviour, under the guise of “customisation”.

A bipartisan bill – the DETOUR Act – has been introduced in the US Congress to try to tackle the loss of privacy and autonomy. If passed, the legislation would ban large online platforms from using the deceptive interfaces known as dark patterns, which trick consumers into handing over their personal data. These manipulative interfaces undermine consumer choice by obscuring alternative choices or pushing users to “agree” as the default option. The bill is also designed to prevent tech firms from driving compulsive usage among children under 13.[10]

3 Discrimination

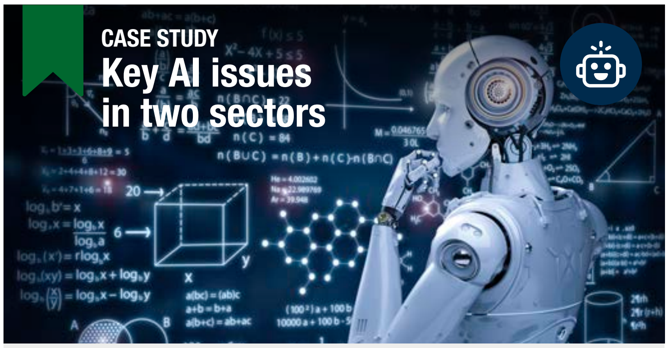
This may occur when companies are making new hires if AI is used to make first round selections and weed out candidates. If there is a bias on the part of the programmer of the algorithm or in the data that is used, then the algorithm itself will be biased, and the initial bias is effectively amplified as any candidate that does not fit a particular template is discarded. For example, Amazon had to scrap an AI recruiting tool that discriminated against women when hiring for software developer jobs and other technical positions.[11]

The Algorithmic Accountability Act, a US Senate bill that would require larger companies to test their algorithms and fix anything inaccurate, unfair, biased or discriminatory, is an attempt to address this.[12] The fear is that this discrimination is more insidious than traditional institutionalised sexism and racism, as it is harder to detect. It can also heighten social exclusion and inequality via misuse in the financial services industry, for example, through customer profiling and credit scoring.

Meanwhile, in the UK, an algorithm that seeks to predict who will reoffend is being trialled by police forces, despite warnings about potential bias.[13]

4 Job losses and loss of social harmony

Increasingly sophisticated AI software could lead to job losses across many fields, with a 2018 OECD report identifying 14% of jobs across 32 countries as “highly vulnerable to automation”.[14] However, a July 2018 report from PWC suggested AI could create as many jobs as it displaces by boosting economic growth. The key issue is that it will be disruptive, requiring people to acquire new skills or relocate, so the winners will likely be those who are well-educated and mobile.[15]



CASE STUDY

Key AI issues in two sectors

Financial services

AI applications are widely used in financial services from the front to the back office, including in robo investment advisory services, customer targeting, algorithmic trading, risk management and operations.

However, there are challenges associated with big data credit-scoring tools, customer profiling and risk assessment in banking and insurance. There is a potential for biased and discriminatory scoring due to input bias, while opaque algorithms can result in a potential breach of the existing regulations relating to fair lending as some groups may be excluded from eligibility for loans.

Janet Wong

Healthcare

AI could revolutionise drug discovery and development as it is able to analyse massive datasets in far less time than that taken by human researchers.

However, AI might work less well where data is scarce, which could affect people with rare conditions, or under-represented groups in clinical trials and research data. Biases in datasets may adversely affect diagnostic outcomes and the effectiveness of treatments for certain patient groups.

We are also beginning to engage with medical device companies using AI. Whilst the US Food and Drug Administration has published an initial framework for AI medical device approval, challenges remain around how a device can be approved as safe for patient use when it is constantly evolving. This is because AI may alter the algorithm and function of the device to treat new and changing symptoms. We believe that as a first step to overcome this potential regulatory hurdle, medical device companies using AI should be able to demonstrate an ethical culture and robust approach and consideration for patient safety through the establishment of company AI principles.

Katie Frame

[10] https://www.fischer.senate.gov/public/index.cfm/2019/4/senators-introduce-bipartisan-legislation-to-ban-manipulative-dark-pattern
[11] https://www.reuters.com/article/us-amazon-com-jobs-automation-insight/amazon-scraps-secret-ai-recruiting-tool-that-showed-bias-against-women-idUSKCN1MK08G
[12] https://www.wyden.senate.gov/news/press-releases/wyden-booker-clarke-introduce-bill-requiring-companies-to-target-bias-in-corporate-algorithms-
[13] https://www.theguardian.com/uk-news/2019/apr/20/predictive-policing-tool-could-entrench-bias-ethics-committee-warns
[14] https://www.weforum.org/agenda/2018/08/here-s-how-vulnerable-to-automation-your-job-is/
[15] https://www.pwc.co.uk/press-room/press-releases/AI-will-create-as-many-jobs-as-it-displaces-by-boosting-economic-growth.html

Ways investors can address this

In April, Hermes EOS, together with law firm BCLP, published a white paper on 'Responsible Artificial Intelligence and Data Governance',[17] to provide a framework for corporate engagement. This sets out six principles, which can be used to open a dialogue with companies.

Investors can begin by asking basic questions such as: does a company know where AI is used within its organisation? Does it have a set of internal guidelines for the responsible use of AI? Is the company likely to be exposed to legal liabilities and financial penalties due to AI applications? Will the negative impact of AI applications cause reputational damage and harm the social licence to operate?

Highlighting the growing importance of this topic, in May 2019 the OECD adopted its Principles on Artificial Intelligence, the first international standards agreed by governments for the responsible stewardship of trustworthy AI[18]. Also, the UK's Institute of Business Ethics published a board briefing in June, Corporate Ethics in a Digital Age, encouraging boards to put the issue on their agendas[19]. At Hermes EOS, we have identified AI, automation and data risk management as an emerging stewardship theme, subject to a higher level of engagement intensity this year. This means focusing on AI applications in other sectors besides technology, especially financial services, where we have already set some objectives, and healthcare.

CASE STUDY
Hikvision

Hikvision's surveillance cameras and facial recognition software have been at the centre of a debate about human rights abuses after a US Congressional hearing on Chinese mass detentions named the company. Hikvision's position is that it is a politically neutral product provider. However, some US asset managers have excluded Hikvision from their portfolios.[16]

We are engaging with the company to encourage the application of global standards such as the UN Guiding Principles for Business and Human Rights, and the development of a global human rights policy for the use of its AI technology. In December 2018, the company created a new compliance department to address compliance-related issues including human rights violation allegations, data protection, fair competition, and bribery and corruption. We are in discussion on the company's responsible use of data for AI training and testing purposes.

