Public Engagement Report

INTO THE BLUE

How to protect ocean biodiversity for future generations

Federated Hermes
EOS

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For professional investors only

This report contains a summary of the stewardship activities undertaken by EOS on behalf of its clients. It covers significant themes that have informed some of our intensive engagements with companies in Q2 2021. The report also provides information on voting recommendations and the steps we have taken to promote global best practices, improvements in public policy, and collaborative work with long-term investors and their representatives.

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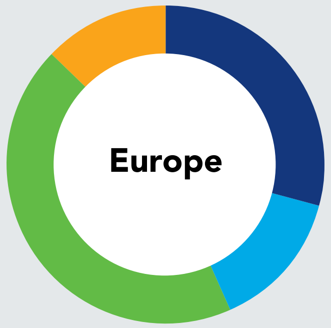
This report has been written and edited by Claire Milhench, Communications & Content Manager, EOS

Engagement by region

Over the last quarter we engaged with 744 companies on 1,871 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.

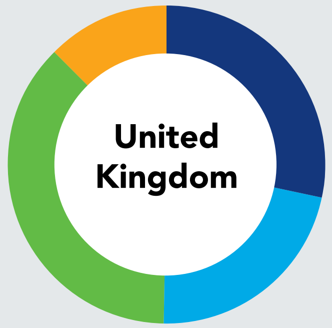
We engaged with 744 companies over the last quarter.

- Environmental **29.4%**
- Social and Ethical **16.1%**
- Governance **43.3%**
- Strategy, Risk and Communication **11.2%**



We engaged with 145 companies over the last quarter.

- Environmental **29.4%**
- Social and Ethical **14.1%**
- Governance **43.8%**
- Strategy, Risk and Communication **12.7%**

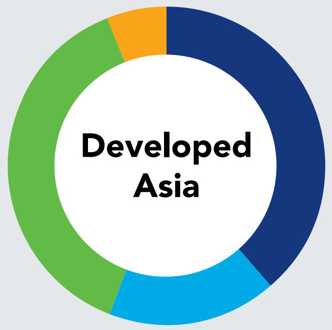


We engaged with 59 companies over the last quarter.

- Environmental **28.6%**
- Social and Ethical **21.7%**
- Governance **37.3%**
- Strategy, Risk and Communication **12.4%**

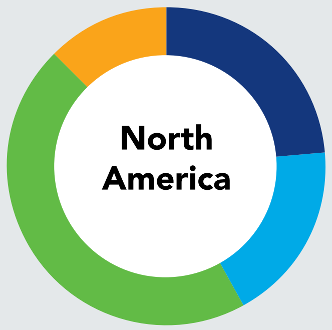
We engaged with 144 companies over the last quarter.

- Environmental **37.4%**
- Social and Ethical **9.3%**
- Governance **44.5%**
- Strategy, Risk and Communication **8.9%**



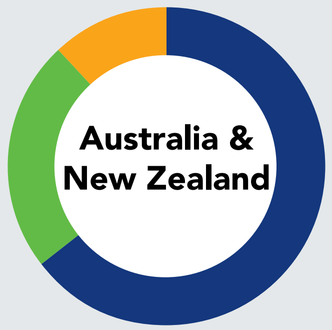
We engaged with 90 companies over the last quarter.

- Environmental **38.6%**
- Social and Ethical **17.2%**
- Governance **38.1%**
- Strategy, Risk and Communication **6.0%**



We engaged with 294 companies over the last quarter.

- Environmental **23.8%**
- Social and Ethical **18.2%**
- Governance **45.7%**
- Strategy, Risk and Communication **12.3%**

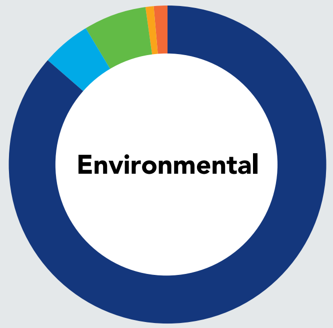


We engaged with 12 companies over the last quarter.

- Environmental **64.7%**
- Governance **23.5%**
- Strategy, Risk and Communication **11.8%**

Engagement by theme

A summary of the 1,871 issues and objectives on which we engaged with companies over the last quarter is shown below.



Environmental topics featured in 29% of our engagements over the last quarter.

- Climate Change **86.5%**
- Forestry and Land Use **4.9%**
- Pollution and Waste Management **6.4%**
- Supply Chain Management **0.9%**
- Water **1.3%**

Social and Ethical topics featured in 16% of our engagements over the last quarter.

- Bribery and Corruption **1.7%**
- Conduct and Culture **10.3%**
- Diversity **27.6%**
- Human Capital Management **23.3%**
- Human Rights **32.9%**
- Labour Rights **4.3%**

Governance topics featured in 43% of our engagements over the last quarter.

- Board Diversity, Skills and Experience **24.0%**
- Board Independence **13.1%**
- Executive Remuneration **45.3%**
- Shareholder Protection and Rights **14.9%**
- Succession Planning **2.7%**

Strategy, Risk and Communication topics featured in 11% of our engagements over the last quarter.

- Audit and Accounting **8.6%**
- Business Strategy **39.2%**
- Cyber Security **2.9%**
- Integrated Reporting and Other Disclosure **23.9%**
- Risk Management **25.4%**

Our oceans under threat

Overfishing, plastic pollution, temperature rises and chemical contaminants have all badly impacted the health of our oceans, upon which billions of people depend for their sustenance and livelihoods. How do we engage with companies to ensure the marine environment is protected for future generations? By Sonya Likhtman, Emma Berntman and Lisa Lange.

Setting the scene

Oceans help to regulate the climate and the water cycle, as well as being a source of food and used for shipping routes. However, following centuries of treating the oceans as an inexhaustible resource at least a third of fish stocks are depleted, while microplastic pollution has become endemic, with potentially dangerous consequences for human health. In this article we explore why these issues matter to investors and the five themes that most closely relate to ocean sustainability: climate change, pollution, sustainable fishing, biodiversity, and human rights.

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Protecting and conserving the marine environment is essential for human life and the economy. The oceans play a central role in regulating our climate and provide key ecosystem services, such as the production of oxygen and carbon sequestration. The biodiversity of our oceans could be a key source of innovation and medical advances, with the potential to discover new antibiotics for example.[1] Sectors such as shipping, tourism and fishing are highly dependent on the oceans, with most global trade occurring by sea and about 80% of tourism occurring in coastal areas.[2] It is estimated that over three billion people[3] depend on the oceans for their livelihoods and that the natural capital of our oceans is valued at US$24tn.[4]

Sectors such as shipping, tourism and fishing are highly dependent on the oceans, with most global trade occurring by sea and about

80% of tourism occurring in coastal areas.

Yet these vast resources are dwindling fast. Climate change, pollution, and overfishing are threatening the sustainability of our oceans. Human activity has had severe ecological consequences for marine ecosystems. The oceans are a prime example of a tragedy of the commons, where an open access resource is depleted to the detriment of all.

[1] Antibiotics search to focus on sea bed – BBC News
[2] UN, Life below water: why it matters
[3] The Ocean Conference 5-9 June, 2017 – United Nations, New York
[4] Ocean Assets Valued at $24 Trillion, but Dwindling Fast | Stories | WWF (worldwildlife.org)

Between
50-80%
of the world's oxygen comes from the ocean

Fishing provides the main source of protein for over
1bn people

Oceans are estimated to contain
50-80%
of the planet's total biodiversity

The consequences of failure

Failing to protect marine ecosystems will have negative consequences for the global economy, posing a systemic risk to long-term investments. There are business model risks for industries such as tourism, while changing sea levels and stronger, more frequent hurricanes pose a physical risk to businesses located in coastal areas. And if a company is linked to ocean pollution it can result in reputational damage, impacting its share price. A prominent example is the Deepwater Horizon blowout that sent oil major BP's share price tumbling by 55% and resulted in the company having to pay over US$65bn in clean-up and litigation costs.[5]

Failing to protect marine ecosystems will have negative consequences for the global economy, posing a systemic risk to long-term investments.

In addition to the risk of litigation, companies that do not adequately manage their impact on ocean sustainability may be underprepared for regulatory changes. International agreements that safeguard the oceans, such as the 1986 ban on commercial whaling, can fundamentally disrupt industries, although the practice continues in Japan, Norway and Iceland.[6]

Today, the global community is starting to see the importance of managing its impact on the oceans. The UK government is one of 30 countries in the Global Ocean Alliance calling for 30% of seas to be protected by 2030.[7] The United Nations Sustainable Development Goals (SDGs) highlight ambitions for action in SDG 14 "life below water",[8] which includes targets on reducing marine pollution, protecting and restoring ecosystems, reducing ocean acidification and sustainable fishing, among others. Finally, consumer awareness of environmental impacts, fuelled by popular documentaries such as the BBC's Blue Planet series, has resulted in significant shifts in market demand for products linked to ocean pollution, such as single-use plastic items.

Today, the global community is starting to see the importance of managing its impact on the oceans.

Investors should be aware of these risks and how the companies in which they are invested impact the oceans. This will involve scrutinising the impact of different companies and sectors on ocean sustainability. Engagement with policymakers will also be required to ensure that the right frameworks and incentives are established to protect ocean health and account for the externalities that damage oceans. Effective stewardship practices should be in place to push companies to understand and monitor how their activities impact and depend on the oceans. They should develop mitigation measures or fundamentally shift their business models where they negatively impact marine ecosystems. Ultimately, companies should work towards solutions that have a net-positive effect on the oceans through innovation and circular economy practices.

[5] BP's Deepwater Horizon bill tops $65bn | Deepwater Horizon oil spill | The Guardian
[6] Commercial whaling: Unsustainable, Inhumane, Unnecessary – EIA Reports (eia-international.org)
[7] Global Ocean Alliance: 30 countries are now calling for greater ocean protection – GOV.UK (www.gov.uk)
[8] Goal 14: Life Below Water | The Global Goals

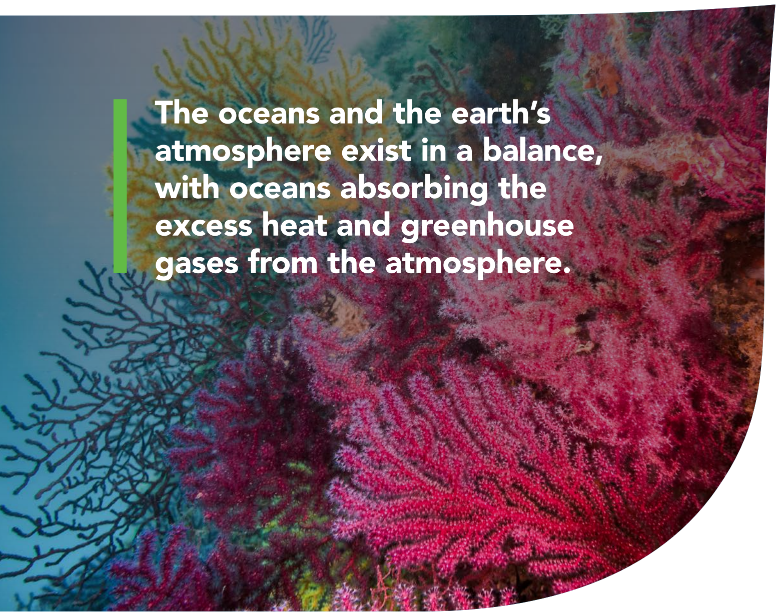
Five engagement themes for ocean sustainability

1. Addressing the climate crisis

The oceans and the earth's atmosphere exist in a balance, with oceans absorbing the excess heat and greenhouse gases from the atmosphere. Oceans have absorbed over 90% of the excess heat in the climate system, with the rate of take-up increasing in the past few decades.[9] The increased water temperature negatively impacts habitats and contributes to sea level rise, as water expands at higher temperatures. Rising temperatures are also causing ice shelves and glaciers to melt at faster rates. The resulting heightened risk of flooding and submersion poses a threat to major cities and coastal communities, including the infrastructure and the diverse economic activities located there.

Ocean warming is also altering global ocean currents, which will have knock-on effects on weather patterns around the world. The increased concentration of greenhouse gases in the oceans is changing their chemical composition and causing acidification, which has a detrimental impact on coral reefs and other species. In fact, research shows that if temperatures rise more than 2°C above pre-industrial levels, coral reefs are likely to become extinct.[10]

It is thought that between 50% and 80% of the world's oxygen comes from the ocean, mostly from oceanic phytoplankton during photosynthesis.[11] This process absorbs carbon dioxide from the atmosphere and eventually locks up carbon deep in the ocean. Other species also act as important carbon stores – a single whale can capture 33 tons of CO_2 over its lifetime.[12]



[9] Carbon Brief, Heat absorbed by oceans has doubled since 1997
[10] IPCC, Special Report on Global Warming of 1.5 °C
[11] NOAA, How much oxygen comes from the ocean?
[12] Protecting whales to protect the planet
[13] Federated Hermes International, Climate Change Expectations
[14] UN Global Compact, 5 Tipping Points for a Healthy and Productive Ocean By 2030
[15] What Is Eutrophication? – WorldAtlas
[16] EllenMacArthurFoundation_TheNewPlasticsEconomy_Pages.pdf
[17] Great Pacific Garbage Patch | National Geographic Society
[18] Ocean plastic pollution | Fauna & Flora International (fauna-flora.org)

Companies must urgently mitigate their contribution to climate change to protect the oceans. This requires a commitment to net-zero emissions by 2050 at the latest, with supporting science-based short- and medium-term targets. We responded to the Science-Based Targets initiative (SBTi) consultation on net-zero target setting, which seeks to bring greater assurance to companies' long-term targets and interim goals. Risk management and disclosure should be aligned to the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD). Our *Climate Change Expectations*[13] provide further details of how companies should address climate change. To achieve a healthy and productive ocean, the UN Global Compact highlights the need to harness renewable ocean energy, such as offshore wind and tidal energy, on a much greater scale.[14]

Companies must urgently mitigate their contribution to climate change to protect the oceans.

We engage with companies across all relevant sectors on climate change. We recently engaged with a Malaysian shipping company on its decarbonisation strategy, board oversight of climate change, and improving climate-related risk management. We are engaging with companies in the food and beverage sector to address supply chain emissions and to encourage a transition to more regenerative and climate-smart agricultural practices as a way to future-proof business models and improve ocean sustainability.

We also engage on public policy measures that will support the private sector in addressing climate change. We have been advocating for mandatory climate-related reporting in line with the recommendations of the TCFD through our public policy consultations to the US Securities and Exchange Commission and the UK's Department for Business, Energy and Industrial Strategy. This will require companies to report on both transition risks and physical risks, to which coastal communities and small island nations may be most vulnerable.

2. Tackling pollution

Pollutants and toxic materials, such as chemicals, industrial waste, oil and plastics, can cause significant harm to ocean ecosystems. Sewage plants, chemical fertilisers and pesticides can cause eutrophication,[15] which is when inorganic nutrients, such as nitrogen and phosphorus, fuel the excessive growth of algae and aquatic phytoplankton. This results in oceanic dead zones devoid of native plants and animals due their low levels of oxygen.

