Stewardship Report 2020

March 2021

Federated Hermes
International

www.hermes-investment.com
For professional investors only

The investment industry can be a powerful force in building a better world – and at the international business of Federated Hermes, we believe active stewardship is the best way to achieve this[1].

[1] The statements, references to officers, practices and policies, and discussions in this report pertain to the international business of Federated Hermes, and not to other businesses engaged in by Federated Hermes, Inc.

Since our 1983 inception, our purpose has always been to provide sustainable wealth creation: generating wealth through investments that enrich investors, society and the environment over the long term[2]. Indeed, we believe effective stewardship that enables us to act as responsible owners is a core component of our unique investment approach – and this view has underpinned our investment decisions, the way we engage with our assets and the way we operate our business since day one.

Today, as the world tackles the challenges of the ongoing coronavirus pandemic and the climate crisis, the role of the investment industry is crucial: we must focus on opportunities to generate positive, sustainable outcomes for investors, society and the environment.

At the international business of Federated Hermes, we are committed to serving our clients' interests – and throughout an uncertain and tumultuous year, in 2020 we maintained our focus on creating long-term value for our clients. Indeed, our stewardship activities were more important than ever as the companies in which we were invested needed to ensure a strong focus on their stakeholders as well as their operational and financial resilience – not only to the pandemic but future crises too. Our focus on long-term material issues, most notably climate change, was unwavering during this time. After all, we recognise that climate emergency requires urgent action and it cannot be neglected even in the face of Covid-19.

The coronavirus has shown us that to tackle a global crisis governments, investors and companies need to come together for the public good. We have seen businesses innovate to find new solutions and adapt to the changing needs of their employees and customers alike. And as the world continues to tackle the pandemic, our focus on delivering sustainable wealth creation will continue unabated as we seek to play our role in building back better from Covid-19.

David Stewart
Chairman,
Hermes Fund Managers Limited

Saker Nusseibeh, CBE
CEO,
International at Federated Hermes

Eoin Murray
Head of Investment,
International at Federated Hermes

Leon Kamhi
Head of Responsibility, International at Federated Hermes

[2] We strive to achieve these goals consistent with client objectives and applicable requirements.

Executive summary

In the UK 2020 Stewardship Code, stewardship is introduced as "the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society".

This definition broadens the application of the revised Stewardship Code – and we supported the changes the Financial Reporting Council made to the Code to represent at a higher level of ambition for stewardship. We also commended the high standards it sets out for the investment industry.

In our 2020 Stewardship Report, we present our purpose, our responsible investment management approach as well as the outcomes of our stewardship activities and examine how the principles of the Stewardship Code are reflected in each of these areas. Through our transparency, we seek to continue to drive improved standards industry-wide.

First, we set out our purpose, our investment beliefs and the values that drive our strategy and business model. From our 1983 inception through to the present day, our sole purpose has been to deliver sustainable wealth creation over the long term. As an active investment manager, we have concluded that successfully making money over the long term is much more sustainable than doing so over the short term. We believe there are two mutually reinforcing strands of responsible investment management: responsible investment and responsible ownership. Together, these aim to generate sustainable wealth creation for the end beneficiary investor, encompassing investment returns and their social and environmental impact. Throughout this report, we have sought to communicate how these core values and beliefs have informed our decisions and activities across the business. Having the right governance in place is key to ensuring success and maintaining high-quality services, as well as learning from experiences so as to make continuous improvements.

From this overarching structure flows our investment and stewardship activities, which are at the heart of how we aim to deliver strong risk-adjusted returns and, consistent with client objectives and applicable requirements, we strive to contribute to positive outcomes in the wider world. It is important to have the right policies, processes and resources in place to carry out these activities to the highest possible standards. In addition, it is crucial to monitor outcomes because this ensures that our approach is effective and achieving the desired results. In turn, this enables us to demonstrate to our clients that we are maintaining high standards of responsible investment and responsible ownership that are having a tangible impact, as well as to identify means of continuous improvement. In particular, we focus on our stewardship approach to Covid-19 and climate change in 2020, as examples of a co-ordinated approach spanning investment risk management, fundamental investment analysis, engagement and advocacy.

In collating this report, we have taken a myriad of steps to ensure it is fair, balanced and understandable. We have provided information across asset classes, with the representation reflecting the makeup of our assets under management (AUM). In doing so, we have communicated our successes, reflected on our learnings and highlighted the changes we will make in the next 12 months. We also provided examples and case studies throughout the report to demonstrate how our investment approach works in practice.

This report also fulfils the reporting requirements for the international business of Federated Hermes – which includes Hermes Investment Management Limited, Hermes Fund Managers Ireland Limited and Hermes Alternative Investment Management Limited – under Annex C of the EU Shareholder Rights Directive and as required by the FCA Conduct of Business Sourcebook 2.2B. An Appendix to this report sets out where in the main body of the report the relevant disclosures can be found.

EOS at Federated Hermes will report separately under the Stewardship Code. Hermes GPE is outside the scope of this report.

Principle 1

Signatories' purpose, investment beliefs, strategy, and culture enable stewardship that creates long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society.

Our goals are to help individuals invest and retire better, to help clients achieve better risk-adjusted returns and, consistent with client objectives and applicable requirements, to strive to contribute to positive outcomes in the wider world.

Who we are

From when our first CEO openly challenged a major UK company to improve its governance to when our current CEO Saker Nusseibeh was awarded a CBE for services to responsible business, the international business of Federated Hermes has always been at the forefront of responsible investing. We are guided by the conviction that responsible investing is the best way to create long-term wealth for investors.

We are an active asset manager with a difference. We were set up to manage the pension funds of BT and the Post Office in September 1983 and have engaged with companies from day one. In 1983, our first CEO, the late Ralph Quartano, admonished the Marks & Spencer Board for the special loans they made available to directors. He made it clear that we were committed to serving the needs of our clients – the 400,000 beneficiaries whose money we part-managed – and that we understood that the investment decisions we made on their behalf helped to determine the shape of the future society they would live in.

In 1996, we set up a dedicated corporate governance team to engage with companies and advise on all aspects of corporate engagement and environmental, social and governance (ESG) policy development, research and analysis, voting recommendations and engagement. In 2004, this team evolved into our stewardship business, now EOS at Federated Hermes (EOS, formerly Hermes EOS). EOS was set up in response to demand from pension funds that wanted to be more active owners of the companies they were invested in.

Our client base has since expanded rapidly, with a significant growth in third-party AUM and stewardship assets under advice (AUA). Yet these origins have driven our purpose, investment beliefs and strategy throughout our history, from when we established our Focus funds in 1998, to our work challenging boards and pushing for corporate-governance reform, to when we founded EOS in 2004.

Since our beginnings, we have helped clients achieve strong risk-adjusted returns through our specialised equity, fixed-income and private-market strategies and, more recently, our multi-asset and proven liquidity-management solutions. Through these strategies and solutions, we continue to help individuals to save and retire better, and support positive change in the wider world.

Figure 1. The international business of Federated Hermes' investment capabilities

	1 LISTED EQUITIES	2 SPECIALIST FIXED INCOME	3 PRIVATE MARKETS	4 THEMATIC
Strategies	Global Equities (including Global Equity ESG) Global Emerging Markets Asia ex Japan European Equities SMID Impact Opportunities SDG Engagement Equity	Global High Yield Multi Strategy Credit Absolute Return Credit Direct Lending Real Estate Debt Unconstrained credit SDG Engagement High Yield	Real Estate Infrastructure Private Equity	Socially Responsible Investment ESG Driven Investing Impact Investing (e.g., Impact Opportunities) Impact through Engagement (e.g., SDG Engagement High Yield, SDG Engagement Equity)
AUM*	**US$31.4bn** £23.0bn / €25.7bn	**US$6.1bn** £4.4bn / €4.9bn	**US$15.3bn** £11.2bn / €12.5bn	**US$12.2bn** £8.9bn / €10.0bn Thematic AUM is also included under equities, credit and private markets
Approach to ESG Factors	Investment process integrates ESG leveraging quantitative ESG analysis and EOS engagement		Responsible and sustainable investment approach across all private markets capabilities	Tailored, specialist strategies designed to meet specific SRI, ESG and Impact-related objectives
5 Stewardship	**Stewardship insights integrated into investment processes and decisions**			
	Stewardship and stakeholder engagement	Public policy advocacy	Hybrid investment and stewardship mandates	
	US$1,282.8bn £938.5bn / €1,048.5bn			

Key: Investment strategy: Strategies that contribute to Thematic investing

* AUM does not include assets under sub advice. Figure 1 includes AUM of Hermes GPE within private markets. Hermes GPE is outside the scope of this report.
Source: Federated Hermes, as at 31 December 2020.

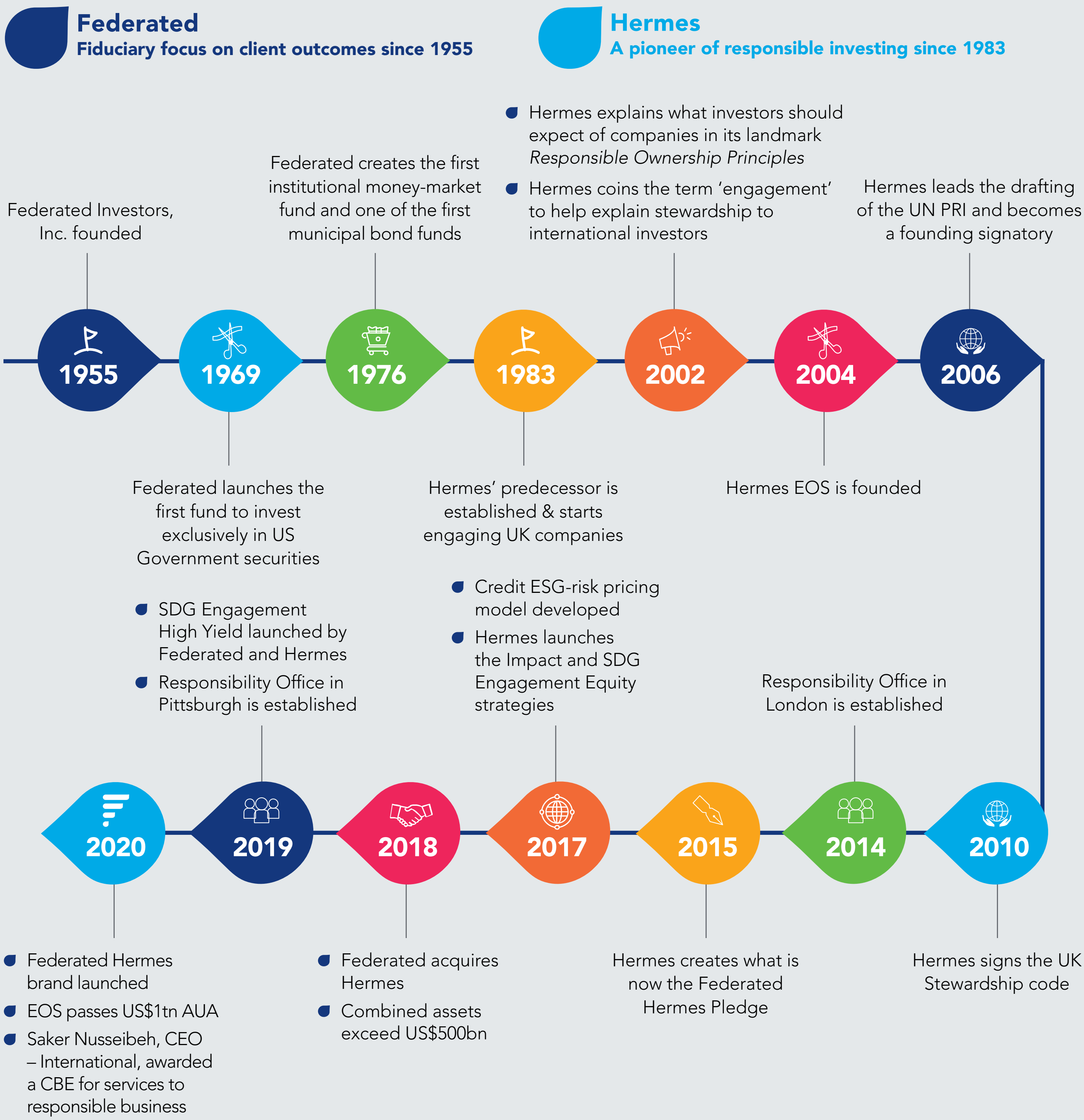
Becoming Federated Hermes

Our new brand launched in February 2020, when Federated Investors, Inc. ('Federated') combined names with Hermes Fund Managers Limited ('HFML') and changed its name to Federated Hermes, Inc. and its New York Stock Exchange ticker symbol from FII to FHI. This rebranding strengthened our position as a global leader in active, responsible investment.

This was a natural step in the development of Federated and HFML, which operates Hermes Investment Management Limited. Since Federated became the majority owner of HFML in 2018, we have been united by a shared commitment to client-centric responsible investment and long-term business growth.

All activities previously carried out by HFML now form the international business of Federated Hermes. Our brand has evolved, but we still provide the same distinct investment propositions, deep integration of responsibility and industry-leading stewardship capabilities for which we are renowned.

Figure 2. Our history as a leading responsible investor has been decades in the making



Source: Federated Hermes, as at February 2021.

Our values

We believe that investing responsibly is the best way to sustain long-term outperformance and contribute to beneficial outcomes for investors, companies, society and the environment.

The international business of Federated Hermes has long advocated and applied this approach. Since first engaging for stronger UK corporate governance in 1983, to chairing the development process of the Principles for Responsible Investment (PRI) in 2006 and becoming a founding signatory, to spearheading the global 2017 Climate Action 100+ initiative involving 370 investors with more than $35tn in assets, we have been at the vanguard of a movement that is now redefining the practice of investing.

