Federated Hermes Global Equity ESG Fund

Geir Lode
Head of Global Equities

Lewis Grant
Senior Portfolio Manager

Louise Dudley
Portfolio Manager

Annual Report 2020
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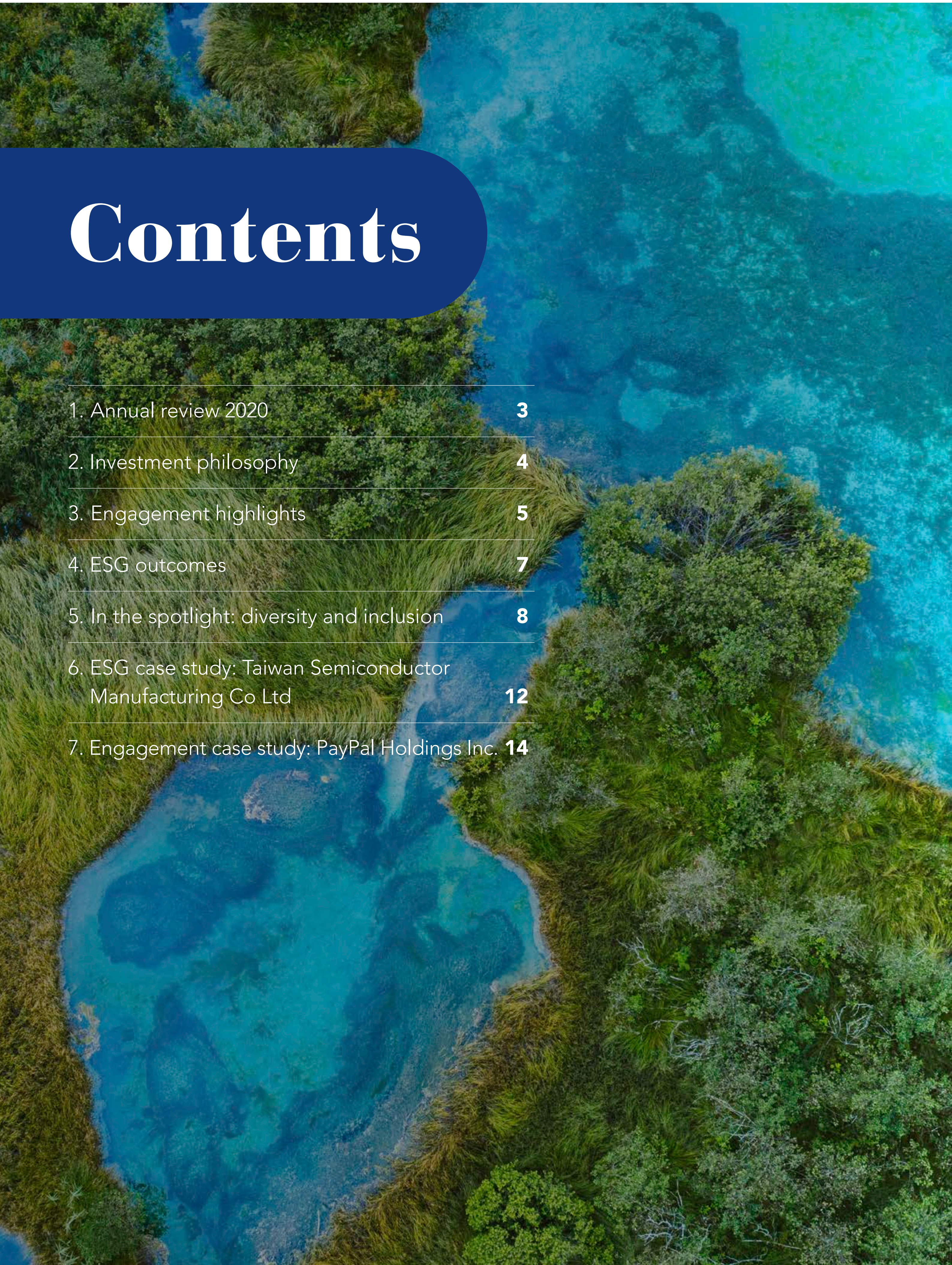

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SECTION 1

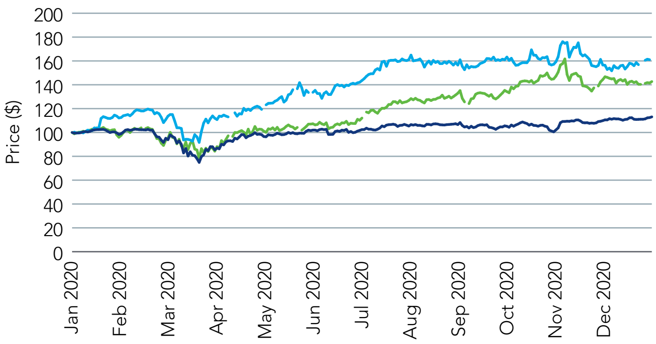
Annual review, 2020

The economic shock brought about by the pandemic has been profound and resulted in unprecedented economic stimulus from governments across the globe. With attempts to contain Covid-19 at the start of 2020 proving forlorn, whole economies shut down and companies with the balance sheet strength and operational efficiency to survive the looming economic slump performed relatively well.

As markets then rallied – fuelled by unprecedented government interventions and a massive loosening of monetary policy – factors such as prospective growth, profitability and sentiment prevailed. The ensuing recovery period was one of stark polarisation: while some industries clearly benefited from the pandemic, there were those that lost out spectacularly.

Our approach, which favours a diverse range of sustainable companies, worked well in 2020. In fact, portfolio companies involved in vaccine development, testing and diagnostics saw exceptional growth (see figure 1).

Figure 1. Two healthcare stocks in our portfolio enjoyed significant growth in 2020 relative to the MSCI ACWI Healthcare Index



MSCI ACWI/HEALTH CARE Index — Lonza Group Ltd — Thermo Fisher Scientific Inc.

Source: Bloomberg, as at 31 December 2021

Renewable energy companies also performed well, thanks – in part – to wind farm projects and the expectation that future fiscal spending will centre on green innovation. In general, well-run and well-capitalised companies outperformed over the period due to their resilience in a recession environment.

And while the portfolio's exposure to industries challenged by the pandemic – such as travel and tourism, and bricks and mortar retail – partially offset this, the impact was tempered by the vaccine announcements of November 2020, which saw the share prices of companies adversely affected by the pandemic surge.

Looking ahead, we remain bullish on the long-term prospects of global equity markets.

For one, the interest rate environment looks likely to remain extremely accommodative, which provides equity markets with a great deal of support, as savers and investors struggle to find attractive assets elsewhere.

What's more, strong results on the effectiveness of Covid-19 vaccines from around the world have provided genuine hope that the worst days of the pandemic might soon be behind us. For the markets, such positive developments have been greeted by a surge in risk appetite, which has seen value stage a recovery.