Plastics pollution is also a threat. In 2016,[16] the Ellen MacArthur Foundation highlighted that there could be more plastic than fish in the oceans by 2050. Marine debris, primarily plastic rubbish, has accumulated in the notorious Great Pacific Garbage Patch,[17] a floating vortex of discarded rubbish between the US and Japan. Plastic waste enters the ocean through rivers, while discarded plastic fishing nets also contribute to pollution and the death of marine wildlife. Conventional plastics break into ever smaller pieces – so-called microplastics that measure under 5mm and accumulate chemicals on their surface. These have become ubiquitous in the marine environment, posing a danger to ocean-dwelling animals, and entering the global food chain.[18]

Investors can voice their concerns about such polluting activities. Depending on the sector, this might mean calling for a reduction in the use of harmful substances that end up in the oceans, such as single-use plastics, and better substance management and processes to address issues such as chemical runoff. With regard to plastic, EOS has set out expectations for companies in the consumer goods, retail and chemicals sectors in the white paper *Investor Expectations for Global Plastics Challenges*.[19] A shift towards circular economy practices that create a closed loop is needed, where materials are fed back into production at the end of their use phase. With an increase in regulation and changing consumer preferences, companies adopting such practices would be considered more resilient.

EOS has a strong record of engaging with companies in different sectors on the prevention of plastics pollution. With retailers we have focused on reducing single-use plastics, setting targets for this reduction, and for recyclability, recycled content and recycling rates. We have engaged with consumer goods and apparel companies to address plastic packaging and the use of synthetic fibres in clothing.

EOS has a strong record of engaging with companies in different sectors on the prevention of plastics pollution.

In 2020, we engaged with a Japanese shipping company about the impact of an oil spill on the local marine environment. We wanted to understand the cause of the accident, the company's measures for preventing another incident, and what it was doing to mitigate and rectify the environmental damage caused.

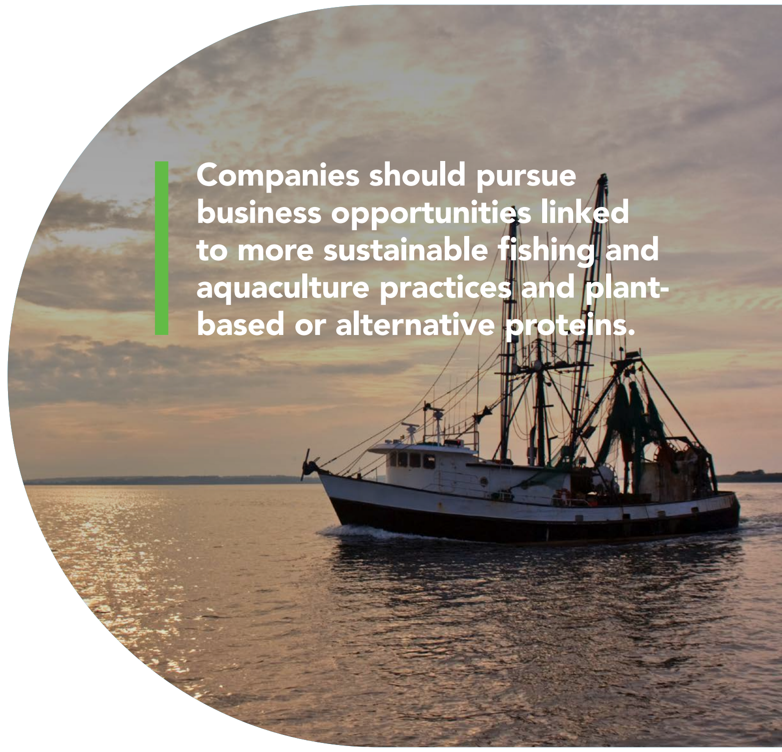
3. Transitioning to sustainable food systems

It is estimated that the principal livelihoods of 880 million people depend on the fisheries sector, with 198 million people directly employed by fisheries and aquaculture or their associated value chain.[20] Fishing is important from a food security perspective and provides the main source of protein for more than a billion people. However, fishing is one of the key drivers of marine wildlife decline alongside climate change and pollution.[21]

Current practices lead to overfishing, where fish are caught at a faster rate than they can repopulate themselves, bycatch, and the destruction of key marine habitats such as coral reefs. Bycatch is the unintended capture of non-target fish species and other marine wildlife such as cetaceans (whales, dolphins and porpoises), sharks, marine birds and sea turtles. It is caused by the use of non-selective fishing gear such as longlines, trawling and gillnets. This sort of gear is estimated to cause the death of 300,000 small whales, dolphins, and porpoises each year, while hundreds of thousands of turtles drown from entanglement in fishing nets.[22] According to the UN Food and Agriculture Organization, the number of overfished stocks globally has tripled in the past 50 years, with a third of fish stocks currently overfished.[23]

Systemic overfishing and loss of marine biodiversity is compounded by the pervasiveness and scale of illegal, unreported, and unregulated (IUU) fishing, which is estimated to account for up to

30% of the catch for high-value fish species.



Systemic overfishing and loss of marine biodiversity is compounded by the pervasiveness and scale of illegal, unreported, and unregulated (IUU) fishing, which is estimated to account for up to 30% of the catch for high-value fish species. IUU fishing ignores quotas, permitted fishing areas and bycatch mitigation measures. According to the World Wide Fund for Nature, over 85% of global fish stocks are at significant risk of IUU fishing.[24]

To address these issues and mitigate the associated financial and reputational risks to companies and their investors, responsible fishing and aquaculture practices need to become the norm and animal protein consumption must be reduced. Investors should expect companies to show to what extent sustainable fishing practices are used, to demonstrate the traceability of their seafood supply chain, and to put in place policies to mitigate any significant negative impact on marine wildlife associated with their operations and supply chain. Companies should also pursue business opportunities linked to more sustainable fishing and aquaculture practices and plant-based or alternative proteins. Priority sectors include aquaculture, wild-catch fisheries, food producers, restaurants, consumer goods and retailers.

[19] investor-expectations-for-global-plastics-challenges-april-2020.pdf (hermes-investment.com)
[20] Scoping study on decent work in fisheries and aquaculture. Issues and actions for discussion and programming (fao.org)
[21] Ocean Habitat | Habitats | WWF (worldwildlife.org)
[22] What is Bycatch? Understanding and Preventing Fishing Bycatch (worldwildlife.org)
[23] The State of World Fisheries and Aquaculture 2020 (fao.org)
[24] scale-illicit-trade-pacific-ocean-marine-resources.pdf (wri.org)

EOS has engaged with retailers such as Sainsbury's and food producers such as Kerry Group, General Mills and Tyson Foods over a number of years. We have asked them to demonstrate a comprehensive approach to protein diversification covering commercial strategy, resilience of protein sourcing strategies, nutritional profile improvements, and tracking their exposure to animal and plant-based proteins.

4. Reversing the loss of biodiversity

Oceans are thought to be the most biodiverse areas on earth, estimated to contain 50-80% of the total biodiversity on the planet.[25] However, climate change, pollution and overfishing are threatening habitats and species, in some cases before they have been discovered. The Living Planet Index shows an average 68% fall in the population sizes of mammals, birds, amphibians, reptiles and fish between 1970 and 2016.[26] As species exist in a delicate balance, disruptions to whole food chains are created when some species are over-exploited or are no longer able to survive in the altered environment.

Marine species have intrinsic value but may also facilitate new medical treatments and deliver other benefits for people. The properties of sea sponges are thought to be valuable for treating some cancers and infectious diseases, for example.[27]

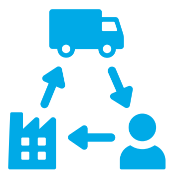
Our white paper on biodiversity, *Our Commitment to Nature*,[28] outlines an engagement framework and expectations for companies. It is critical that companies understand their impacts and dependencies on biodiversity, including marine biodiversity. We are encouraging companies to commit to having a net-positive impact on biodiversity throughout their operations and supply chains by 2030 at the latest.

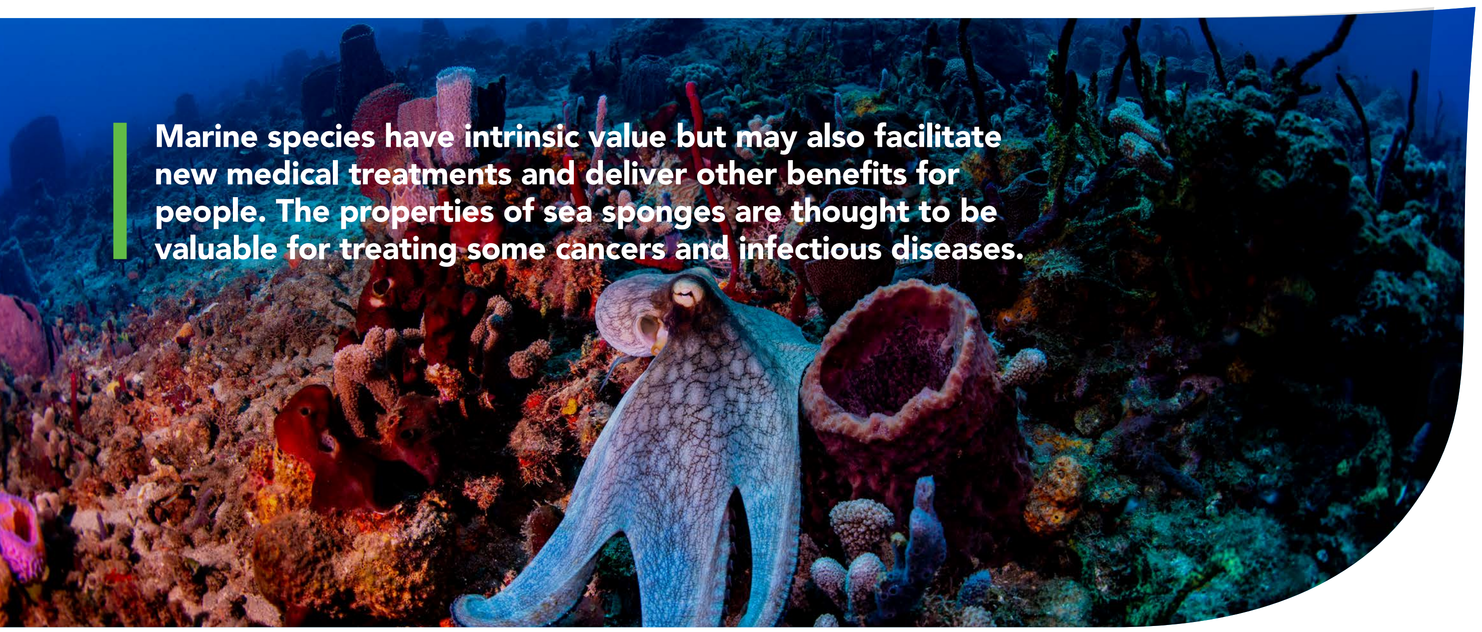
Dependencies may include generating revenue for the tourism industry, the discovery of new drugs for the pharmaceuticals sector, and the continued supply of seafood for food-related industries. Once companies have identified their most material impacts and dependencies, a biodiversity strategy must focus on these issues. Key activities include reducing greenhouse gas emissions in line with the goals of the Paris Agreement, reducing the volume of fertiliser used in agricultural practices to minimise chemical runoff, and developing sustainable plastic and packaging strategies.

The Living Planet Index shows an average **68%** fall in the population sizes of mammals, birds, amphibians, reptiles and fish between 1970 and 2016.

As well as our direct engagements with companies, we are working on collaborative engagement initiatives and public policy engagement as signatories to the Finance for Biodiversity Pledge. With a small group of investors we are exploring the formation of a Nature Action 100, which would include collaborative engagement focused on ocean sustainability. We are also urging governments to agree an ambitious Global Biodiversity Framework at the upcoming COP 15, as the private sector needs support from regulators if we are to collectively halt and reverse biodiversity loss.

We are encouraging companies to commit to having a net-positive impact on biodiversity throughout their operations and supply chains by 2030 at the latest.





[25] EcoMENA, Deep Oceans and Biodiversity
[26] WWF Living Planet Report, 2020
[27] Mongabay, The sponge with the secret recipe: A cancer-fighting chemical
[28] EOS, Our Commitment to Nature, 2021

5. Protecting human rights

The global seafood industry, and in particular IUU-fishing, is linked to labour-related challenges and serious human rights abuses. The industry is characterised by informal, isolated, seasonal, remote and often hazardous work, and a lack of transparency around conditions in the complex value chain increases the vulnerability of crews. Declining fish stocks driven by overfishing coupled with growing consumer demand for cheap seafood has led to increased abuse of fishing crews. As labour costs are often the largest part of vessel expenses, ship operators may target migrant worker groups who are especially vulnerable to human traffickers, abusive brokers and captains.[29] The International Labour Organization has estimated that 40.3 million people are victims of modern slavery, of which 25 million are in forced labour.[30] Some 11% of identified forced labour cases occur in the agriculture and fishing sector. Investigations into the seafood industry have uncovered abuses such as forced labour, unpaid wages, long hours, poor living conditions, physical abuse and even murder.

Over the past decade we have engaged on hundreds of supply chain human rights issues across the food, consumer goods and retail sectors. This includes engaging on human rights issues in the seafood supply chain with companies such as CK Hutchison. EOS engages using the UN Guiding Principles on Business and Human Rights framework and seeks to understand a company's operating context, governance, human rights due diligence and reporting of salient human rights risks, plus any actions taken to prevent and mitigate these risks, and the provision of remedy. The pandemic has highlighted the vulnerability of crews, with the International Maritime Organization estimating that 400,000 seafarers[31] were stranded at sea. Travel restrictions meant that crews were stranded on board for prolonged periods of time, unable to get home to their families. EOS has engaged with Asian and European shippers such as Swire Pacific and Maersk to determine how they managed and mitigated the negative impacts on the physical and mental health of their crews and facilitated their return home.

An opportunity for change

Our society is dependent on the oceans in a myriad of ways and it is therefore important to reverse this tragedy of the commons and nurture the long-term sustainability of ocean ecosystems. We will continue to explore new areas of company and public policy engagement to protect the oceans and ensure the continuity of the vast benefits that they yield. With the COP 26 for climate change and the COP 15 for biodiversity due to take place later this year, there is an excellent opportunity to place ocean sustainability higher on global policy agendas.

[29] Blood-water-06-2019-final.pdf (ejfoundation.org)
[30] wcms_575479.pdf (ilo.org)
[31] 400,000 seafarers stuck at sea as crew change crisis deepens (imo.org)

Abate and switch: steel seeks low carbon solutions

Steel production is extremely carbon and energy intensive, and there are technological challenges to reducing emissions. But such "hard-to-abate" sectors will come under increasing pressure. How do we engage with companies in this sector and what are the industry's options?

Setting the scene

Steel is used in everything from construction and cars to white goods, as well as wind turbines and mass transportation systems, which help to mitigate climate change. But steel production is both carbon and energy intensive, and there are considerable challenges to overcome to cut emissions. Although steel can be recycled, there is not enough scrap steel to meet the continued growth in steel demand. In addition, scrap impurities limit the potential for recycled steel, meaning that smelting of virgin iron ore is required for high grade products. Steel is therefore considered a hard-to-abate sector, but national net-zero commitments and pressure from customers mean that solutions must be found to help drive down emissions.

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Steel goods will play a vital role in the transition to a low-carbon world, but the production process itself is notoriously carbon and energy intensive, accounting for around 7% of energy sector CO_2 emissions.[1] Blast furnaces must run at temperatures of over 2,000°C, and the raw materials themselves – coking coal and iron ore – are extracted from the ground in other energy intensive processes.

