Federated Hermes

Monday 30 March 2020

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Federated Hermes response to consultation "Revision of Stewardship Principles for Institutional Investors"

Dear Mr Yu,

Federated Hermes welcomes the opportunity to provide our comments on the Taiwanese Stewardship Code. Federated Hermes is an asset manager with a difference. Our stewardship business, EOS, is one of the world's leading engagement resources, advising on US$877bn on behalf of international institutional investors. Federated Hermes is a global leader in active, responsible investing with US$576bn (as of 31 December 2019) in assets under management. The views expressed in this communication are those of Federated Hermes and do not necessarily represent the views of all clients.

We see stewardship as being at the heart of responsible ownership and fundamental to delivering better, sustainable returns for investors. We believe the Stewardship Code plays an important role in supporting investors and asset managers in Taiwan to integrate stewardship in their operations. In this response we draw from our extensive stakeholder engagement which also provided the basis for our consultation response to the Financial Reporting Council's consultation on the UK Stewardship Code of 2020. As the Financial Reporting Council to a large extent adopted our recommendations, we recommend the UK Code as an example of how codes can be structured to provide guidance on application and reporting.

Investors at initial stages of developing a stewardship approach will need guidance and context as support. Setting the scene for development of stewardship, including an introduction to the impact on business of environmental, social and governance issues and the value investors can bring through responsible ownership, can help internal momentum and guide a wider discussion of the role of investors. Sufficient explanation is needed, for investors to understand fully the implications of the principles presented in the stewardship code, how they relate to each other and, to form a coherent approach. Without a richer understanding of the purpose, wider context and the meaning of signing up to the Stewardship code, adoption risks becoming a mere tick-box exercise. Without guidance for signatories, it risks remaining an ambition without meaningful steps taken to integrate the perspective into operations. We therefore recommend the addition of an introductory text setting out the context and aims in which the code has been developed and revised.

The Code should set out principles that aim to strike a balance between a visionary outlook to set the tone and serve as inspiration while providing clarity for investors who are just starting out. To serve this purpose, we believe further consideration should be taken to how the principles are formulated so that they are helpful in pointing towards a stewardship perspective and how they support investors in adopting such a mindset. Simply put, the 'why' of the principles, in addition to

the expected action (the 'what'), while the 'how' is explained in guidance. Clarity on expected actions will also simplify mechanisms for enforcement.
Signatories must be clear on what it means to adopt the Code and that doing so is the start of a journey. A greater emphasis on context in the Code or supporting guidance can help clarify implications and support the development of a stewardship approach. The implementation of code principles will depend on the individual investor as they must align with the investment profile, strategy, markets and stakeholders. This will also support the signatories' development of meaningful disclosure about their activities and outcomes to demonstrate how stewardship is applied in their context.

Enabling investors to adopt a stewardship approach requires a commitment from the top and implementation of an effective governance function and a regular review of policies to ensure they are enabling the sought behaviour, especially in the development phase. Assurance of processes and a feedback loop to regularly assess effectiveness is key to embedding policies into behaviours on an organisation-wide scale. Effective governance is needed to assure that processes are fit for purpose. This is also important in managing conflicts of interest and ensuring the organisation keeps learning and developing.

Lastly, the Exchange should consider the long-term pathway of development of the Code and make provisions for a monitoring and enforcement mechanism. In our experience, this is a crucial component for realisation of the ambitions of the Code.

We hope that our response will be helpful to the revision work. In case of any questions please do not hesitate to reach out to us on christine.chow@hermes-investment.com and marcus.wilert@hermes-investment.com.

Principle 1 Establish and disclose stewardship policies

"Guideline 1-1 When establishing stewardship policies, an institutional investor is advised to contemplate its role in an investment chain, its nature of business and how to protect rights and benefits of its clients and beneficiaries."

To enable contemplation of the role of an organisation to become effective, stewardship requires a robust framework to translate beliefs into actions. We would like to reference best practice examples from the 2020 UK Stewardship Code[1] for suggestions on the following disclosure by signatories to meet the expectations of Guideline 1-1. For example:

1. **CONTEXT**: Signatories should explain the purpose of the organisation, values, business model and strategy; and their investment beliefs, such as what factors they consider important for desired investment outcomes and why.
2. **ACTIVITY**: Signatories should explain what actions they take to ensure that their values and investment beliefs enable effective stewardship.

[1] https://www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Dec-19-Final-Corrected.pdf

3. **OUTCOME**: Signatories should disclose how their purpose and investment beliefs have guided their stewardship approach, investment strategy and decision making; and the method of assessment on how well they have been protecting the rights and benefits of clients and beneficiaries.

> *"Guideline 1-2*
> *Institutional investors should integrate environmental, social, and corporate governance (ESG) factors into the investment evaluation process to fulfill their stewardship responsibility and create long-term investment value."*

We believe it should be up to individual institutional investors to develop their own philosophy and approach to integrating ESG factors or not to fulfill their stewardship responsibility. Effective stewardship cannot happen without this – so it should not be something regulators try to prescribe. However, given that many investors may be embarking on stewardship for the first time, it would be helpful to give guidance on the range of issues that would typically be included for focus under stewardship outcomes, including reference to good corporate governance practices globally and ensuring that companies adhere to the Taiwan Corporate Governance roadmap (2018-2020)[2]. Signatories should build up capacity to understand and to address the key environmental and social risk issues such as the challenge of climate change, the challenge of the energy transition and security in Taiwan, workers' rights, modern slavery issues in the supply chain and fair pay.