On the flipside, the companies that benefited most in 2020, especially if that benefit was transitory, are likely to have more difficult comparable earnings to beat. In other words, markets could remain polarized, but in a mirror image of 2020. For how long is unclear, but in due course we would expect the importance of company fundamentals to be reinstated.

Over the longer-term, the transition to a more sustainable economy continues to represent an exceptional market opportunity. It is clear that fiscal spending is going to play an important role in nations' efforts to stimulate economic recovery and we believe this represents a once-in-a-generation opportunity to pivot investment towards addressing the most important issues that face the planet and society.

As such, companies that play an active role in adapting to and mitigating some of our greatest societal challenges are likely to be rewarded through future policy and legislation promoting sustainable development. Green infrastructure is changing much quicker than many expected, as governments around the world become more ambitious with their climate targets. And this could accelerate further, given US President Joe Biden's stance on the matter.

At the international business of Federated Hermes, we are helping to drive change by engaging with companies on a wide range of environmental, social and governance issues. We believe increasing pressure from investors – and more environmentally and socially responsible consumer spending habits – will ultimately drive companies across all sectors to become operationally cleaner and greener. As a result, there will be winners and losers in all corners of the market, as investors look beyond the most obvious, top-performing sustainable companies. Those whose business models take longer to transition will, over time, come into play and the opportunity set will broaden.

SECTION 2

Our investment philosophy

We believe in:

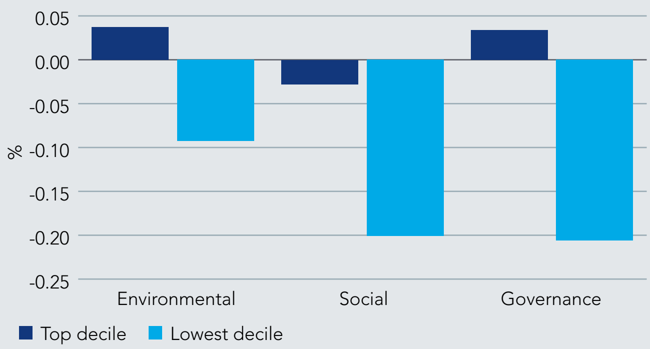
- **Pragmatism:** a combination of time-tested fundamental and ESG characteristics that are attractively priced
- **Responsibility:** integration of ESG factors and active ownership minimises the probability of negative surprises and can unlock hidden value
- **Sustainability:** companies with a competitive advantage and sustainable business models are more likely to offer visibility of earnings growth
- **Long-term focus:** investing over the long term allows companies to reach their true potential

Validating the philosophy

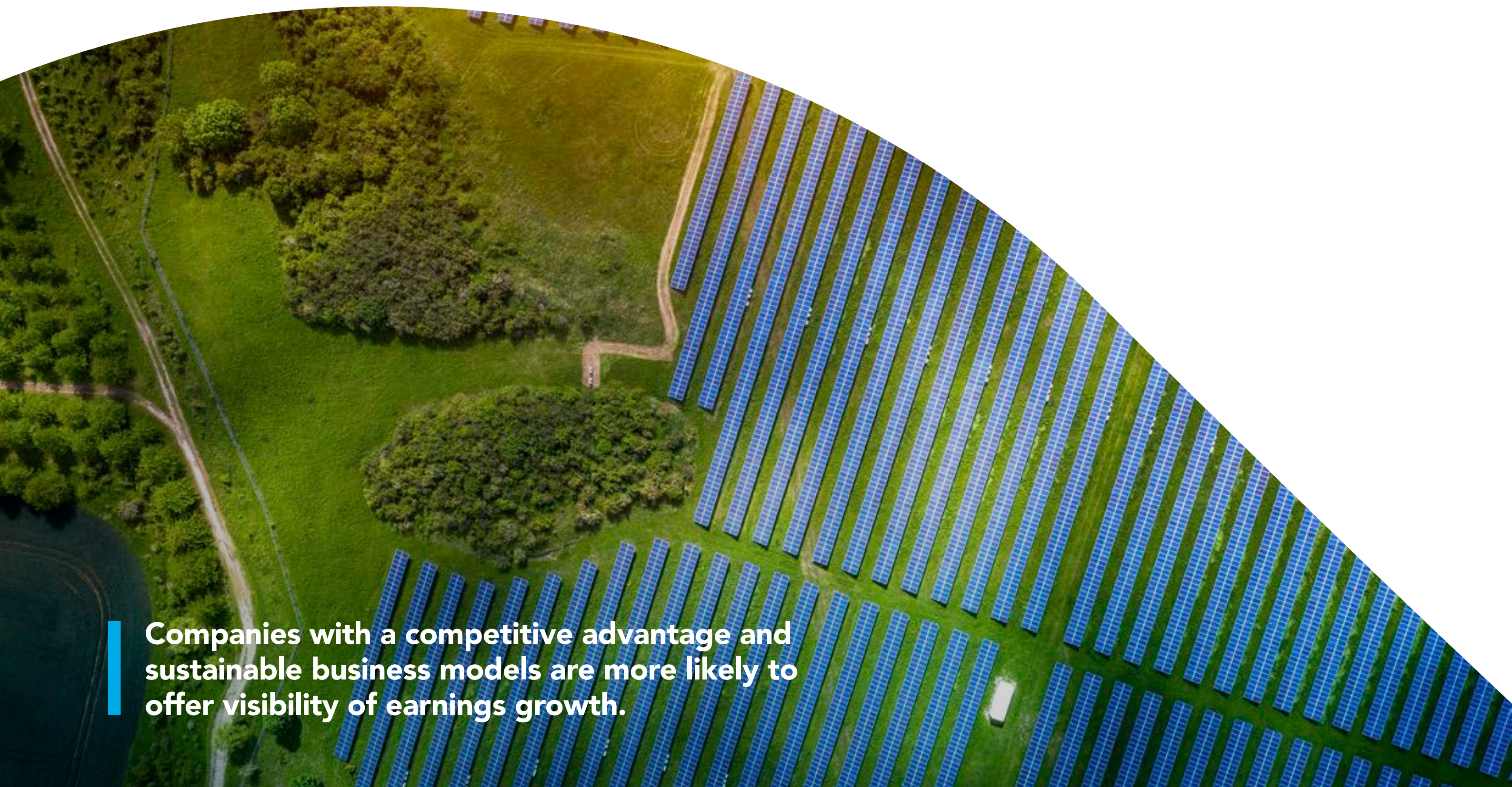
In our latest study, ESG investing: How Covid-19 accelerated the social awakening, we analysed the correlation between a company's ESG score and shareholder returns since 2009. The findings reinforced what already know: a robust link exists between underperforming firms and poor social and governance metrics. But interestingly, while the governance premium has remained unchanged since we conducted a similar study in 2018 (at 24bps per month on average), the social premium strengthened to 17bps over the same period. Companies are now thinking beyond their shareholders – they are thinking about their employees, customers and suppliers.