We aim to act with integrity in everything we do. The Federated Hermes Pledge, established in 2015, compels us to put clients' interests first and to act responsibly. It is a clear expression of our values and has been signed by 99% of employees at the international business of Federated Hermes. The pledge is as follows:

I pledge to fulfill, to the best of my ability and judgment and in accordance with my role, this covenant:

- I will act ethically, responsibly and with integrity.
- I will put the interests of our clients first, consistent with our fiduciary responsibilities.
- I will encourage responsible behaviour in the firms in which we invest and on which we engage.
- I will act with consideration for our community and the environment both now and in the future. I will encourage others to do the same.
- I will work with industry colleagues and other key stakeholders to develop and improve our industry's contribution to society.
- I will treat my clients, my colleagues and all other stakeholders with dignity and respect and as I would wish to be treated.
- I will deal with our regulators in an open, co-operative and timely way.
- I will communicate clearly and honestly with all parties inside and outside our firm.
- I will manage conflicts of interest fairly between all parties.

Our fiduciary heritage and expertise in responsible investment ensure that our clients' interests come first.

We believe that investing responsibly is the best way to sustain long-term outperformance and contribute to beneficial outcomes for investors, companies, society and the environment.

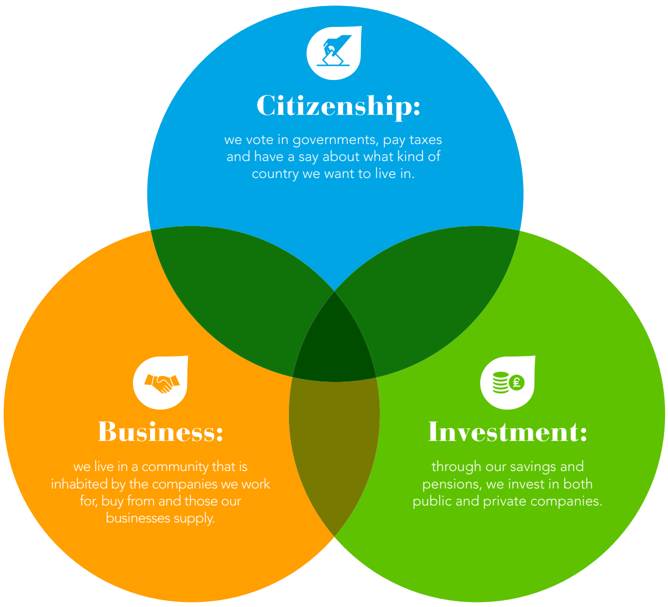
Our investment beliefs

We believe the purpose of investment is to create wealth sustainably over the long term.

That's why focusing on wealth creation at the expense of the planet and society – the very future for which investors are saving – is counterproductive. Our world faces multiple challenges, including climate change, inequality and navigating the ever-pervasive growth of artificial intelligence. Investment management has a key role in addressing those challenges and the industry must behave in a way that is consistent with solving the world's problems rather than compounding them. This will have notable positive financial implications for investors and society, guarding against significant risks to the long-term health of the economy. Successful sustainable wealth creation should provide investors with income to spend as they get older, an ability to buy goods and services and help to build a world in which investors are happy to live.

In the finance industry, there is often an odd notion that investment is somehow disconnected from our everyday world and future. Yet in reality, the spheres of business, investment and citizenship are all connected. We as individuals are invested in businesses through our pensions and savings, and also act as stakeholders who buy from these companies and work for them. Businesses impact the world that we live in, and we should not isolate the impact of owning these companies as shareholders from the effect that these firms have on us as employees and citizens.

Figure 3. Citizens, businesses and investors share a common duty



Source: Federated Hermes, as at February 2021.

As an active investment manager, we have concluded that successfully making money over the long term is much more sustainable than doing so over the short term. We believe there are two mutually reinforcing strands of responsible investment management: responsible investment and responsible ownership. Together, these aim to generate sustainable wealth creation for the end beneficiary investor, encompassing investment returns and their social and environmental impact.

- As responsible investors, we embrace high-active-share investing. We take a holistic approach that integrates material ESG considerations and engagement insights into all of our investment products, something that offers our fund managers an additional vantage point with which to assess an asset's potential to deliver long-term sustainable wealth. We firmly believe that our ability to mitigate ESG risks and capture the investment opportunities arising from these considerations is essential to achieving consistent investment outperformance for our clients.
- As responsible owners of the assets we manage of behalf of our clients, we actively engage through dialogue with companies on ESG issues. We believe that 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.

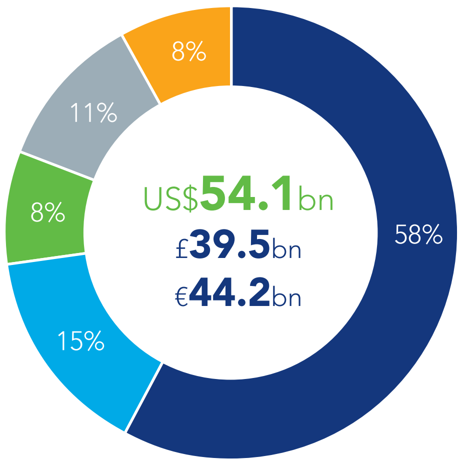
We have demonstrated through the almost 40-year history of our firm that responsible investment and stewardship often leads to better financial outcomes[3]. Moreover, robust research increasingly indicates the positive impact of stewardship on investment performance, with high-quality academic evidence showing that engagement can pay off financially and non-financially. Successful engagement can translate into significant outperformance: studies have shown that engagement can generate significantly higher annualised returns[4], while also leading to lower downside risk.[5] There is no conflict between doing good and good investment management – they are one and the same thing.

Our business model and strategy

The international business of Federated Hermes is committed to delivering superior risk-adjusted investment returns for our clients. In addition to our financial targets, we understand that the way we achieve our investment objectives will have wider societal impacts. As such, we seek to provide both a better financial future for our ultimate stakeholders and a more sustainable society. The pursuit of sustainable wealth creation drives the execution of all of our strategies.

Our heritage has enabled us to put this into practice since 1983. We did this first by managing the assets of the BT Pension Scheme (BTPS) and subsequently by offering our skills to a broad and fast-growing range of global customers that includes institutions and advised private investors. Our specialist, high-conviction investment teams now manage £39.5bn / €44.2bn / $54.1bn of assets across equities, credit, private debt, real estate, infrastructure and private equity.[6]

Figure 4. A diversified platform



Total AUM (Millions)	USD	GBP	EUR
Equity	**31,537**	23,071	25,775
Real Estate	**8,013**	5,862	6,549
Infrastructure	**4,260**	3,116	3,482
Fixed Income	**6,031**	4,412	4,929
Private Equity	**4,216**	3,084	3,446

Figure 4 includes AUM of Hermes GPE (infrastructure and private equity). Hermes GPE is outside the scope of this report. Source: Federated Hermes, as at 31 December 2020.

Over the past decade, the investment industry has been increasingly challenged by the rapid growth of passive investment vehicles, particularly exchange-traded funds. During this time, our commitment to active investing has never wavered: we combine high-conviction, high active share investment with ESG analysis and stewardship across all of our strategies.

In recent years, we have diversified our business by developing a broad and deep fixed-income platform, providing specialist capabilities across the entire asset class – from corporate bonds and synthetic instruments to loans and asset-backed securities. This platform has been built to help investors respond dynamically to opportunities throughout market cycles.

In addition, we have established an impact franchise, spearheaded by our Impact Opportunities and SDG Engagement Equity strategies and followed by our SDG Engagement High Yield Credit strategy, with further products in the pipeline. All three of these impact strategies focus on investments that relate to the attainment of UN Sustainable Development Goals (SDGs). By working with companies to deliver positive change, these distinct capabilities show that sustainable investing remains central to our identity and purpose.

[3] https://www.hermes-investment.com/uki/insight/equities/esg-investing-a-social-uprising/ ; https://www.hermes-investment.com/uki/press-centre/fixed-income/new-research-shows-relationship-esg-factors-credit-spreads/; https://www.hermes-investment.com/uki/insight/fixed-income/pricing-esg-risk-sovereign-credit/

[4] Dimson, E., Karakas, O. and X. Li. (2015). Active Ownership. The Review of Financial Studies, 28(12), 3225-3268.

[5] Hoepner, A.G.F., Oikonomou, I., Sautner, Z., Starks, L.T., and X.Y. Zhou. (2020). ESG Shareholder Engagement and Downside Risk. ECGI Finance Working Paper 671/2020.

[6] This figure includes the AUM of Hermes GPE (infrastructure and private equity). Hermes GPE is outside the scope of this report.

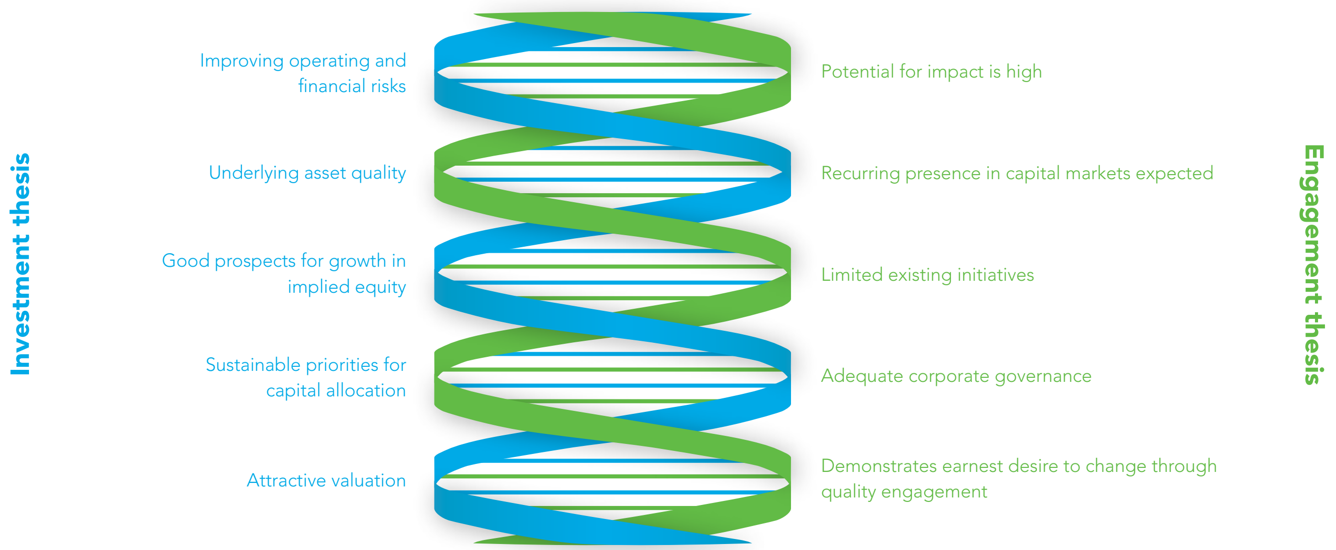
Through EOS – one of the largest stewardship resources of any fund manager in the world – we engage companies on strategic and material ESG concerns to promote investors' long-term performance and fiduciary interests. EOS offers a shared service model, engaging on behalf of both the international business of Federated Hermes and third-party clients. EOS provides a platform for like-minded investors to pool resources, creating a powerful force for positive change. The team works on behalf of long-term global investors who entrust us with the stewardship of approximately £938bn/€1.0tn/$1.3tn of assets (as at 31 December 2020)[7] invested in over 10,000 companies worldwide, working collectively in support of shared goals. This pooling of assets increases the influence we can have with companies, which means we can have a more meaningful impact on the issues of most collective importance to our clients.

Our strategy

We plan to maximise opportunities for future growth and bring the most appropriate investment strategies to our global client base. With the resources of the wider Federated Hermes group, we now have a truly global presence of investment and business-development capabilities that are both diverse and highly complementary. In North America, we have a deep and well-established distribution network and product range, which includes liquidity strategies, dividend income, emerging-market debt and trade finance. Our international business is widely recognised in the pan-European market, with a strong distribution platform and a rapidly growing presence in Asia.

Our investment capabilities fully integrate ESG considerations and engagement insights, which are of increasing interest to North American investors, and in public markets benefit from the engagement work of our stewardship team, EOS. We have a well-established thematic franchise with the development of equity and fixed-income impact products, which focus on creating positive SDG-aligned impact in the companies that they invest in for the benefit of wider society.

Figure 5. Profitability and positive change: two halves of the whole



Source: Federated Hermes, Bloomberg, as at February 2021. For illustrative purposes only.

Within both equities and credit, we are building on the growing demand for our ESG-integrated capabilities and leveraging our core skills to offer thematic sustainable-investing strategies. We see strong appetite from our existing clients and relationships, particularly in the UK and European markets, and have seeded a number of new strategies in this space. Pension schemes in northern Europe are increasingly looking to make impact investments both in private and public markets. We also see interest from large wealth managers who want to offer sustainability-focused portfolio solutions.

Building on the strengths of our fixed-income team, we are developing our multi-asset and unconstrained credit offering. Our first Unconstrained Credit strategy provides a solution for investors who are seeking to outsource their full credit exposure or enhance their fixed-income allocations in a daily-dealing UCITS fund. We also plan to further develop our direct lending capability, which seeks stable, risk-adjusted returns in a portfolio focused on senior-secured loans with the flexibility to target higher yields. We already manage UK and European portfolios within this asset class and plan to explore new related opportunities.

[7] EOS' clients also manage approximately $4.5tn assets as of 01 May 2020.