According to the International Energy Agency (IEA), the steel industry is currently the largest industrial consumer of coal, which satisfies about

75% of its energy demand.

According to the International Energy Agency (IEA), the steel industry is currently the largest industrial consumer of coal, which satisfies about 75% of its energy demand. The IEA's recent *Net Zero by 2050* report shows that emissions from heavy industry, including steel, must decline by 20% by 2030 and by 93% by 2050, versus 2020 levels.[2] Almost 60% of this reduction is modelled to come from technologies that are under development today. Over the same period, global demand for steel is expected to increase by more than a third.[3]

[1] https://iea.blob.core.windows.net/assets/eb0c8ec1-3665-4959-97d0-187ceca189a8/Iron_and_Steel_Technology_Roadmap.pdf
[2] Net Zero by 2050 – A Roadmap for the Global Energy Sector (windows.net)
[3] https://www.iea.org/reports/iron-and-steel-technology-roadmap

Steel producers need to reduce the carbon intensity of their processes, rather than continuing on their current path. If they fail to act, they may find themselves exposed to regulatory risks and chasing increasingly expensive carbon offsets alongside other high-emitting sectors such as airlines. But the industry faces a number of challenges on the road to decarbonisation.

Decarbonisation challenges

Over 70% of global steel production currently comes from blast furnaces, where coke is used to achieve the very high temperatures needed. Electric arc furnaces emit significantly less carbon than traditional blast furnaces, using electricity to melt recycled steel in a process that is estimated to use up to 10 times less energy.

Unlike plastics or paper, which have a short life cycle, it can be

20-50

years before steel reaches the end of its useful life and becomes available for recycling.

However, a large-scale switch from blast to electric arc furnaces is not feasible, as scrap impurities in recycled steel mean that manufacturing high value-added products is more of a challenge. In addition, there is not enough recycled steel to meet the demand in fast-growing emerging markets. Unlike plastics or paper, which have a short life cycle, it can be 20-50 years before steel reaches the end of its useful life and becomes available for recycling.

Another problem is the large fleet of relatively young blast furnaces in Asia. With so much sunk capital, switching to electric arc furnaces is not feasible in the near-future, so there is a strong imperative to find ways to decarbonise existing blast furnace steel production.

Risks and opportunities

Given the urgent need to align all sectors with the goals of the Paris Agreement to keep global temperature increases within safe limits, maintaining a business-as-usual stance presents a number of risks for steel producers and their investors.

Countries such as Sweden, the UK, France, Denmark, New Zealand and Hungary have already made legally-binding national net-zero emissions commitments[4], and some three-quarters of 2020 steel production came from countries where such commitments were in law, in proposed legislation or set out in a policy document.[5]

At the same time, buyers of steel products such as car manufacturers and construction companies are committing to net-zero targets that apply across their supply chains, and so will be seeking zero-carbon steel to help them get there. SteelZero, an initiative launched in December 2020, is bringing steel buyers together to drive the demand for zero-carbon steel.[6] Steel producers who can decarbonise early will benefit from a first-mover advantage by satisfying this demand. However, regulatory intervention may be required to support investment and help the sector as a whole.

In another sign of the growing impetus for change, a group of six banks formed the Steel Climate-Aligned Finance Working Group, to help define common standards of action for steel sector decarbonisation through a collective climate-aligned finance agreement.[7]

SteelZero, an initiative launched in December 2020, is bringing steel buyers together to drive the demand for zero-carbon steel.

Producers who fail to innovate may run the risk of asset stranding. This may be the case for some of the newer blast furnaces in Asia, particularly if the European Union introduces a carbon border tax or similar adjustment mechanism to level the playing field and avoid carbon "leakage". This describes a situation where higher carbon-emitting players gain a trade advantage by avoiding locally-applicable carbon taxes.

Over 70% of global steel production currently comes from blast furnaces, where coke is used to achieve the very high temperatures needed.

[4] Which countries have a legally-binding net-zero emissions target? (nsenergybusiness.com)
[5] Calculated by the international business of Federated Hermes using World Steel Association data from 2020 production by country and Net Zero Tracker, Energy & Climate Intelligence Unit
[6] Building demand for net zero steel | The Climate Group
[7] Six global banks join forces to decarbonize steel – Climate Action

Our engagement approach

We engage with some of the world's largest steel producers including Posco and Severstal, where we co-lead the collaborative engagement with the companies as part of Climate Action 100+ (CA100+). Our expectations of steel companies to address climate change are as follows:

- **Net-zero emissions by 2050 at the latest –** Several companies including ArcelorMittal and Posco have recently made this commitment, following engagement.
- **Supporting short and medium-term targets –** Once a long-term goal is in place, short- and medium-term targets should be set, aligning with Paris Agreement goals along the journey to net zero. This is to avoid a disorderly, late transition and steel producers continuing to pump out high levels of greenhouse gases up until 2050, baking in catastrophic levels of global heating for decades to come.
- **A strategy for how these goals will be met –** Targets should be supported by a clear strategy for decarbonisation, indicating the technologies the company will be relying upon.
- **Capex and R&D spend aligned with the goals of the Paris Agreement –** These should be reflective of the company's chosen strategy and demonstrate its contribution to the commercialisation of key technologies.
- **Strong governance and aligned executive remuneration –** We expect strong oversight from board directors with the skills and experience to hold management to account for delivering on the long-term climate strategy; executive pay should be tied to successful climate strategy delivery.
- **Reporting in line with the TCFD recommendations, including scenario analysis –** Financial reporting and underlying risk management processes should be aligned with the four TCFD pillars; scenario analysis should be used to test the viability and resilience of business models under regulatory and market changes, including an EU Border Carbon Adjustment Mechanism and a 1.5°C scenario.
- **Paris-aligned lobbying and policy advocacy activity –** Companies should ensure lobbying and public policy activities are aligned with the Paris Agreement goals, including withdrawing from industry associations where views do not align.

Companies should ensure lobbying and public policy activities are aligned with the Paris Agreement goals.

Steel company engagements

1. ArcelorMittal

To this end, we engaged with ArcelorMittal, encouraging it to set a global net-zero target. In September 2020 it set such a group-wide commitment, building on its 2019 pledge for its European business to reduce emissions by 30% by 2030, and to be carbon neutral by 2050. It is exploring the use of hydrogen as a reducing agent at a demonstration plant in Hamburg, and in March 2021 it launched three initiatives under its XCarb trademark. These include an innovation fund that will invest up to $100m annually in companies developing pioneering or breakthrough technologies to accelerate the transition to carbon neutral steelmaking. Meanwhile, its Smart Carbon projects are aimed at reducing emissions from blast furnaces.[8]

2. NLMK

We have also engaged with Russia's largest steelmaker, Novolipetsk Steel (NLMK), on climate change and carbon emissions reduction with the objective of improving the management of climate-related risks. In September 2020, the company announced greenhouse gas emission reduction targets for 2023, which included investment projects to boost energy efficiency, reduce the consumption of carbon-containing fuels and develop decarbonisation technologies.[9]

It also joined Step Up, the World Steel Association's decarbonisation programme, which aims to reduce the industry's environmental impact. NLMK has worked to improve its energy intensity through equipment upgrades and better processes and aims to increase its electricity self-sufficiency to 94% by 2023.[10]

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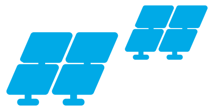

In 2021 we wrote a letter to the chair following the company's low Level 1 score by the Transition Pathway Initiative. Reviewing its response, we agreed it should be graded better at Level 3. NLMK has improved the management, governance and disclosure of its climate change risks and opportunities, aligning its reporting with the four pillars of the Task Force on Climate-related Financial Disclosures. It is also participating in the Net Zero Steel Pathway Methodology Project, which aims to develop recognised guidance on the net-zero transition pathway for steelmaking. We encouraged it to work on medium-term and long-term emission reduction targets to accompany its 2023 target.

3. Posco

Finally, we have engaged extensively with Posco on climate change as a co-lead for the company under CA100+. We asked Posco to set new, ambitious, long-term targets for reducing its Scopes 1 and 2 emissions in line with the Paris Agreement, and to adopt the recommendations of the TCFD. Posco has now set targets to reduce its carbon emissions by 20% by 2030, by 50% by 2040, and for carbon neutrality by 2050, against the 2017-2019 average baseline of its Scopes 1 and 2 emissions. It has also adopted the recommendations of the TCFD. You can read about this in detail online in our Posco case study.

[8] https://corporate.arcelormittal.com/media/press-releases/arcelormittal-launches-xcarb-signalling-its-commitment-to-producing-carbon-neutral-steel
[9] https://nlmk.com/en/media-center/news-groups/nlmk-group-updates-ghg-emission-reduction-targets-leading-up-to-2023/
[10] https://nlmk.com/upload/iblock/bee/NLMK-_-ESG-presentation-November-2020.pdf

Decarbonisation options and potential pitfalls

There are three possible routes to decarbonisation for steel producers to consider, but as each is insufficient alone, the industry will need to pursue all three.[11] Increasing the production of low-carbon steel will be expensive, so regulatory support is also required to facilitate decarbonisation and the scaling-up of technologies.

1. Demand management

According to the Energy Transition Commission, demand management could reduce emissions by over 35%[12]. In theory, a fully circular economy for steel is possible. However, as emerging markets continue to industrialise and urbanise at a rapid pace, the demand for steel is expected to remain strong well past 2050, particularly in countries such as India. Although companies can give some consideration to the redesign of products for efficiency and circularity, steel may be locked away for decades in bridges, ships, trains and buildings before it is scrapped and recycled.

2. Energy efficiency and renewable power

Promoting energy efficiency measures and best-in-class technologies could help to drive down emissions from the steel production process, especially in the next five to 10 years, according to the IEA.[13] This could reduce emissions from the steel sector by up to 20%.[12] The World Steel Association encourages its members to adopt measures such as heat or energy recovery, coke dry-quenching and electricity savings.

As the proportion of steel produced from electric arc furnaces increases, it is important to ensure the electricity is generated from renewable sources. However, if all electric arc furnaces currently in operation were fully powered by electricity from renewable sources, this would gobble up about 40% of existing global wind and solar generating capacity.[14] Nevertheless, the number of electric arc furnaces must increase significantly to reduce the sector's overall emissions.

3. Decarbonisation technologies

- **Carbon capture, utilisation and storage (CCUS) and offsetting –** At its most basic level, CCUS means capturing carbon dioxide emissions from sources such as blast furnaces and preventing them from entering the atmosphere either by reusing or storing the emissions. Offsetting means compensating for carbon dioxide emissions produced by the industry through other means, such as planting trees. However, reducing emissions is always preferable to CCUS and offsetting, which should be treated as a last resort.

  As steel production tends to be concentrated in particular locations (unlike aviation) it might be possible to capture the carbon emitted at source, by retrofitting the steel plant. This could then be stored – perhaps in depleted oil and gas fields – but this is currently untested. Even if it were technologically viable, CCUS would not be commercially viable without a very high carbon price (estimated at up to €215[15]). This is because it brings no benefits to the steelmaking process but would require significant additional energy and infrastructure to capture, transport and store the carbon. If the steel industry relies solely on offsetting, it will find itself in fierce competition for land from aviation and other hard-to-abate sectors, as well as agriculture.
- **Green hydrogen, biomass, and other alternatives to fossil fuel reductants –** Some companies are already exploring using replacements for coal in blast furnaces. For example, Brazil's Gerdau is trying out biomass (wood or charcoal), which is how steel was originally produced. But this relies on local availability, and the sustainability of the biomass production.

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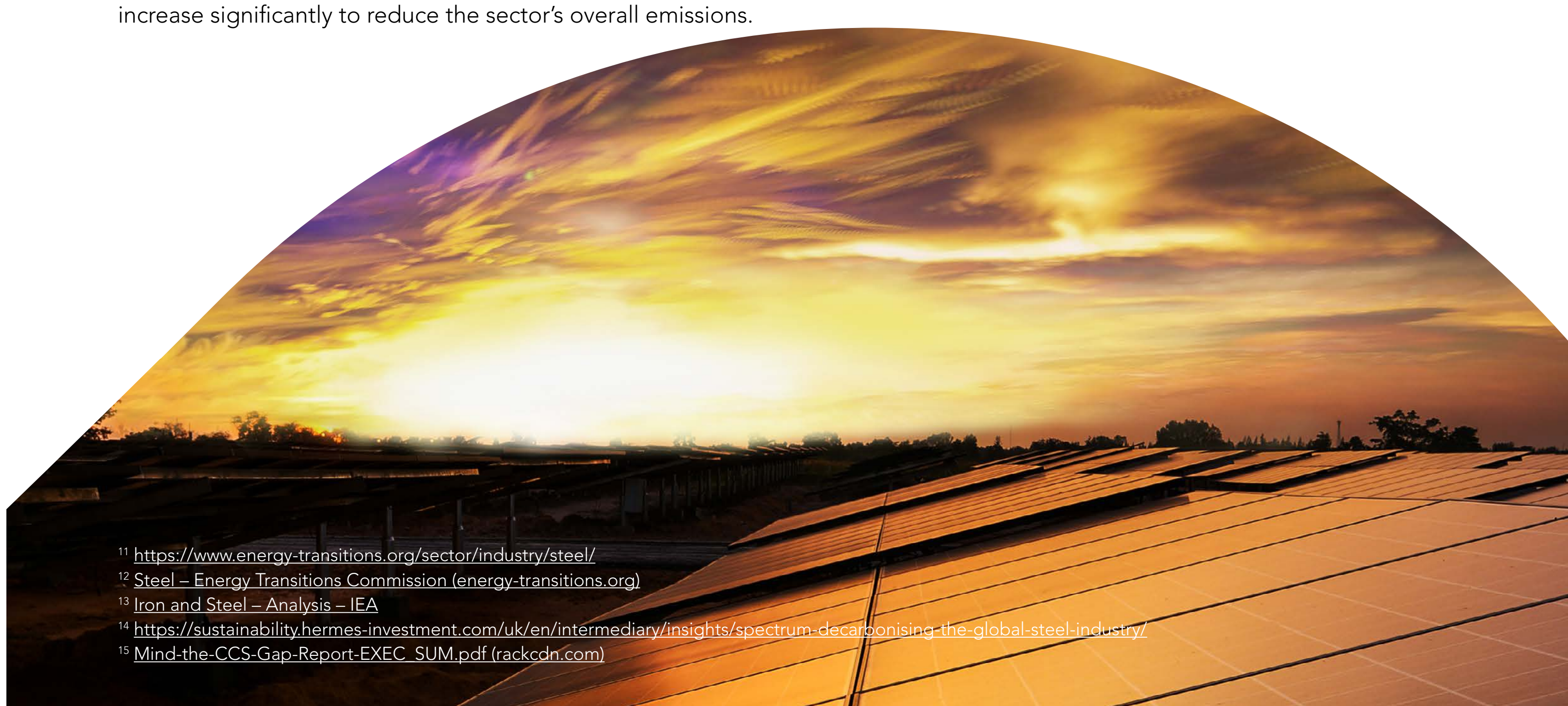
40% of existing global wind and solar generating capacity.



