A truly integrated approach to ESG

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Federated Hermes International

www.hermes-investment.com
For professional investors only

Pioneering ESG integration

In aiming to deliver Sustainable Wealth Creation, the international business of Federated Hermes has been at the forefront of investment and sustainability since 1983.

For us, as members of the Global Equities team at the international business of Federated Hermes Investment outperformance goes hand-in-hand with procuring positive, real-world outcomes. Indeed, we have been integrating environmental, social and governance (ESG) criteria into our investment process since inception. As far back as 2014, we were conducting in-depth research to determine the impact of ESG factors on shareholder returns, thus proving ESG investing to be more than just a feel-good phenomenon.

In a 2018 study, we argued that ESG investing had been transformed from a niche to a mainstream activity, with ESG criteria increasingly important to companies, investors and society alike. Since then, the topic has not only become more newsworthy, demand for ESG investment products has also accelerated. We recognise this and offer a suite of "ESG integrated" and "ESG focused" strategies:

Figure 1. Our product offering: "ESG integrated" versus "ESG focused"

ESG Integrated

Federated Hermes International Global Equity Core

Developed excluding North America

- Idea generation driven by proven long-term fundamental characteristics
- Corporate governance systematically assessed for all investments
- Social characteristics assessed in Europe and Japan where it has been proven to add value
- Subjective review of ESG characteristics for all investments utilising expertise of EOS

ESG Focused

Federated Hermes International Global Equity ESG

Screened ESG | **Low Carbon**

- Idea generation driven by proven long-term fundamental characteristics
- Additional emphasis on companies with **good or improving** ESG characteristics
- ESG systematically assessed for all investments
- Subjective review of ESG characteristics for all investments utilising expertise of EOS

Customisable across regions, risk and return objectives and ethical beliefs

Source: Federated Hermes, as at March 2021.

Since 2007 we have continued to hone our approach, developing our proprietary tools, while working closely with our in-house Responsibility Office and dedicated stewardship team, EOS at Federated Hermes ("EOS").

Figure 2. Federated Hermes Global Equities: our advancements in ESG investing to date

2007
- Geir Lode joins and Hermes Global Equities founded.
- Tasked with integrating ESG into investment process.

2008
- Lewis Grant joins as Portfolio Manager. MultiFRAME created.
- Global Equity Fund launched.

2009
- Louise Dudley joins the team from EOS to lead ESG and Responsible Investing research.

2010
- ESG Dashboard is created.

2012
- The QESG score is created
- Global Screened ESG Strategy launched
- Matt Shoreson joins the team

2013
- Global ESG Strategy launched
- The ESG Portfolio Monitor created

2014
- Global ESG Fund launched
- "ESG doesn't just make you feel good, it makes you money" report highlights the importance of governance

2016
- "ESG still makes you feel good and still makes you money" report confirms governance still adds value
- Low Carbon Strategy launched
- Andrew Hurley joins the team