> "Principle 2 Establish and disclose policies on managing conflicts of interest"

This is particularly important in Taiwan as many companies are founder and family controlled with ample opportunities for related party transactions and as a result, conflicts of interest arise. Besides a policy to manage conflicts of interest, we recommend signatories keep a centralised register of suspected conflicts of interest which make such issues auditable.

For example, this register should include:
1) How the conflicts were identified, the date and by whom
2) A detailed description of the suspected conflict
3) The mitigation procedures and controls
4) The responsible persons for managing the conflicts
5) Follow up actions and conclusions
6) A sign off by independent and responsible officers that the conflicts have been addressed, mitigated and concluded

The signatory should consider disclosing relevant metrics such as
1) Cross-directorships within the same business group;
2) The number of issues considered potential conflicts are identified; and
3) Average time required to come to a conclusion and close a case.

This register should be available for authorities for inspection when requested.

[2] https://www.sfb.gov.tw/en/home.jsp?id=121&parentpath=0,117,118,120

Guideline 3-3
An institutional investor is advised to use environmental, social, and corporate governance (ESG) factors to monitor, analyse, and evaluate the related risks and opportunities of the investee company. An institutional investor is advised to understand the sustainable development strategy of the investee company.

Signatories should commit to a process to review and challenge whether the ESG factors they monitor, analyse and evaluate cover the current business, macro-economic, geographic and societal realties for such issues that are of evolving nature; they are not static or topics, and tend to expand, with changing standards and global best practices over time. Established ESG metrics may become out of date as new information and data sets become available and provide new insights into the emerging ESG issues identified. This is also supportive of the signatory's understanding of the sustainable development strategy of the company as their engagement deepens.

Signatories should also disclose if they have an internal or external assurance to ensure that the stewardship processes they put in place are implemented as intended.

Guideline 4-4
An institutional investor should pay attention to the engagement, the positive impact brought to the investee company after negotiation, the formulation plan and concerns for future negotiation, so as to determine subsequent investment decisions.

A signatory should also pay attention to the unintended outcomes of its engagement which could result in negative impact. This is an essential step of an established thought process when measuring impact in the Social Return on Investment (SROI) framework[3]. For example, when encouraging a company to innovate senior citizens (silver community) co-living options, communication channels with family of different generations should be integrated in the design so that senior citizens would not feel isolated.

Guideline 4-5
An asset manager of passive funds should be committed to enhancing the long-term value of the investee company due to the restrictions on selling shares, actively engage in dialogue and interaction with the investee company and participate in voting at shareholders' meetings.

3 http://www.socialvalueuk.org/app/uploads/2016/03/The%20Guide%20to%20Social%20Return%20on%20Investment%202015.pdf

We support that passive managers should also be held to the same standards as active signatories especially with regards to fulfilling their voting responsibilities, disclosing their voting policies and results, as well as the processes around managing the conflicts of interest.

We also support the changes under Guideline 6-3. We are pleased to share our stewardship reports and publications for your reference and for sharing with other signatories:

1) Stewardship: the 2020 vision[4]
2) EOS Literature – covering corporate governance principles by markets, global voting and remuneration policies, quarterly public engagement reports and annual reports with voting statistics. Please see the Corporate Governance Principles for Taiwan in English and Chinese.[5]
3) EOS Engagement Plan 2020-2022[6]
4) Insights on case studies[7]
5) Quarterly public engagement reports
6) Thought-pieces – Example: On AI and data governance[8] and AI applications in financial services[9]
7) Latest research on ESG[10]

Guideline 6-3 Under a situation where clients and beneficiaries are vast in number or the provision of status of fulfilment of stewardship duty is not specified in an agreement, an institutional investor is advised to publish a stewardship report disclose its stewardship activities annually on its website or disclose its stewardship activities in its reports such as business report and annual report.

We recommend that the requirement to produce and publish a report should extend to all signatories regardless of their client base or other circumstances. Our experience is that disclosure is important to drive behavioral change. We agree with the suggested points of disclosure but recommend that signatories also state the outcomes they seek through their stewardship activities.

We hope our input into this consultation is helpful. Please do not hesitate to contact us if you have any questions.

[4] https://www.hermes-investment.com/ukw/wp-content/uploads/2019/10/0007368_hermes_stewardship_paper_v71.pdf
[5] https://www.hermes-investment.com/ukw/stewardship/eos-library/
[6] https://www.hermes-investment.com/ukw/eos-insight/eos/eos-engagement-plan-2020-2022/
[7] https://www.hermes-investment.com/ukw/stewardship/eos-insights/
[8] https://www.hermes-investment.com/wp-content/uploads/2019/04/investors%E2%80%99-expectations-on-responsible-artificial-intelligence-and-data-governance.pdf
[9] https://www.hermes-investment.com/ukw/insight/strategy/ai-applications-financial-services/
[10] https://www.hermes-investment.com/ukw/eos-insight/eos/shareholderengagementresearch/

Yours faithfully,

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