Within our real estate business, in January 2020, we completed the acquisition of MEPC Limited, a UK commercial real-estate developer and asset manager, from BTPS, a longstanding client and our former majority owner. By adding further expertise in specialist asset management and development management, we have greatly enhanced our real-estate proposition – and particularly our ability to deliver urban-regeneration schemes, which not only provide the opportunity for attractive long-term financial returns but positively impact the environment, communities and local economies in which they are located. These projects are key manifestations of our purpose and help differentiate us from our competitors. In the next few years, we will be developing significant mixed-use placemaking projects in Manchester, Leeds, Birmingham, Bristol and Glasgow. MEPC will reinforce our ability to deliver successful outcomes across all these sites and should in the future afford us the opportunity to apply our highly successful urban-regeneration model overseas.

We have also been appointed by global asset owners to carry out engagement activities on their behalf. Through EOS, we are entrusted with advising on approximately approximately £938bn / €1.0tn / $1.3tn of assets (as at 31 December 2020). We expect growth in this area to continue as demand increases for sophisticated engagement expertise and combined investment and stewardship mandates for clients that are seeking a holistic approach to managing their investments.

To support delivery of this growth, we will continue to develop our distribution using a combination of in-house and third-party resources as appropriate.

How we have ensured a culture of effective stewardship

In our publication 'Stewardship: the 2020 vision', we explained how active stewardship must sit at the heart of investment firms' activity, operations and purpose. This must apply across all asset classes, from equities and corporate credit to real estate, infrastructure, private equity and even sovereign debt and hedge funds.

When Federated Investors, Inc. and Hermes Investment Management rebranded as Federated Hermes in February 2020, the focus was on our position as a leader in active, responsible investing. Our investment beliefs, strategy and culture ensure that stewardship is naturally at the heart of the international business of Federated Hermes. We believe that creating long-term wealth sustainably through active investment and ownership delivers the best outcomes for our clients. Throughout this report, we highlight some of the actions we have taken to ensure our investment beliefs, strategy and culture enable effective stewardship, including:

> **In our publication 'Stewardship: the 2020 vision', we explained how active stewardship must sit at the heart of investment firms' activity, operations and purpose.**

Governance: We have embedded the need for effective stewardship in governance structures across the business, as described under Principle 2. This sends a clear signal of its importance to our business.

Embedded throughout the product lifecycle: Stewardship is incorporated into our product-development process right from the start. A product's relationship to responsible investment and active ownership is a key consideration at the concept development stage and we consider throughout the development process how to ensure it delivers holistic returns for clients. A recent example is our SDG Engagement High Yield Credit strategy, which has stewardship at the heart of its investment mandate and approach. The strategy was launched in late 2019 and grew substantially during 2020. It seeks to achieve a meaningful social and/or environmental impact as well as a compelling return by investing in high-yield bonds and engaging with bond issuers for positive social and environmental outcomes that support the attainment of the SDGs.

Stewardship is also key to our client-service provision. We act as responsible stewards of all the capital in which we invest, through allocation, management and engagement with assets. Through EOS, we also provide broader stewardship services for our clients' equity and credit investments in third-party products. A growing number of clients are enlisting these wider services and there is a growing recognition of the need for high-quality stewardship. As we set out under Principle 2, once a product is live there is a strong governance process in place to continuously review the ESG and engagement integration of the product and to ensure that it continues to deliver the necessary outcomes for our clients. This is done through the Customer Outcomes Group (COG) and Portfolio Review Committee (PRC). All of our investment teams integrate ESG and engagement insights into their investment decision making, as we explain in more detail under Principle 7.

Transparency: Transparency around our activities is key to enabling scrutiny and continuous improvement. Our Delivering Holistic Returns strategy sets out our approach to acting as a responsible owner, investor and firm. Our inaugural Responsibility Report describes how we delivered that in 2019-2020 and sets out how our Responsibility Office strives to ensure that as a firm we meet the expectations of others, working with teams across the business to do so. It also provides an overview of how our investment teams fully integrate ESG and engagement insights into their decision-making across all asset classes. We have also continued to publish our EOS engagement plan and quarterly updates as well as case studies from public and private markets, our Responsible Property Investment report and our real-estate socioeconomic reports. More information is available under Principle 6.

Resourcing: We have ensured that we have appropriate resourcing, including by carrying out a significant expansion of our stewardship team in recent years. More information is available under Principle 2.

Expert support: Our Responsibility Office offers support to our all investment teams in their integration of ESG and engagement information, including through the development of proprietary tools that enable analysts to see ESG data and engagement information for individual companies and their portfolio as a whole. This reflects our core investment belief that responsible investment and stewardship lead to better financial results. More information on our progress during 2020 is available under Principle 7.

Long-term focus: A lot of our engagements are longer-term efforts, and we carry out a continuous dialogue with companies. For example, more than half of our relationships with the companies in our core public-market engagement programme have been going for more than seven years. Our engagement team conducts thorough research and an assessment of each company to ensure the nature of our engagement is accurate, which allows us to carefully build quality, trusting relationships with these firms. More information is available under Principle 9.

Collaboration: Our collaborative approach – described further under Principle 4 – acknowledges the significant quantity and quality of resource needed for effective stewardship and the importance of cooperation to deliver maximum impact across asset classes, sectors and geographies. We set out how we have worked with other stakeholders in the system under Principle 4.

What this means for our approach to investment and stewardship

From the recognition that it is more sustainable to create wealth over the long term cascades a series of decisions and actions that turns an investor into a responsible owner or steward of capital. Responsible, active ownership helps create businesses that are much more resilient to exogenous shocks. These firms are more likely to survive over the long term, and by doing so create better outcomes for our investors and society. As the world continues to be affected by the coronavirus pandemic, investing responsibly matters more than ever. Indeed, we believe that it is the best way to sustain long-term outperformance and contribute to beneficial outcomes for investors, companies, society and the environment.

According to MSCI and Sustainalytics data, ESG factor performance was positive relative to the broad market (proxied here by the S&P 500 index) from the start of the year until the end of March. Companies with the highest ESG scores (quintile one) consistently outperformed laggards (quintile five) across all pillars on a market-cap-weighted basis (see figure 6)

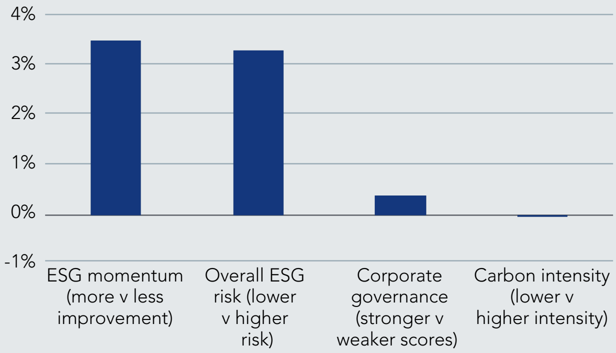
Figure 6. ESG factor performance, S&P 500 market-cap weighted, Q1 2020 total returns

MSCI pillar:	Quintile 1	Quintile 5	Spread
Environmental	-19.1	-21.6	2.5
Social	-17.9	-21.3	3.4
Governance	-16.4	-23.1	6.7
Overall	**-14.8**	**-27.0**	**12.2**

Source: S&P Global, MSCI, Federated Hermes, as at May 2020.

Looking at a shorter time window still, the results from Sustainalytics are broadly similar from the market peak on 19 February.

Figure 7. S&P 500 ESG factor performance since the market peak on 19 February (sector neutral)



Source: RBC, S&P Global, Sustainalytics, Trucost, Federated Hermes, as at May 2020.

This is brought to life and complemented by bottom-up fundamental research on material ESG factors, which of course influences the decisions we make in our stewardship and investment processes. We place both stewardship and high-active-share investing at the heart of what we do. This ensures that we invest and engage with conviction: we build investment portfolios that we believe are meaningfully different from the market and as such we expect to outperform in the long term. Rather than betting on whether the market goes up or down, this combination of high conviction, high-active-share investing and stewardship means that we focus on sustainable wealth creation. In our investment decisions, we take into consideration both ESG data and fundamental research about a company's ESG performance. As responsible owners we seek positive change in our engagement, not just information. While our engagements with investees cover a broad range of ESG and strategic issues, they share a focus on outcomes that create wealth sustainably. Principles 7 and 9 set out how we have continued to maintain high standards of stewardship and responsible investment during 2020, guided by our purpose.

Our purpose in practice

The spread of coronavirus into a pandemic has undoubtedly dominated the collective experience of people around the world in 2020. It has also had a huge impact on the investment industry and the assets in which we invest. Our approach to navigating this period has been guided by our purpose and investment beliefs.

Within our stewardship business, we have focused engagement dialogues on the operational and financial resilience of companies and, critically, their treatment of the workforce, suppliers and customers. We also modified our voting policies and have taken a more flexible approach to the re-election of key directors to avoid unplanned disruption to board composition at this critical time. We have expressed support for companies that take a long-term approach to the pursuit of their stated business purpose, with a focus on achieving positive societal outcomes – something we believe is the best way to achieve long-term sustainable wealth creation. We have also continued to engage on wider sustainability priorities, including climate change and diversity and inclusion.

REAL ESTATE CASE STUDY

A clear example of how our purpose and investment beliefs have guided our decision-making during 2020 is the way in which our Real Estate team stewarded and managed our assets during the crisis. The pandemic has emphasised the need for built-environment wellbeing and our team has focused on providing necessary support to tenants to ensure safe re-occupancy for staff.

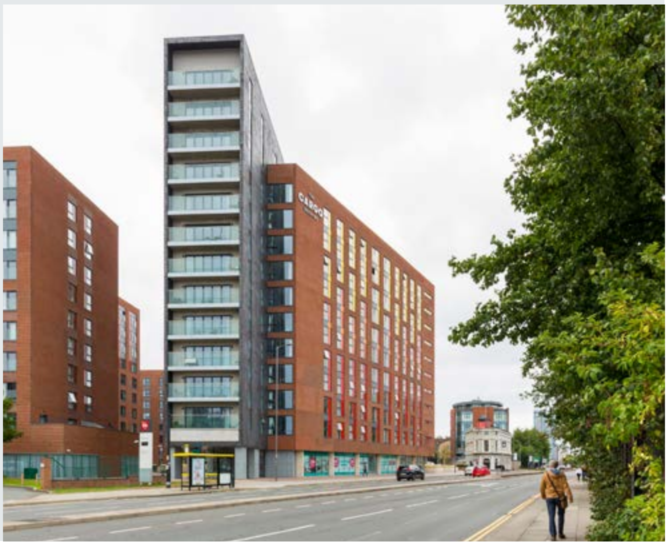
Since the start of the national lockdown in March, we negotiated with our insurers to make £300,000-worth of funds available through a Risk Management Bursary (RMB) fund to pay for various risk-mitigation measures, including extra security for empty buildings, clear protective screens for receptions, stand-alone hand-sanitiser units and directional signs to ensure social distancing. The cost of these items would normally be re-charged back to the tenants through the service charge, but we managed to avoid this (at what is already a very difficult financial time for the tenants) by reimbursing the costs through the RMB scheme.

Since April, we have also had a 'buddy' system in place in our residential properties. This was organised by the site-management teams and means that residents who are at risk or self-isolating can reach out to their 'buddy' when they need supplies. The buddies also act as a first point of contact in an emergency and can notify site teams. There are 46 buddies at our Cargo building in Liverpool and 29 at Pomona Wharf in Manchester. The system has helped to open up communication channels, preventing a situation where people become isolated in their apartments. In addition, on-site mental-health practitioners have been issuing mental-health awareness kits to residents who are suffering from anxiety and other mental health concerns.

We also worked with the British Property Federation – which advises the UK government – to develop guidance for landlord and tenants, including on how to approach rental payments when national restrictions are in place. We remain mindful of this guidance when carrying out our own real-estate operational activities and assess the appropriate course of action for each case. Our managing agents have worked on a close one-to-one basis with our occupiers to understand their financial situations and to reach a resolution when the occupiers are facing financial difficulties.

Finally, we are currently in the process of developing a design and operational brief for wellbeing in buildings to improve air quality, access to outdoor spaces and mental wellbeing in a post-pandemic world.

Cargo Building, Liverpool



Within our broader investment business, we have worked hard to look after the wellbeing of our own staff, supported our local community through charitable donations and are working with our local community organisations. For example, we donated £50,000 to the East End Community Foundation's Coronavirus Emergency Fund in April. Using the donations from both our business and other donors, the East End Emergency Fund had awarded £896,826 in grants by 31 July 2020. This helped support 32,655 local residents, with 74% of funds spent on food, toiletries and household essentials. Our donation of £50,000 to the Meals for the NHS campaign in April also directly contributed to the delivery of 8,300 meals to frontline staff and enabled the onboarding of five new hospitals with 1,500 meals over 30 days. Our donations also supported the independent restaurants that provided the meals.

More information about how our investment and stewardship businesses have responded to the coronavirus crisis is available in Principle 4.

How effectively have we served clients and beneficiaries?

Throughout this report we seek to demonstrate the outcomes of our responsible investment and responsible ownership, which we believe are in our clients' best interests. This includes financial performance, stewardship outcomes and advocacy successes. We believe that our investment approach helps us to deliver sustainable long-term wealth creation by building a better world for our clients and future generations.

External evaluation: There are several external bodies that have validated our achievements and bolstered the credibility of our claim that we are serving the best interests of our clients.

In 2020, the international business of Federated Hermes was assessed by Real Impact Tracker, which certifies institutions most committed to delivering positive impact, and achieved the highest score in the history of its certification. As a result, we have joined Real Impact Tracker's certified community, for which around only 5%-10% of fund managers are eligible to qualify. In achieving the grade 'A' score, we were commended for listening and contributing to academic research to determine the importance of ESG factors in the investment process and to establish the best approach to create impact on behalf of our clients.

We were also named asset manager of the year in the OpRisk Awards 2020, which recognise firms that see the function as an active shield against costly missteps and reputational damage, to protect themselves and their customers. The judges were impressed by how we integrated the Federated Hermes Pledge and its contribution to the strong culture that underpins our risk controls.