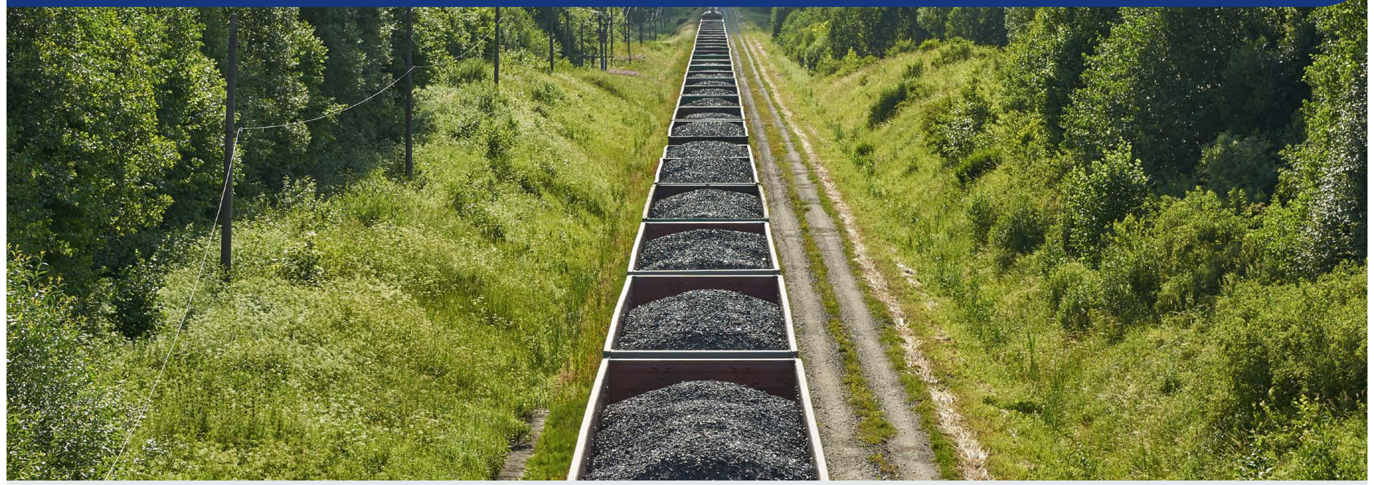
[11] https://www.energy-transitions.org/sector/industry/steel/
[12] Steel – Energy Transitions Commission (energy-transitions.org)
[13] Iron and Steel – Analysis – IEA
[14] https://sustainability.hermes-investment.com/uk/en/intermediary/insights/spectrum-decarbonising-the-global-steel-industry/
[15] Mind-the-CCS-Gap-Report-EXEC_SUM.pdf (rackcdn.com)

Companies such as ArcelorMittal and China Baowu are among those trialling hydrogen as a reducing agent in blast furnaces. However, climate neutral hydrogen is not likely to be available in sufficient quantities in the foreseeable future so natural gas may be used as a bridge. Hydrogen is also being used to produce directly reduced iron (DRI) as a potential feedstock for electric arc furnaces. Industrial hydrogen is currently regarded as "grey" – meaning it is derived from fossil fuels such as natural gas and lignite. Green hydrogen can be electrolysed from water using renewable power, but this is small-scale and highly energy-intensive. Another possible approach is to use electrolysis to reduce iron, as explored by Boston Metal and Siderwin, but to date this has only been achieved in lab conditions, not industrial trials.

Looking ahead

Now that some companies have announced net-zero by 2050 targets, we will be encouraging them to set ambitious short- and medium-term targets, to ensure there is progress in the near term. The significant technological challenges facing the steel industry mean that it must invest and innovate to achieve carbon neutrality, with appropriate support from regulators. We will look at companies' capital allocation decisions, to assess whether they are investing sufficient resources to achieve net zero, as well as collaborating with miners and the buyers of steel. In the coming years we will seek far greater clarity on the actions taken by each entity along the steel value chain, and the resources they have invested in pursuing net-zero solutions.

Reducing carbon emissions along the supply chain



Steel companies have an interest in reducing the emissions from their supply chain as iron ore and coal mining are energy intensive. These raw material inputs for steelmaking are also bulky and heavy to transport, generating more carbon emissions. How can each sector help the other, and how are we engaging with miners on this issue?

Although carbon emissions from the steel industry dwarf those from iron ore mining, the diggers, haulage equipment, pit winding gear and crushing and processing machinery all consume a great deal of power. Once the raw materials have been extracted, they must be transported to the steel plant – either by rail or by ship, with the latter burning dirty bunker fuels.

These emissions could be reduced if miners transitioned their dig, haul and rail fleets from diesel to electric power, hydrogen or fuel cell electric vehicles. The latter is a longer-term ambition, although mining EVs such as huge dumper trucks are being piloted. But mining companies should also work towards cutting their Scope 3 emissions – those arising from the use of their iron ore and coal in the steelmaking process.

To this end, miners are teaming up with their customers to develop and trial new technologies:

- We have engaged with Rio Tinto on climate action both one-to-one and as part of CA100+. Rio Tinto's iron ore customers are now 88% covered by national net-zero goals. We engaged with the company on related value chain actions and aims and welcomed its new Scope 3 Partnership Goals. Although we challenged that the goals remain high level without detail on emissions outcomes, the company stated that it will be able to articulate its goals better and report its progress against them as its partnerships develop.

  Rio Tinto has announced partnerships with steelmakers in China, Japan and Canada such as its $10m investment with Baowu for two ore preparation pilot plants, one using biomass and the other exploring microwave technology. In engagement we investigated the company's exposure to the substantial, and often new, blast furnace fleets in Asia, and the company's related view on carbon capture and storage. The company's partnership funding will also support work on carbon dioxide utilisation and conversion.[16]

[16] https://www.riotinto.com/en/news/releases/2020/Rio-Tinto-advances-climate-partnership-with-China-Baowu-Steel-with-US10-million-investment

- Vale is seeking to reduce its Scope 3 emissions by 15% by 2035 "through active engagement with clients from the steel and metallurgy industries". In 2020 it announced a tie-up with Kobe Steel and Mitsui & Co to supply low greenhouse gas metallics and steelmaking solutions to the steel industry.[17]

  We recently engaged with Vale's head of climate change, as part of CA100+, exploring its action plan to achieve its medium-term carbon emissions reduction targets. Vale aims to be a leader in low carbon mining and expects its peak carbon emissions to come in 2023, declining by 33% by 2030 in comparison with 2017.

  To achieve the 2030 target, Vale does not plan to use offsets for Scopes 1 and 2 emissions, with 80% of its electricity consumption coming from renewable sources already. It has invested in wind farms and other renewable energy projects in order to secure its energy supply.

  We said that we expect to see an ambitious plan to reduce Vale's Scope 3 emissions. Emissions from steelmaking account for 94% of these, and shipping accounts for 3%. The head of climate change said that approximately 20% of the Scope 3 reduction will come from Vale's own initiatives, such as developing new iron ore blends that will result in lower emissions when transformed into steel.

- BHP has agreed a five-year partnership with China Baowu with the intention of investing up to $35m and sharing technical knowledge to help the steel industry decarbonise.[18] BHP has also committed to reducing its Scopes 1 and 2 emissions by at least 30% by 2030 relative to 2020. The target is science-based and aligned with the company's ambition to be carbon-neutral by 2050. The plan to achieve the medium-term target is based on decarbonisation of the electricity supply and the truck fleet.

Vale aims to be a leader in low carbon mining and expects its peak carbon emissions to come in 2023, declining by

33% by 2030 in comparison with 2017.

We said that we expect to see an ambitious plan to reduce Vale's Scope 3 emissions.

We had asked BHP to strengthen the link between climate performance and remuneration, and this has been implemented. Actual reduction in operational emissions, actions to reduce operational emissions on the pathway to net-zero emissions, and actions to address Scope 3 emissions will be KPIs accounting for 10% of the short-term incentive plan.

- We co-lead the Climate Action 100+ collaborative engagement with Anglo American. The company is making substantial progress on technologies to reduce direct and energy use emissions. This includes technologies in the short-term for methane vent air capture, renewables at all sites during the decade, and piloting and rolling out hydrogen fuel cell trucks, as well as other technologies to reduce energy use.

  Regarding its value chains, we welcomed the company undertaking a 1.5-degree disruptive scenario analysis, which we see as key to really understanding the transition risks in the iron ore and metallurgical coal business in particular. We believe that greater disclosure is needed at the company, and the sector more broadly, on how value chain transition risks will be mitigated and capital allocated accordingly. We have also called on the company to set measurable goals for actions that will lead to emissions reduction outcomes in the value chain.

Jaime Gornsztejn
Sector lead: Industrial & Capital Goods

Andy Jones
Sector co-lead: Mining & Materials

In 2020 Vale announced a tie-up with Kobe Steel and Mitsui & Co to supply low greenhouse gas metallics and steelmaking solutions to the steel industry.

[17] http://www.vale.com/EN/aboutvale/news/Pages/vale-informs-on-non-binding-heads-of-agreement-with-kobe-steel-and-mitsui-co.aspx
[18] https://www.bhp.com/media-and-insights/news-releases/2020/11/bhp-partners-with-china-baowu-to-address-the-challenges-of-climate-change/

A watershed for climate change stewardship?

2021 may come to be viewed as a watershed year for climate change and investor stewardship, with a Dutch court decision against Royal Dutch Shell, Engine No. 1's proxy contest with Exxon, and majority support for a shareholder climate resolution at Chevron all occurring in May. With other recent developments, such as the International Energy Agency's Net Zero by 2050 report – and COP 26 on the horizon – have we reached a tipping point for climate stewardship?

If we needed more evidence that the pandemic has served as a wake-up call on climate for businesses, investors, policymakers and individuals, this year's voting season emphatically provided that. Mainstream sentiment has shifted, and the momentum is with investors calling for faster action on climate change.

We have seen this in the growing number of investment managers – including the international business of Federated Hermes – committing to net zero as part of the Net Zero Asset Managers Initiative.[1] Signatories pledge to work with their clients to reach a goal of net-zero greenhouse gas emissions by 2050 or sooner, in line with wider efforts to limit global warming to 1.5 degrees Celsius. With 128 signatories and around $43tn in assets, the initiative is close to representing almost half the global asset management sector in terms of total funds managed. Meanwhile, the UN-convened Net Zero Asset Owners Alliance has attracted over 40 institutional investors, representing over $6.6tn.

For further information, please contact:

Nick Spooner
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With climate transition votes on the agenda for the first time at some 18 annual shareholder meetings, the stage was set for a busy season of scrutinising the fine detail of companies' transition strategies. Aside from the growing investor concern, there is regulatory and societal pressure on companies to align more quickly with the goals of the Paris Agreement, but as yet no established consensus or unified framework to guide an assessment of how aligned companies are. This presented investors with an analytical challenge and allowed some companies to win votes for transition plans that in our view had significant gaps or were misaligned.

Signatories pledge to work with their clients to reach a goal of net-zero greenhouse gas emissions by 2050 or sooner, in line with wider efforts to limit global warming to 1.5 degrees Celsius.

Central banks, policymakers and other financial standard-setters are now cognisant that climate change poses a systemic risk – one that could be far more severe than the economic hit from the pandemic. Addressing it will require a multi-faceted response – from cutting carbon emissions and improving the assessment and reporting of climate risks, to reducing the impact from issues such as deforestation, and rewiring the global financial system to support the transition to a low carbon economy.

[1] Net Zero Asset Managers Initiative – Home

Here we examine some of the defining moments from the past quarter:

The IEA gets to grips with net zero

The publication on May 18 of a landmark special report by the International Energy Agency (IEA) outlining a 1.5-degree scenario set the scene for the oil industry shareholder meetings that followed. *Net Zero by 2050: A Roadmap for the Global Energy Sector*[2] was a leap forward for an influential organisation that had previously taken a conservative approach to the growth outlook for low-carbon technologies. The report set out the priority actions needed to build a global energy sector with net-zero emissions. It argued that the technical challenges were surmountable, that oil sales had peaked, and that gas would not be far behind.

Why was this so significant? The IEA had released a Net-Zero Scenario – though with very little detail – at the end of 2020. The report provided this detail. Previously the IEA had lacked a 1.5-degree scenario, with its Sustainable Development Scenario (SDS) and B2DS the closest, although these were in the range of 1.6-1.8 degrees of heating above pre-industrial levels. To appreciate the significance of these scenarios it is worth noting how widely these are used by companies in their own scenario planning, including large oil and gas companies such as Chevron. Whilst the IEA's scenarios are intended for policymakers, the granularity of the information on certain technologies and the outlook for commodities is information that can be integrated into company and investor financial modelling.

We have engaged with the IEA over several years about the publication of a 1.5-degree report, understanding how significant this would be for companies undertaking scenario analysis to determine their climate strategies. As well as signing letters to the organisation through the Institutional Investors Group on Climate Change (IIGCC) and other bodies, in 2019 we went to Paris with a small group of investors to meet the IEA's executive director, Fatih Birol, to talk about the possibility of producing a 1.5-degree scenario.

In future IEA reports we will be looking for clear price assumptions on commodities to help us understand whether fossil fuel companies are using reasonable assumptions within their annual reports and accounts.

Dutch court ruling against Royal Dutch Shell

NGOs have tried to win legal cases against fossil fuel companies in the past – and failed. But in a case brought by the Dutch arm of Friends of the Earth, the judge ruled that the oil and gas major should materially update its strategy to align to the Paris Agreement goals.[3] This includes setting a target to reduce its emissions by 45% in absolute terms by 2030 across its entire energy portfolio and the aggregate volume of all emissions including those of its products. Shell is appealing the decision, but if it stands, it could set a legal precedent. In the meantime, Shell is complying with the judgement and is accelerating its strategy.

The report set out the priority actions needed to build a global energy sector with net-zero emissions.

We have engaged with the IEA over several years about the publication of a 1.5-degree report, understanding how significant this would be.

The NGO's case was that Shell's strategy had not given due consideration to its duty of care to protect human rights under the Dutch Civil Code. Although Shell's goal is to become a net-zero business by 2050, the judge ruled that it must cut emissions deeper and earlier. Just a few weeks prior, investors had endorsed Shell's climate strategy through a 'say-on-climate' vote that delivered 88% support.

We had recommended a vote against the company's transition strategy because it appeared misaligned with the Paris Agreement goals, with a lack of climate action safeguards such as absolute reduction targets before 2050 or commitments to align the company's capex with meeting the Paris goals. We also recommended a vote against the financial reporting due to the lack of progress on aligning with Paris Agreement scenarios.

Over the past 12 months we have seen other legal challenges brought against big polluters based on climate damages – but this is the first where a company has lost.

The judge said that there was a human rights obligation on the company to take further action. This suggests that it may not be sufficient just to consider climate-related financial risks based on the impacts from the energy transition and maintaining shareholder value. Investors and companies may also need to consider the impact of each business on the environment and the future harms that may be caused by historical emissions.

Over the past 12 months we have seen other legal challenges brought against big polluters based on climate damages – but this is the first where a company has lost. This should set alarm bells ringing at high-emitting companies. If a company's historical emissions are used to assess its overall environmental impact, there could be a higher level of litigation risk, even if a company's net-zero plans are robust. For example, over 90% of RWE's capex is now going into environmentally-sustainable investments[4], but in the past it was the largest emitter in the EU. One way to mitigate this risk might be for companies to set net-negative targets to reduce their past contribution.