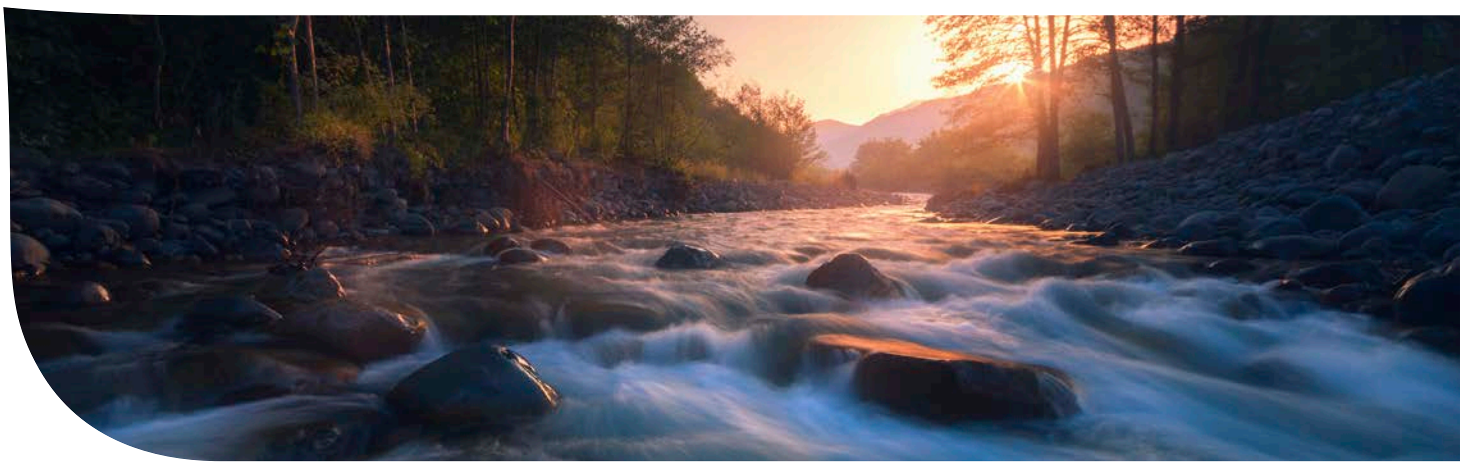
2017
- ESG Dashboard 3.0 launched

2018
- "ESG investing: A social uprising" report highlights the growing importance of social factors in Europe and Asia

2019
- Sam Stephenson joins the team

2020
- "ESG investing: how Covid-19 accelerated the social awakening" report highlights that good or improving social practices adds value

Source: Federated Hermes, as at March 2021.



Our approach to ESG integration

Our underlying philosophy is to create a diversified portfolio of good, solid companies, which have attractive growth and profitability characteristics and stand to deliver long-term outperformance. Quality characteristics bolster short- and long- term stability, and ensure we capture innovative and disruptive market trends.

The way a company is managed, its relationship with key stakeholders and the sustainability of the its products and/or services are an integral part of this quality assessment. Drawing on our experience of running responsible portfolios for over ten years, we are cognizant that standards continually evolve and, as such, we continually seek improvement both from our investment process and from companies held within our portfolios.

When it comes to ESG integration, our approach is founded on four core beliefs:

Companies with good and improving ESG characteristics will tend to outperform

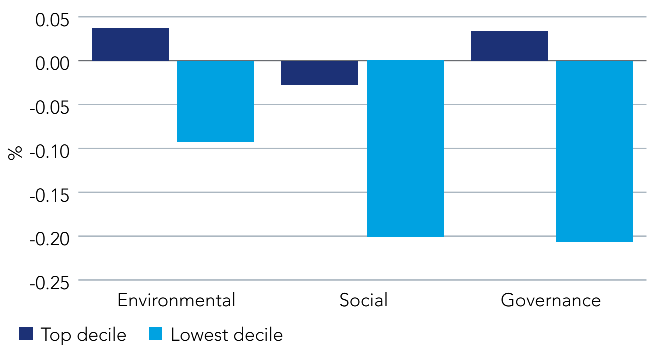
ESG metrics are measures of quality and help to determine business resilience. They suggest a long-term mindset which investors should favour, not just because of the here and now, but because sustainability requires a long-term focus to deliver long-term results.

Our approach is backed by rigorous research, with our inaugural ESG study conducted in 2014. Here, we highlighted one of the most important tenets of our investment philosophy: that companies with good or improving environmental, social or governance characteristics stand to outperform their peers.

We revisited this concept in a recent piece, entitled, 'ESG investing: How Covid-19 accelerated the social awakening'. As with our 2014 study, we created historic, quantitative scores for companies in our investment universe, this time for the period from 31 December 2008 to 30 June 2020. And as before, companies that ranked within the top decile did, on average, financially outperform those in the lowest decile.

Figure 3. 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.

ESG should be considered in qualitative as well as quantitative terms, and make use of multiple data sources

Due to a lack of rigour in data quality and the timeliness of what companies report, ESG metrics should be considered qualitatively, as well as quantitatively. This is the only way to build a holistic view of a company's ESG behaviours.