We are founding members of the PRI and in 2020 received an A+ in Strategy and Governance, Listed Equity Integration, Listed Equity Active Ownership, Fixed Income SSA, Fixed Income Securitised and Property modules and an A in Fixed Income Corporate Financial and Fixed Income Corporate Non-Financial modules.[8]

We won the Asset Managers Category at the 2020 International Climate Reporting Awards in recognition of how we have integrated climate-related considerations into our reporting and business practices. The jury recognised our efforts to address climate-analysis issues, particularly through our development of propriety tools. We were also recognised in the PRI Leaders' Group 2020. This showcased PRI signatories whose responses to the PRI Reporting Framework demonstrated a breadth of excellence in responsible investment and climate reporting.

We won a range of asset-class and product-specific awards during 2020 in recognition of our leadership in responsible investment, including:

- Winner of the ESG Advocate (Asset Management) category at the 2020 Portfolio Adviser Wealth Partnership Awards
- Fixed Income Innovation of the Year at the Professional Pensions UK Pensions Awards 2020
- Property Manager of the year at Pensions Age Awards 2020
- Real Estate Investment Management Company of the year at Corporate LiveWire Innovation & Excellence Awards 2020
- Best Irish Asset Management Company in the category 8 to 15 rated funds at the European Funds Trophy
- Top Performer in the Emerging Markets Equity Fund – Long Term Performance at Investors Choice Awards 2020, EMEA Top Performers
- Winner of the Best Global Emerging Markets Fund for Hermes Global Emerging Markets at Fund Manager of the Year Awards 2020
- Best performing fund in 2019 (Multi Strategy Credit Fund) in the Absolute Return Bonds category at the UCITS Hedge Awards 2020
- Best Specialist High Yield Debt Fund category for Global High Yield Credit Fund at the Investment Week Specialist Investment Awards 2020
- Best case study (SDG Engagement High Yield Credit commentary: Barclays) at the Pensions for Purpose Awards 2020

[8] Two modules (fixed-income corporate financial and fixed-income corporate non-financial) missed out on an A+ as the PRI's assessment framework did not recognise SDG-related engagement with issuers in the SDG Engagement High Yield Credit Fund as a thematic approach. Without this indicator, the assessment would have provided fixed income with an overall A+.

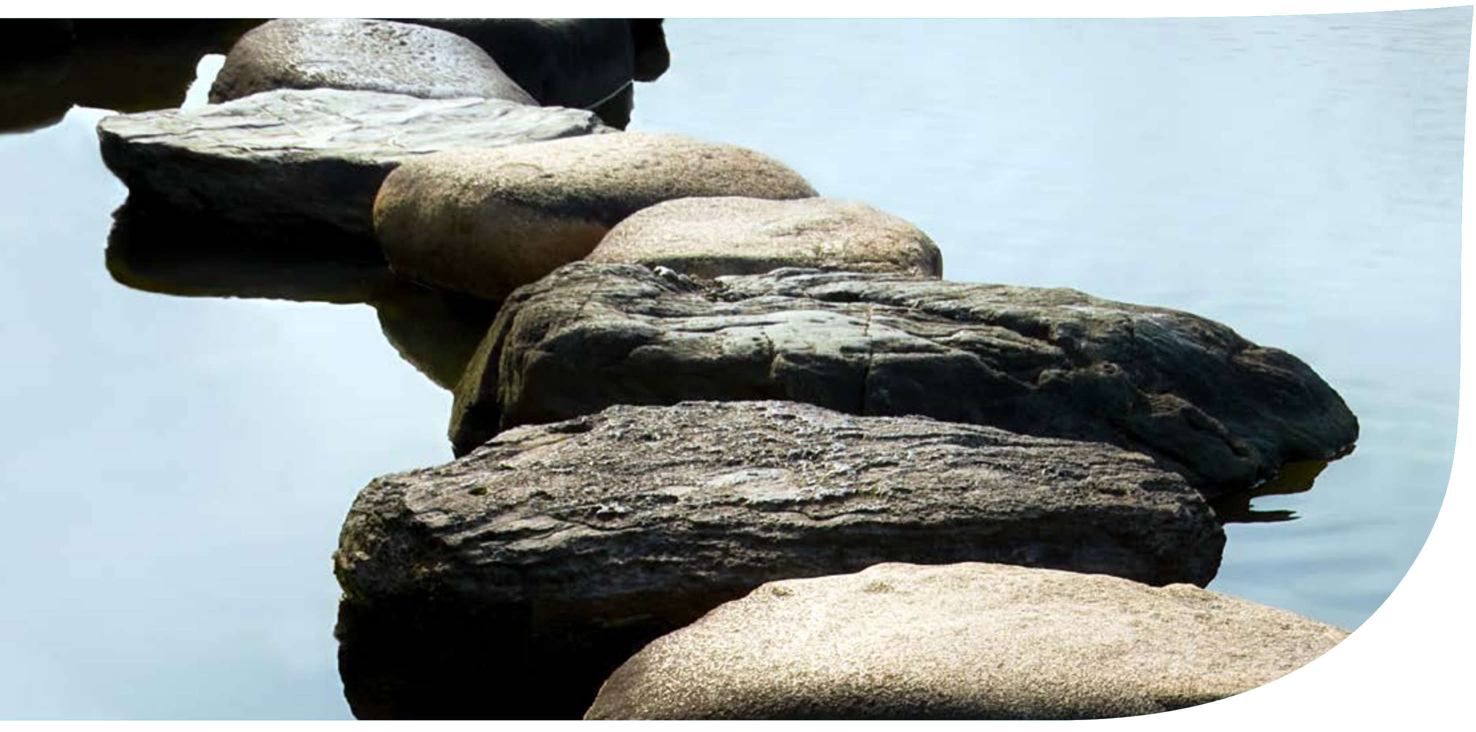
Our approach to promoting effective stewardship is also supported by the growth of literature on the subject, which demonstrates that there are direct financial benefits for investors when engagement occurs at the right level and with the appropriate resources. A few years ago, EOS shared its engagement data with an international team overseen by Professor Andreas Hoepner from University College Dublin. The authors formulated a very simple research question, which can be paraphrased as: 'what effect do engagements by EOS have on the riskiness of targeted companies?'. The study revealed that companies that are successfully engaged by EOS exhibit a lower risk profile, particularly when environmental issues are tackled. A summary of the study can be found here.

Client input: We seek client views through a number of fora to ensure we understand how we can best meet their needs. This is set out in further detail under Principle 6.

Continuous review of client outcomes: We have a number of governance structures in place (described under Principle 2) to ensure fairness to clients and beneficiaries, including through our Customer Outcomes Group (COG). We also conduct post-implementation annual reviews on an ongoing basis to confirm that all products continue to meet a customer need, perform in line with their stated objectives and have continued commercial viability. Each product is viewed holistically, with data collated across the business using a standard template. Information collated for the annual reviews includes performance figures, client demand and peer-group comparison analysis. Customer feedback may be obtained by a third-party market research agency or directly through the sales and client teams, and this feedback will be considered as part of the review. Any products that have not met marketed performance targets, do not continue to meet a customer need or have failed to attract assets will be flagged with the COG for consideration. One-off or ad hoc reviews may also be conducted in response to market events to ensure the product range remains appropriate within the context of our broader investment and corporate strategy.

We also have pricing committees and complete an internal mapping exercise every year. This considers factors such as each client's AUM in order to identify and address material anomalies between clients. During 2020, there were a number of cases where an investor increased their holding in a fund and subsequently reached the required AUM for a lower-fee institutional share class. At this point, we offered them the opportunity to move into this share class so that they could benefit from lower fees. In 2020, we took the decision to reopen one of our funds due to the availability of residual capacity. We did this in a phased way, opening it first to existing investors to allow those that qualified to switch free of charge to a cheaper share class. While we could have reopened only the more expensive share classes – which had been introduced when the fund was approaching the upper end of its capacity limit – we decided it was right to open all the share classes to ensure fairness to all clients.

Plans for the future: We always strive to improve the outcomes that we deliver for clients. As a result, we have increased the resources we dedicate to stewardship across public and private markets, as well as increased the capacity within our Responsibility Office to support all teams in their integration of ESG and engagement information. We recognise that this process is never complete, and that continuous improvement and innovation is required if we are to remain market leaders. Over the coming year, we intend to increase public transparency around our advocacy outcomes and to develop our client reporting to provide greater detail on our stewardship activities.



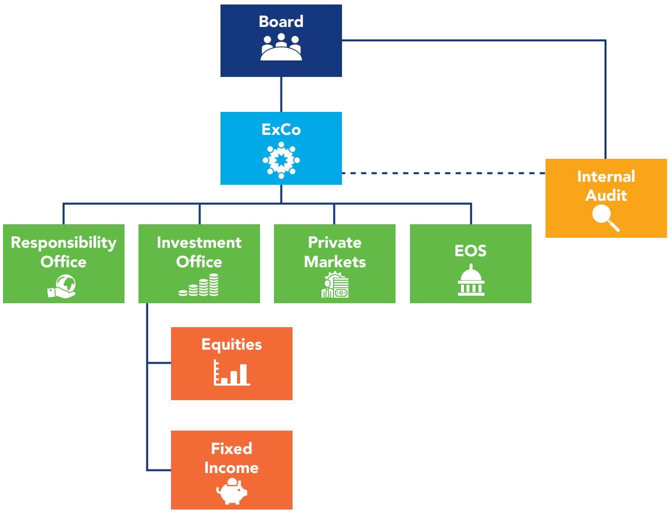
Principle 2

Signatories' governance, resources and incentives support stewardship.

Our governance structures

All of our staff are responsible for implementing our stewardship approach, although there are several functions within the business that play a particularly significant role:

Figure 8: The internal structure of key stewardship functions of the international business of Federated Hermes[9]



Source: Federated Hermes, as at February 2021.

Responsibility Office. Established in 2014, our dedicated Responsibility Office reports through the Head of Responsibility to our CEO and acts as a hub of expertise and support to assist every employee in our business to work towards our core purpose of delivering sustainable wealth creation over the long term. The Responsibility Office coordinates and supports the integration of our responsibility approach and activities across our funds and stewardship services. This includes quarterly meetings with each of the investment teams to review their ESG and engagement integration activities, as well as asset and issuer-specific discussions related to ESG and engagement. The Responsibility Office is also responsible for leading our advocacy and corporate citizenship work, as well as holding each department accountable for ensuring that we act as a responsible firm. By doing so, it keeps the interests of clients and their beneficiaries at the centre of what we do. To ensure responsibility is embedded in all the firm's business decisions, Responsibility Office colleagues are members of the firm's key committees (the key committees which oversee our stewardship approach are described in further detail later in this section).

The Responsibility Office has also established an Innovation Lab to generate novel insights from data and present them in a highly intuitive and useable format. The purpose of the Lab is to help the investment teams deliver better returns and engagers to focus on critical ESG issues. The Lab also supports our advocacy and policy work by providing analysis for compelling, evidence-based reports.

Investment Office. Our Investment Office is the guardian of the investment outcomes we deliver to clients. It acts independently to ensure that our strategies are performing in the best interests of clients and embodies our commitment to acting as a responsible and transparent asset manager. The Head of the Investment Office is a member of the Executive Committee (ExCo).

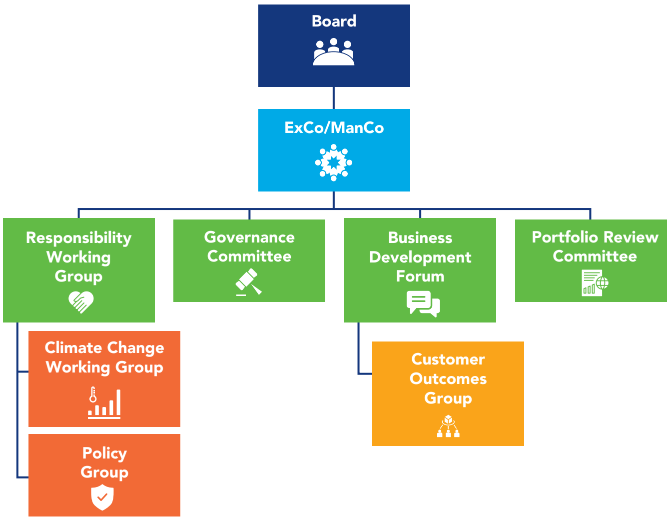
Portfolio managers and investment analysts: Each of our investment teams has formulated their own responsibility plans that explain how, in the context of their particular strategy and investment universe, they incorporate ESG factors and engagement into their investment process. Each team is responsible for undertaking its own fundamental ESG research and the team members are accountable through the performance appraisal system for their part in delivering on our mission.

EOS. EOS is a limited company wholly owned by the international business of Federated Hermes. Its activities and direction are overseen by a legal board, comprising members of the international business of Federated Hermes' ExCo, the Chair of EOS, the Head of EOS and a member of our board. Day-to-day operations are managed by EOS' functional heads team, which consists of the Head of EOS and directors of the client and business development team, business management and stewardship services. The Head of EOS reports directly into the CEO of the international business. We have an established Engagement Management Committee, which considers engagement quality, continuity and coverage in the interests of clients. EOS also has a Client Advisory Board (CAB) which contains client representatives who provide insight, advice and guidance on EOS' business strategy and service offering and to ensure that the EOS service is and remains a client-driven offering. The EOS team boasts one of the largest stewardship resources of any fund manager in the world. The team is composed of individuals with a diverse mix of backgrounds, skills and perspectives and has been at the forefront of the development and evolution of responsible investment practices globally. The EOS team leads our public-markets engagement activity.

[9] This chart covers key functions delivering stewardship and is not an exhaustive representation of the internal governance structure of the international business of Federated Hermes

Internal audit function. The Internal Audit team's primary role is to help the Board, its committees and executive management to protect the assets, reputation and sustainability of the organisation. The function is responsible for providing independent, objective assurance to management through a systematic and disciplined risk-based approach and assessment of the control framework. Responsibility matters and the investment teams' ESG integration is considered as part of the front-office audits, reflecting how ESG is incorporated into the core investment processes. More information is available under Principle 5.