Our responsible AI and data governance principles

- Trust
- Integrity
- Transparency
- Accountability
- Action
- Safety

Building on our experience of engaging on these issues, we have created a further framework, based on identifying material legal and financial risks, and social impacts.

A risk factor assessment
Material legal and financial outcomes

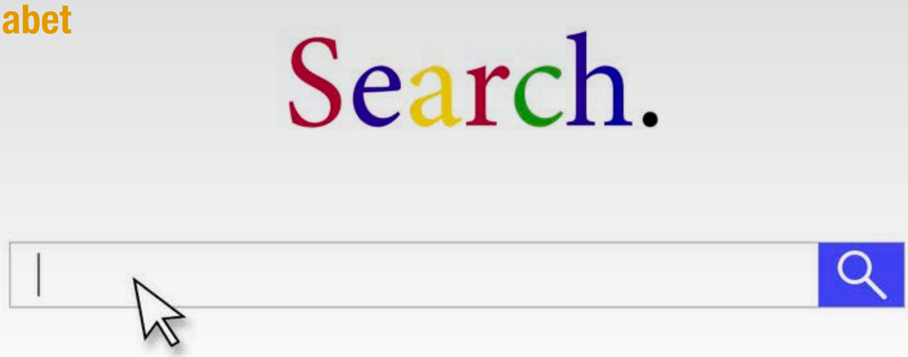
- Regulatory
- Counterparty
- Cybersecurity
- Exploitation
- Operational

A process-driven approach
Salient social impacts

- Input bias
- Process bias
- Outcomes bias
- Explainability
- Oversight

[16] https://www.ft.com/content/36b4cb42-50f3-11e9-b401-8d9ef1626294
[17] https://www.hermes-investment.com/ukw/eos-insight/eos/investors-expectations-on-responsible-artificial-intelligence-and-data-governance/
[18] https://www.oecd.org/going-digital/ai/principles/
[19] https://www.ibe.org.uk/userassets/pubsummaries/ibe_board_briefing_corporate_ethics_in_a_digital_age_summary.pdf

CASE STUDY
Alphabet



Through its powerful search engine Google, Alphabet can revolutionise the responsible development and use of AI and set industry standards. It has already taken a number of steps to this end, including publishing a set of principles[20] and a white paper.[21] However, when expert opinions and human judgement are introduced into AI's non-linear systems,[22] unconscious bias is not necessarily resolved and may even increase, without careful monitoring and oversight.

At the company's June 2019 shareholder meeting we spoke in support of a shareholder proposal regarding the establishment of an independent societal risk oversight board committee. This committee would assess the potential societal consequences of the company's products and services and offer guidance on strategic decisions. We argued there was a gap in board skills to provide the required societal risk oversight.

We also asked Alphabet to improve its internal governance structure overseeing AI technologies to harness employee and stakeholder ethical insights, and to regularly monitor and report on the human rights impact for content reviewers and provide sufficient support.

51.3% of the votes are held by the co-founders of Google

Disappointingly, Alphabet's CEO Larry Page and its president Sergey Brin did not attend the meeting, even though as co-founders of Google they hold 51.3% of the votes. With Alphabet opposing the proposal, it did not pass. Other shareholder proposals focused on sexual harassment, diversity and antitrust issues also failed.[23,24] Yet more employees spoke up at the meeting, and one contractor employee shared his own personal experience of discrimination.

Despite the apparent setback, the experience will further unite institutional investors on collaborative engagement. It also deepens our conviction of supporting a single, one share, one vote system that aligns economic interest with voting power.

Since the meeting, the company has made immediate but piecemeal improvement, publishing a new blog describing how responsible AI is put into action. It has also introduced an extension module for its AI platform, which focuses on providing a library of tools and testing components to emphasise safety and other ethical aspects of AI. And for content reviewers, the CFO has committed to providing some benefits, but it is unclear how far this goes. The company employs many temporary workers and contractors who may not be covered under this commitment.

Governance of the company and its human capital management remain our key concerns. An employee who led a walkout in November 2018 has since resigned. We plan to work with other institutional investors and shareholders to push for direct dialogue with the board and stronger societal risk and AI ethics oversight.

[20] AI at Google: our principles, Sundar Pichai CEO, 7 June 2018
[21] https://ai.google/static/documents/perspectives-on-issues-in-ai-governance.pdf
[22] Defined as a system in which the change of output is not proportional to change of input
[23] https://www.theguardian.com/technology/2019/jun/19/google-alphabet-shareholder-meeting-protest-sexual-harassment
[24] https://www.theguardian.com/technology/2019/jun/19/google-alphabet-shareholder-meeting-protest-sexual-harassment

SPRINGING INTO ACTION

Reflections on the 2019 voting season

The 2019 voting season was dominated by concerns about gender diversity, board composition and climate change, with executive remuneration continuing to drive dissent in the US, UK and France. By Amy Wilson.

Setting the scene

In the first half of 2019 we recommended voting at almost 8,000 meetings, covering some 89,400 resolutions. We made at least one voting recommendation against management at 64% of meetings, up from 55% in the first half of 2018, with particular increases in the United States, Taiwan and Japan. In addition to our dialogue with board directors and executives over the season, we attended nine shareholder meetings to raise concerns and put questions to the board, including at Google owner Alphabet and German car manufacturer Daimler.

There were some significant shareholder resolutions, including on climate change at BP and opioids at pharmaceutical companies Mylan and Mallinckrodt, plus a raft of shareholder proposals at Alphabet. These covered everything from sexual harassment and diversity to the establishment of an independent board committee to provide oversight of societal risk, which we spoke in favour of. In cases such as BP, where collaborative engagement had laid the groundwork for the management's support, shareholders secured a win, but at Alphabet, where the co-founders retain majority voting power, it proved impossible to get resolutions over the line (see Alphabet case study, pg21).

For further information, please contact:

Amy Wilson
amy.wilson@hermes-investment.com

2019 voting:

8,000 meetings

89,400 resolutions

Climate change continues to increase in relevance at shareholder meetings. As part of our role in the Climate Action 100+ (CA100+) initiative, we spoke at the AGMs of Anglo American, Centrica, BP, Volkswagen and Daimler to challenge companies on their management of climate-related issues, their disclosure in line with the Task Force on Climate-related Financial Disclosures and their alignment with the Paris Agreement.