Figure 4. Our quantitative and qualitative ESG considerations

Quantitative

- Proprietary 'QESG score' integrating internal and external databases
- ESG Dashboard for all companies in investable universe
- Portfolio analysis of all strategies
- Ongoing research on ESG factors' performance

Qualitative

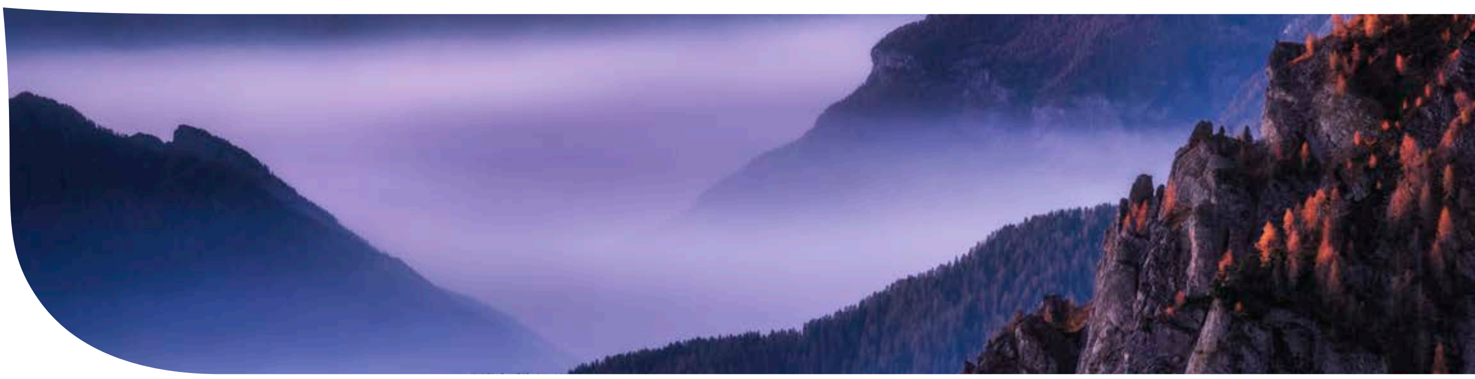
- Fundamental company research on ESG using research providers and primary sources
- Engagement generating additional insights
- Ongoing research on material ESG issues

Source: Federated Hermes, as at 31 March 2021.

Our pioneering "QESG Score" combines proprietary voting and engagement data from EOS with data from leading third-party providers such as Bloomberg, Sustainalytics and Trucost.

We have demonstrated how this enhances shareholder returns[1], however, we also understand that the quality of data and the timeliness of company disclosures can vary.

Therefore, our own company research interrogates data inputs and considers that a quantitative assessment might not always be the best way to ascertain a company's actions. We are not afraid go beyond the numbers and speak to companies directly, or seek further insight from engagers in EOS.



[1] See 'ESG investing: How Covid-19 accelerated the social awakening'.

Figure 5. Our proprietary ESG integration tools

QESG scores
- ESG score for listed companies, capturing both the current sustainability performance and direction of travel
- Combines our ESG research and engagement insights with data from Sustainalytics + MSCI, Trucost and Bloomberg

Emerald
- Our engagement database, recording our interactions, objectives and progress made with companies
- The information and conclusions drawn from strategic and sustainability dialogues with companies helps inform investment decisions

ESG Dashboard
- Provides ESG metrics at the portfolio and company levels
- Integrates proprietary and third-party data providers to form E, S and G scores – and ultimately the QESG Score

Carbon Tool
- Carbon-risks metrics include:
- Risk levels and footprints of portfolios/companies relative to their benchmarks/peers, including Scope 1, 2 and 3 emissions[2]
- Value at risk due relative to carbon-pricing and policy scenarios
- Carbon risk engaged on within portfolios and progress achieved

Portfolio Snapshot
- Captures the ESG performance of and engagement activity on assets and in aggregate across portfolios relative to their respective benchmarks

Corporate Governance Tool
- Assesses the governance quality of companies using targeted information, flagging behaviours failing the landmark *Responsible Ownership Principles*
- Compares the company to peers in its industry, sector and country of operations

[2] Scope 1 emissions: all emissions from activities directly controlled by a company. Scope 2 emissions: indirect emissions from electricity purchased and used by the organisation. Scope 3 emissions: all other indirect emissions from activities of the organisation, occurring from sources that they do not own or control.