Figure 2. Companies with poor ESG practices have historically underperformed over the long term

Average monthly total relative returns of companies in the top decile and lowest decile based on environmental, social and governance scores from 31 December 2008 to 30 June 2020. Figures are calculated using constituents of the MSCI World index assuming monthly rebalancing.



Source: Federated Hermes, as at 30 June 2020.



Companies with a competitive advantage and sustainable business models are more likely to offer visibility of earnings growth.

SECTION 3

Engagement overview, 2020

Alongside our colleagues at our stewardship business, EOS at Federated Hermes ('EOS'), we seek to drive change through board and executive-level interactions. Our engagements with portfolio companies often include meetings with divisional heads, investor relations teams, board members, chairs, lead independent directors and chairs of board committees. Through our interactions, we gain information related to specific engagement objectives and issues. Our proprietary milestone system allows us to track our engagement progress.

Furthermore, we benefit from the wider research universe covered by EOS, a diverse team with backgrounds including law, banking, sciences, academia, accountancy, climate change and corporate strategy, and the collective ability to speak fluently in over 10 languages. In turn, the team's skills, languages, connections and cultural understanding enable local language dialogues which are of great importance.

2020 has been a year like no other.

As national lockdowns and social distancing became the norm, much of our stewardship activity moved online. Meetings that would typically be held face-to-face with board members and company executives were conducted via video conferencing software for the first time.

We found, however, that this did not lead to a drop-off in communication. In fact, with the requisite technology being rolled out in time for primary voting seasons across the world, we have been able to maintain our relationship with companies unabated.

If anything, the level of interaction between us and the companies in which we invest has increased. In the wake of localised lockdowns, supply chain disruption, and changes to employee working conditions, companies have been proactive in communicating their response to the pandemic and reassuring investors. Employee health, safety and mental wellbeing has been a frequent topic at board meetings and Covid-19 has undoubtably raised the bar when it comes to the importance of social issues. By engaging with companies to procure decent working conditions, protect workers' rights, and promote a safe and secure working environment, we are directly pushing for real world outcomes related to the UN Sustainable Development Goals (specifically SDG 8, which looks to, "Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all").

We have also seen a continued focus on environmental issues, with companies making accelerated progress on how they consider their impact on the natural world, as well as how climate change is impacting their business. Here, requesting the disclosure of metrics aligned to the Task Force on Climate-related Financial Disclosures (TCFD) has been one of the top engagement objectives identified for companies.

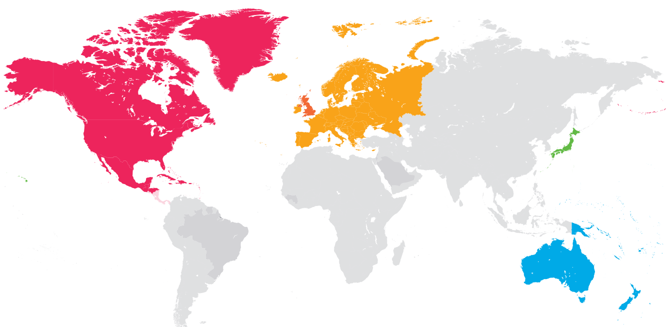
But while social and environmental engagements were plenty, the importance of good governance should not be forgotten. Diversity and remuneration were key issues, and the structure of CEO pay was one area in which we sought improvements. Here, we looked to ensure sufficient long-term incentives were in place to align CEOs with the continued commercial success of their companies, in consideration of all stakeholders. The inclusion of ESG metrics in remuneration policies is happening slowly and we advocate for this to be accelerated across all sectors and regions.

Engagement progress, 2020

Total number of engagement issues and objectives **323**

Number of companies engaged: **80**

Issues and objectives engaged by region



Australia and New Zealand **3**

Developed Asia **44**

Emerging and developing markets **32**

Europe **68**

United Kingdom **12**

North America **164**

Source: Federated Hermes, as at 31 December 2020.

Engagement objectives by theme

Source: Federated Hermes, as at 31 December 2020.

Environmental: issues and objectives engaged

Source: Federated Hermes, as at 31 December 2020.

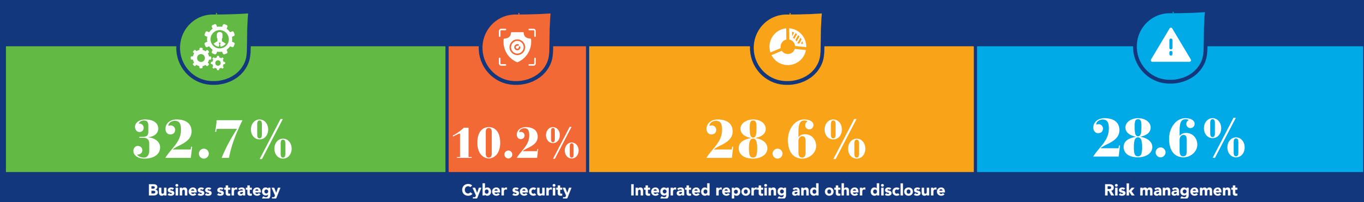
Social and ethical: issues and objectives engaged

Source: Federated Hermes, as at 31 December 2020.

Governance: issues and objectives engaged

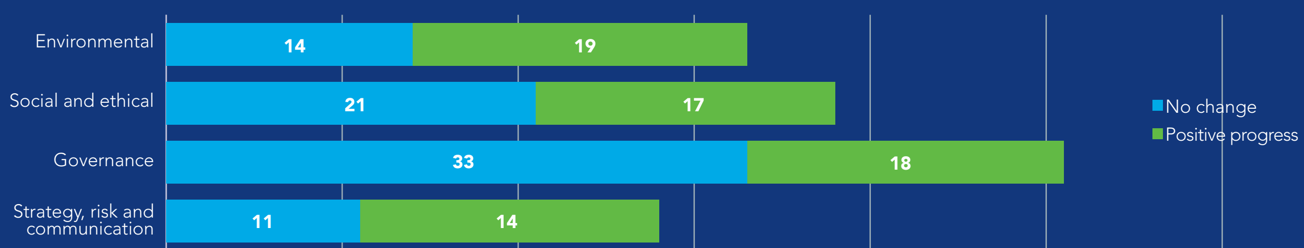
Source: Federated Hermes, as at 31 December 2020.

Strategy, risk and communication: issues and objectives engaged



Source: Federated Hermes, as at 31 December 2020.

Milestone status of engagement



Source: Federated Hermes, as at 31 December 2020.

Voting, 2020

Voting is a key part of demonstrating active ownership and ensuring companies are meeting the needs of shareholders. This year we experienced a voting season like no other: AGMs went 'virtual' amid coronavirus lockdown measures, leading to different challenges for businesses. Remuneration was a key focus, as job uncertainty and swift changes in consumer demands led to employees being rewarded differently.