We led a group of eight institutional investors to speak at BP's AGM, proposing support for a resolution that called on the company to set out a strategy consistent with the goals of the Paris Agreement. We challenged the chair to commit to demonstrating in compelling terms that BP's strategy really is consistent with the Paris Agreement goals, even during a period of growth in oil and gas. The company promised to respond to this challenge in a report.

We are supporters of the Transition Pathway Initiative (TPI), a global, asset-owner led initiative that assesses companies' preparedness for the transition to a low carbon economy. This year, we introduced the guideline that we would consider recommending a vote against the chair of the board of a company with a management ranking of 0 or 1 by the TPI, unless the company has provided a credible plan to address the climate risks and opportunities of the low carbon transition.

We wrote to 63 companies to advise them of this guideline and to request further engagement ahead of the AGM. We also met with over 10 companies including Ferrari, CEZ, Suzuki and Concho Resources. Japanese motor vehicle manufacturer Suzuki agreed to make improvements to its reporting in response to our engagement.

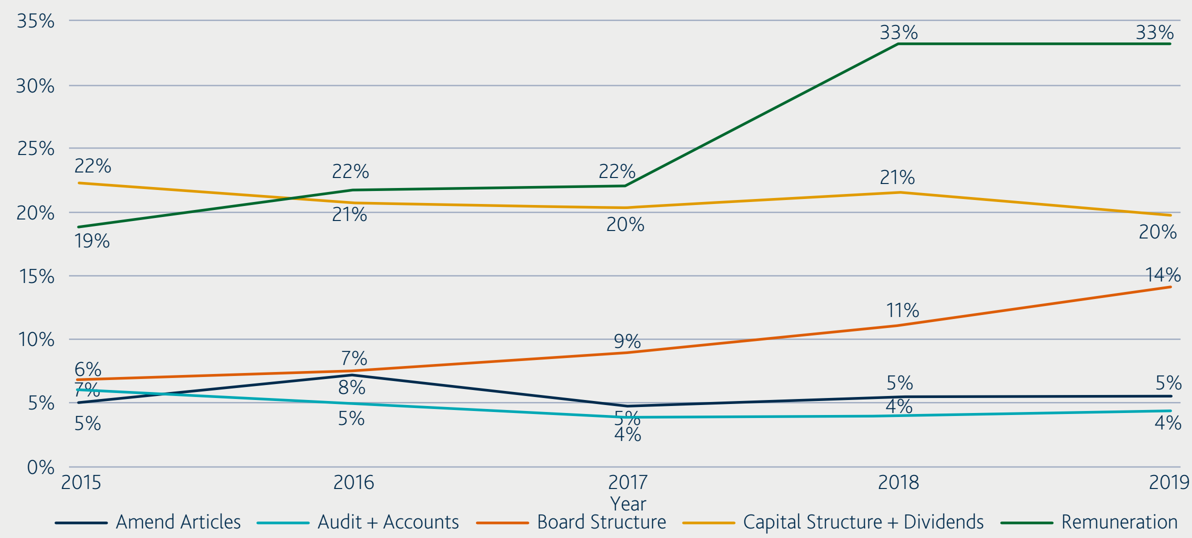
Bruce Duguid, head of stewardship, Hermes EOS, outside the BP AGM.

We voted against the chair of the nominations and governance committee at Vistra Energy and Steel Dynamics, which is our precedent in the US. In both these cases, we had broader concerns than just climate governance, but we cited this as a principle reason in our engagement outreach. We also voted against the chair of Shougang Resources.

In the US, a number of shareholder resolutions were filed focusing on the extent to which companies demonstrate resilience to climate change or provide evidence of strategic alignment to the goals of the Paris Agreement. This means limiting the rise in the global temperature to a maximum of well-below two-degrees Celsius, with an ambition of limiting warming to 1.5-degrees.

Over 20 of these resolutions were withdrawn after companies made voluntary commitments to satisfy the proposals. We recommended support for high profile resolutions at Chevron, Duke Energy and Amazon. However, we did not recommend support for the climate change proposals by campaign group Follow This at Equinor and BP, based on the progress of engagement under the CA100+ initiative and concerns over the extent to which it would limit strategic choices. The shareholder resolution at BP was the only institutional investor-led climate resolution in Europe, as others were withdrawn following commitments by companies, including at Royal Dutch Shell, Equinor and Glencore.

Proportion of resolution type with recommended votes against management, H1 2015–19



Source: Hermes EOS. Note: Top 5 voting categories only

Executive remuneration

Executive remuneration remained one of the most contentious issues across markets in H1 2019, with a 39% recommended vote against rate, up slightly from 38% in H1 2018.

In the US we recommended voting against 82% of 'say-on-pay' proposals, focusing on insufficient share ownership requirements; awards of stock options with short vesting periods; CEO pay that was disproportionately high compared with that of senior management and pay packages targeted above the median levels of peers; and disproportionate levels of perquisites.

Targeting CEO pay in the top quartile of peers is one of the ways we seek to address quantum, a critical issue in the US following many years of pay ratcheting up. For example, we opposed pay proposals at Best Buy, Target and Walmart where CEO pay was in the top quartile of peers. Walmart also had an insufficiently strong anti-pledging policy, although we secured assurances from the company that this would be reviewed and improved before the next annual meeting.

Remuneration:

39%
recommended vote against rate

75%
of FTSE 350 companies will be putting their next 3-year remuneration policy to the vote in 2020

In the UK, approximately 75% of FTSE 350 companies will be putting their next three-year remuneration policy to a vote in 2020. As such, most votes in 2019 were on the remuneration report against the current in-flight policy approved in prior years. We opposed 30% of remuneration reports based on concerns such as the use of metrics not aligned to long-term value, pay outcomes not aligned to performance, and excessive quantum.

For example, we opposed the report at oil producer Royal Dutch Shell, where the policy – which we did not support due to the excessive variable pay opportunity – paid out at near maximum. This resulted in an approximately £20m pay out to the CEO. Likewise at housebuilder Persimmon, although we welcomed a number of positive steps taken by the board to address pay and related issues on company culture and customer service, we remained unsupportive of the remuneration report. This included an award of £38m for the CEO from the final tranche of a defective underlying scheme.

We also opposed the remuneration report at Lloyds Banking Group due to concerns that intended pension reductions were offset in other areas. Meanwhile, after our engagement with HSBC, the bank reduced the executive pension contribution rate from 30% to 10%, setting an important precedent for the industry.