Figure 9. The internal structure of key stewardship oversight functions of the international business of Federated Hermes[10]



Other Sustainable Investing Fora:

Responsible Property Management

Sustainability Investing Centre

EOS Engagement Management Committee

Innovation Lab

Source: Federated Hermes, as at February 2021.

We have extensive oversight of our responsible investment and stewardship processes, activities and outcomes across the firm – something that is indicative of their importance to our business and how they form a core part of our approach. Accountability for delivering effective stewardship across asset classes is integrated at every level of our governance, including:

Board. We have a well-established governance structure that is led by the Board of HFML. The Board is responsible for the governance of the organisation and ensuring its effective operation. It also considers all stakeholders when establishing objectives and policies. Among the Board's responsibilities is the formulation of our strategy, which is to help individuals invest and retire better, to help clients achieve better risk-adjusted returns and, consistent with client objectives and applicable requirements, we strive to contribute to positive outcomes in the wider world. The Board is also responsible for overseeing our approach to climate change.

Executive Committee (ExCo). The ExCo is responsible for setting the strategic direction of the business and ensuring the objectives agreed with the Board are met. Our CEO has passionately led the development and implementation of our mission and responsibility goals. We believe it is our responsibility to lead discussion and debate about the fiduciary responsibilities of fund managers to our clients, their stakeholders and, ultimately, society at large – tasks that our CEO actively leads and contributes to. In particular, our CEO is the founder of the 300 Club, an independent forum that challenges the orthodoxy of the investment industry and puts forward approaches to align the industry more closely to the goals of beneficiaries. He is also a member of the Banking Standards Board, the FCA-PRA Climate Financial Risk Forum, the International Integrated Reporting Council and the Global Steering Committee of UNEP FI.

Management Committee (ManCo): Senior management representatives across the business attend ExCo meetings once a month. The purpose of this extended ExCo meeting is to facilitate the cascade of information (where appropriate) to the ManCo representatives' business areas, which in turn helps support the effectiveness of ExCo's decision making. ManCo representatives include the Head of Responsibility and the Head of EOS.

Responsibility Working Group (RWG). Meeting every quarter, the RWG is made up of senior representatives from across the business and is chaired by our Head of Responsibility. This group reviews and makes recommendations to the ExCo on issues that relate to our policy, the delivery of sustainable wealth creation for our clients and beneficiaries and efforts to share best practice across the organisation.

Climate Change Working Group (CCWG). The CCWG reports to the RWG and meets every quarter. With authorisation from the Board or ExCo as appropriate, its aim is to develop and implement a formal business-wide climate-change strategy. The CCWG is also a formal Task Force on Climate-related Financial Disclosures (TCFD) Working Group that is responsible for – but is not limited to – developing a new risk-management approach and enhanced product and engagement offerings.

Policy Group: The Policy Group brings together senior members of the Responsibility Office, EOS, Marketing and Communications teams to discuss our policy and advocacy work. In addition to acting as a communication forum, the Policy Group sense-checks the proposed approach to advocacy. In the event an issue cannot be resolved within the Group, it will be escalated to the appropriate forum, usually the Responsibility Working Group.

Governance Committee. The Governance Committee is a formal oversight committee that is responsible for overseeing the formulation and delivery of our engagement and voting policy for all our equity funds.

[10] This chart covers key functions overseeing stewardship and is not an exhaustive representation of the internal governance structure of the international business of Federated Hermes.

The committee is accountable to and reports to our CEO. The members include the Head of Responsibility, Head of Investment, Head of EOS, Head of Client Relationship Management and the Strategic Risk and Compliance Director.

Business Development Forum (BDF). The BDF is responsible for approving or rejecting new products. Its members consider how desirable and suitable a product is from a commercial, customer and portfolio-management perspective, which includes looking at how it is aligned with our responsible investment and ownership approach. The committee is also responsible for setting fees and pricing and reviewing ongoing product and range suitability, target markets and profitability.

Customer Outcomes Group (COG). The COG meets every month and supports product governance by providing a forum through which products (including funds and segregated mandates) are reviewed and assessed through a client-centric lens. Good product governance is aligned with our focus on responsible investment management and we aim to put the customer at the heart of product design and management. The COG makes use of a customer-centric view when reviewing investment products and considering our obligations to investors (both directly and indirectly via distributors). The group reviews every strategy at least annually, which includes looking at how well the fund integrates ESG and its engagement progress.

Portfolio Review Committee (PRC). The PRC supports the ExCo by assessing and managing the investment teams, their corresponding processes and related activities. It reviews investment performance across all the firm's portfolios and carries out monthly deep dives into specific investment strategies. As part of this review, the PRC considers the investment implications – at a portfolio and issuer level – of the ESG performance of holdings and the level and progress made in engagement with the portfolio's assets.

Responsible Property Management (RPM) oversight. The Real Estate RPM team uses a steering group with relevant representatives from the business to ensure the decision-making process is inclusive and transparent. For day-to-day implementation, working groups with external experts are used to ensure project decisions are made with the help of investment managers, delivery counterparts and the RPM team.

Sustainability Investment Centre (SIC): The SIC supports the development of the firm's responsible investment capabilities. It facilitates monthly conversations between teams across the business to pool in the best ideas in the sustainable space and supports our focus on long-term sustainable wealth creation.

Accountability for delivering effective responsible investment and ownership outcomes for all clients resides within the international business of Federated Hermes. While our majority and minority shareholders, Federated Hermes, Inc. and BTPS, are both clients of EOS, we have clear policies in place to identify, manage and mitigate potential conflicts of interest as described under Principle 3.

Details of the specific governance we have around managing climate-related risks and opportunities are available in our Climate-Related Financial Disclosures report.

As well as formal governance structures, we have a structured approach to ensuring that we carry out effective engagement and integrate stewardship into our investment processes. This is evidenced in our reporting against Principles 7 to 12, particularly through our ESG and engagement integration approach, engagement selection process and milestone engagement tracking system.

Resourcing stewardship

All analysts and portfolio managers are responsible for ESG and engagement integration, and a significant amount of engagement takes place across all our funds. However, the Responsibility Office plays a key role in keeping them informed on material ESG issues for their investments as well as working with them to identify engagement opportunities. The Responsibility Office plays an oversight and support role in ensuring the investment teams have access to the right resources to efficiently integrate ESG and engagement (in conjunction with EOS for public markets).

While the above is the standard process across all of our strategies, we do have specific strategies which engage with all investee companies and where successful engagement is explicitly part of the ex-ante investment proposition. These include the SDG Engagement Equity and SDG Engagement High Yield Credit strategies. Given these strategies' additional focus on engagement and limited holdings overlap with other of our and EOS' third-party clients' portfolios, we have dedicated engagers who focus solely on these strategies and work closely with EOS to ensure a consistent approach.

We use a number of third-party data providers which support our efforts to integrate ESG and also inform our stewardship activities. These include Sustainalytics, Trucost, CDP, FactSet, MSCI and Bloomberg. We are also actively engaging with other data providers to ensure our teams have access to the latest and most relevant data for our investment approaches. More details on our use of service providers is available under Principle 8.

Public markets

We have one of the largest dedicated stewardship resources of any fund manager in the world, in the form of our public-markets engagement team, EOS. EOS has intentionally built a diverse team of experienced and international voting and engagement professionals who have the expertise, language skills and cultural knowledge to work to deliver real beneficial change within companies. Our diverse engagement team draws on a number of skillsets and our senior engagers come from a range of backgrounds. These include – but are not limited to – corporate law, accountancy, portfolio management, international development banking, investment research, corporate social responsibility, strategy consulting, company secretarial and academia.

We have one of the largest dedicated stewardship resources of any fund manager in the world, in the form of our public-markets engagement team, EOS.

Our ability to engage in the local language and our understanding of local culture and business practice are critical to the success of our engagement work. Within EOS, we have team members of many different nationalities who are fluent in a range of key languages. 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. The depth and breadth of this resource reflects our philosophy that stewardship activities require an integrated and skilled approach. Intervention at senior management and board director level should be carried out by individuals with the right skills, experience and credibility.

Our EOS engagement professionals are divided into designated teams covering ESG and strategy-related themes, sectors and regions. This ensures we have experts who can educate the wider team on developments and best practice in their respective areas. Each engager is responsible for engagement, voting recommendations and ESG analysis, focusing on the combination of regions, sectors and themes that they have been appointed to cover.

The team is based in the UK and the US – London staff cover engagement in Europe, Asia and emerging markets and Pittsburgh staff cover engagement in North America. Our professionals travel to undertake engagements in person where possible at company headquarters. EOS also has a number of senior advisers who provide additional resource and expertise specific to some local markets.

Given that the EOS engagement resource operates across our funds, it is critical that engagers integrate effectively with fund managers. Our approach to ensure this is described further under Principle 7.

We have also invested in systems and processes to ensure effective stewardship. EOS has an online Engagement Management System which allows us to accurately record, track and report on our engagement work. It also ensures that the history of our engagement is available for any member of the team who may be new to leading a company engagement. Our investment teams are also able to access this database, which affords them a full and instantaneous view of the engagement history with the company.

Private markets

Our real-estate business contains a four-person Responsible Property Management (RPM) team which works closely with both internal and external stakeholders, including investment managers, external delivery counterparts for technical expertise, property managers and onsite facility managers. The team members engage with our tenants to ensure that various sustainability initiatives are successfully delivered and also work closely with a number of industry working groups to ensure it remains aware of industry trends and best practice. We recognise the importance of collecting, sharing and linking sustainability and responsible-property investment (RPI) information among the various organisational levels of our investment and asset-management process. As a result, we have developed and integrated a series of RPI tools and procedures that link our strategic investment targets for portfolio strategies and the management of a property's technical characteristics and operational performance.

Our private-debt team directly engages with the sponsor and management team to remedy any ESG issues that arise during the life of a loan. This engagement is conducted in collaboration with EOS to ensure that the engagement is outcomes focused and impactful.

Performance management

Through pay awards, we look to ensure that the aspirations we articulate in the Federated Hermes Pledge are reinforced. In that way, our philosophy is to reward individual contribution, as demonstrated by the delivery of long-term sustainable results that are aligned with our business strategy, values, behaviours and which serve the best interests of our clients and shareholders while enabling the business to grow to its full potential[11].

In 2020, we updated our behaviour framework to more explicitly set out the behaviours that are the visible manifestations of our Pledge. All individuals are rated equally on their behaviours and on their technical performance as part of the performance management process, to encourage a focus on meeting the needs of our clients and beneficiaries and supporting our commitments to society and to the environment. Individuals will be highly rated if they perform successfully while embodying our behaviours as conveyed in the Pledge.

Reflecting on our governance structures

The efficiency of our governance structure is reflected in the outcomes we deliver for clients, which are evidenced throughout this report.

Oversight of effective stewardship is integrated into all levels of our governance and the structures and processes detailed earlier help us reflect on improvements to support effective stewardship. This is also closely connected with Principle 5, where we provide more detail on the internal and external reviews and assurances we have to support continuous improvement. During 2020, we were pleased to see that our governance approach remained effective while the majority of staff worked remotely due to pandemic-related restrictions.

[11] For more information, please see our Remuneration Policy: https://www.hermes-investment.com/ukw/remuneration-policy/

For example, our Governance Committee continued to provide oversight of the formulation and delivery of engagement and voting throughout 2020 by reviewing:

- Several policies relevant to stewardship – as described further under Principle 5 – to ensure that our stewardship processes were supported by effective governance. This included approving an update to our Stewardship Conflicts of Interest Policy to ensure it was aligned with the International Corporate Governance Network (ICGN) model disclosure on conflicts of interest.
- The EOS Conflicts of Interest Register and Log and EOS' voting recommendations and engagement activity.
- A targeted advocacy initiative and its recommendations to ensure that appropriate background due diligence had been carried out.

The update to our behaviour framework in 2020 has reinforced the responsibility of all staff to ensure they embody the values set out in the Federated Hermes Pledge, which are all the more important during these challenging times.

In recognition of our growing business, we have increased the resources within the Responsibility Office and EOS to ensure we can continue to maintain high standards of stewardship and meet client expectations. As set out under Principles 3 and 4, we have managed all potential conflicts of interest arising during 2020 and our teams have worked hard to develop an effective approach to the systemic risks the industry is facing.

Principle 3

Signatories manage conflicts of interest to put the best interests of clients and beneficiaries first.

Our public Conflicts of Interest Policy sets out our commitment to act professionally at all times. We commit to keeping the best interests of our clients and their beneficiaries in mind and to take appropriate steps to identify circumstances that may give rise to conflicts of interest that entail a risk of damage to our clients' interests. It includes examples of conflicts of interest – such as the receipt of confidential information, conflicts of interest between clients, personal conflicts and conflicts between our business and clients – and the appropriate procedures we have established to manage any conflicts of interest identified and to prevent damage to client interests.

Due to the importance of stewardship to our business, we have developed a specific Stewardship Conflicts of Interest Policy. We acknowledge our position as a fiduciary for our clients and their beneficiaries and seek always to act in their best interests. Accordingly, we take all reasonable steps to identify actual or potential conflicts of interest. We also maintain and operate arrangements to minimise the possibility of such conflicts giving rise to a material risk of damage to the interests of our clients.

The international business of Federated Hermes also is subject to Federated Hermes' Code of Business Conduct and Ethics.

Across the firm we take all reasonable steps to identify conflicts of interest between:

- The international business of Federated Hermes – including its managers, employees and appointed representatives or any person with a relevant direct or indirect link to them – and our clients; and
- Any one client of the international business of Federated Hermes and the other clients.