[2] Pathway to critical and formidable goal of net-zero emissions by 2050 is narrow but brings huge benefits, according to IEA special report – News – IEA
[3] Dutch court orders Shell to accelerate emissions cuts | Financial Times (ft.com)
[4] As determined by the EU Taxonomy – https://www.group.rwe/en/press/rwe-ag/2021-05-12-rwe-confirms-forecast/

Votes on climate transition plans

This voting season saw a series of formal shareholder votes on companies' climate transition plans in the US, Canada, the UK, France and Spain, among others. This followed attempts in recent years to improve investor scrutiny of companies' actions on climate, and reflected the rapid expansion in company commitments to achieving net-zero emissions.

Whilst we were supportive of the idea in principle, we had some initial concerns about the concept. The high level of support for transition plans, including Shell's, suggests these concerns were justified. There is a tendency for investors to vote in line with management, which may suggest they do not have the technical skills or the time to evaluate plans properly. One of the biggest dilemmas is how to balance the absolute performance of the company in terms of its commitments and how Paris-aligned these are, against its general momentum on climate.

We decided to apply a more rigorous approach in our assessment of transition plans, setting a robust standard of alignment to the Paris Agreement goals for companies to pass. This meant that we recommended voting against some high profile names, including Total, Glencore, Shell and Aena (see our voting season article on page 21 for more details).

To an extent, high levels of investor support for such plans should have been expected as most of the companies targeted were considered "leading" on the climate transition in their sector. However, few companies came out of the process unscathed, given the public scrutiny. More investors are asking for such votes as an accountability mechanism, and we are seeing more large asset managers backing shareholder proposals calling for Scope 3 targets, as at Chevron, or supporting shareholder-proposed directors with a view to improving the company's stance on climate change, as at Exxon. However, there is still work to do to ensure that more investors understand what it takes to be Paris-aligned.

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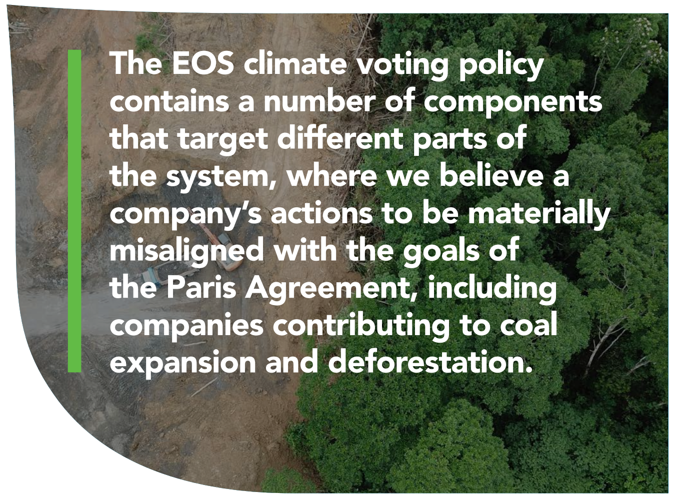

The EOS climate voting policy contains a number of components that target different parts of the system, where we believe a company's actions to be materially misaligned with the goals of the Paris Agreement, including companies contributing to coal expansion and deforestation.

Leaders and laggards

In March, Climate Action 100+ issued its net-zero benchmark for the world's largest carbon emitters.[5] This defined the key indicators of success for business alignment with a net-zero emissions future and the Paris Agreement goals. The benchmark, which we had helped to design, set clear engagement priorities to drive faster climate action. However, the benchmark assessments showed that no company had fully disclosed how it would achieve its goals to become a net-zero business by 2050 or sooner. The plan is to refine and expand the benchmark over time and it is likely to become a key test for companies.

EOS has continued its leadership on climate change engagement and voting by developing and testing its own assessments of companies and reflecting this in its voting recommendations. We have had a formal climate change voting policy in place since 2019, using the Transition Pathway Initiative (TPI) scoring system. While valuable, this assessment is reasonably limited in scope and in 2021 we expanded our policy to draw on a broader assessment of companies' actions.

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The EOS climate voting policy contains a number of components that target different parts of the system, where we believe a company's actions to be materially misaligned with the goals of the Paris Agreement, including companies contributing to coal expansion and deforestation.

Given the growing momentum on this issue as COP 26 edges closer, companies stubbornly refusing to accept that climate change is something that they must address will be increasingly exposed – and vulnerable to accelerated policy changes and lawsuits. Investors are losing patience with the laggards, and a company's failure to pick up the pace could prove value destructive. This could happen sooner than some companies seem to think.

[5] https://www.climateaction100.org/news/climate-action-100-issues-its-first-ever-net-zero-company-benchmark-of-the-worlds-largest-corporate-emitters/

Votes for change

This year we saw a notable increase in shareholder resolutions seeking a vote on climate transition plans, and proposals for racial equity audits. Investors are calling for a swifter, more fundamental response to these deepening environmental and social crises.

Setting the scene

This voting season saw the emergence of formal shareholder votes on companies' responses to climate change. This followed attempts to improve investor scrutiny of companies' actions on climate and the rapid expansion in company commitments to achieving net-zero emissions.

Meanwhile, investor focus on racial equity continued. Our tightening vote policies led us to oppose FTSE 100 chairs in the UK at five meetings for failing to meet minimum expectations for racial diversity on boards, while shareholder proposals filed with several US companies urged each board to oversee a racial equity audit analysing the company's impacts on non-white stakeholders and communities of colour. Finally, as the impacts of the coronavirus pandemic continued to be felt around the world, scrutiny of company actions – including the treatment of employees and executive pay – remained high on the agenda.

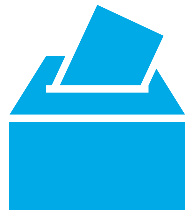
Amy Wilson
Theme co-lead: Business Purpose & Strategy
amy.wilson@hermes-investment.com

The 2021 voting season took place in the shadow of the coronavirus pandemic, with its impacts still being felt. Companies continued to hold shareholder meetings virtually or in hybrid formats, with 2021 being a key year to establish new practice norms.

We made at least one voting recommendation against management at

67% of meetings, up from

61% in the first half of 2020.



Some countries, such as Denmark and Japan, introduced legislation to allow virtual-only meetings, leading companies to propose changes to their Articles of Association to allow this. We selectively supported these, for example at Maersk and Novo Nordisk, where we were able to gain assurances that companies would conduct the meetings in ways that protect all shareholder rights and that they would return to in-person or hybrid meetings as soon as practicable. For Japanese companies, we said they should not conduct a virtual-only meeting unless absolutely necessary. We supported this type of proposal at Takeda Pharmaceutical, SoftBank Group and Sumitomo Mitsui Banking Corporation.

In the first half of 2021, we made voting recommendations at 9,630 meetings, versus 7,976 over the same period in 2020. We made at least one voting recommendation against management at 67% of meetings, up from 61% in the first half of 2020. We 'attended' and asked questions at 22 shareholder meetings, including Deutsche Bank, BP, Google owner Alphabet, Novartis, Amazon and Facebook, up from nine in 2020.

We made statements at nine meetings and asked live questions at six, submitting questions in advance for others. We recommended votes on 2,395 shareholder resolutions in the first half of 2021. Some 468 of these were in the US (versus 420 in 2020), where we recommended against management on 262 proposals or 56% (versus 64% in 2020).

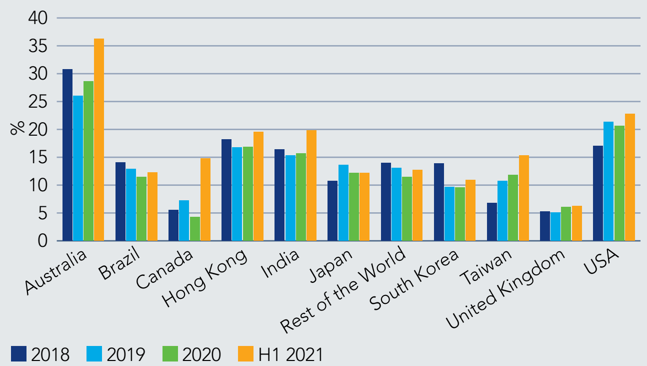
Climate change

2021 can be seen as a tipping point for investor engagement and voting on climate change, with the emergence of 18 'vote on transition' proposals at companies spanning oil and gas, construction, aviation, and consumer goods. Japan saw its second and third shareholder resolutions on climate change, after the first at Mizuho Financial Group in 2020.

This year, two similar proposals were filed at Mitsubishi UFJ Financial Group and Sumitomo Corp, asking the companies to align their business strategies to the Paris Agreement goals. These companies were targeted for their significant exposure to fossil fuels, including coal. We accelerated our engagements with them, while also seeking views from the NGOs who had filed the proposals, then recommended support for both.

EOS has had a formal climate change voting policy in place since 2019 targeting climate change laggards and we strengthened this again in 2021. We continued to use the Transition Pathway Initiative (TPI) assessment, setting a threshold of Level 4 for all European companies, coal mining companies or oil and gas companies, or Level 3 for all other companies. We also identified several other areas where we believed a company's actions were materially misaligned with the goals of the Paris Agreement, including companies contributing to coal expansion and deforestation.

Percentage of proposals voted against management per key market



Source: EOS data

This year the policy identified over 250 companies - versus around 130 in 2020 - including over 190 outside the EOS engagement programme. We wrote to companies setting out the reasons for our concern and requesting further engagement, and saw a high level of response. This enabled us to successfully engage with over 45 companies beyond the core engagement programme. The work is ongoing, as many of the companies identified are based in regions where shareholder meetings will be held later in the year.

To date, we have recommended opposing the election of the responsible director for climate change (usually the chair) at over 100 companies, including Canadian Natural Resources and China Resources Cement Holdings. We supported directors by exception to our policy at companies where we noted progress or gained assurance that positive changes would be made, including at Itochu.

Climate transition plan votes

This year also saw the emergence of 'say-on-climate' resolutions, with various companies facing a shareholder vote to approve their climate change transition plan. This came in response to various movements to improve investor scrutiny of such plans, following the rapid expansion in the number of companies aiming to achieve net-zero emissions.

EOS is generally supportive of the concept of a vote on transition plans, believing it will improve a company's focus on climate change and aid transparency. It will also improve investor scrutiny and engagement, and provide a clear pathway to engagement escalation in the event of material opposition from shareholders.

We sought to support proposals that demonstrated robust target-setting, were aligned to external frameworks and accreditations such as the Science-Based Targets initiative, and where we could see a clear and credible strategy in place to achieve the stated targets, including at Unilever, Aviva and Nestlé. However, we did not support the proposed climate plans at Royal Dutch Shell, Glencore and Total, as these did not appear to be aligned to the Paris Agreement goals, or at airport operator Aena, due to a lack of targets for the Scope 3 emissions that are critical to its transport infrastructure.

In our role as Climate Action 100+ (CA100+) co-lead for the French oil and gas major Total, we led a group of 35 institutional investors to move a collective statement[1] at the annual shareholder meeting. Although we and the other CA100+ co-leads all recommended voting against Total's climate policy, only 8% of shareholders did so, demonstrating that there is more work to do to educate investors on what it takes to be Paris aligned. Similarly, at Royal Dutch Shell, its policy attracted a vote of only 11% against, but a Dutch court differed in its view (see page 19) and a separate resolution requiring targets aligned to the Paris goals attracted 30% support.

We also led a delegation of eight institutional investors who spoke at the annual shareholder meeting of chemicals company LyondellBasell, in our role as CA100+ lead. While the other agenda items together took only 12 minutes to resolve, this was followed by over 45 minutes of debate on the company's climate change strategy. This elicited some useful, if still rather vague commitments on a forthcoming new climate strategy anticipated for Q3. Earlier this year, we had escalated this engagement by obtaining support from 27 institutional investors to use a legal mechanism under Dutch law to require a discussion on climate change at the shareholder meeting – the only legal route used by CA100+ in Europe this year.

Proxy battle at Exxon

In the US, oil major Exxon, another notable climate change laggard, partially lost a proxy battle with activist investor Engine No. 1. Three out of four directors proposed by Engine No. 1 were appointed against management advice, with a view to improving the company's stance on climate change. We recommended support for all four, believing that additional board refreshment would preserve and enhance long-term shareholder value through the energy transition.

Engine No. 1's concerns about Exxon's long-term financial underperformance, overly aggressive capex, and lack of sufficient plans for climate change echoed those expressed in our engagement with the company over the years. We also recommended support for various shareholder resolutions that we believed would enhance transparency and action on climate change and related material issues.

Meanwhile, a shareholder resolution requiring Scope 3 targets at another US oil major, Chevron, gained 61% support from investors. We had recommended support for the proposal, noting that Chevron's existing strategy in relation to the energy transition appeared to assume that it would not need to shrink in the short, medium and possibly long term. Accordingly, it had set emission intensity targets for its Scopes 1 and 2 emissions only. To us, this seemed a very high-risk strategy, made riskier by being widely shared by its sector peers.

A shareholder resolution at Chevron requiring Scope 3 targets gained **61%** support from investors.

We also recommended support for another proposal requesting an audited report on how a significant reduction in fossil fuel demand, as envisaged by the International Energy Agency's net-zero 2050 scenario, would impact the company's financial position and underlying assumptions.

Diversity and inclusion

We have tightened our voting policies for diversity and inclusion, demanding greater representation of women and ethnic minorities on boards and amongst leadership teams. Globally, we opposed the re-election of directors deemed most responsible due to concerns about insufficient diversity. In the US, where we expect women and ethnic minorities to make up at least 40% of the board at the largest companies, we opposed 39% of nominating committee chairs, including at Kinder Morgan, Thermo Fisher Scientific and Discovery.

In the UK, we continued to push for greater gender diversity on boards and among executives/leadership teams. We expect FTSE 350 boards in the UK to have reached 33% female representation, for FTSE 100 companies to have at least one woman on the executive committee, and for women to comprise at least 20% of the executive committee and its direct reports. We opposed the directors responsible (typically the board chair) at companies that fell below our expectations, such as at Ocado, Imperial Brands and Glencore.

[1] https://www.iigcc.org/media/2021/05/Total-2021-AGM-Statement-.pdf

CASE STUDY

Berkshire Hathaway and climate change

In November 2020, the international business of Federated Hermes together with California Public Employees' Retirement System (CalPERS) and Caisse de Dépôt Et Placement Du Québec (CDPQ), filed a shareholder proposal asking Berkshire Hathaway's board to publish an annual assessment addressing how the company manages physical and transitional climate-related risks and opportunities. Tim Youmans, the EOS lead for North America, spoke at the 2021 shareholder meeting on behalf of the proposal.

We had concerns that the board of Berkshire Hathaway believes climate-related disclosures to be immaterial and unnecessary for investor interests, and that climate change is not a major threat to aspects of the company's business, including its insurance operations. The company only provides qualitative statements that its subsidiaries are managing climate risks effectively. For over a year Berkshire Hathaway was unresponsive to our repeated requests to engage at the parent company level on climate-related reporting and targets.

In conjunction with CalPERS and CDPQ, we filed a shareholder proposal, hoping to trigger a dialogue with Berkshire Hathaway on climate change. Following confirmation in February that the company would include the shareholder proposal in its definitive proxy statement, we wrote to the company chair and CEO Warren Buffett in March 2021 requesting a meeting to discuss the proposal with him or an appropriate board representative. The chair declined, but said he hoped that a representative of the proposal would be able to present it at the meeting.