Crucially, we saw an increase in shareholder proposals, which are an important mechanism to hold management to account. Shareholder resolutions most frequently covered topics such as the disclosure of climate change impacts, lobbying policies, and diversity and inclusion reporting.

Voting breakdown

Meetings where we voted in favour:	Meetings where we voted against, against and abstained, or with management by exception:
28%	**72%**

Source: Federated Hermes, as at 31 December 2021.

SECTION 4

ESG outcomes

We are cognisant that every company has both positive and negative impacts when it comes to its operations. Here we present a snapshot of our Fund's carbon metrics:

41%
lower than the benchmark index

Carbon footprint (scope 1 and 2) per $m invested

Fund:	Benchmark:
80.8	**133.5**

Carbon intensity – tonnes per $m of sales (scope 1 and 2)

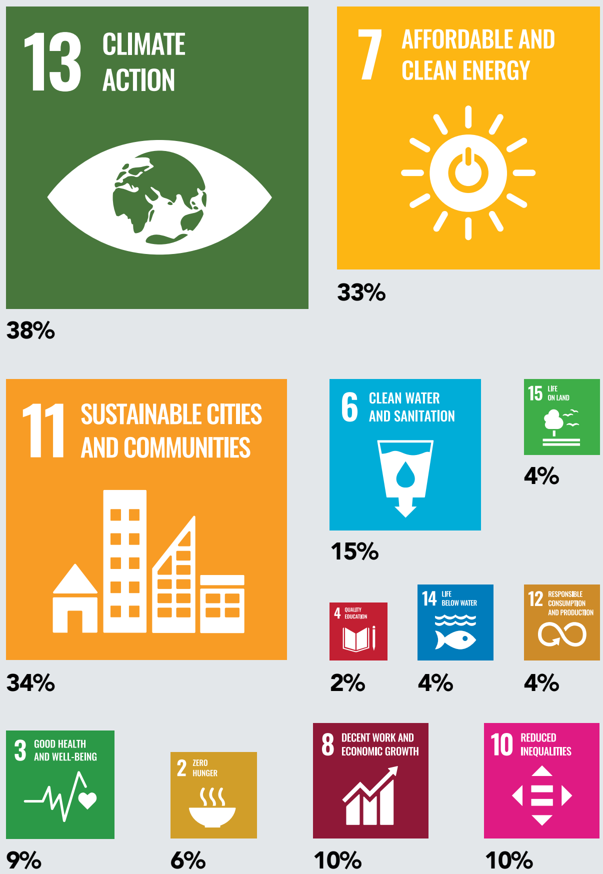
Fund:	Benchmark:
136.4	**232.7**

Environmental opportunities exposure

41%

SDG exposure

Here we demonstrate our SDG exposure – that is, companies where there is revenue exposure to investable themes which are aligned to the UN Sustainable Development Goals (SDGs).



Source: Federated Hermes, as at 30 June 2020.

Science-based targets

We continue to see increased momentum behind climate action and carbon risk management, in line with the rollout of the Task Force on Climate-related Financial Disclosures (TCFD) framework. The fact that more of our portfolio companies are committing to TCFD reporting – and to net zero or science-based decarbonisation targets – is evidence of this trend:

Globally, in total over

1,100 companies are taking science-based climate action and over

570

companies have approved science-based targets, up from

350

only six months ago.

5 companies in our portfolio have committed to action within two years of setting science-based targets for scopes 1 and 2, which are classified as 2 degrees, well-below 2 degrees or 1.5 degrees.

Another **18** of our portfolio companies already have these commitments in place.

By weight in total, this is

24%

of the portfolio as at the end of December 2020.

SECTION 5

In the spotlight: diversity and inclusion

"A change is gonna come": marching towards a more diverse and inclusive society in 2020

2020 was a year of international reckoning. Rallying cries for racial equality reached fever pitch over the summer, as the tragic death of George Floyd sparked global outrage and galvanised the 'Black Lives Matter' movement (BLM).

The moment was one not just of challenge, but of solidarity. With protesters around the world united in their demands for change, 2020 presented an opportunity to collectively reflect on how society is measuring up to expectations of diversity and inclusion, and where exactly it is falling short.

The outcome of Australia's vote for marriage equality, the UK's gender pay gap reporting, and Japan's **30%** female leadership target are all headline-grabbing news stories from recent years that have received global coverage.

But it's not just ethnic diversity and inclusion that has come under scrutiny; themes such as gender equality and lesbian, gay, bisexual and transgender (LGBT) rights have also gained prominence. The outcome of Australia's vote for marriage equality, the UK's gender pay gap reporting, and Japan's 30% female leadership target are all headline-grabbing news stories from recent years that have received global coverage.

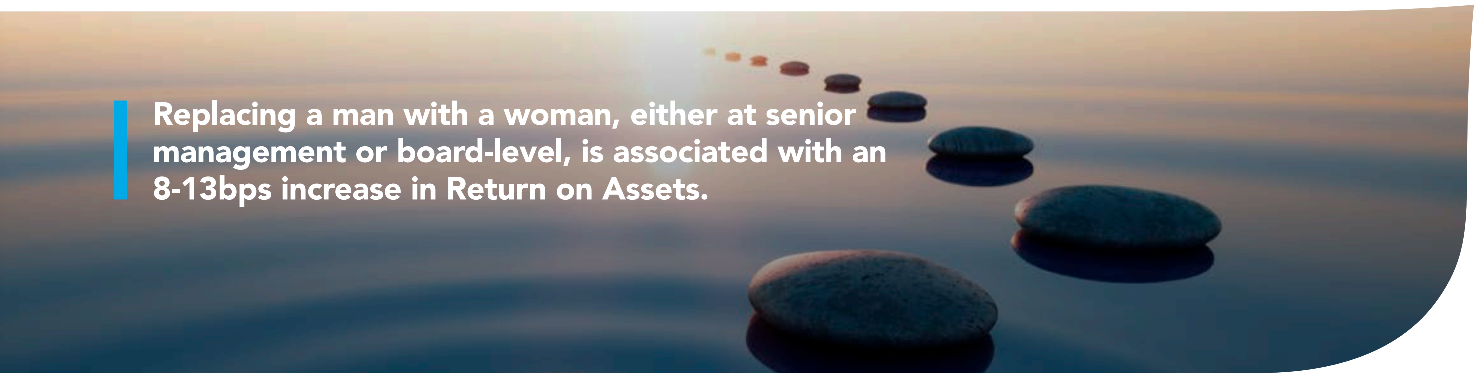
As well as helping a company attract and retain talent, a strong diversity and inclusion policy is therefore commensurate with better strategic outcomes and the pursuit of innovation.