We have summarised key aspects of our policy below and the full version is publicly available online. In addition, we have identified a set of conflicts of interest that are likely to arise in connection with engagement activities and have put in place controls to manage such instances.

Potential conflicts of interest

Ownership

- Federated Hermes, Inc. and BTPS are major shareholders of the international business of Federated Hermes, of which EOS is part. EOS has a clear policy to carry out any engagement with BT Plc and Federated Hermes, Inc. in the same way as with any other company. Responsibility would reside with a senior member of the stewardship team, not the relationship director.
- EOS is fully owned by the international business of Federated Hermes and the Head of EOS reports to the CEO of the international business. Any conflict which may arise between clients of the EOS service and other clients of the international business of Federated Hermes will be addressed in a similar way to conflicts between any of our clients.

Clients and prospects

The international business of Federated Hermes provides services not only to BTPS and Federated Hermes Inc, but also to other institutional investors, including a number of pension funds sponsored by corporations, governments and other organisations, and fund-manager clients. These services include voting recommendations and engagement with companies in which the international business of Federated Hermes' clients are equity shareholders and/or bond investors.

As a result, the following real or perceived conflicts may arise:

- We may engage with or vote the shares of a company which is the sponsor of one of our pension-fund clients – such as BT plc – or is a company within the same group as one of our clients or prospects.
- We may engage with a government or government body that is the sponsor or associate of the sponsor of one of our clients or prospects.
- We may engage with a company which is a tenant of our Real Estate division's property investments.
- We may engage with a company which has a strong commercial relationship, including as a service provider, with the international business of Federated Hermes and/or with clients or prospects.
- We may vote on a corporate transaction, the outcome of which would benefit one client or prospect more than another.
- We may engage with a company where certain clients or prospects are equity holders and others are bond holders.
- We may hold meetings with companies for the dual purpose of delivering both our fund management and engagement services.
- We may otherwise act on behalf of clients who have differing interests in the outcome of our activities.

Individuals

At the individual level, engagers may have a personal relationship with senior staff members in a company in the stewardship programme or personally own the securities of that company.

Stock lending

The international business of Federated Hermes does not engage in stock lending.

Managing and monitoring conflicts: a singular focus

In all our activities, we seek to promote the long-term value and success of the companies in which our clients invest. As such, we engage with market regulators and other actors to influence public policy and regulation to enable this outcome.

Stewardship activities are exercised with the aim of influencing the company's behaviour. However, these activities are not carried out with the intention to obtain non-public information, nor is information obtained intended to manipulate the market.

In the case that material non-public information is obtained through stewardship activities, our compliance department is informed, and an information barrier is created for 'insiders' until the information is publicly disseminated. During the application of the information barrier, stewardship professionals are not allowed to act upon or share the non-public material information. The EOS engagement management system Emerald requires that engagement professionals certify that they have either not received any inside information whilst conducting each engagement interaction or that they have received inside information and followed the applicable compliance procedure.

While we welcome client input and suggestions for engagement, all of our engagements are selected and pursued on the basis of an objective assessment of the severity of the problems faced by the companies engaged or the opportunities available to them, the likely effect of public policy and regulation and the likelihood of success in achieving value-enhancing change or mitigating value-destroying change. We give due regard to the value of the company to our clients and the value at risk given the issues in question.

In our engagements with companies which are the sponsors of (or in the same group as) our clients, we are careful to protect and pursue the interests of all of our clients by seeking to enhance or protect the long-term value of the companies concerned. In the first instance, we make clear to all pension-fund clients with corporate sponsors that we will treat their sponsoring parent or associated companies in the same way as any other company. In addition, we ensure that in such situations the relevant client relationship director or manager within the international business of Federated Hermes, including EOS, is not leading the engagement or making the voting recommendation to clients. This same approach would hold true with respect to any engagement with a company with whom we, our owners or our clients have a strong commercial relationship, including suppliers. If we become aware of potential conflicts, they are disclosed if necessary, to the companies to enable them to be managed effectively.

As noted above, engagement activities and the generation of voting recommendations in relation to BT plc or Federated Hermes, Inc. are delegated to a senior member of the EOS team and relevant investment team members, not the client relationship manager or director.

Members of our investment teams have separate processes and management but are encouraged to join engagement meetings with their stewardship colleagues and discuss the implementation of our voting policies. EOS' external clients are also invited to join upcoming engagement meetings on a sustainable and appropriate basis. The engagement objectives are set out and the voting recommendations made and provided by our stewardship team in line with the international business of Federated Hermes' Responsible Ownership Principles (or, where agreed, client-specific policies). EOS engagers and the international business of Federated Hermes' investment teams occasionally hold joint engagement meetings with companies at which EOS' external clients are not present. While carrying out joint engagements may mean that investment teams have access to non-inside information before it is disseminated to our stewardship clients, we believe the benefits to clients of these joint meetings is substantial. In particular, it produces an enhanced engagement process that focuses on the relevant and material ESG risks and results in a better appreciation of ESG risk in investment decisions.

We have well-established, publicly disclosed voting principles. Based on these and the judgements reached through engagement with individual companies, we provide voting recommendations to our third-party stewardship clients who request to receive voting recommendations. There may be occasions where one of our third-party clients seeks to influence the voting recommendations advice we give to other institutional clients. In such circumstances there would be director-level involvement and an objective judgement reached based upon what we believe to be in the best long-term interest of our clients. All third-party clients retain full discretion over their final voting decision.

Clients and internal investment teams may at times have different immediate interests in the outcome of certain corporate activities, most notably in the result of a takeover bid involving two public companies. In addressing such situations, we are open with clients about the conflict and disclose it where practically possible.

As in other cases, we consider through our company engagements and voting recommendations not so much the financial effect of a deal for any one client, and more the long-term value that could be created or is at risk of being destroyed for our clients.

For our internal investment teams, the voting recommendation provided by our stewardship team will inform their assessment. However, they will make their final judgement independently with a view to their fiduciary obligations to their clients. On the rare occasion that the investment team and EOS disagree on the appropriate voting action, the matter is logged and escalated for consensus to be reached at the director level. It is expected that votes cast by our investment teams would be consistent with the recommendations that we provide to our stewardship clients who request to receive voting recommendations other than in limited circumstances. In such cases the rationale for divergence will be documented.

Review of conflicts of interest

In addition to the broader measures set out above, staff members must flag to their line managers any potential conflict of interest they recognise with a company they are engaging with. We also have policies that seek to avoid any potential conflicts for individual staff members of the international business of Federated Hermes that arise from engagements with companies in which individuals have personal investments or some material personal relationship with a relevant individual. Where a staff member has a personal connection with a company, he or she is required to make this known and is not involved in any relevant engagement activities.

Recording and escalation

We maintain a register of instances of conflicts as they arise. In those limited circumstances where a conflict over our approach to providing voting recommendations (aside from that directed by EOS third-party client-specific policies) or engagement arises which is not able to be resolved in the manner set out above, the matter is referred to an escalation group which reports to an independent sub-committee of the Board. The escalation group is comprised of the Heads of Investment, Responsibility, Client Relations, Compliance and EOS. Instead, the group is guided by our mission to deliver long-term holistic returns, our published Responsible Ownership Principles, voting policies and other appropriate industry-endorsed guidance. If there is no majority view in the group, the CEO will make a final decision. All such instances would be documented and reported to the Risk and Compliance Committee, which is an independent sub-committee of our Board.

Real estate

Our real-estate business has formal procedures to deal with conflicts of interest. One potential area of conflict is the allocation of real-estate investments between client portfolios. However, it is important to note that each portfolio has its own geographical and structural bias and specific investment objectives in terms of risk, income profiles, hold periods and target lot size. This separation is also compounded by the different timings in liquidity between the various client portfolios. As not all are in the market for new products at any given time, in practice this is rarely an issue.

Another factor that reduces the risk of conflicts is the fact that investments are allocated on a first-past-the-post basis. This means that the investment team that first receives the introduction has the first opportunity to acquire the investment. If the opportunity is not a fit for the particular fund, it is made available for other clients managed by the international business of Federated Hermes. In most cases, it will be clear when a particular investment should be placed between client funds, but where there is any doubt, the allocation decision will be approved by the CEO of our real-estate business and the rationale for the allocation set out in the papers presented to the investment executive for formal approval.

Any other type of potential conflict of interest would be reported to and dealt with by our real-estate Board, or the appointments committee for matters relating to our FHPUT fund.

Annual review

We review our Stewardship Conflicts of Interest Policy annually to ensure it adequately reflects the types of conflicts that may arise so that we can ensure that they are appropriately managed and as far as possible mitigated. The Policy is publicly available on our website.

Our conflicts-of-interest approach in practice

Our policy on conflicts may be best understood by considering its impact in practice.

Our EOS conflicts-of-interest register contains a description of stewardship conflicts, what mitigation procedure and controls were put in place, whether it was then reported to the escalation group if necessary and any follow-up actions and conclusions. It is reviewed by senior management on a regular basis. The following are examples of potential stewardship conflicts which we identified and managed in 2020:

- **Initial voting recommendation difference with an investment team:** EOS' initial voting recommendation for a company was against the remuneration report due to the use of options for executive directors. The relevant investment team signalled that preventing the company from being able to use the options would put the company at a competitive disadvantage, due to the importance of retaining talent in the industry. Following further discussion, EOS decided to recommend support by exception. One strong rationale for this was the fact that the executive directors were the founders and long-term shareholders, which mitigated concerns related to the use of options.
- **Voting recommendation against our policy limits:** An assessment of a company's resolutions led to an EOS recommendation to vote against the remuneration policy. This was because according to our voting guidelines, the shareholding requirement was lower than our limit. We also had concerns about the remuneration report that related to the low actual shareholding of the CFO and the narrow share-based metrics in the long-term incentive plan. The vote was escalated for further discussion with another engagement-team member and EOS' Head of Stewardship. Following further discussions and clarifications with the company, EOS decided to still recommend a vote against the remuneration policy but were able to support the report.
- **Initial voting recommendation difference with an investment team:** Our voting guidelines indicated that we support the remuneration report for a company. This vote was escalated to another team member and EOS' Head of Stewardship. After discussions between EOS engagers and an engager based in one of our investment teams, taking into account additional context regarding the company's debt position and poor treatment of workers during the coronavirus crisis, EOS decided to recommend voting against the remuneration report.

Principle 4

Signatories identify and respond to market-wide and systemic risks to promote a well-functioning financial system.

Identifying risks

The Investment Office is responsible for the daily oversight of market risk across the international business of Federated Hermes, as well as the oversight of the underlying portfolio managers' adherence to their pre-defined/client-agreed investment processes. The Investment Office's main remit is to act as an independent investment risk consultant on behalf of our clients. While the Investment Office can challenge our portfolio managers' decisions, positioning and risk exposures, it cannot force change. What the Investment Office can do, if the issue is sufficiently serious enough, is to escalate the matter to the Portfolio Review Committee (PRC). The PRC would then meet with the portfolio manager, consider the issue and then, along with the Investment Office and the portfolio manager, agree a resolution. If no resolution can be agreed, the matter can be escalated to the ExCo, which has the authority to force change and agree client communications. The members of our Investment Office take the time to understand individual fund managers' styles so that they can aid and enhance their process.

We run a series of both hypothetical and historical stress tests across our portfolios that vary according to the asset class and strategy. This includes geopolitical events and shocks to markets, interest rates and currencies.

Given the long-term nature of our investment approach, the purpose of these tests is not to push portfolio managers to make immediate portfolio changes but to enhance their analysis and strategy. The crisis induced by the Covid-19 pandemic has reinforced the importance of such tests, as described in more detail below.

Shortly before the Covid-19 pandemic, we set up a bear-market council for portfolio managers to identify low-probability but high-impact risks outside of the mainstream and develop scenarios to stress-test our portfolios against. While we were unable to get the council into full swing before the Covid-19 pandemic emerged, 2020 has demonstrated why such exercises are valuable. This exercise is something we are looking to develop further in 2021, in order to create an even more robust framework for our stress testing.

We may also identify market failures or barriers to responsible investment and stewardship through our investment and engagement activities. Where this is the case, we will identify the relevant policymakers to engage with on the topic.

Advocacy and involvement in industry initiatives

We recognise that as investors we have an opportunity and a responsibility to help address market-wide and systemic risks. We engage constructively with regulators and policymakers globally to address environmental, social and other market failures that may prevent the financial system from operating in the best interests of its ultimate asset owners. This includes addressing barriers to responsible investment and stewardship. We seek to go beyond the minimum standards set by regulators and to demonstrate and share best practice.

We have two staff members working full-time on public policy in the Responsibility Office. This includes the Head of Policy and Advocacy, whose team works with staff across the firm to ensure advocacy work is well informed, relevant and impactful. Our stewardship service, EOS, also has a comprehensive programme of engagement with legislators, regulators, industry bodies and other standard setters to help shape capital markets. The result is an advocacy policy that aims to lead rather than follow the policy debate. In addition to contributing to the advocacy work carried out by the Responsibility Office and EOS, members of the investment team are directly involved in an extensive range of industry initiatives and often hold advisory roles to contribute their expertise. Examples are discussed in more detail later in this section.

We often engage directly with regulators and policymakers and aim to be a progressive and constructive voice in the debate. We provide practical insights about how proposed policies might play out in practice and help to identify suggested alternatives that might better achieve their responsible-investment policy aims. We also respond to consultations from policymakers to provide constructive feedback, using a networked approach to gain relevant input from teams across the business. Over the course of 2020, we responded to more than 20 consultations from regulators, policymakers and industry initiatives.

Building on this work, we identify areas for more in-depth advocacy and engagement where we feel that significant change is needed and where we can add value. In 2020, this included the EU sustainable finance agenda, corporate governance in South Korea and the future of the UK investment industry (see boxes).