ESG integration needs to happen at the corporate, portfolio and stock level

We believe in leading by example at the corporate level, managing our aggregate exposure to ESG risk at the portfolio level, and identifying companies experiencing positive change or undertaking unnecessary ESG risk at the stock level.

Our approach to ESG integration is essentially three-pronged:

- **Corporate level:** Supported by EOS – one of the largest stewardship resources of any asset manager globally – and our Responsibility Office, we **drive responsibility** by lobbying legislators, financial service intermediaries and industry bodies.
- **Portfolio level:** Through a combination of in-house and third-party metrics, we **manage responsibly** by assessing how our portfolios are positioned in both absolute and benchmark-relative terms.
- **Stock level:** We **invest responsibly** by looking at individual companies to determine areas of concern, which might in turn warrant deeper analysis.

Figure 6. The three tiers to holistic ESG integration

Corporate Level Driving responsibility	**Responsible investment policy and strategy** A clear vision to unlock hidden value by investing responsibly	**ESG Integration** Founding signatory of Principles for Responsible Investment; all assets under management integrate ESG considerations	**Sector and public policy engagement** Promote best practice and influence the market to implement responsible investment principles	**Strategy and policy targets provide guidance and structure**
Portfolio Level Managing responsibly	**Risk management** Managing aggregate exposures to ESG risks	**Tracking ESG Risks** Portfolio ESG Monitor highlights the best & worst companies across our holdings	**Independent assessment** Regular meetings with EOS and our Responsibility team to discuss ESG risks	**Sustainability and responsible investment tools integrated throughout the investment process**
Stock Level Investing responsibly	**Stock Selection** Avoiding companies with unnecessary ESG risks and identifying companies undergoing positive change	**Systematic assessment** ESG embedded in fundamental analysis via the QESG Score and ESG Dashboard	**Active ownership** Voting and engagement insights from EOS along with controversial company reports	**Combining insights from EOS with specialist external research**

Source: Federated Hermes, as at March 2021.

True ESG integration is about active ownership

Engagement and stewardship have become an integral part of the investor toolkit. They provide a forward-looking assessment of a company's ESG behaviours, which we believe is invaluable.

Engagement plays a key role in our approach to ESG integration. We work with EOS to not only measure a company's current behaviours against certain key criteria, but also futureproof our assessment. Crucially, engagement provides forward-looking metrics, which help us gauge how a company's ESG behaviour is changing over time. Where we do not deem there has been sufficient progress on an issue, we may decide to exit the position.

As long-term investors and active owners, we also look for companies with positive exposure to the United Nations Sustainable Development Goals (UN SDGs), as we believe these companies will have strong, long-term corporate strategies. Likewise, there are certain behaviours we avoid, such as involvement in tobacco, high carbon intensive assets or behaviours that breach international norms.

What are our key considerations in relation to E, S and G?

We assess each company's exposure to business-critical E, S and G risks and analyse the processes (policies and procedures), the reality of company performance and the trend. We consider the preparedness of the company, as well as the time horizon and how effectively risks are managed.

E

We view climate change as the most meaningful environmental issue, both in relation to a company's direct impact (and natural resource use), and how resilient said company is to physical and transition risks. While we have seen data availability and disclosure improve year-on-year, we work closely with our colleagues in EOS to evaluate a company's value chain, policies and procedures. We also consult industry reports.

We have completed scenario analysis at the portfolio-level using the PACTA tool and we are integrating Trucost temperature monitoring. We also monitor exposure to positive green themes and use a wide range of data sources –including CDP, TPI and SBTi – to add depth to our analysis. For further detail on our consideration of climate change within our investment process see our *Equitorial* piece, Balancing the Carbon Equation.