Tim Youmans, the EOS lead for North America, attended the company's annual meeting at the broadcast location, with the meeting held virtually and broadcast live by Yahoo Finance. The company chair, three vice chairs and a media representative also attended in person.

During the question-and-answer session in the lead up to the formal annual meeting, the company's chair and vice chairs addressed questions about the company's actions on climate. Buffett stated that the company's material emissions resided within two of its largest businesses – railroad and energy – both of which report on climate, with the railway business committed to a science-based target. On the topic of providing climate reporting across the group, he added: "It's asinine, frankly, in my view. We do some other asinine things because we're required to do it, so we'll do whatever's required. But to have the people at Business Wire, Dairy Queen ... making some common report ... we don't do that stuff at Berkshire."[2,3]

In our supporting statement for the climate reporting shareholder resolution, we urged the company to provide annual disclosure at the subsidiary level on climate risks, as these risks and impacts are not transparent, and shareholders can only purchase shares in the combined parent company entity. While the company has historically performed well, simply asking shareholders to "trust" the company on its capital deployment decisions without climate risk being adequately disclosed is concerning. For example, Berkshire Hathaway Energy is now the largest US power company without a net-zero goal.

The shareholder proposal went to a vote immediately after the EOS introduction without further comment from the chair/CEO beyond saying the proposal was interesting and that the views set forth were well written. Berkshire Hathaway insiders, including Warren Buffett, control 35% of the company's voting power. With Berkshire Hathaway opposing the shareholder proposal, it was defeated, but when adjusted for non-insiders, the vote results were close to 60% in favour of the proposal.

Vice chair Greg Abel – who has been named by Buffett as his likely successor – has stated that all the company's coal-fired power plants will be shut down by 2049 and that there is a transition plan for renewable energy. However, the timing for these shutdowns is not aligned with the Paris Agreement making it all the more urgent that Berkshire Hathaway begins to disclose its climate risks.

Tim Youmans
EOS Lead, North America

Joanne Beatty
Theme lead: Corporate Reporting

[2] https://www.reuters.com/business/sustainable-business/berkshire-shareholders-reject-climate-change-diversity-proposals-that-buffett-2021-05-01/

[3] https://buffett.cnbc.com/video/2021/05/03/buffett-asinine-for-berkshire-to-compile-a-climate-change-report.html

We also began voting on racial diversity in the UK, opposing any FTSE 100 board chairs where the board had failed to meet the minimum expectations of at least one ethnic minority director. This meant we opposed at five companies – Carnival, Croda International, Evraz, Next and Informa.

Where we received assurances that this issue would be urgently addressed, we supported on an exceptional basis, including at housebuilder Persimmon and defence company BAE Systems.

In Continental Europe, we recommended against the discharge of the supervisory board chair at Heidelberg Cement as there were no women on the managing board. The company had a target of adding one woman by 2025 but it has now said that one will join later this year in a new role on the managing board. We also recommended a vote against a director at ArcelorMittal due to concerns about poor gender diversity, and at Bouygues. Here we raised concerns about the absence of women on the executive committee and recommended a vote against the re-election of the chair.

We have been disappointed by the lack of progress on gender diversity in China, Hong Kong and Taiwan. Many companies in China and Hong Kong have not met our expectation for women to comprise at least 20% of a board by 2021 and we recommended voting against the re-election of directors at Tencent and Tingyi Cayman Islands Holding Corp. In Japan, where progress has also been slow, we look for 10% women on boards of TOPIX 100 companies, and one female director at other companies.

In Continental Europe, we recommended against the discharge of the supervisory board chair at Heidelberg Cement as there were no women on the managing board.

Japanese companies express support for the concept of board gender diversity and do not rule out appointing women in the future, but this has not translated into more women on boards, and we have not seen credible plans to introduce women. Companies often state that directors are appointed on merit, and that their recruitment pool is limited. However, we expect companies to look at talent outside the traditional pools and to address the serious lack of diversity, and the risks of group think and complacency.

We have applied our policy of recommending a vote against nomination committee chairs, or members or chairs of a board where this not possible, and have extended this to new male board members where independence is not a concern. For example, at Japanese retailer Seven & I we recommended a vote against an independent non-executive director who chairs both the remuneration and nominations committees for insufficient diversity, and pay concerns.

Racial equity audits

This year we also saw a significant number of racial equity audit shareholder proposals, including at US banks Goldman Sachs and JPMorgan Chase. Resolutions requesting enhanced disclosure on the effectiveness of diversity and inclusion programmes were also filed at American Express, Berkshire Hathaway, Johnson & Johnson and others.

Although we did not always agree with every aspect of the supporting statements, we broadly agreed with their substance, believing that racial equity audits would add substantial value beyond the actions the companies were already taking. During engagement we explained that audits can provide additional insight into the root causes of complex problems that companies must address in order to develop enduring solutions. They also enable more rigorous performance evaluation against underlying challenges and increase a board's capacity to provide effective oversight.

We subsequently recommended support for the racial equity audit shareholder proposals at Bank of America, Citigroup, Goldman Sachs, JPMorgan Chase and Wells Fargo, among others, in order to accelerate momentum for closing racial equity gaps in society.

A few of these proposals were withdrawn, such as at BlackRock and Morgan Stanley, or were put to the vote with the support of management. BlackRock plans to implement the resolution "as is" and will publish the findings of the racial equity audit by 2022, while Morgan Stanley will undertake a review with a narrower scope. At IBM the board recommended that shareholders support a resolution for a diversity, equity and inclusion report as it "aligns with IBM's goals of a diverse and inclusive workforce". We encouraged other companies to consider supporting proposals in this manner.

In the US, where we expect women and ethnic minorities to make up at least

40% of the board at the largest companies, we opposed

39% of nominating committee chairs.

Executive remuneration

In 2021, shareholders in many countries were asked to vote on the decisions taken on executive pay for 2020, which heightened concern given the backdrop of Covid-19. We set a clear expectation that boards should continue to use their judgement to ensure that executive pay could be justified in the context of the experience of other stakeholders, particularly for companies that had made redundancies, benefited from government support, or were otherwise in distress.

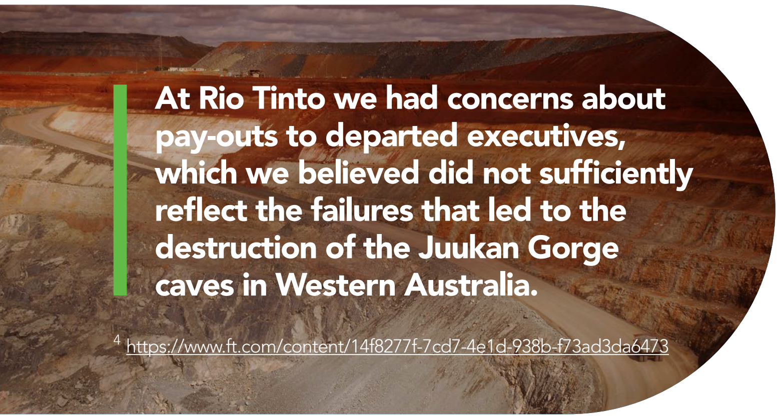
We saw some good practices. In the UK many companies repaid the money received from the government to furlough their employees or in business rates relief, and it was generally accepted amongst those not able to do so that they should not pay bonuses to executives.

However, we opposed pay proposals at Vinci and Whitbread, where non-financial elements of the CEOs' bonuses were judged to have been fully achieved and were paid or rolled over to next year respectively. This was despite the fact that both companies used government support to furlough employees and made redundancies.

Likewise, we opposed the remuneration report and the re-election of the remuneration committee chair at publisher Informa, where the decision was taken to adjust pay-outs to executives from a long-term incentive scheme that would have lapsed, in the face of a significant negative impact from the pandemic. This follows several years of poor pay practices and an inadequate response to shareholder concerns. The company saw one of the biggest defeats on record, with 62% of votes cast against the remuneration report.

We believe there are substantial issues with executive pay practices in the US and opposed 80% of "say-on-pay" proposals in the first half of 2021. These concerns were exacerbated by decisions to insulate executives from the impacts of Covid-19, relative to other stakeholders. For example, at hotel chain Hilton, we recommended voting against the say-on-pay proposal and the chair of the compensation committee.

The compensation committee had altered the performance metrics in the long-term incentive plan due to Covid-19 after the company realised that the performance stock units would not pay out. This meant that the long-term plan paid out much higher, appearing out of step with the company's decision to lay off 25% of its staff in mid-2020.



At Rio Tinto we had concerns about pay-outs to departed executives, which we believed did not sufficiently reflect the failures that led to the destruction of the Juukan Gorge caves in Western Australia.

[4] https://www.ft.com/content/14f8277f-7cd7-4e1d-938b-f73ad3da6473

As well as scrutinising decisions taken against the backdrop of the pandemic, we continued to oppose pay where we judged it to be excessive or misaligned with the interests of long-term shareholders and other stakeholders.

Elsewhere, we recommended a vote against the board chair at fast food chain McDonald's due to the board's failure to oversee a sufficient investigation into allegations of misconduct against the former CEO. We also recommended a vote against the executive compensation and compensation committee chair due to a failure in the company's clawback policies to recoup the severance awards made to the former CEO.

Similarly, at Disney we recommended a vote against the say-on-pay item and the compensation committee chair due to the high quantum of pay awarded to the CEO and executive chair, with pay remaining in the top quartile. The company had not adequately adjusted the executive chair's pay when he stepped down from his CEO role in 2020 and did not provide justification for continuing to pay the executive chair above the market rate.

As well as scrutinising decisions taken against the backdrop of the pandemic, we continued to oppose pay where we judged it to be excessive or misaligned with the interests of long-term shareholders and other stakeholders. At miner Rio Tinto, we opposed the remuneration report due to the heavy focus on shareholder returns in its pay schemes, with limited consideration of other, important strategic and stakeholder factors. We also had concerns about pay-outs to departed executives, which we believed did not sufficiently reflect the failures that led to the destruction of the Juukan Gorge caves in Western Australia. The company suffered a significant defeat with over 60% of shareholders opposing the remuneration report.

We believe there are substantial issues with executive pay practices in the US and opposed

80% of "say-on-pay" proposals in the first half of 2021.

We also recommended a vote against at AstraZeneca, which proposed further increases to the already substantial incentive awards offered to its CEO, and where we opposed the previous schemes on the basis of excessive quantum. Investors voted about 40% against, a sign of the growing discontent.[4] Finally, we recommended opposing at BAE Systems due to a retention package for the CEO that we believe raises serious questions about the effectiveness of the board in managing the succession plan for this role.

Company engagement highlights

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

Overview

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

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

Walt Disney

Engagement theme: Diversity

Lead engager: Velika Talyarkhan

EOS was concerned by the lack of diversity among the executive leadership team at Walt Disney. We raised the issue with the lead independent director in July 2019, asking the company to consider appointing ethnically diverse executives to the team. In a follow up letter to the lead independent director, we noted that both ethnic and gender diversity were lower at this level than in the rest of the organisation. We explained that diverse role models and leadership are a key aspect in retaining and developing diverse talent, and we encouraged the company to increase its reporting on diversity and inclusion to demonstrate progress. The company acknowledged our concern, explaining that it had recently lost some diverse senior employees to competitors. We thanked the company for its enthusiasm on the topic and its work on encouraging equal and diverse representation across the organisation and in its content.

In February 2020, the company sought our feedback on its disclosure of workforce diversity data. We urged it to set and publish targets and to consider reporting on gender and ethnic pay gaps at all levels of the organisation. In late 2020, we were pleased to learn that the company had promoted several diverse individuals to the executive leadership team. Additionally, during the 2020 third quarter earnings investor call, the company announced a six-pillar diversity and inclusion strategy. We will continue to engage on its diversity and inclusion strategy and encourage additional diversity disclosure.

Vale

Engagement theme: Board composition and succession

Lead engager: Jaime Gornsztejn

EOS started engaging with Brazilian miner Vale on board composition and succession in 2019. As the company was transitioning from concentrated to dispersed ownership, the board succession model, based on nominations by the controlling shareholders, which prevails in most Brazilian companies, was not fit for purpose. We raised our concern with the chair, emphasising the importance of implementing a structured approach to board nomination, based on a skills matrix aligned with the strategic pillars and a board evaluation. Subsequently, we engaged with the independent directors, the chair and the deputy chair on best practice in board composition and succession, led by a formally established, majority independent nomination committee. We highlighted that engagement with investors and other stakeholders is a key component of the board nomination process.

In Q3 2020 the company created a nomination committee and committed to implementing a structured board succession process, in line with international best practice, aiming for the 2021 board election. In Q4 2020, we expressed our expectations to the nomination committee, for a majority independent board with a diverse range of skills, experiences and personalities, an independent chair and the elimination of the role of alternate director. The nomination committee published its report in Q1 2021, outlining the target skills matrix, the search procedure and the 12 nominees, in line with our expectations, which warranted our recommendation for their election. A group of investors requested that the election be held under the cumulative voting system and presented four alternative candidates, who were elected together with eight of the nominees selected by the nomination committee.

Fujifilm

Engagement theme: AI and data governance

Lead engager: Sachi Suzuki

As part of our ongoing dialogue with Japan's Fujifilm, we first discussed the importance of the responsible use of artificial intelligence (AI) and data governance at our meeting at its headquarters in December 2019. We highlighted its particular relevance to the company's imaging and healthcare businesses including medical systems. We explained that in April 2019 the US Food and Drug Administration had published the Proposed Regulatory Framework for Modifications to Artificial Intelligence/Machine Learning-Based software as a Medical Device paper and shared our Investors' Expectations on Responsible Artificial Intelligence and Data Governance paper.

In our call with an executive officer in April 2020, Fujifilm explained its work on data governance as well as its understanding of the risks related to the use of AI. We encouraged it to document this and publish a policy. We were pleased that the company published a Fujifilm Group AI policy following our engagement, which addresses risks such as bias, lack of fairness and discrimination and the importance of monitoring the use of AI. The policy also discusses how the company handles personal information and how it will ensure transparency and accountability, as well as committing to providing training to relevant staff. When we met again in Q2 2021, the company thanked us for our suggestions.

Zoetis

Engagement theme: Employee engagement and retention

Lead engager: Emily DeMasi

We initiated engagement on animal health company Zoetis's employee engagement and retention strategy in our first in-person engagement with the company in Q3 2018. Following this meeting, the director of investor relations sent an email explaining that the company's human resources strategy focused on fostering a highly collaborative culture and highlighted its new development programme. This helps employees define, plan and engage in developing themselves and others.

During a call in Q4 2019, the company explained that it was working to establish more robust ESG policies and programmes, including on human capital management, and was proud of its high levels of workforce retention following a recent acquisition. We encouraged it to communicate its human capital management policy more actively in line with the ongoing updates to its ESG strategy. To monitor the success of employee engagement, Zoetis collects feedback via a bi-annual survey, where employees can anonymously share their thoughts on the company's strategy for growth, workplace climate and other critical elements of their workplace experience. Employee participation in these surveys has increased from 81% in 2016 to 90% in 2020.