EU Sustainable Finance

2020 was a year of progress for the European Union's (EU's) Action Plan on Sustainable Finance, which seeks to reorient capital flows towards sustainable investment, manage financial risks stemming from climate change, resource depletion, environmental degradation and social issues and foster transparency and long-termism in financial and economic activity. We strongly support these aims and have been actively engaged since the launch of the action plan in 2018, working constructively through bilateral and collective discussions with the European Commission (EC), industry initiatives and our peers.

In 2020, we engaged extensively with the EC and European Supervisory Authorities (ESAs) on the draft Regulatory Technical Standards of the Sustainable Finance Disclosures Regulation. These proposals received significant pushback from the industry, and we used our practical experience of sustainable approaches to investing to suggest constructive ways forward that would more effectively achieve the aims of the original regulation.

We produced a briefing that we shared with the EC, ESAs and regulators in member states to reflect on the progress made so far in phase one of the EU's Sustainable Finance Action Plan and propose six key action points to adjust and enhance the current regime to ensure that the action plan is a resounding success. This has formed the basis of our subsequent engagement.

Nearly three years since the EU Commission put its sustainability plan into action – and amid a second tranche of proposed reforms for the 2020-25 period – in a five-part blog series, we reviewed the journey to date and mapped out the most promising routes ahead to reach the HLEG destinations.

Throughout the year, we also responded to several consultations set up by the EC, including the EU Non-Financial Reporting Directive and the EU renewed Sustainable Finance Strategy.

Future of the UK investment industry

We strongly believe in a sustainable investment industry that works for its beneficiaries to deliver sustainable wealth creation and have developed a set of ambitious reforms that we believe would achieve this. We hosted an external roundtable in the summer of 2020 with industry experts and other stakeholders to discuss and develop these ideas, which was summarised by Jericho Chambers. We focused on identifying the actions that industry, regulators and governments can take.

We contribute to policy discussions both directly and in collaborative fora and initiatives. We are a member of several industry bodies and initiatives around the world and are co-founders of many of them. Through these initiatives we engage with others both within and beyond the investment industry to promote responsible investment, including ways that the industry and our investees can respond to market-wide and systemic issues such as climate change. Colleagues from across the business – including the Responsibility Office, EOS and the investment teams – take on advisory roles in many of these organisations to share our practical expertise. Given the global nature of our investments, this work spans asset classes and geographies.

More detail on the groups and associations in which we participate and promote responsible investment and stewardship are listed on our website. Notable examples of our work with key industry initiatives in 2020 include the following:

We promote stewardship as an important means of responding to risks, including through our membership of the Stewardship Working Group of Her Majesty's Treasury Asset Management Taskforce. The working group aims to drive coherence across existing initiatives, promote the importance of stewardship in the UK and promote the UK as a centre of excellence for stewardship internationally.

The Real Estate Responsible Property Management team participates in a number of industry think tanks. These include the Better Buildings Partnership (BBP), UK Green Building Council (UKGBC), British Property Federation (BPF) and the Institutional Investors Group on Climate Change (IIGCC). We are a board member of the BBP and a working-group chair for a number of BBP initiatives. In addition, we are a supporting member on the UKGBC Social Impact and Climate Justice initiatives. We also are a part of the sustainability committee and insurance steering group for the BPF.

We joined the IIGCC in 2006 and are active members of several working groups. We have been involved in a range of collaborative engagement and advocacy initiatives and contributed to the draft Net Zero Investment Framework, which was launched for consultation in 2020. We co-signed letters to the audit committees of some of the largest European listed companies in the sectors identified by the Taskforce for Climate-related Financial Disclosures (TCFD) as most exposed. We also led a session for the IIGCC's corporate engagement programme on best practice for effective collaborative engagement as part of Climate Action 100+. Different sector teams are now formulating a strategy and identifying which companies could be ready for a shareholder resolution. Given our leadership role in Climate Action 100+ – we lead or co-lead engagements with 29 companies – we will continue to shape this agenda going forward.

Halting and reversing tropical deforestation will be essential if we are to avoid the consequences of severe climate change and biodiversity loss. Deforestation and forest degradation, mostly driven by beef, palm oil, soy and other agricultural commodity production, has continued despite the immense value of tropical rainforests. Alarmingly, the rate of deforestation has increased in Asia, Africa and Latin America during the coronavirus pandemic.[12] We are working as part of the recently formed Investors Policy Dialogue on Deforestation in Brazil to reverse this trend in the Amazon rainforest, engaging with relevant government authorities and associations to promote sustainable land use and to improve company disclosure and management of the various ESG risks associated with soy and cattle. We further demonstrated our commitment to this issue by signing the Finance for Biodiversity pledge in 2020. In addition to calling on global leaders to agree on effective measures to reverse nature loss in this decade, we have committed to take ambitious action to protect and restore biodiversity through our own investment decisions and engagement by 2024 at the latest. Work is now underway internally to meet these ambitious goals. Finally, we have also recently supported the UK government's 2020 consultation on legislative proposals to tackle illegal deforestation in supply chains and the Business for Nature's consultation on the CBD Post-2020 Global Biodiversity Framework.

[12] https://www.ft.com/content/b72e3969-522c-4e83-b431-c0b498754b2d

Figure 10. Our reach: we are involved in many key industry initiatives Source: Federated Hermes, as at February 2021.

Source: Federated Hermes, as at February 2021.

We also describe in further detail how we have been involved in collaborative engagement to address both thematic issues and individual issues under Principle 10.

Engagement with investees

Where we have identified market-wide and systemic risks such as climate change or the impact of the pandemic, we will engage with our investees to ensure they have appropriately assessed, managed and mitigated the risks. This may be through collaborative engagement alongside other investors or industry initiatives, which we discuss in more detail under Principle 10.

EOS focuses its public-markets stewardship on the issues with the greatest potential for long-term positive outcomes for investors and their beneficiaries. Generally, EOS' work is embodied in a response to systemic risks but interlinked to this are market-wide risks it must consider. The full taxonomy under Principle 9 identifies 12 key themes and 36 related sub-themes for engagement which could be considered systemic risks. Within this, our work maintains a focus on the most material themes.

Below, we set out in more detail how we have responded to two key market-wide and systemic risks in 2020: climate change and Covid-19. These are examples of how our response to identified market-wide and systemic risks can result in changes to our investment portfolios, our engagement with companies and our advocacy efforts.

In focus: climate change

We aim to understand both a company's contribution to climate change and its exposure to related risks and opportunities, which should allow us to play a positive role in encouraging firms to generate lower emissions and reduce the risks arising from climate change. This is driven by the goals we set out under Principle 1: to help individuals invest and retire better, to help clients achieve better risk-adjusted returns and, consistent with client objectives and applicable requirements, we strive to contribute to positive outcomes in the wider world.

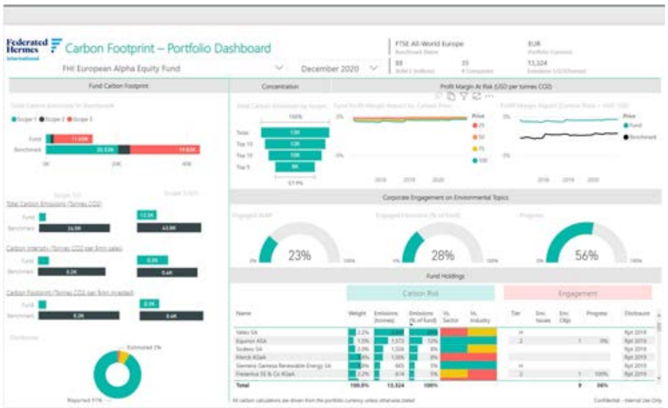
The physical and transition risks posed by climate change represent a systemic threat to financial stability, our economy and society and will have a significant impact on both the financial state and lives of our clients and end beneficiaries. Asset managers have an important role to play in accelerating the transition to a net-zero carbon and resilient economy.

Our Responsibility Report and Climate-Related Financial Disclosures report set out in more detail how we have integrated an assessment and management of climate-related risks and opportunities into our investment decision making. This includes the governance structures we have in place to ensure climate-related risks and opportunities are appropriately managed and that the outcomes of our risk-management processes feed into our business strategy. Our assessment of and response to the systemic risk of climate change spans our top-down investment risk and asset-level analysis, our engagement activities and our operational risk management. In 2020, our Climate Change Working Group focused on designing and implementing a strengthened firm-wide climate strategy, which included expanding our existing top-down and bottom-up risk-management approaches.

Assessing risk in public markets

Our integrated approach to managing climate risk and opportunities is based on our belief that we can create positive feedback loops between investment and stewardship. This should help reduce climate-related risks and maximise the opportunities for the companies and assets in which we invest. The primary means through which we monitor and measure the climate-change exposure of our investment portfolios is through our proprietary carbon tool, which measures a fund's carbon footprint relative to its benchmark and calculates its carbon efficiency/intensity. As well as providing a carbon heatmap, the tool enables portfolio managers to stress-test the resilience of our portfolios to a range of carbon prices, identify whether high-emitting companies in the portfolio are being engaged with or whether engagement needs to be initiated, and understand the progress on any climate or wider environmental engagements already underway. The information also helps increase our investment team's awareness of carbon-related risks, which can lead to updated valuations and potentially change investment decisions.

Figure 11. Carbon footprint – portfolio dashboard



Source: Federated Hermes, as at February 2021. For illustrative purposes only.

We also use other external tools, including the 2 Degrees Investing Initiative's Paris Agreement Capital Transition Assessment (PACTA) tool and the Trucost climate tool.

EOS: engaging on climate-change issues

Engagement is a crucial element of our approach to managing climate change and climate is a specific engagement focus in EOS' public-markets engagement programme. EOS aims for all companies to have a business model consistent with achieving net-zero emissions and an effective transition plan to deliver this by 2050 or sooner.

EOS has taken an active role in a wide range of initiatives related to climate change, including the Climate Action 100+ initiative. Climate Action 100+ is a major global investor initiative, launched in 2017, that aims to help limit global warming to well-below 2°C and as close as possible to 1.5°C. It engages with more than 100 of the world's biggest greenhouse-gas emitters and a further 60 or so companies that have a significant opportunity to drive the clean energy transition. EOS is leading or co-leading the engagement on 29 companies.

EOS is leading or co-leading the engagement on **29** companies

The initiative, which is scheduled to last five years, has had some notable successes. Significant progress has been seen across a range of industries, including some of the most challenging to decarbonise. Examples of focus companies making substantial net-zero commitments so far include Heidelberg Cement, Duke Energy, Nestle, Daimler, Volkswagen, BP, Thyssenkrupp, ArcelorMittal, BHP Billiton, Centrica and Saint-Gobain. Yet analysis shows that a significant step-change is still required from the majority of target companies in addressing climate change as a strategic business risk. Further action is needed to drive the necessary changes at these companies.

GLOBAL EMERGING MARKETS CASE STUDY

TSMC

Headquartered in Taiwan, TSMC is the world's largest semiconductor foundry. Its products are used in a wide range of applications in the computer, communications, consumer and industrial sectors, and are used in end markets such as mobile devices, high-performance computing, automotive electronics and the internet of things (IoT).

TSMC's operations consume vast amounts of electricity and water. The company must be commended for its water-management framework, yet tackling electricity consumption has historically been a challenge due to the shortage of sizeable green electricity suppliers in Taiwan. However, there is growing pressure from responsible investors who see the business case for climate-change mitigation and adaptation strategies.

TSMC achieved zero carbon emissions from power consumption in its overseas sites in 2019 after it purchased renewable energy certificates and carbon credits. TSMC has also set sustainability targets: it wants 25% of the power consumed by its fabrication operations to be supplied by renewables and to procure 100% of its energy for the rest of the business from renewable sources by the end of 2030.

Despite these goals, TSMC's current use of renewable energy is low. We recently engaged the senior management team to encourage the company to make progress on this front, despite the constraints in the local power market. The team understood our views and highlighted the company's efforts to work with the Taiwanese government to overcome some of the obstacles.

Following our engagement, TSMC signed a landmark 20-year deal to buy the entire power production of Ørsted's third offshore windfarm in Taiwan. This comes to 920 megawatts, a significant increase on TSMC's current renewable-energy power-purchasing agreements. The windfarm is expected to start commercial operations in 2025-26, subject to grid availability and the final investment decision and should enable the group to eliminate more than 2m metric tonnes of carbon CO_2 emissions a year. In 2020, the deal gave TSMC the confidence to become the first semiconductor company in the world to join RE100, the alliance of businesses committed to 100% renewable-energy use. TSMC has pledged that all power consumed in its manufacturing plants and offices worldwide will be sourced from renewables by 2050.

Real estate: building a better future

Our Real Estate team has integrated climate risk management throughout its investment decision-making and asset-management processes. A responsible property investment (RPI) acquisition checklist is used when acquiring new assets, which covers specific ESG issues like climate change, with a particular focus on flood risk and mitigation.

Our Real Estate team's responsible property development and refurbishment guidance also sets out a series of guidelines and principles for our project and development managers to follow. This ensures a consistent, start-to-finish approach to sustainable refurbishment and development, making use of key RIBA Stages. The approach also follows BREEAM principles, which adopt sustainable methods of construction to deliver an operationally efficient and sustainable building or refurbishment. In order to further our net-zero alignment aspirations, we have signed up to pioneer a number of industry projects in 2020. These include the Better Buildings Partnership Design for Performance initiative, which focuses on carbon reduction in operations, and the London Energy Transformation Initiative, which supports the development of net-zero aligned assets.

Adaptation measures are embedded in the design and construction of the building. The team monitors the 10 UN Global Compact Principles and also the mandatory completion of both initial and final responsible-property-development action plans.