The upshot is that on matters related to diversity and inclusion, companies are increasingly being held to account by investors. And for good reason. Studies have shown that diversity adds value to corporate decision-making by helping leadership avoid 'Groupthink', a phenomenon that occurs when a group of individuals – in their desire for harmony and/or conformity – reaches a consensus without critical reasoning. As well as helping a company attract and retain talent, a strong diversity and inclusion policy is therefore commensurate with better strategic outcomes and the pursuit of innovation.

In fact, diversity and inclusion metrics are fast becoming a kind of shorthand, by which investors can evaluate company culture more objectively. Robust policies on hiring, human rights and working conditions can be used to identify companies who value employees as a stakeholder group.

What's more, in 2020 – and with the significant impact of the global pandemic – the U.S. Securities and Exchange Commission (SEC) mandated companies make a statement on human capital as part of their standard financial reporting. Doing so highlights the contribution of social issues to financial outcomes, and the now well-researched relationship between diversity, inclusion and profitability. Indeed, a report by the International Monetary Fund (IMF) – as far back as 2016 – revealed that replacing a man with a woman, either at senior management or board-level, is associated with an 8-13bps increase in Return on Assets[1].

[1] See Gender Diversity in Senior Positions and Firm Performance: Evidence from Europe (IMF, 2016).



Replacing a man with a woman, either at senior management or board-level, is associated with an 8-13bps increase in Return on Assets.

Benchmarking success in gender equality: Index trends and sector variance

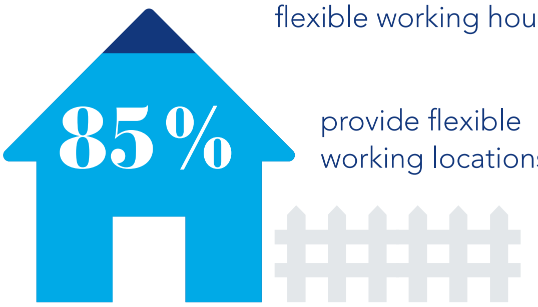
As investors, we have benefitted from greater disclosure in the area of diversity, as this enables us to get a more holistic picture of the companies we invest in. As well as observing 'what gets measured, gets managed' in practice, with data disclosure improving greatly over the last few years, it is now possible to compare the diversity and inclusion efforts of one company with another.

This is exactly what Bloomberg's Gender-Equality Index (GEI) looks to do. Launched in 2016, GEI "tracks the performance of public companies committed to disclosing their efforts to support gender equality through policy development, representation and transparency"[2]. Over the last year, GEI has grown by 55 constituents, despite the threshold for inclusion having increased. New entrants include the likes of Nike Inc. and Target Corp.

The company data underpinning GEI highlights a few positive developments[3]:

Companies are committed to flexibility:

87% of the **380** index members offer flexible working hours, and



85% provide flexible working locations.

Women are better represented at board-level:

On average, members' boards are **29%** female, and more than half of companies require a gender diverse slate of candidates for management positions.

Companies are trying to recruit more women:

69% of companies had strategies in place to attract female talent.

79% of member companies evaluate their advertising and marketing materials for gender bias, while

59% conduct a global gender-based compensation review.

Company sponsored community projects are on the rise:

60% of index member companies sponsor financial education programmes for women and

64% of companies sponsor programs educating women in STEM subjects.

[2] See Bloomberg GEI for more information
[3] Please note, the 2021 index uses company data from the fiscal year 2019. See Bloomberg GEI for more information

But although these numbers are certainly encouraging, work still needs to be done to improve data quality. The GEI attributes a 'data excellence' score to each company, which breaks down into sub-scores across five pillars.[4] While the level of disclosure among companies last year was high, the average data excellence score was just 55%[5].

Another observation is that diversity characteristics vary significantly across sectors and regions, as highlighted by the skews seen in Bloomberg's Gender-Equality Index[6]. Other data sources[7] corroborate these sector and regional differences, suggesting there is a need to look beyond market averages.

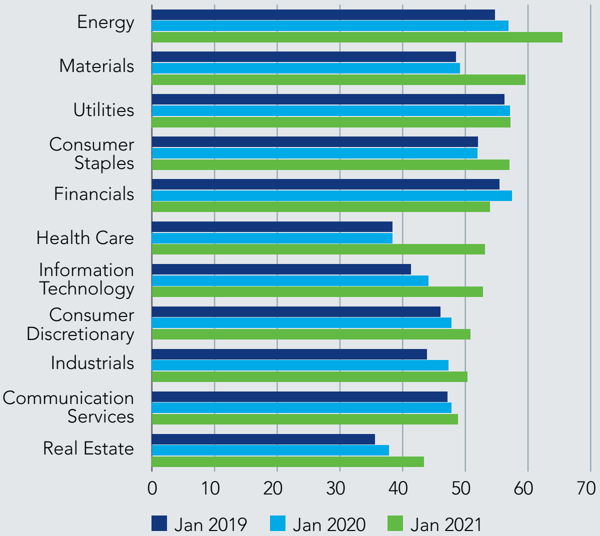
Using the biotechnology industry as an example, the number of biotech companies in the MSCI ACWI Index to achieve at least three women on their corporate board increased from 33% in 2019 to 35.9% in 2020. But the industry still underperforms global constituents of the MSCI ACWI Index in gender diversity. 38.7% of companies in the MSCI ACWI Index had three or more women on the board (as at 9 November 2020).[8]

Over the last two years, the sectors that have consistently ranked highest for discrimination policies and diversity programmes are energy, materials and utilities.

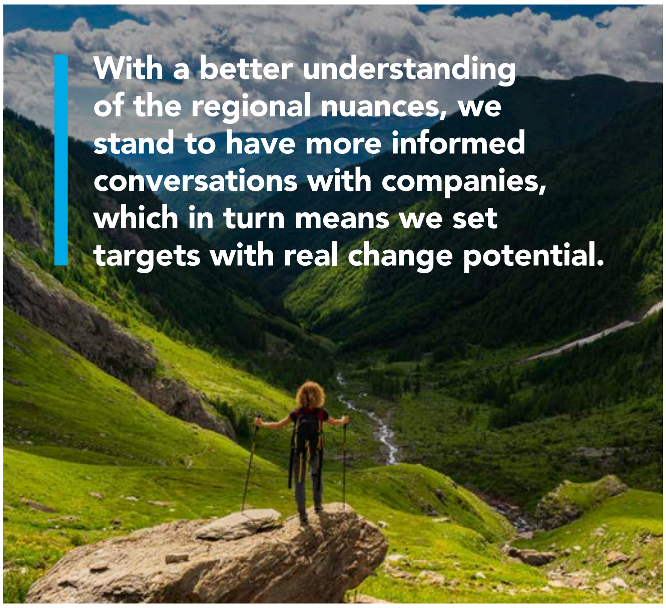
The biggest improvers over the same period are healthcare and IT.

At the bottom end, real estate and communication services rank worst on these metrics.