In France investors have had a binding vote on remuneration policies since 2016, and a binding vote on the remuneration report containing the variable pay award for the previous year since 2018. In 2019, shareholders of CGG, a geoscience company serving the oil and gas industry, opposed the remuneration report for the former CEO and the remuneration policy for the new CEO for the first time since the vote was introduced in 2016.

In Asian markets, executive pay tends to be lower but less transparent than in Europe and the US. However, we continued our engagement with companies to encourage them to link incentive plans to performance criteria including sustainability metrics such as c limate-related targets. Some companies say they are considering these.

In Hong Kong, shareholders only occasionally get to vote on long-term pay plans at annual meetings. At this year's Samsonite AGM, we opposed the proposed share award scheme, due to concerns about the dilution rate and the structure of the scheme.

In Asian markets, executive pay tends to be lower but less transparent than in Europe and the US.

In Japan, although companies are not required to seek shareholder approval on executive pay annually, it is required when changing the ceiling of the aggregate amount or introducing an incentive scheme. Some companies voluntarily seek a vote on the payment of a cash bonus. At the annual meeting for Takeda Pharmaceuticals, we recommended voting against the payment of the cash bonus as we were not convinced that the substantial increase this year could be justified. We also supported the shareholder proposal to add a clawback clause. This is not yet common in Japan but we believe it is important for Takeda, which pays its executive team comparable amounts to those of Western market peers.

Board composition and diversity

Board composition is critical to the good management of companies, and one of the most important shareholder powers is the ability to elect board directors.

Ensuring a diverse board is vital to good decision-making, so we stepped up our expectations on gender diversity this year. In the UK, we tightened our policy for board-level gender diversity with a guideline of 30% women for FTSE 100 boards and 25% for FTSE 250 boards. We also introduced a policy on below-board diversity, with the guideline that we would consider recommending a vote against the chair of FTSE 100 companies with no women on their executive committee.

Composition recommendations:

30% women for FTSE 100 boards

25% of FTSE 250 boards

In support of this, we wrote to 13 FTSE 100 companies to express concerns about gender diversity on the executive committee, and the board where relevant, or to clarify current levels where it was unclear from the company's disclosures. We had follow-up engagements with a number of companies, reassured by some of the actions underway.

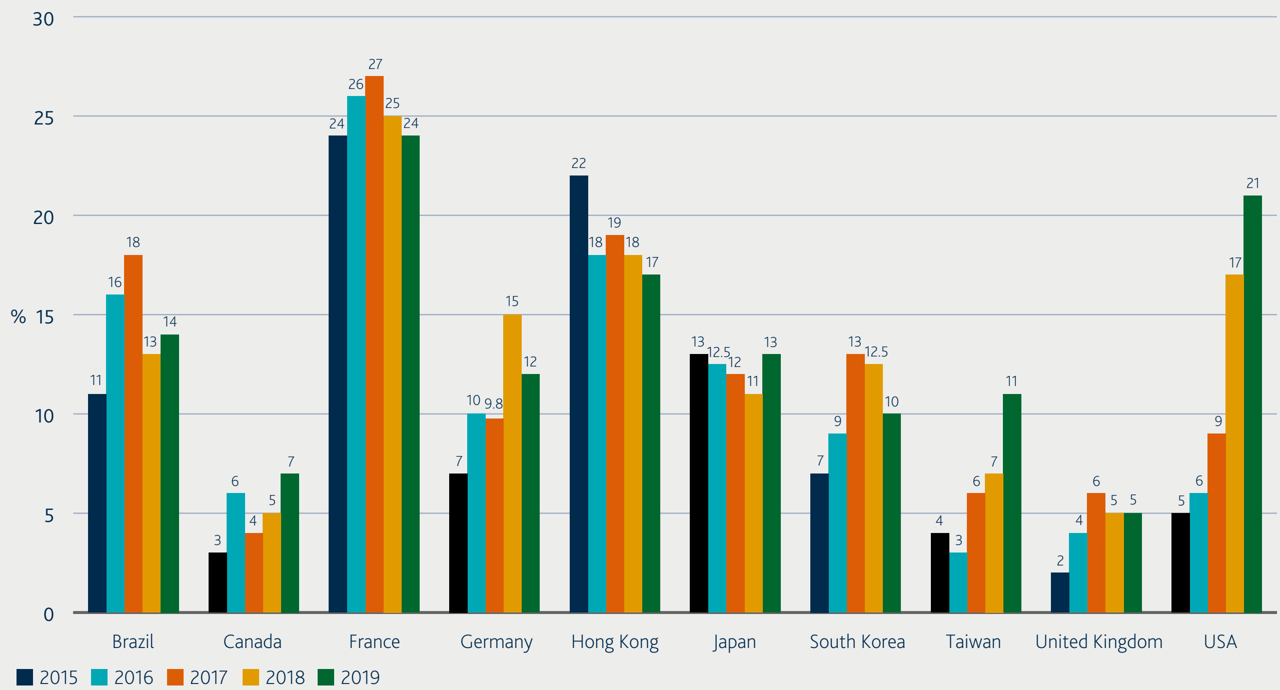
In Germany, we released our new German Corporate Governance Principles, which set out our expectations for 2020 and beyond, including that companies achieve 30% female representation on executive boards.

We opposed the election of the chair where we judged current progress and the companies' plans to rectify the situation to be insufficient, such as Fresnillo, Spirax-SarcoEngineering, Glencore, Prudential and Just Group.

In the US, we continued to push our expectations on board diversity across a number of dimensions, recommending opposition to 869 proposals up to H1 2019, compared with 615 proposals during the entire year in 2018.

Board gender diversity continues to be a challenge in Asian markets including South Korea and Japan. Very few Korean companies have female directors, although the number of Japanese companies with female directors has increased in the last year or two. The percentage of women is still low, however, with most of these companies having only one female director. We welcomed the appointment of two new female directors at Sony this year, bringing the total to four, or 30% of the board.

Percentage of proposals voted against management per key market



Source: Hermes EOS


Engager Roland Bosch, speaking at the Daimler AGM.

In Germany:

Only 8%
of companies have more than one woman on the executive board

2/3RDS
of companies still have no female board members

In Germany, we released our new German Corporate Governance Principles, which set out our expectations for 2020 and beyond, including that companies achieve 30% female representation on executive boards. Currently, only 8% of German companies have more than one woman on the executive board. Two-thirds still have no female board members.