In a videocall with the director of investor relations in Q4 2020, we congratulated the company on significant improvements to its overall employee turnover rate, which has decreased substantially since 2016, from over 10% to less than 2%. The company was proud to highlight that the turnover rate for executives was 0.1% in 2019. We continue to engage the company on its human capital management, including the achievement of its diversity and inclusion goals, which target increasing representation by gender and ethnicity across multiple levels of the organisation by 2025.

Dexcom

Engagement theme: Diversity and disclosure

Lead engager: Joanne Beatty

Our engagement with US diabetes care company Dexcom's head of corporate affairs in 2020 focused on increasing board diversity and environmental, social and governance (ESG) disclosures. We have encouraged the company to increase its board diversity since 2019, and, in our discussion with the company in Q4 2020 we were pleased to learn it had increased gender diversity from 11% in 2019 to 22%, with the addition of two new board directors. The company also appointed a head of human resources focused on increasing diversity and inclusion and building a strong diverse talent pool.

The company undertakes many positive impact programmes, including human capital initiatives, many of which are not disclosed publicly. Since 2019, we have intensified our engagement with the company on the benefits of increased ESG disclosures. In March 2020, we were pleased to see the company publish its inaugural sustainability report, structured on the company's core values. EOS engagement in 2021 will focus on further improvements to the company's ESG disclosures and strategy including encouraging target setting for priority topics such as climate and waste, among other topics.

We have encouraged the company to increase its board diversity since 2019, and, in our discussion with the company in Q4 2020 we were pleased to learn it had increased gender diversity from

11% in 2019 to **22%**

JD.com

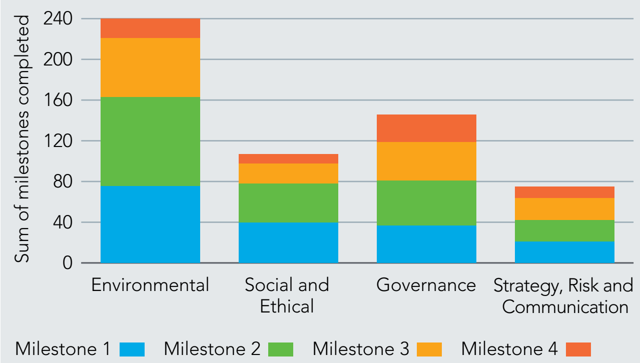
Engagement theme: Shareholder protection and rights

Lead engager: Haonan Wu

As part of our ongoing dialogue on shareholder rights, we voiced our concerns that this Chinese online retailer had not held any annual shareholder meetings. As it is a Cayman Islands-registered company listed in the US, it is not legally required to hold them. We first raised our concern in 2017 and explained that holding an annual shareholder meeting allows minority shareholders to vote and elect independent directors who are supposed to represent their interests, in addition to voicing any concerns and questions directly to the company.

We reiterated our concern twice in Q1 2019 with a senior executive and obtained reassurance that the company was considering this. During a meeting in Q1 2021 with a senior executive, we were pleased to hear that JD.com has confirmed it will hold an annual general meeting this year. We continue to engage on other ESG issues including circular economy, gender diversity and human capital management, and we welcomed JD.com's first ESG report disclosures in Q1 2021.

Milestones completed by stage, H1 2021



Source: EOS data

CASE STUDY

Novartis

EOS has engaged with global healthcare company Novartis since 2009. By 2018, we had escalated our engagement on gender diversity at the board level by recommending a vote against the re-election of the nominations committee chair. We did this again in 2019. In Switzerland, we expect at least 30% of the board to be women but Novartis had achieved just 25%. We reiterated our concerns with the vice chair in October 2019. We also suggested extending the horizon of the long-term incentive plan to be more aligned with the business cycle of a pharmaceutical company.

Prior to the 2020 shareholder meeting, we informed the company of our recommendation to vote against the re-election of the auditor and the re-election of the audit committee chair. This was due to the excessive tenure of the auditor, as the same firm had been in place since 1940. In March 2020, we also had a call with the head of data science and AI and with the global head of ethics, risk and compliance. We noted the importance for the company to demonstrate the existence of robust governance processes considering the firm's strategy to 'go big on data and digital'.

Subsequently, we noted the company's nomination of a woman to the board and its aspiration to find female candidates for two of the other nominations. In December 2020, the vice chair provided us with further assurance on gender diversity and the latest annual report also gives us confidence, in line with our engagement.

On remuneration, we welcomed the introduction of a post-vesting holding period for the long-term incentives. We were also pleased to hear that a new audit firm would be proposed for election at the 2022 shareholder meeting. In February 2021, in line with our suggestion to leverage its leadership position on AI, the company sent us a copy of its new paper on the ethical and responsible use of AI. We now wish to see Novartis joining global efforts to reverse nature loss by 2030.

Read the engagement case study in full at

https://www.hermes-investment.com/ukw/eos-insight/eos/novartis-case-study/

Engagement objectives:

Governance:
- Gender diversity
- Board effectiveness
- Remuneration

Risk management:
- Auditor rotation
- AI

Sustainable Development Goal:

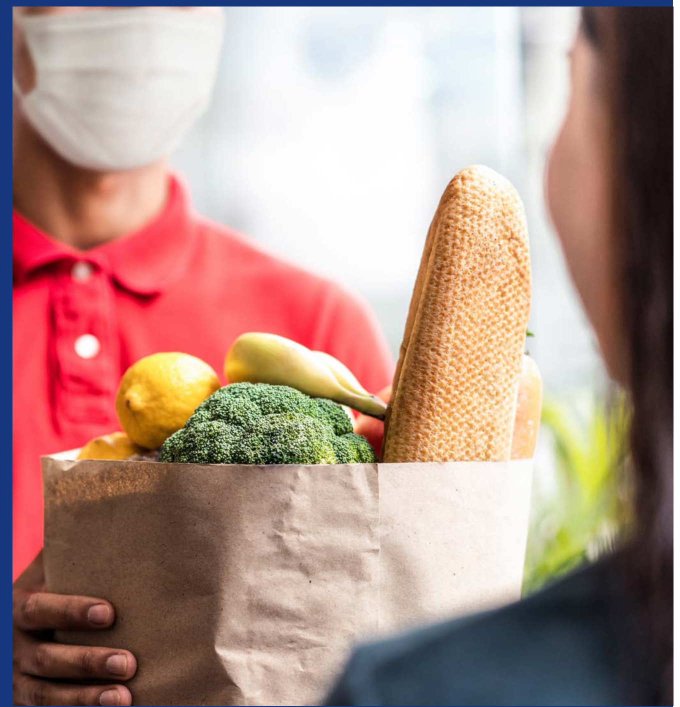
5 GENDER EQUALITY

Pauline Lecoursonnois
Theme lead: Shareholder Protection and Rights
Sector lead: Consumer Goods

BLOG SPOTLIGHT

Flexible and vulnerable - the gig worker's dilemma

This quarter we began a new EOS Insights series examining the pandemic's broader implications for society. In the third article, engager Katie Frame explored how Covid-19 has had a disproportionate impact on those in non-standard or 'gig' work.



Gig work provides the worker with flexibility and supplemental income, while the company benefits from the ability to control labour costs and respond quickly to changes in demand. However, the classification of the worker as an independent contractor means that wages exclude benefits that full-time or part-time workers would normally receive, such as a guaranteed national minimum wage, sick pay, holiday pay, pension contributions and health insurance. Gig workers also often lack the intangible benefits associated with jobs, such as career development opportunities.

It is this lack of social protection in the workplace that has exacerbated the risks to which gig workers and others in insecure jobs have been exposed during the pandemic. One study has shown that workers on zero-hours contracts and in other insecure jobs are twice as likely to have died of Covid-19 as those in other professions.[1] The lack of sick pay provision means that if workers fall ill, they may face choosing between losing their income or going to work while sick, increasing the risk of passing on the infection to others.

Our engagement

During the pandemic our engagement on gig and other contract workers has centred around company management of the most material human capital issues given the belief that increased productivity and business sustainability is achieved through investment in the workforce. We focused on three main areas: fair pay; health and safety; and worker engagement.

For example, companies should ensure that there are measures in place to compensate workers for lost pay if they are unable to work during the pandemic. They should also ensure that the appropriate type and amount of personal protective equipment is readily available at no net cost to workers.

A key challenge for engagement on the treatment of gig and other contract workers is the lack of disclosure by companies. Often these workers are not included in company disclosures on workforce policies and performance, leaving investors unable to understand the extent of the risk to the business from precarious working conditions. Therefore, in our engagement we ask for enhanced transparency on the wider workforce, not just the directly-employed staff. Additionally, we seek to ensure that company actions go beyond rhetoric through the announcement of policies, and that companies regularly assess the design of their policies and procedures, as well as their implementation.

Companies and investors have a clear responsibility to engage to ensure worker health, safety and wellbeing is prioritised, particularly for these most vulnerable workers. This will require the development of new forms of staff protection for gig workers, given their vital role in modern economies.

Read the EOS Insights article in full at

https://www.hermes-investment.com/ukw/eos-insight/eos/flexible-and-vulnerable-the-gig-workers-dilemma/

or take a look at our new pandemic stewardship hub, which hosts all our related articles in one place

https://www.hermes-investment.com/ukw/eos-insight/eos/stewardship-in-a-pandemic/

Katie Frame
Sector lead: Pharmaceuticals and Healthcare

[1] https://amp-theguardian-com.cdn.ampproject.org/c/s/amp.theguardian.com/uk-news/2021/apr/16/workers-in-insecure-jobs-twice-as-likely-to-die-of-covid-tuc-research-finds

Public policy and best practice

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

Overview

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

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

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

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

Mandatory TCFD consultation by UK's BEIS

Lead engager: Nick Spooner

We responded to a consultation by the UK Department for Business, Energy & Industrial Strategy on mandatory TCFD (Task Force on Climate-related Financial Disclosures) for listed companies, large private companies and limited liability partnerships. We promoted enhanced regulation around climate risk reporting in line with the TCFD recommendations. Where material, we noted the importance of scenario analysis within the strategic report to demonstrate each company's awareness and preparedness for climate-related risks. We noted the importance of regulation around Scope 3 emissions reporting and the beneficial impact this could have for emissions transparency on a global scale. We stressed the importance of auditors in overseeing annual reports to ensure that the energy transition is properly considered.

Response to HKEX consultation on corporate governance code

Lead engager: Hanah Chang

We submitted our response to the consultation held by the Hong Kong Exchanges (HKEX) on the corporate governance code and related listing rules. We supported HKEX on its approach and the inclusion of elements such as board independence and diversity. The re-election of "long-serving INEDs" – independent non-executive directors who have sat on a company's board for nine years or more – will now be subject to a separate vote by independent shareholders.

On the matter of diversity and nominations, single-gender boards cannot be called diverse anymore. Companies will be required to set gender diversity targets and timelines for diversity for both the board and management. Boards will need to review the effectiveness of their board diversity policies annually.

After the revised rules become effective, HKEX has proposed that existing companies with single-gender boards will be allowed a three-year transition period in which to appoint at least one director of the absent gender. IPO applicants are not expected to have single-gender boards. Nomination committees will be upgraded from a "code provision" (a part of the code subject to comply or explain) to a listing rule. The role of chair cannot be taken by an insider - from now on, the role must be filled by an independent non-executive director.

Australian Treasury consultation on greater transparency of proxy advice

Lead engager: Pauline Lecoursonnois

We submitted our response to a consultation by the Australian Treasury on reform options, regarding proxy advisory services. We welcomed the Treasury's review and supported its stated goals to strengthen the transparency and accountability of proxy advice.

However, we did not support the proposed reform options. We believe some of the risks associated with the implementation of these options include inefficiencies in the delivery of services by proxy advisory firms, compromised independence, reduced quality of advice and reduced competition.

Instead, we encouraged the Treasury to promote constructive, long-term engagement between companies and institutional investors that is not limited to the narrow framework of proxy voting. More direct and well-informed dialogue between companies and institutional investors and their advisers could ensure that each company's specific circumstances are taken into consideration by fiduciaries charged with exercising shareholder rights in the best interests of retirees and other investors.

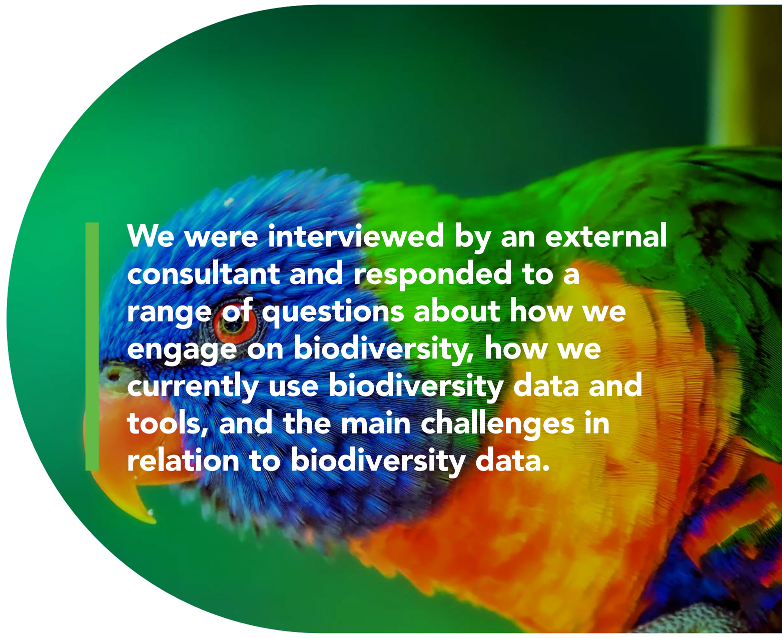
The imposition of burdensome procedural requirements on proxy advisory firms does not advance this purpose, and instead will inhibit effective shareholder engagement. We suggested alternative solutions, such as the introduction of a demanding stewardship code.

Consultation response on Japan's Corporate Governance Code

Lead engager: Sachi Suzuki

We responded to the public consultation on the proposed revision of Japan's Corporate Governance Code. We welcomed many of the changes, which reflected the suggestions we had made in our previous discussions. This included an added emphasis on diversity in management and a requirement for companies that are listed on the prime market to report in line with the TCFD recommendations.

We made a number of suggestions to strengthen the Code, including a request for an explicit reference to the Paris Agreement goals, a specific target for the appointment of female directors, stronger wording against cross-shareholdings, plus more stringent independence criteria for directors and statutory auditors, among others.