Figure 3. Sustainalytics scores for the discrimination policy and diversity programmes of MSCI World constituents over the last two years



Source: Sustainalytics. Average scores for MSCI World constituents by industry for the last two years, as at January 2021.



How does our portfolio address diversity and inclusion?

In our latest ESG research paper, we reiterated that social and governance factors need to be considered in a strategy's investment process if outperformance is to be achieved. Our stock selection model incorporates such metrics to evaluate 1) the quality of workplace policies and processes, and 2) how companies have previously responded to negative incidents.

We recognise, however, that an approach relying on company statistics and reports has its limitations. Data remains patchy in some parts of the world, which is why we engage with companies to build a more holistic picture.

Another observation is that diversity characteristics vary significantly across sectors and regions, as highlighted by the skews seen in Bloomberg's Gender-Equality Index.

And it is through our engagement efforts that we have noticed more companies proactively discussing diversity with stakeholders, as well as committing to make improvements. At the country-level, we have seen governance measures introduced to promote board independence, and more elections, as well as minimum levels of representation for women. Positive examples would be Norway and Spain, where companies must fill a gender quota when electing board representatives. But these examples have not been celebrated for their success at encouraging gender balance more broadly in business.

[4] These pillars are female leadership and talent pipeline, equal pay and gender pay parity, inclusive culture, sexual harassment policies, and pro-women brand.
[5] See ESG Clarity, "Bloomberg's Gender Equality Index Receives Record Disclosure" (28 January 2021).
[6] While, historically, the size of a business has also had a significant impact, this has been less apparent more recently.
[7] Other data sources for assessing diversity include MSCI, Sustainalytics, Equileap, the Corporate Human Rights benchmark (CHRB) and the Workforce Disclosure Initiative (WDI). Rather than just giving individual metrics, these data providers allow investors to get a broader view of how companies are performing. A company that participates in the WDI, for instance, is seen as having a proactive attitude towards measuring human capital outcomes.
[8] A large body of research suggests that having three women on a corporate board represents a "tipping point" in terms of influence. See, "The tipping point: women on boards and financial performance" (MSCI, Dec 2016).

While progress has admittedly been slow, getting companies themselves to set relevant targets is one way we hope to speed things up. Here, we leverage the resources of our dedicated stewardship team – EOS at Federated Hermes (EOS) – and the Corporate Governance Principles they have created. These principles are country-specific and outline our expectations of companies on a whole host of issues, including matters related to diversity and inclusion. With a better understanding of the regional nuances, we stand to have more informed conversations with companies, which in turn means we set targets with real change potential. In December 2020, EOS sent letters to the largest US companies, with copies of their updated US Corporate Governance Principles, which included a call for greater action from companies on racial justice and diversity and inclusion, something we welcome.

The United Nations Sustainable Development Goals (UN SDGs) provide an ambitious framework by which we might be able to measure our progress.

Good intentions? Our collective responsibility to advocate real change

In an article published last summer, a journalist for *The Guardian* newspaper stated, "The George Floyd uprising has brought us hope. Now we must turn protest to policy"[9]. If 2020 was an all too painful reminder of the inequalities embedded in our social, economic and political systems, then the financial industry has a role to play in advocating reform. Collectively, we cannot allow 2020's push for equality to lose momentum in the months and years to come.

The SDGs provide an ambitious framework by which we might be able to measure our progress. At the international business of Federated Hermes, our advocacy work at both the industry- and company-level supports the UN SDGs, including SDG 5 (gender equality) and SDG 10 (reduced inequality). We would argue that now is the right time for companies to align their targets with those of the UN SDGs, ahead of the latter's proposed completion in 2030.

Furthermore, while it is important that improvements are made to company employment and procurement practices, we must also strengthen the visibility and representation of minorities. Our engagement with companies continues to focus on this. As a team, we also advocate for greater awareness in the financial industry by, for example, being part of the CFA UK Inclusion and Diversity Network.

All things considered, our outlook for 2021 remains positive. With the impacts of the pandemic still being felt across global economies, companies have a unique opportunity to reset their long-term strategic plans. We have seen that Covid-19 has hit women, minorities and the undereducated the hardest. While government stimulus will certainly soften the blow, corporates have a responsibility and role to play in rebuilding an inclusive workforce and society.

EOS sets market-level vote policies on D&I, which take account of local context, balanced with international good practice. In 2021, key changes included an expansion of our UK vote policy to consider opposing the chairs of FTSE 100 companies that do not have at least one ethnic minority board director, and which do not have at least 20% women in the leadership population of the executive committee and its direct report. This builds on the existing policy to consider opposing the chairs of FTSE 350 companies that fall below the Hampton-Alexander recommendations of 33% women on a board, and FTSE 100 companies with all-male executive committees.

[9] See "The George Floyd uprising has brought us hope. Now we must turn protest to policy" (The Guardian, 30 June 2020)

SECTION 6

ESG CASE STUDY:

Taiwan Semiconductor Manufacturing Co Ltd

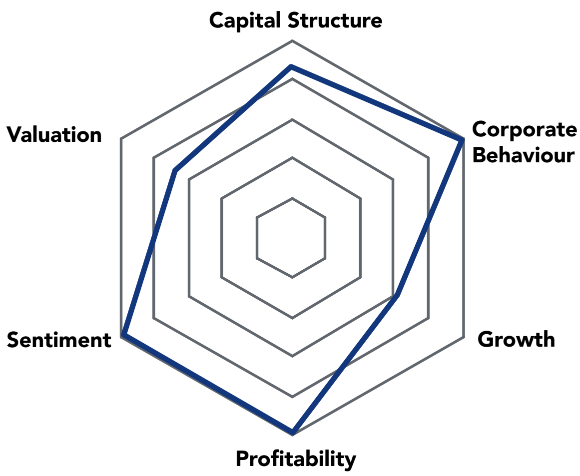
Taiwan Semiconductor Manufacturing Co Ltd (TSMC) is the world's largest contract silicon chip maker, powering everything from personal computers to cars and industrial equipment.

Recorded a **55.6%** share by revenue of the global semiconductor foundry market in Q4 2020[10]

As of January 2021, ranked the world's **10th** largest company by market capitalisation[11]

TSMC earns a place within our Global Equities strategies not just as the dominant player in the huge global semiconductor market, but as an industry leader on most ESG issues. It scores highly across all factor categories in our proprietary Alpha Model (see figure 4.) and has an attractive valuation relative to its peers. While its focus is entirely on semiconductor foundry services, it provides its chips to a diverse range of customers, working with businesses including Apple Inc. and Intel Corp. to provide processing power across sectors from consumer electronics to telecoms, automotives and industrial technology.

Figure 4. The Alpha Model provides a thorough analysis of TSMC's long-term prospects



Source: Federated Hermes, as at 31 December 2020.