We raised the issue of diversity at German car manufacturer Daimler's AGM, along with concerns about audit tenure that led us to oppose the ratification of the auditors. In our speech we expressed our support of the new corporate structure and the recent changes to the management board. However, we see the role of CEO as very different to that of chair and believe the outgoing CEO's potential move upwards to the supervisory board should not be an automatic one.

At Dutch financial services group ING we opposed the discharge of directors – in effect a vote against management performance over the previous year – along with 63% of shareholders. This followed collective engagement with the board, and concerns that the executive and supervisory board had failed in their duties to safeguard the bank's reputation and ensure full compliance with legal and regulatory frameworks.

Shareholder resolutions

We recommended votes on almost 2,000 shareholder resolutions in H1 2019. Some 415 of these were in the US, where we supported 279, or 67%.

Resolutions calling for lobbying and political transparency were a key theme. In general we recommended support for these, including at Ford, General Motors, Duke Energy, UPS, Altria, Illumina, Honeywell and AT&T. We saw emerging voluntary good practices from Royal Dutch Shell, which produced a report on its membership of trade associations and an assessment of where their views on climate change contradicted Shell's stated support of the Paris Agreement.

As part of our participation in the Investors for Opioid Accountability initiative, we spoke at the AGM of Mallinckrodt, an Ireland-based company that manufactures generic opioids and generates 90% of its sales in the US. We presented two resolutions requesting a board-level report on governance measures related to opioids and a report disclosing lobbying activities. Both of these passed. We also co-presented a shareholder proposal at pharma company Mylan's AGM on clawback policies, which received majority support.

In the UK, at Barclays, we reviewed and ultimately did not support a proposal from an activist investor. While we agreed that shareholder returns and the performance of the investment bank had been disappointing, we questioned the diagnosis and strategy proposed by the activist and the suitability of the board nominee. We will continue our individual and collective engagement with the bank to ensure the execution of a focused and forward-looking corporate strategy, which will be constructively challenged by a refreshed board.

Finally, in Japan we supported the shareholder proposals at housing materials manufacturer Lixil Group filed by former CEO Kinya Seto, who was seeking to elect himself back to the board along with seven other candidates. All the shareholder proposals passed at the meeting and Seto was reappointed as CEO, a sign of growing shareholder activism in Japan.

We saw emerging voluntary good practices from Royal Dutch Shell, which produced a report on its membership of trade associations and an assessment of where their views on climate change contradicted Shell's stated support of the Paris Agreement.

ENGAGEMENT ON STRATEGY

Business strategy and structural governance issues are at the heart of many of our most successful engagements.

Overview

Our approach to engagement is holistic and wide-ranging. Discussions range across many key areas, including business strategy and risk management, which covers environmental, social and ethical risks. Structural governance issues are a priority too. We challenge and support management on the running of the company and management's approach to ensuring the company's long-term future. 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 environmental, social and governance issues as risks to the company's strategic positioning puts things solidly into context for management. The issues may also present opportunities. For instance, businesses may benefit from fresh thinking at board level. Similarly, a change of chief executive can be the catalyst for enhanced business performance and the creation of long-term value for shareholders.

Examples of recent engagements

Board strength and remuneration

Lead engager: Andy Jones

We provided detailed input to a board-commissioned review of investor sentiment on board strength, remuneration, and environmental and social management and reporting at this European utility. We praised the diversity of the board and its evolution towards clean energy expertise. We suggested that more political and regulatory experience, in particular in the US, would be beneficial. We also welcomed the company's recent changes to its remuneration policy, including pension alignment to the wider workforce and greater shareholding requirements. We encouraged the company to put its role in tackling the fundamental societal questions relevant to its business – low carbon electricity, heat and transport transition, affordable and reliable energy - at the heart of its purpose, vision and communications.

Board skills and AMR

Lead engager: Emma Berntman

This global pharmaceutical company is reviewing its board skills evaluation process and is on track to provide disclosure in its next annual report. We have pressed for this over several years. We commended the addition to the board of an international female director with strong financial skills. The company has achieved its 2016 diversity target of three female shareholder-elected directors ahead of the 2020 deadline. It acknowledged that there is a need to improve diversity beyond board level and is exploring how it can accelerate this, particularly at senior management levels, although disappointingly it does not plan to set targets. The company provided insights on its diversity programme and unconscious bias training for senior management and we suggested that it considers appropriate metrics to measure the outputs of these initiatives, which the company welcomed. Finally, we encouraged the company to perform an antimicrobial resistance risk scenario analysis to determine business resilience as antibiotics lose their efficacy. The company promised to revert to us in writing.

Remuneration and diversity

Lead engager: Katie Frame

We recommended a vote against the say-on-pay proposals at this US media services provider. We have serious concerns about the current pay structure due to the very high quantum, which is often not linked to performance or share ownership. Additionally, whilst we noted that the company seems to be doing the right thing in relation to allegations of sexual harassment and other inappropriate behaviour, we expect greater disclosure, with targets to demonstrate that the company is committed to a diverse and inclusive workplace and culture.

Sustainability reporting

Lead engager: Christine Chow

We provided feedback on this Asian insurer's ESG report. This clarified its commitment to TCFD and the associated three-year strategy, especially its infrastructure debt strategy, and its approach to financial inclusion. The company commended us on our leadership on climate change and said that our corporate and public policy engagements had helped its dialogue with companies. We brainstormed on its current plan to address the impact of pollution on health. We recommended looking into opportunities to address indoor pollution. At its request, we further explained our corporate governance principles and how we have engaged with companies on board gender diversity.

CASE STUDY

Over a decade of engagement with Siemens and WPP

As we celebrate our 15-year anniversary, we also reflect on over a decade of engagement with UK advertising and public relations company WPP and German industrial conglomerate Siemens. Demonstrating that positive change can take a number of years, our latest case studies are now available in full on the website. Below, we spotlight a recent two-part blog on the challenges of engaging in Asia.

WPP

Lead engagers: Emma Berntman and Pauline Lecoursonnois

We have been engaging with WPP since 2009 on topics such as board effectiveness, remuneration, business structure and succession planning. Since 2010, we have sought changes to the remuneration policy, pushing for more reasonable levels of pay, and a greater alignment with business performance and the delivery of strategic objectives. Given the management challenge stemming from the complex structure of the business, we asked the board to demonstrate contingency and succession plans for the CEO role. In 2012, we began requesting that much of this work be done under a new chair, as the incumbent chair appeared unable to appropriately balance the influence of the CEO. We also pressed for a refreshment of the board to ensure it had the skills and experience necessary to challenge management effectively.