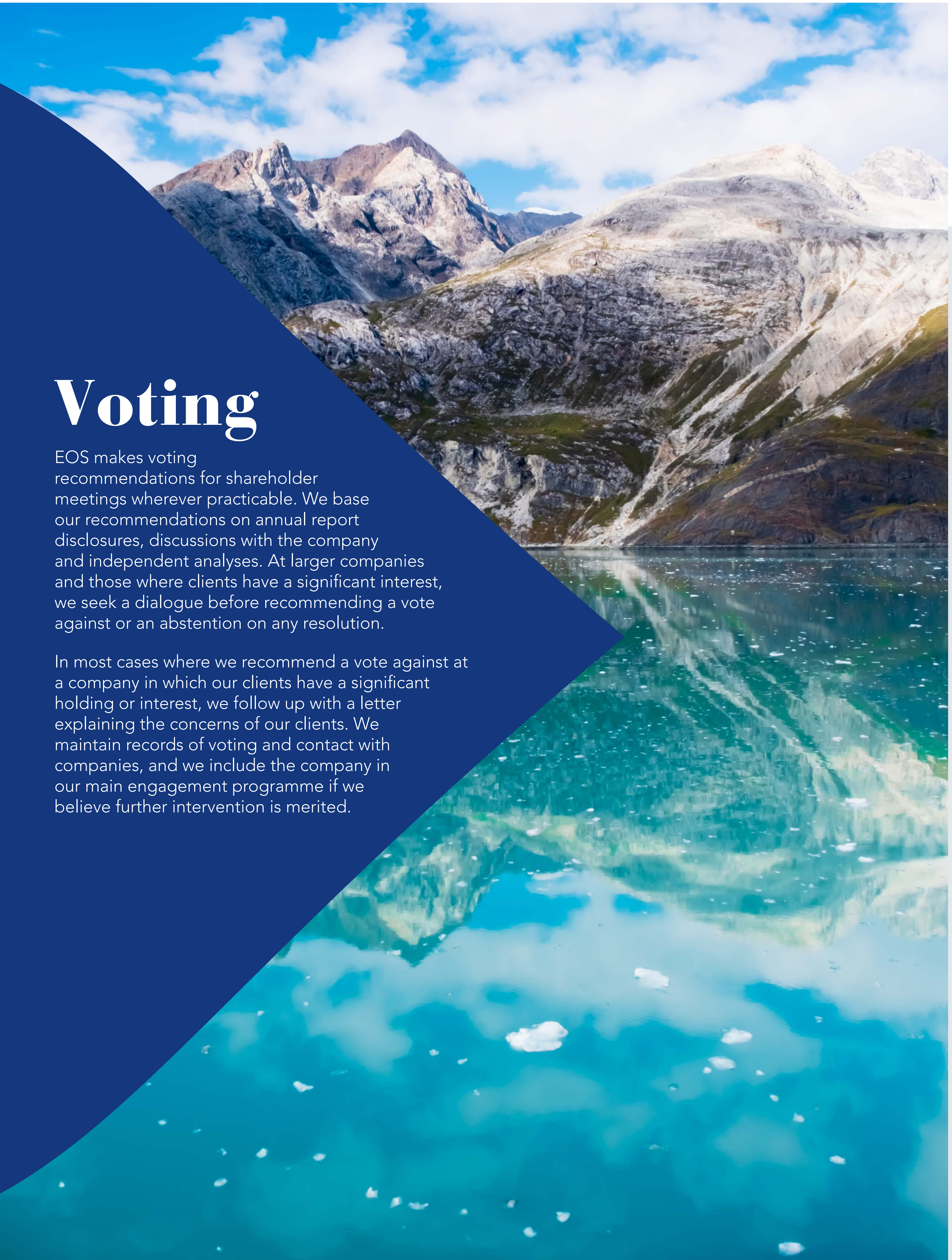


Interview for the PRI's biodiversity data scoping study

Lead engager: Sonya Likhtman

We participated in a biodiversity data scoping study that was commissioned by the PRI. We were interviewed by an external consultant and responded to a range of questions about how we engage on biodiversity, how we currently use biodiversity data and tools, and the main challenges in relation to biodiversity data. We outlined our five pillar engagement framework for biodiversity, which covers governance, strategy, measurement, targets, and disclosure. We highlighted the importance of considering both biodiversity impacts and dependencies. We explained which datasets and information we use and articulated some of their limits. We emphasised the need for qualitative analysis for biodiversity to accompany quantitative analysis, especially until there is greater alignment about what to measure and disclose.

We said that a credible benchmark or company ranking framework for biodiversity, similar to the Transition Pathway Initiative for climate change, would be helpful for improving our understanding of company performance. However, we acknowledged that currently it may be difficult to make accurate assessments due to limited disclosure on biodiversity by companies. Other challenges we highlighted include the difficulty of comparing between companies, the lack of a single indicator for biodiversity, and confusion amongst companies about which data to report. Nonetheless, given the urgency of reversing biodiversity loss, we stressed the importance of companies and investors taking action to address biodiversity risks and opportunities even in the absence of a perfect dataset or framework.



Voting

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

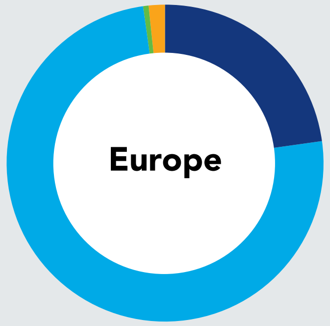
In most cases where we recommend a vote against at a company in which our clients have a significant holding or interest, we follow up with a letter explaining the concerns of our clients. We maintain records of voting and contact with companies, and we include the company in our main engagement programme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

Voting overview

Over the last quarter we made voting recommendations at 7,824 meetings (92,941 resolutions). At 5,652 meetings we recommended opposing one or more resolutions. We recommended voting with management by exception at 116 meetings and abstaining at 24 meetings. We supported management on all resolutions at the remaining 2,032 meetings.

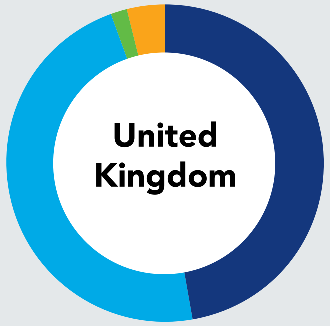
We made voting recommendations at **7,824** meetings (**92,941** resolutions) over the last quarter.

- Total meetings in favour **26.0%**
- Meetings against (or against AND abstain) **72.2%**
- Meetings abstained **0.3%**
- Meetings with management by exception **1.5%**



We made voting recommendations at **1,012** meetings (**17,845** resolutions) over the last quarter.

- Total meetings in favour **22.9%**
- Meetings against (or against AND abstain) **75.1%**
- Meetings abstained **0.4%**
- Meetings with management by exception **1.6%**



We made voting recommendations at **364** meetings (**6,261** resolutions) over the last quarter.

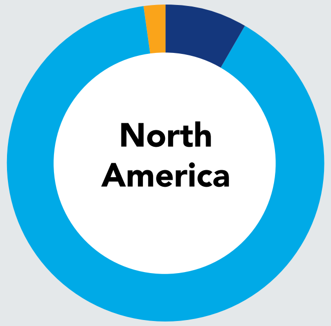
- Total meetings in favour **47.3%**
- Meetings against (or against AND abstain) **47.3%**
- Meetings abstained **1.6%**
- Meetings with management by exception **3.8%**

We made voting recommendations at **2,344** meetings (**27,260** resolutions) over the last quarter.

- Total meetings in favour **36.2%**
- Meetings against (or against AND abstain) **62.8%**
- Meetings abstained **0.5%**
- Meetings with management by exception **0.6%**

We made voting recommendations at **1,384** meetings (**14,318** resolutions) over the last quarter.

- Total meetings in favour **39.1%**
- Meetings against (or against AND abstain) **59.8%**
- Meetings with management by exception **1.2%**



We made voting recommendations at **2,670** meetings (**27,008** resolutions) over the last quarter.

- Total meetings in favour **8.5%**
- Meetings against (or against AND abstain) **89.3%**
- Meetings with management by exception **2.1%**

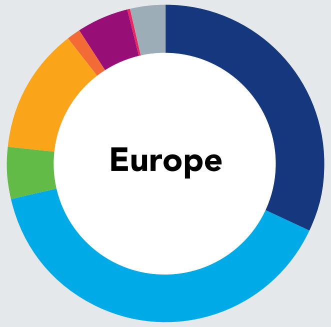
We made voting recommendations at **50** meetings (**249** resolutions) over the last quarter.

- Total meetings in favour **24.0%**
- Meetings against (or against AND abstain) **74.0%**
- Meetings with management by exception **2.0%**

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

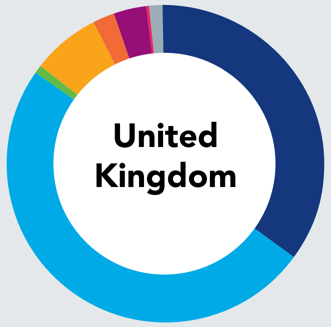
We recommended voting against or abstaining on **16,699** resolutions over the last quarter.

- Board structure **52.0%**
- Remuneration **24.5%**
- Shareholder resolution **4.6%**
- Capital structure and dividends **8.9%**
- Amend Articles **3.4%**
- Audit and Accounts **3.7%**
- Investment/MandA **0.6%**
- Poison Pill/Anti-Takeover Device **0.1%**
- Other **2.1%**



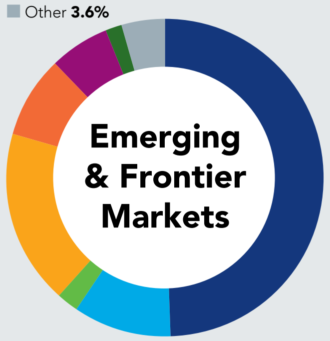
We recommended voting against or abstaining on **2,822** resolutions over the last quarter.

- Board structure **32.2%**
- Remuneration **39.3%**
- Shareholder resolution **5.5%**
- Capital structure and dividends **12.6%**
- Amend Articles **1.6%**
- Audit and Accounts **5.1%**
- Poison Pill/Anti-Takeover Device **0.2%**
- Other **3.6%**



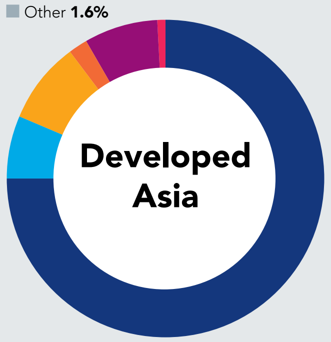
We recommended voting against or abstaining on **442** resolutions over the last quarter.

- Board structure **35.1%**
- Remuneration **49.8%**
- Shareholder resolution **0.9%**
- Capital structure and dividends **6.8%**
- Amend Articles **2.3%**
- Audit and Accounts **3.4%**
- Poison Pill/Anti-Takeover Device **0.2%**
- Other **1.6%**



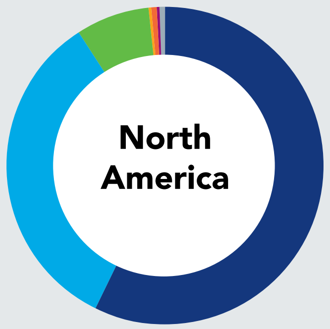
We recommended voting against or abstaining on **5,141** resolutions over the last quarter.

- Board structure **49.6%**
- Remuneration **9.8%**
- Shareholder resolution **2.4%**
- Capital structure and dividends **17.7%**
- Amend Articles **8.4%**
- Audit and Accounts **5.9%**
- Investment/MandA **1.9%**
- Other **4.2%**



We recommended voting against or abstaining on **2,028** resolutions over the last quarter.

- Board structure **73.7%**
- Remuneration **6.1%**
- Shareholder resolution **2.0%**
- Capital structure and dividends **8.3%**
- Amend Articles **2.0%**
- Audit and Accounts **7.1%**
- Poison Pill/Anti-Takeover Device **0.8%**



We recommended voting against or abstaining on **6,172** resolutions over the last quarter.

- Board structure **57.5%**
- Remuneration **33.7%**
- Shareholder resolution **7.3%**
- Capital structure and dividends **0.4%**
- Amend Articles **0.6%**
- Audit and Accounts **0.1%**
- Other **0.5%**

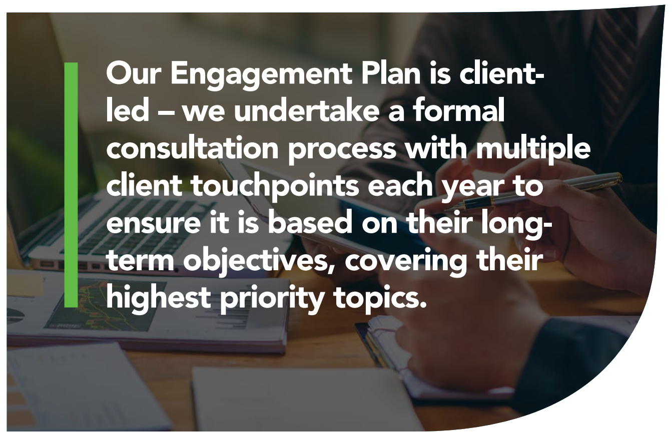
We recommended voting against or abstaining on **94** resolutions over the last quarter.

- Board structure **23.4%**
- Remuneration **63.8%**
- Shareholder resolution **3.2%**
- Capital structure and dividends **3.2%**
- Amend Articles **5.3%**
- Audit and Accounts **1.1%**

The EOS approach to engagement

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

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



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

Our services

Engagement

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

Public policy

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

Voting

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

Screening

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

Advisory

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

The EOS advantage

- **Relationships and access** – Companies understand that EOS is working on behalf of pension funds and other large institutional investors, so it has significant leverage – representing assets under advice of US$1.75trn as at 30 June 2021. The team's skills, experience, languages, connections and cultural understanding equip them with the gravitas and credibility to access and maintain constructive relationships with company boards.
- **Client focus** – EOS pools the priorities of like-minded investors, and through consultation and feedback, determines the priorities of its Engagement Plan.
- **Tailored engagement** – EOS develops engagement strategies specific to each company, informed by its deep understanding across sectors, themes and markets. It seeks to address the most material ESG risks and opportunities, through a long-term, constructive, objectives-driven and continuous dialogue at the board and senior executive level, which has proven to be effective over time

EOS team

Engagement

Dr Hans-Christoph Hirt
Head of EOS

Joanne Beatty
Sector lead: Chemicals

Dr Emma Berntman
Sectors: Retail, Pharmaceuticals & Healthcare

Roland Bosch
Sector co-lead: Financial Services

Hanah Chang
Sectors: Transportation, Financial Services, Technology Hardware

George Clark
Voting and Engagement Support

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

Emily DeMasi
Sector co-lead: Financial Services

Bruce Duguid
Head of Stewardship, EOS

Yu-Ting Fu
Sector: Financial Services

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

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

Tim Goodman
Sectors: Oil & Gas, Technology Software

Jaime Gornsztejn
Sector lead: Industrial & Capital Goods

Laura Jernegan
Sectors: Financial Services, Pharmaceuticals & Healthcare

Andy Jones
Sector co-lead: Mining & Materials

Lisa Lange
Sectors: Transportation, Financial Services, Consumer Goods

Pauline Lecoursonnois
Sector lead: Consumer Goods

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

Claire Milhench
Communications & Content

Ian Munroe
Voting and Engagement Support

James O'Halloran
Director of Business Management, EOS

Nick Pelosi
Sector co-lead: Mining & Materials

Hannah Shoesmith
Sector co-lead: Technology Software

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

Sachi Suzuki
Sector lead: Transportation

Sarah Swartz
Sectors: Chemicals, Consumer Goods, Utilities

Velika Talyarkhan
Sector co-lead: Technology Software

Kenny Tsang
Theme: Human Rights

Amy Wilson
Sector lead: Retail

Haonan Wu
Sectors: Transportation, Chemicals, Technology, Utilities

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

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

Client Service and Business Development

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

Diego Anton
Client Service

Alexandra Danielsson
Client Service

Rochelle Giugni
Client Service and Business Development

Charlotte Judge
Communications & Marketing

Alice Musto
Client Service

Federated Hermes

EOS

Federated Hermes

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

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

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

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

Our investment and stewardship capabilities:

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

Why EOS?

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

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