Some headwinds but ongoing growth potential

TSMC leads industry peers for Alpha Model Factors including Profitability, Corporate Behaviour and Capital Structure. Its net and gross margins are trending upwards, while customer orders have remained robust through 2020, thanks largely to 5G and stay-at-home driven demand growth.

Despite trade tensions, the company has so far managed to sell to both the US and China. The US, the company's biggest market, has seen 30% year-on-year revenue growth[12]. Looking forward, TSMC's penetration of the 5G phone market is estimated to more than double, reaching almost 50% in 2021. Meanwhile, production of Apple's A17 processor, which is due to start in 2023, provides a boost to the company's medium-term outlook. Further out, the company's biggest challenge may lie in the limits of Moore's Law[13] being reached, however, its strong focus on innovation (TSMC's R&D/Sales ratio is above 8%) provides some comfort in this respect.

[10] https://www.statista.com/statistics/867223/worldwide-semiconductor-foundries-by-market-share/, retrieved 26.01.2021
[11] https://companiesmarketcap.com, retrieved 26.01.2021
[12] Source: TSMC company accounts.
[13] Moore's law (named after Gordon E. Moore, the co-founder of Intel) is based on the observation that the number of transistors which can be fitted on a chip (and hence its processing power) tends to double every two years. In recent years, the pace of improvement in processing power has slowed as designers begin to reach the limits of what is physically possible.

ESG performance

TSMC has a reputation for being responsive to shareholder concerns and this is validated by our own experience. It has consistently attained high sustainability standards and was recently upgraded to an 'AAA' rating by MSCI. Disclosure is good and its ability to manage risk has been demonstrated by a lack of major controversies. With regards to governance, the company's board has an independent majority and all designated board committees are fully independent. On the corporate behaviour front, it has a robust anti-corruption framework, with measures in place to support staff training and report unethical behaviour. Given that 59% of TSMC's facilities are in water-stressed regions of Taiwan, the fact that the intensity of the company's three-year average water withdrawal was 21% lower than the industry is another clear positive (as at 31 December 2019).[14]

On the downside, TSMC relies heavily on its skilled workforce to constantly innovate and stay competitive, meaning the company is exposed to attrition-related risks. However, the company's robust compensation schemes, engagement programs, and well-defined career progression help counter this.

TSMC is also subject to potential reputational risks relating to 'conflict minerals' used in chip production. To address this, TSMC employs supplier oversight mechanisms including audits and due diligence programs, with all of its smelters undertaking initiatives to conform to the Responsible Mineral Assurance Process[15].

> **On the downside, TSMC relies heavily on its skilled workforce to constantly innovate and stay competitive, meaning the company is exposed to attrition-related risks.**

Engagement

We have completed engagements with TSMC on two key themes: one related to governance, while the other concerned cyber security. We first engaged with the company in 2015 to raise concerns around the strong influence of the founder on the board and the lack of a clear succession plan. This issue was fully resolved in 2018, with the founder retiring and two former co-CEOs joining the board as chair and CEO.

A second issue of concern arose in August 2018 when the company suffered a virus attack, causing delays to shipments and significant loss of revenue. TSMC dealt with the issue promptly, hiring two outside technology security companies to design, implement and stress test re-engineered software and processes. At the same time, they committed to strengthening board oversight over internal audit and instilling a more risk-aware culture.

Looking forward, we are in ongoing discussions with the company relating to climate change policy, water stewardship, remuneration to support sustainable wealth creation and cobalt supply chain programmes.

We view TSMC as an industry-leading company with good all-round performance and a proactive approach to ESG issues, making it a natural fit for our Global Equities strategies.

Engagement timeline

Engagement objectives

We encouraged TSMC to:

- Put a clear and transparent succession plan in place ahead of the company's founder and chair retiring;
- Improve IT security following a cybersecurity attack in 2018.

Q3 2015

- We raise concerns regarding the company's succession plan.
- We question the appointment of co-CEOs as a temporary measure and seek clarity as to how responsibilities are divided between the two executives.

Q2 2016

- After expressing concerns about the significant role played by the soon-to-retire founder and lack of succession plan, the company acknowledges that a clear succession plan needs to be put in place.

Q2 2017

- The board approve a motion to nominate the co-CEOs to the board as directors, pending shareholder approval.

Q4 2017

- The founder and chair announces his retirement by 2018, relinquishing any involvement in the company's management activities.

Q2 2018

- The former co-CEOs join the board as chair and CEO. The founder leaves the board without taking on any formal or informal advisory role. The succession transition is complete.

Q3 2018

- We raise concerns regarding the root cause of a virus attack the company experienced in August 2018.
- The company acknowledges that operational processes and systems need to improve.

Q4 2018

- The company announces its plan to strengthen information security, which includes re-engineering all software, hiring two external companies for design and implementation, and introducing stress testing measures.
- The chair acknowledges that board oversight with respect to the internal audit function should be strengthened.

Q2 2019

- The company's new system appears to work well, with no further breaches reported.
- Vendor contracts are revised, with a penalty clause to guarantee deliverables are virus-free, and the company strengthens its accountability and oversight processes.

Q3 2020

- The company commits to zero information breaches, which it achieves. We close the objective.

[14] Source: MSCI
[15] Source: http://www.responsiblemineralsinitiative.org

SECTION 7

ENGAGEMENT CASE STUDY:

PayPal Holdings Inc.

PayPal Holdings Inc. is a US-based company which provides digital payment solutions to online vendors, auction sites and other commercial users.

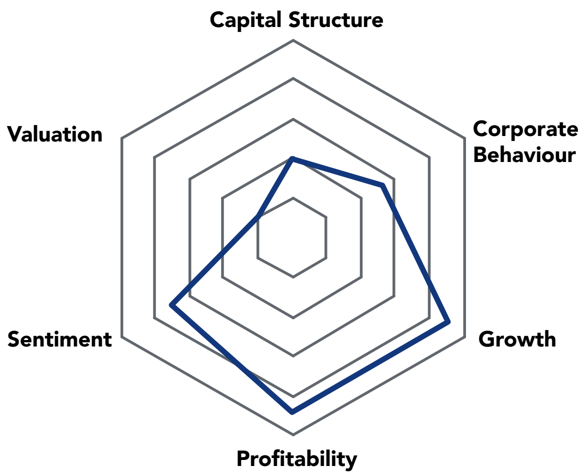
Ranked
#182
on the 2020 Fortune 500 list of largest US corporations by revenue (it's higher ever placing)

Operates in more than
200
markets globally

Handled
$900bn
in payments in 2020

Our Global Equity strategies focus on a diverse range of companies, which have one thing in common: a healthy combination of solid long-term fundamentals and good or improving ESG characteristics. We use our proprietary Alpha Model to rank potential investments in terms of six key factors: PayPal is a good example of a stock which, despite being expensive, is liked by the model owing to high scores for profitability, growth and sentiment factors.