The election of a new chair at the 2015 AGM was a vital step towards rebuilding shareholder confidence. Under his leadership, WPP implemented a revised remuneration policy and succession planning became a higher priority. The importance of this was underscored when the founder CEO departed unexpectedly in April 2018. We continue to engage with the company to reduce the complexity of its group structure and enable more effective board oversight, and to future-proof it against industry challenges.

Siemens

Lead engagers: Lisa Lange and Michael Viehs

Following a compliance crisis in 2006, which triggered the departure of the CEO and chair, we had an intensive dialogue with the company's incoming chair. We subsequently articulated our concerns about the composition of the supervisory board and the effectiveness of its work, as well as its remuneration. Encouraged by the company, we spoke at seven AGMs between 2007 and 2018. After an internal review and the recommendations of an independent investigation, the company introduced a series of changes to its compliance system. In addition, in 2008 the supervisory board was revamped and the company switched from variable pay to fixed pay only for non-executives.

Following our 2014 AGM intervention, the company carried out an externally facilitated board evaluation, overhauled a key committee and replaced two supervisory board members at the next AGM. Today, the board is much improved with three female directors, and expertise more relevant to the development of the business such as engineering, digitisation and software. We continue to engage with Siemens on climate change, aiming to ensure the company aligns its business model to the goals of the Paris Agreement, and successfully implements its Vision 2020+ strategy

Blog Spotlight

Overcoming engagement obstacles in Asia

The influence of family and state and the fact that stewardship is still in its early stages are just two of the challenges that engager Janet Wong highlights for investors attempting to engage with companies in Asia. Her two-part blog reflects on our experience in this region and explains our approach to ensure that engagements progress.

For example, working with regulators and policymakers can help improve protections for minority shareholders, while local associations may help promote a transition to a low carbon economy and encourage take up of the TCFD. Developing relationships with key stakeholders and sharing international best practice also help to build support and understanding of stewardship.

Read the case studies and blogs in full at
www.hermes-investment.com/ukw/stewardship/eos-insights

Companies engaged on strategic and/ or governance objectives and issues this quarter:

Global
146

Region	Companies
Developed Asia	28
North America	60
Emerging Markets	17
United Kingdom	18
Europe	23

PUBLIC POLICY AND BEST PRACTICE

Hermes EOS contributes to the development of policy and best practice on corporate governance, sustainability and shareholder rights to protect and enhance the value of the shareholdings of its clients 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. Hermes 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.

Highlights

Sustainable Stock Exchanges Advisory Group meeting

Lead engager: Christine Chow

At the Sustainable Stock Exchanges (SSE) Advisory Group meeting at the United Nations in Geneva, we contributed to the drafting of a working document on how to embed sustainability in stock exchange operations. The paper will go through two rounds of public consultation followed by a launch in September 2019 to celebrate the 10th anniversary of the SSE Initiative. We encouraged the exchanges to address conflicts of interests in governance, cyber and data security, and safeguarding shareholder interests to support good stewardship practices.

In addition to the Task Force on Climate-related Financial Disclosures (TCFD) recommendations, which are already included, we recommended referencing the United Nations Guiding Principles for Business and Human Rights, and the Sustainability Accounting Standards Board's reporting guidance for securities and commodities exchanges in the guidance document. This would form a good basis to report on strategy and ESG issues. To demonstrate board oversight and progress on sustainability, we encouraged the exchanges to disclose board-level sustainability priorities, metrics and progress in annual reporting, with disclosure to include peer learning activities that strengthen the interactions of SSE Initiative members. We acknowledged that non-listed or government-led exchanges may have a different set of priorities.

International Energy Agency meeting on scenario analysis

Lead engager: Nick Spooner

We met senior executives at the International Energy Agency (IEA) to discuss the energy scenarios produced by the organisation, and how these could be improved to serve a greater societal role. We had a robust discussion on the importance of a 1.5-degree scenario. The IEA is going through a period of transition to develop a closer working relationship with emerging economies. We recognised that there may be differences in terms of prioritisation. However, we highlighted how critical it was for a 1.5-degree scenario to be produced from an investment perspective, so that investors understand how to align their investments, and the scale of the changes that are required.

With the special report by the Intergovernmental Panel on Climate Change (IPCC) published in October 2018, the IEA is well aware of the urgency. We encouraged a more conservative attitude towards carbon capture, utilisation and storage, which has failed to meet expectations over the past few decades. We set markers to continue to develop this relationship and are well placed in the production cycle for the IEA's annual World Energy Outlook to influence the 2019 publication. We were assured that the 1.5-degree report was under consideration, although they could not commit to this.

Palm oil investor expectations statement

Lead engager: Hannah Shoesmith

As part of the PRI investor working group on palm oil we contributed to and signed an investor expectations statement on sustainable palm oil. This was released on 3 April by the PRI and is signed by 55 investment organisations with approximately US$7.9tn in assets under management. It expects companies across the palm oil value chain to: implement and publicly disclose a policy of 'no deforestation, no peat, no exploitation' as a minimum; commit to full traceability to plantation level; and map and disclose palm oil concession areas, for companies involved in the production of palm oil. It also strongly encourages companies to: make efficient investments to improve palm oil yield and productivity without expanding production to new concession areas; become members of the Roundtable on Sustainable Palm Oil; and apply its new principles and criteria. We will continue to engage with Kuala Lumpur Kepong, a palm oil producer, as well as two Indonesian banks, BRI and BMI on palm oil financing, and raise it as an issue with consumer, food and beverage companies.

Brazilian Institute of Corporate Governance call

Lead engager: Jaime Gornsztejn

In a call with the Brazilian Institute of Corporate Governance (IBGC), we gave our feedback on the comply-or-explain disclosures made by Brazilian companies and discussed possible actions to improve these. In 2018, Brazilian companies listed on the main stock exchange index had to submit a report on their compliance with Brazil's corporate governance code. The IBGC is preparing a report on the quality of the disclosure and asked for our feedback. We expressed our disappointment with the defensive approach generally used, which shows a lack of understanding about the comply-or-explain framework. We acknowledged, however, that in other markets there was a learning curve after the initial adoption of a soft law structure. We agreed to follow up after the publication of the IBGC report to discuss actions to improve disclosure quality.