S

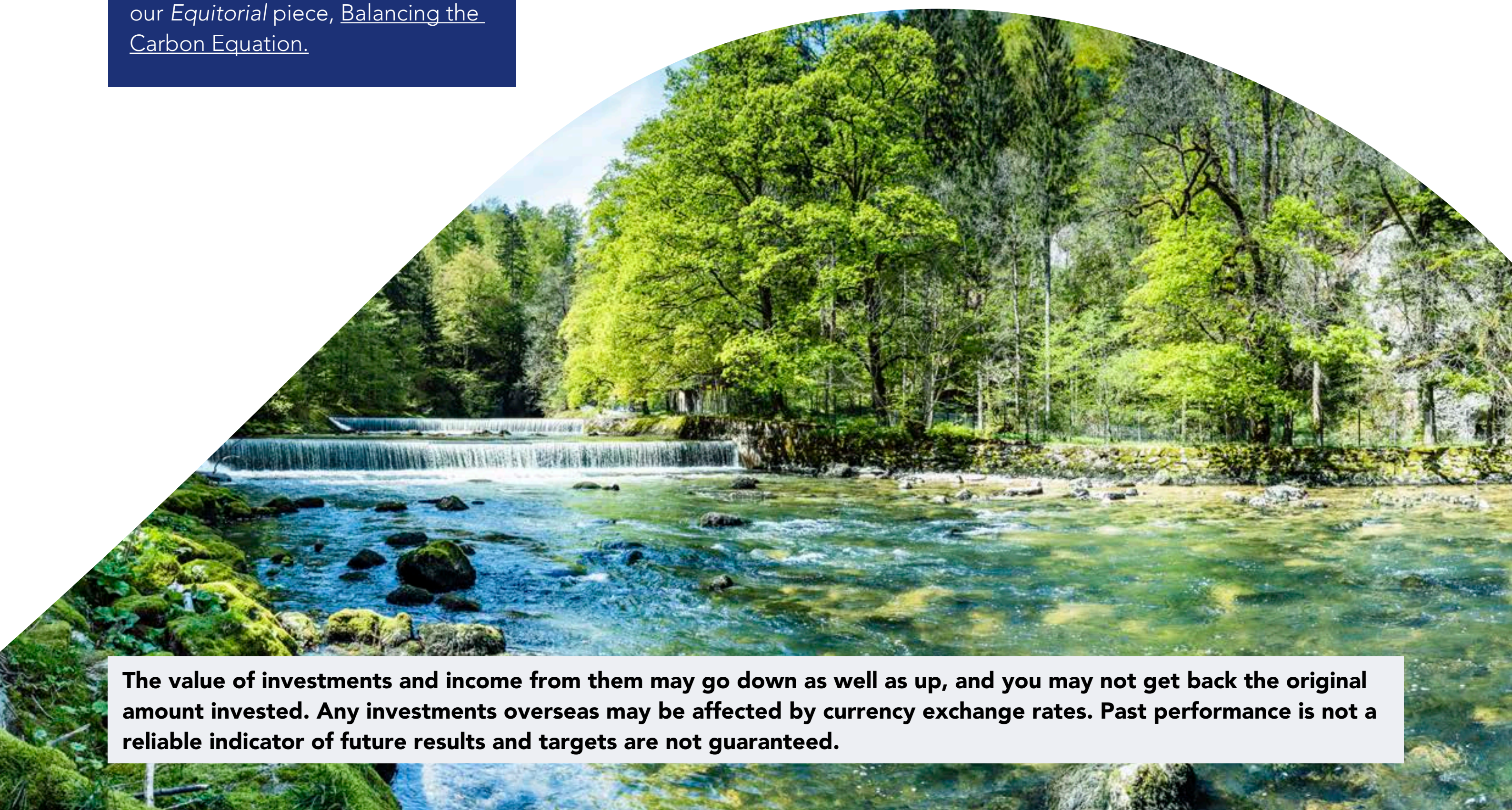
From a social perspective, we consider human rights, human capital management and product safety as areas of significant potential risk. It is important to consider these metrics in relation to the company itself, as well as its supply chain, local communities and society as a whole.

Unsurprisingly, Covid-19 has escalated some social issues – such as long-term employee welfare, and diversity and inclusion – to board-level importance. The latter is a topic discussed in-depth in our annual report for 2020.

G

Governance continues to be the most crucial aspect of our ESG assessment, as good governance supports solid environmental and social practices. Remuneration, shareholder rights and board structure are key, as are ethics and culture.

We believe the inclusion of a governance pillar in the framework used by the Task Force on Climate-related Financial Disclosure (TCFD) corroborates our view.



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

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

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