Figure 5. The Alpha Model provides a thorough analysis of PayPal's long-term prospects



Source: Federated Hermes, as at 31 December 2020.

Solid fundamentals with plenty of potential for growth

As a leading figure in the growth of digital payments over the past 20 years, PayPal can reasonably claim to be a household name in most parts of the world. Ubiquity and brand recognition apart, analysts have many reasons to favour the firm as an investment.

PayPal's key performance metrics include the number of active accounts held by the company, customer engagement and total payment volume. With online spending expected to continue to ramp up over the next couple of years, growth in these segments looks set to continue.

> **PayPal's key performance metrics include the number of active accounts held by the company, customer engagement and total payment volume.**

Beyond this, and broadening out from its e-commerce base, the company has plenty of scope for further market growth. New areas such as online donations, food delivery, e-ticketing, travel, ride sharing, gaming, streaming subscriptions and crowdfunding all have huge potential, with many actually being boosted by the current environment.

PayPal has responded to the opportunity both by increasing transactions with existing clients and by adding new clients, leading to healthy revenue growth. The company's operating margin is also improving, as higher margin items become more important. Subsidiaries Venmo, Xoom and Honey are all contributing positively[16].

[16] Venmo is a peer-to-peer digital wallet mainly used for payments between friends; Xoom enables cross-border money transfer from the US and Canada to over 100 countries; Honey is a browser extension which enables the use of coupons and vouchers on e-commerce websites.

Ethically, the company places a strong focus on anti-money laundering measures, as well as seeking to restrict the use of its services for causes that advocate violence, hatred or racial intolerance.

ESG and purpose

PayPal compares favourably to peers from an ESG vantage point, thanks to a strong top-down focus from CEO, Daniel Schulman, on acting as a responsible financial steward (Schulman has been with the company since 2014). As a responsible business, the company claims to pursue profit and purpose hand-in-hand, working with regulators while seeking to transform and democratise financial services and e-commerce. By broadening the demographics for digital payments, PayPal aims to create a truly cashless society. Ethically, the company places a strong focus on anti-money laundering measures, as well as seeking to restrict the use of its services for causes that advocate violence, hatred or racial intolerance. Meanwhile, its $600 transaction limit protects consumers.

Engagement

We have engaged directly with PayPal on ESG-related issues, with progress made on several engagement objectives. The company agreed that it needs to better explain its approach to human rights and set out plans to identify and disclose its biggest risks in relation to this issue. It also acknowledged the need to reduce its Scope 3 emissions under the Greenhouse Gas (GHG) Protocol by engaging with its customers in this regard (Scope 3 covers all indirect emissions that occur in a company's value chain).

Overall, we see PayPal as a strong, profitable company with continually improving ESG performance and the potential for significant further growth, making it an obvious choice for our Global Equity strategies.

Engagement timeline

Engagement objectives:

We encouraged PayPal to:

- Develop a plan to help merchants and end-customers reduce their greenhouse gas emissions;
- Increase employment of African Americans and Hispanics, particularly in technical and senior roles;
- Publicly announce that it carries out human rights impact assessments and confirm that its approach to human rights is informed by the UN Global Principles.

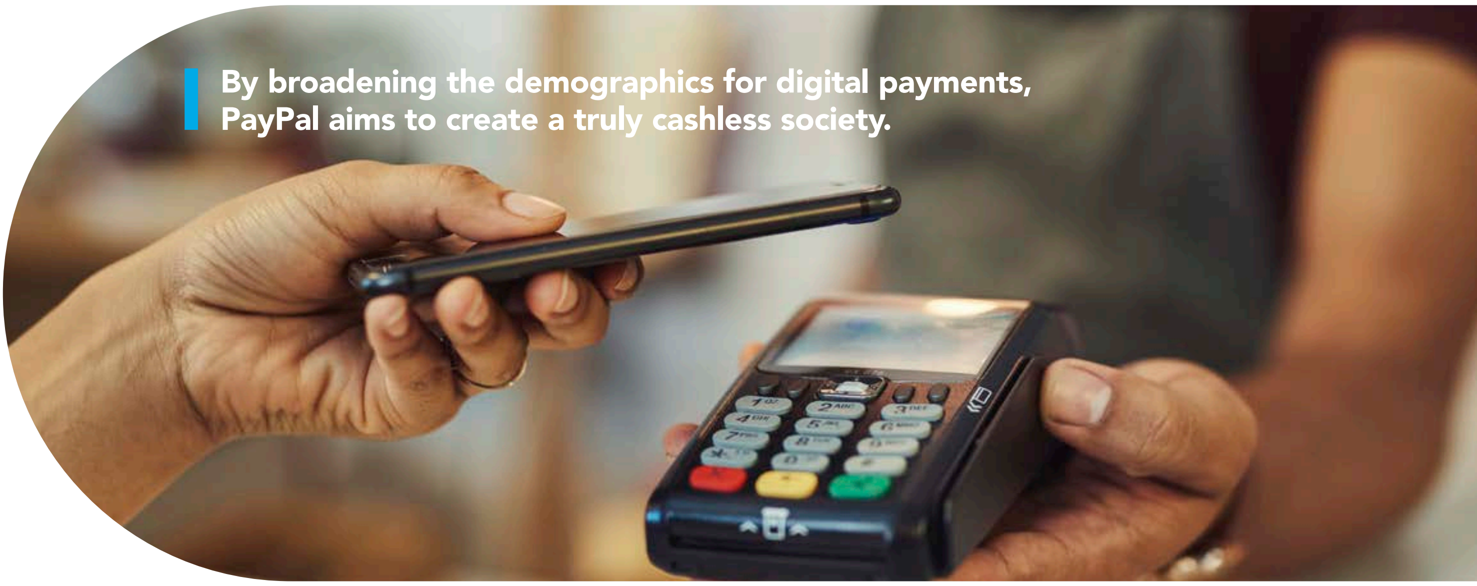
Q2 2020

- We write to the company to explain that it should carry out a human rights impact assessment on its most salient issues, as well as those carrying particular reputational risk.
- We ask the company to explicitly include the UN Global Principles (UNGPs) and other key human rights documents in its forthcoming policy.

Q4 2020

- The company acknowledges that it needs to better explain its human rights policy and processes, and confirms that it plans to complete its human rights saliency project by the end of Q2 2021.
- We ask the company to develop a plan to help its merchants and end-customers reduce greenhouse gas emissions; the company acknowledges this.
- We ask the company to set targets around the increased employment of African Americans and Hispanics, particularly in senior and technical roles; the company acknowledges this.

By broadening the demographics for digital payments, PayPal aims to create a truly cashless society.



The value of investments and income from them may go down as well as up, and you may not get back the original amount invested. Any investments overseas may be affected by currency exchange rates. Past performance is not a reliable indicator of future results and targets are not guaranteed.

Federated Hermes
International

Federated Hermes

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

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

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

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

Our investment and stewardship capabilities:

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

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