Access to Medicine Foundation meeting

Lead engagers: Katie Frame and Kimberley Lewis

We met the Access to Medicine (ATM) Foundation to reiterate our concerns about the current ranking structure and methodology of the ATM Index, which favours some companies due to their existing product portfolio. The foundation acknowledged our concern and noted that other investors had expressed similar sentiments, but seemed reluctant to act, as multiple influential stakeholders are involved in the index. We agreed to continue to discuss these concerns by participating in the upcoming ATM methodology consultation process.

We noted our appreciation for the publication of the Antimicrobial Resistance Benchmark, which does not rank companies but provides useful information on company approaches to antimicrobial resistance. However, we explained that the benchmark should also consider the risk that antimicrobial resistance poses to different companies. The foundation acknowledged this point and said it could offer more investor briefings to share insights about the risk of antimicrobial resistance for pharmaceutical companies.

Responsible vehicle parts supply chains

Lead engager: Sachi Suzuki

We participated in an OECD meeting about responsible vehicle parts supply chains, with a focus on the OECD's work in Japan and Thailand. Most of the participants were from automotive manufacturers or related companies, and we were one of the few institutions representing investors. We commended the OECD on the great work it has been doing in this area and on other issues, including conflict minerals, but noted that some companies appear to only follow the OECD guidance and are unwilling to disclose further details. We asked the OECD to encourage companies to go beyond compliance with the basic due diligence programme, which was fully acknowledged.

Global Campaign to Stop Killer Robots

Lead engager: Bram Houtenbos

We introduced ourselves to the co-ordinator of the Global Campaign to Stop Killer Robots, a coalition of NGOs seeking a ban on fully autonomous weapons. We have identified fully autonomous weapons as an area of emerging concern, but it appears that ESG research providers do not yet screen companies on this basis. We requested a call with campaign representatives to establish what the campaign is doing to involve investors, and to determine what scope there is to integrate this topic into our engagement and screening services.

Traidcraft meeting on supply chain statements

Lead engager: Claire Gavini

We met policy officers from the NGO Traidcraft, which is seeking our support to develop a UK government-endorsed central repository for the Transparency in Supply Chain statements produced under the Modern Slavery Act. Every organisation carrying out business in the UK with a total annual turnover of £36m or more is required to produce these. The NGO would also like the government to produce a public list of which companies are operating in the UK market and pass the turnover threshold for issuing a statement, so that no companies can evade this requirement. We offered to seek feedback from the Institute of Chartered Secretaries and Administrators on the feasibility of these requests. We agreed to attend a meeting with the UK Home Office to present our investors' perspectives.

VOTING

Hermes EOS makes voting recommendations at general 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 6,367 meetings (76,363 resolutions). At 4,338 meetings we recommended opposing one or more resolutions. We recommended voting with management by exception at 87 meetings and abstaining at 19 meetings. We supported management on all resolutions at the remaining 1,923 meetings.

We made voting recommendations at **6,367** meetings (**76,363** resolutions) over the last quarter.

- Total meetings in favour **30.2%**
- Meetings against (or against AND abstain) **68.1%**
- Meetings abstained **0.3%**
- Meetings with management by exception **1.4%**

We made voting recommendations at **892** meetings (**21,751** resolutions) over the last quarter.

- Total meetings in favour **30.7%**
- Meetings against (or against AND abstain) **67.7%**
- Meetings abstained **0.4%**
- Meetings with management by exception **1.1%**

We made voting recommendations at **358** meetings (**5,851** resolutions) over the last quarter.

- Total meetings in favour **50.0%**
- Meetings against (or against AND abstain) **41.1%**
- Meetings abstained **1.4%**
- Meetings with management by exception **7.5%**

We made voting recommendations at **1,854** meetings (**21,751** resolutions) over the last quarter.

- Total meetings in favour **33.9%**
- Meetings against (or against AND abstain) **65.5%**
- Meetings abstained **0.3%**
- Meetings with management by exception **0.3%**

We made voting recommendations at **1,391** meetings (**15,223** resolutions) over the last quarter.

- Total meetings in favour **37.0%**
- Meetings against (or against AND abstain) **62.6%**
- Meetings with management by exception **0.4%**

We made voting recommendations at **1,825** meetings (**19,782** resolutions) over the last quarter.

- Total meetings in favour **16.8%**
- Meetings against (or against AND abstain) **80.9%**
- Meetings abstained **0.3%**
- Meetings with management by exception **2.1%**

We made voting recommendations at **47** meetings (**286** resolutions) over the last quarter.

- Total meetings in favour **44.7%**
- Meetings against (or against AND abstain) **55.3%**

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

We recommended voting against or abstaining on **12,935** resolutions over the last quarter.

- Board structure **50.7%**
- Remuneration **21.1%**
- Shareholder resolution **6.0%**
- Capital structure and dividends **11.2%**
- Amend Articles **2.6%**
- Audit and Accounts **4.8%**
- Investment/MandA **0.3%**
- Poison Pill/Anti-Takeover Device **0.3%**
- Other **3.0%**

We recommended voting against or abstaining on **2,301** resolutions over the last quarter.

- Board structure **33.6%**
- Remuneration **32.2%**
- Shareholder resolution **5.3%**
- Capital structure and dividends **17.4%**
- Amend Articles **1.7%**
- Audit and Accounts **5.4%**
- Poison Pill/Anti-Takeover Device **0.2%**
- Other **4.2%**

We recommended voting against or abstaining on **332** resolution over the last quarter.

- Board structure **40.4%**
- Remuneration **47.9%**
- Shareholder resolution **0.9%**
- Capital structure and dividends **5.1%**
- Amend Articles **1.8%**
- Audit and Accounts **2.4%**
- Poison Pill/Anti-Takeover Device **1.5%**

We recommended voting against or abstaining on **4,159** resolutions over the last quarter.

- Board structure **51.1%**
- Remuneration **8.3%**
- Shareholder resolution **2.6%**
- Capital structure and dividends **19.5%**
- Amend Articles **6.1%**
- Audit and Accounts **4.9%**
- Investment/MandA **0.9%**
- Other **6.6%**

We recommended voting against or abstaining on **2,171** resolutions over the last quarter.

- Board structure **68.1%**
- Remuneration **5.0%**
- Shareholder resolution **2.2%**
- Capital structure and dividends **9.5%**
- Amend Articles **1.4%**
- Audit and Accounts **12.6%**
- Poison Pill/Anti-Takeover Device **1.2%**

We recommended voting against or abstaining on **3,914** resolutions over the last quarter.

- Board structure **52.3%**
- Remuneration **34.0%**
- Shareholder resolution **12.3%**
- Capital structure and dividends **0.1%**
- Amend Articles **0.3%**
- Audit and Accounts **0.4%**
- Other **0.6%**

We recommended voting against or abstaining on **58** resolutions over the last quarter.

- Board structure **12.1%**
- Remuneration **74.1%**
- Shareholder resolution **6.9%**
- Capital structure and dividends **6.9%**

What is Hermes EOS?

Hermes EOS helps long-term institutional investors around the world to meet their fiduciary responsibilities and become active owners of public companies.

Our team of engagement and voting specialists monitors the investments of our clients in companies and intervenes where necessary with the aim of improving their performance and sustainability. Our activities are based on the premise that companies with informed and involved shareholders are more likely to achieve superior long-term performance than those without.

Pooling the resources of like-minded investors creates a strong and representative shareholder voice and makes our company engagements more effective. We currently have £501.1/€560/$637.7 billion* in assets under advice.

Hermes has one of the largest stewardship resources of any fund manager in the world. Our 32-person team includes industry executives, senior strategists, corporate governance and climate change experts, accountants, ex-fund managers, former bankers and lawyers.

The depth and breadth of this resource reflects our philosophy that stewardship activities require an integrated and skilled approach.

Intervention at senior management and board director level should be carried out by individuals with the right skills, experience and credibility. Making realistic and realisable demands of companies, informed by significant hands-on experience of business management and strategy-setting is critical to the success of our engagements.

We have extensive experience of implementing the Principles for Responsible Investment (PRI) and various stewardship codes. Our former CEO led the committee that drew up the original principles, and we are engaged in a variety of workstreams through the PRI Collaboration Platform. This insight enables us to help signatories in meeting the challenges of effective PRI implementation.

How does Hermes EOS work?

Our company, public policy and best practice engagement programmes aim to enhance and protect the value of the investments of our clients and safeguard their reputation.

We measure and monitor progress on all engagements, setting clear objectives and specific milestones for our most intensive engagements. In selecting companies for engagement, we take account of their environmental, social and governance risks, their ability to create long-term shareholder value and the prospects for engagement success.

The Hermes Responsible Ownership Principles[1] set out our fundamental expectations of companies in which our clients invest. These cover business strategy, communications, financial structure, governance and management of environmental and social risks. The engagement programme we have agreed with our clients, as well as the Principles and their regional iterations, guide our intervention with companies throughout the world. Our approach is pragmatic, as well as company- and market-specific, taking into account the circumstances of each company.

We escalate the intensity of our engagement with companies over time, depending on the nature of the challenges they face and the attitude of the board towards our dialogue. Some engagements involve one or two meetings over a period of months, others are more complex and entail multiple meetings with different board members over several years.

At any one time around 400 companies are included in our core engagement programme. All of our engagements are undertaken subject to a rigorous initial assessment and ongoing review process to ensure that we focus our efforts where they can add most value for our clients.

While we can be robust in our dealings with companies, the aim is to deliver value for clients, not to seek headlines through campaigns which could undermine the trust that would otherwise exist between a company and its owners. We are honest and open with companies about the nature of our discussions and aim to keep these private. Not only has this proven to be the most effective way to bring about change, it also acts as a protection to our clients so that their positions will not be misrepresented in the media.

For these reasons, this public report contains few specific details of our interactions with companies. Instead, it explains some of the most important issues relevant to responsible owners and outlines our activities in these areas.

We would be delighted to discuss Hermes EOS with you in greater detail.

For further information, please contact:
Dr Hans-Christoph Hirt, Head of Hermes EOS
Hans-Chistoph.Hirt@hermes-investment.com

*As of 30 June 2019
1 https://www.hermes-investment.com/ukw/wp-content/uploads/sites/80/2018/03/final-responsible-ownership-principles-2018.pdf

HERMES EOS TEAM

Engagement

Dr Hans-Christoph Hirt
Executive Director, Head of Hermes EOS

Dr Emma Berntman
Sectors: Consumer & Retail, Pharmaceuticals & Healthcare

Roland Bosch
Sector lead: Financial Services

Dr Christine Chow
Team lead:
Asia & Emerging Markets
Sector lead: Technology

George Clark
Voting and Engagement Support

Michael Dieschbourg
Head of Stewardship and Responsibility North America

Bruce Duguid
Director, Head of Stewardship, Hermes EOS

Katie Frame
Sectors: Consumer & Retail, Pharmaceuticals & Healthcare, Technology

Claire Gavini
Sectors: Consumer & Retail

Tim Goodman
Sector lead:
Oil & Gas

Jaime Gornsztejn
Sector lead: Industrials & Capital Goods

Aaron Hay
Sector lead: Chemicals

Bram Houtenbos
Voting and Engagement Support

Andy Jones
Team lead: Europe
Sector lead: Mining

Lisa Lange
Sectors: Automotive, Financial Services, Technology

Pauline Lecoursonnois
Sectors: Consumer & Retail, Industrials & Capital Goods

Kimberley Lewis
Sector lead: Pharmaceuticals & Healthcare

Sonya Likhtman
Sectors: Consumer & Retail, Mining, Pharmaceuticals & Healthcare

Claire Milhench
Communications & Content

James O'Halloran
Director of Business Management, Hermes EOS

Hannah Shoesmith
Sectors: Consumer & Retail, Financial Services, Technology

Nick Spooner
Sector lead:
Utilities

Sachi Suzuki
Sector lead: Automotive

Marcus Wilert
Sectors: Consumer & Retail, Financial Services, Technology

Amy Wilson
Sector lead:
Consumer & Retail

Janet Wong
Sectors: Technology and Financial Services

Tim Youmans
Team lead: North America
Sectors: Financial Services, Industrials & Capital Goods, Technology

Client Service and Business Development

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

Rochelle Giugni
Client Service and Business Development

Charlotte Judge
Communications & Marketing

Marwa Maan
Client Service

Alice Musto
Client Service

HERMES EOS

OUTCOMES BEYOND PERFORMANCE

HERMES INVESTMENT MANAGEMENT

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

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

Our investment solutions include:

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

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

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

Stewardship
Active engagement, advocacy, intelligent voting and sustainable development

Offices

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

Why Hermes EOS?

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

Contact information

Hermes EOS

Dr Hans-Christoph Hirt Hans-Christoph.Hirt@hermes-investment.com

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

EOS00443 0006738 07/19