> **We have set our proposed pathway to achieving net-zero emissions by 2035 across the managed assets included within our £6.1bn UK real-estate portfolio.**

In 2019, we joined the Better Building Partnership Climate Change Commitment (along with 22 other signatories) with the aim to achieve net-zero emissions across our real estate portfolios by 2050. As part of this commitment, on behalf of our clients, we have set our proposed pathway to achieving net-zero emissions by 2035 across the managed assets included within our £6.1bn UK real-estate portfolio. We aim to deliver on this aspiration in four specific areas:

1. **Decarbonisation.** Remove the use of fossil fuels, increase energy efficiency, use green tariffs and reduce embodied carbon in our new development and major refurbishments. This should support improvements in local infrastructure and emphasise best-practice innovation.
2. **Deliver energy efficiency.** Reduce energy use intensity by 66% in the years to 2035 against a 2018 baseline.[13]
3. **Stakeholder engagement.** Work with occupiers, suppliers and other stakeholders to successfully transition to net-zero alignment.
4. **Utilise offset opportunities.** Use credible, permanent carbon-removal methodologies for residual carbon utilising schemes, such as natural-capital solutions for carbon sequestration to address embodied carbon.

We have developed this pathway using the UK Green Building Council's Advancing Net Zero Framework and aligning the 2035 target with our clients' stated objectives and targets.

[13] 'Net zero carbon: energy performance targets for offices', published by UKGBC on 14 January 2020.

The pathway has a phased approach. The first phase aims to address managed assets in the UK, looking at the publication of detailed targets and timelines in 2021. Subsequent phases will seek to address the wider international portfolio and consider the specific challenges relating to the occupied areas of the residential assets. Our real estate clients' pathway to net zero excludes our corporate office and related activities, our real-estate debt capability and funds where we only have an advisory role. All of these will have their own targets and net-zero strategies and we will look to align our managed-asset portfolio's pathway. We continue to develop and implement initiatives across our real-estate portfolio that are designed to reduce carbon emissions and improve efficiencies in our built environment portfolio, making use of new technology and best practice gleaned from our active engagement in peer-group benchmarking.

Our annual RPI report also publicly discloses the environmental and social outcomes for our real-estate funds. In 2006, we set a target to reduce the carbon emissions from our real-estate portfolio by 40% by 2020. By the end of 2019, we had not only achieved but also beat the target by 25.45 percentage points. This was despite the fact the portfolio had grown from 105 to 175 buildings.

Advocacy: delivering positive industry-wide change

Looking beyond investment and stewardship, we also believe that policymakers have a key role to play in determining the investment risks and opportunities created by climate change. In 2020, we carried out extensive advocacy work on climate-related issues. This aimed to promote positive change relating to the rules governing both financial markets and the real economy.

We continue to be active members of – among others – the IIGCC, Climate Action 100+, the Asia Investor Group on Climate Change, the Better Buildings Partnership, CDP, Ceres and the UK-China Green Finance Task Force. We also took on a number of new external roles related to climate change in 2020, including the Committee on Climate Change Net Zero Finance Advisory Group, Financing the Just Transition Alliance, the Investors Policy Dialogue on Deforestation in Brazil, CDP's Science Based Targets Campaign and the Japan Climate Initiative. In addition, we became co-chairs of the new Investment Association's Climate Change Working Group, which aims to shape the UK investment industry's response to this systemic risk.

We responded to a range of consultations in 2020, supporting increased disclosure throughout the investment chain as well as improved standards in the real economy. We were also involved in developing the IIGCC Net Zero Investment Framework, which was launched for industry consultation in August 2020.

In addition, we are members of the FCA-PRA Climate Financial Risk Forum (CFRF). Our CEO chairs the Disclosures Working Group (DWG) of the CFRF, which in June 2020 published practical guidance for how financial institutions can disclose climate-related financial risk. We will continue to chair the DWG during phase two of the CFRF.

Finally, we founded and now chair the UK chapter of the Partnership for Carbon Accounting Financials (PCAF). The PCAF was launched in September 2020 and our involvement demonstrates our continued commitment to driving innovation in sustainable investment at an international level. PCAF is an industry-led group to standardise carbon accounting in the financial sector, enabling firms to measure the level of financed emissions and to work collaboratively in enacting genuine change. The working group will be observed by Mark Carney's COP26 unit and will collaborate with both the UK Government and the Bank of England.

In focus: Covid-19

The Covid-19 pandemic is a public health crisis. It is also a major threat to economic sustainability, businesses and individual households. Its impact on many, if not all of our ultimate clients – beneficiaries of pension, insurance and other funds who are also members of the workforce and citizens – is unprecedented in modern times. Our experience of the crisis supports our long-held belief that the support of stakeholders and a social licence to operate are fundamental to long-term value creation.

As part of the Investment Office's stress tests described earlier in this section, we run regular liquidity stress tests which assume a constraint on trading conditions. Liquidity risk is two-sided, and we consider both how long it would take to liquidate portfolios without incurring excessive trading costs and what client redemptions are likely to be under particular scenarios. The Covid-19 pandemic saw a significant increase in liquidity risk due to the market sell-off in March. However, as we had good liquidity across our products, we were able to meet the demand for client redemptions without making significant portfolio changes. Our analysis focused on where best to source liquidity for redemptions, while factoring in the longer-term view of how we wanted to position our portfolios both during and after the crisis to ensure we continue to deliver on client expectations. Our ability to weather this crisis has reinforced the importance and robustness of our existing risk-management practices. Going forward, we hope that the bear-market council described in the previous section will provide an even stronger framework for us to assess such risks. Given the ongoing nature of the crisis, we will continue to evaluate the efficiency of our risk-management practices in order to identify any learnings and future development.

Stakeholder focus and long-term value creation

Perhaps our most significant response to the Covid-19 pandemic has been through engagement. We did not predict the scale of the risk emanating from the pandemic, yet we believe we have tailored our approach to engagement during the crisis as effectively as possible and recognise the unprecedented challenges facing companies. We think that the businesses that pay the closest attention to their stakeholders, while supporting the efforts of governments and wider society, will emerge from the crisis the strongest. Through encouraging this approach in our engagement, we believe we are helping to promote the return of well-functioning financial markets.

In the early days of the pandemic, our focus was on the operational and financial resilience of companies and, critically, their treatment of employees, suppliers and customers. These short-term factors underpinned whether a company was able to survive the pandemic. We summarised our concerns in an open letter to chairs and CEOs in April. We also modified our voting policies for the 2020 shareholder-meeting season to reflect the ongoing crisis. For example, we urged companies to strengthen their balance sheets and act in their long-term interest when making capital-allocation decisions, including dividend pay-outs. In markets where there is a vote on dividends, we will support companies that are prudent as they navigate the immediate financial impact of the pandemic.

As the crisis has evolved, our engagement has focused on the lessons learned and the post-crisis response. We therefore shifted our attention towards sustainability-focused risk management in order to address how a company can become more resilient to future crises, recognising that the world now looks very different to how it did in 2019.

Please refer to our reporting under Principle 1, which sets out the approach that our real-estate team took when managing our assets during the crisis.

Looking beyond the pandemic

As countries plan for a post-pandemic recovery, we are engaging with companies, policymakers and society as a whole to reflect on the factors behind the crisis. This may mean reassessing business models, energy and transport infrastructure and economic systems that fail to align with the goals of the Paris Agreement on climate change.

In the first instance, companies should not be surprised if governments regulate to insulate society from future pandemics. Actions that could significantly impact companies include enhancements to employment law and health and safety regulations. We also believe that business activities that threaten future health and wellbeing, including those relating to intensive animal farming with its links to anti-microbial resistance and infections transmitted from animals to humans, could face new controls.

Advocacy: building back better

Our engagement efforts have been supported by wider advocacy work. As well as working collaboratively with others through the industry initiatives we are members of, we have published several pieces setting out our thinking and suggested response to the impacts of the pandemic on the investment industry.

This includes our article entitled 'Building back better: why climate action is key to a resilient recovery' which contends that governments across the world can maximise longer-term benefits by ensuring that stimulus measures in response to the pandemic are combined with efforts to tackle climate change, thereby creating a more sustainable and resilient future for all. The article sets out a series of actions that governments across the world could take to do so.

ENGAGEMENT CASE STUDY

Managing pandemic risk

We engaged with Tesco, the UK supermarket, on governance and culture in the wake of the 2014 accounting scandal.[14] It now has a markedly different culture and robust processes governing risk management, including for financial reporting and audit. We discussed how this had been reflected in its response to the pandemic in our most recent engagements with the Chair of the Audit Committee and the Chief People Officer.

Pandemic risk was on the company's radar and was rapidly escalated, with a swift operational response. The firm increased available delivery slots from around 590,000 when the UK lockdown was imposed in March to 1m by the end of April. Likewise, efforts to rebuild trust with stakeholders, including employees, have resulted in an engaged and motivated workforce that has enabled the company's response. To support the increased capacity and provide cover for employees who are isolating, Tesco has employed around 50,000 temporary staff, including 4,000 new drivers and 12,000 new pickers, and has begun paying a 10% bonus on the hourly rate to employees.[15]

[14] https://www.ft.com/content/2ff76972-1388-11e7-80f4-13e067d5072c
[15] https://www.tescoplc.com/news/2020/tesco-serves-more-than-one-million-online-grocery-orders-in-a-week/

Principle 5

Signatories review their policies, assure their processes and assess the effectiveness of their activities.

Ensuring our policies support effective stewardship

We regularly review our policies to ensure they remain effective. The process for doing so depends on the specific policy:

- Our Conflicts of Interest Policy is reviewed annually by our Risk and Compliance Committee, which reports into our Board. No material changes were made to this policy in 2020.
- Our Stewardship Conflicts of Interest Policy is reviewed annually by the Governance Committee to ensure it adequately reflects the types of conflicts that may arise. This means we can ensure that they are appropriately managed and, as far as possible, mitigated. In 2020, the Policy was updated to ensure it was aligned with the ICGN model disclosure on conflicts of interest. This included specifying the independence of our investment and stewardship teams.
- Our Engagement Policy for the international business of Federated Hermes, as required by the Shareholder Rights Directive II (SRDII), covers our public-equity engagement approach. It is reviewed annually by our Governance Committee, with the latest review in December 2020. As required under SRDII, we report annually against this Engagement Policy. We have incorporated our reporting against SRDII into this Stewardship Code report. More information is available in the Annex.
- Our Engagement Plan is a key policy for public-markets engagement and covers the next three years. It is updated on an annual basis using a structured horizon scanning exercise which considers extensive feedback from our investment teams and EOS third-party clients, as well as an external scan of industry issues. This ensures that we consider fresh perspectives and continue to identify the key themes which cover our clients' priority areas, ensuring we carry out effective stewardship.

- EOS' Global Voting Guidelines act as a policy which inform EOS' voting recommendations to our investment teams as well to EOS clients who request to receive voting recommendations. The international business of Federated Hermes Global Voting Policy and Guidelines, which are aligned with EOS' Global Voting Guidelines, inform the investment decisions made by our investment teams. Our Guidelines are informed by a hierarchy of external and internally developed global and regional best-practice guidelines. We have 22 EOS-developed regional corporate governance principles, available on our website, which set out our fundamental expectations of the companies our clients invest in. We also have nearly 50 country-level policies. The primary policy-development cycle for EOS voting guidelines is an annual process and runs in conjunction with the policy-review process at ISS[16], which informs its benchmark research. EOS looks at feedback from clients, evolving best practice in each market, as well as the changes made at ISS in view of resolution-level data for past voting seasons, to consider what additional changes are warranted. Further input is provided by our Engagement Plan, which identifies thematic priorities for engagement. These can often be boosted by enhanced vigilance and potentially escalation through our voting recommendations. EOS completes its major policy changes before the main voting season in each market. Once changes are applied, the policy is monitored to ensure it is having the desired effect and is adjusted further where appropriate. Our Global Voting Policy and Guidelines are approved annually by the Governance Committee. The regional corporate governance principles are approved by the Engagement Management Committee and noted by the Governance Committee.
- Our investment Exclusions Policy is reviewed every quarter by the Responsibility Working Group. This policy applies across asset classes.
- Our strategy and approach to acting as a responsible owner, investor and firm, 'Delivering Holistic Returns', is updated by the Responsibility Office every two years. We now report annually against this strategy in our Responsibility Report, which was first published in 2020.
- Our Responsible Property Development (RPD) guide also helps us embed sustainability principles into refurbishment and maintenance. This guide is reviewed at least annually and any time there is a relevant major legislation change. It is reviewed by our third-party delivery counterparts, Carbon Intelligence and GWP Project Services. We are currently developing a design innovation brief focusing on our new development, regeneration and placemaking schemes. This will consider innovation in sustainability through design, construction and supply-chain engagement.

[16] ISS is a provider of corporate data, analytics and insight. Its services include proxy-voting services. The way we use ISS research is explained further under Principle 12.

Our approach to assurance

We have several internal and external processes in place to maintain high standards of stewardship.

The department, together with senior management, continues to augment and embed the firm's compliance framework, which includes:

- Managing any potential conflicts of interest.
- Improving the monitoring of regulatory and client-specific guidelines through the implementation of new systems.
- Ensuring that the risks associated with new products, instruments and markets/locations are adequately considered.
- Money laundering and 'Know Your Client' responsibilities.[17]
- Staff inductions and regulatory training.

Our Compliance team is represented on the Portfolio Review Committee (PRC) and Customer Outcomes Group (COG). More information is available under Principle 2.

Our internal audit function's primary role is to help the Board and its committees and the ExCo to protect the assets, reputation and sustainability of the organisation. The Internal Audit team is independent of the day-to-day operations and management of the company and is responsible for providing independent, objective assurance to management through a systematic and disciplined risk-based approach and assessment of the control framework across the firm. Internal audit reports are published at the conclusion of each audit. The individual reports highlight any control weaknesses noted, along with agreed remediation actions, owners and expected resolution dates. Updates on all reports and the status of open internal audit issues are provided to the Executive Committee the Board Audit Committee.

The 2020 Audit Plan included reviews of product development, sales, change management, client on-boarding, compliance activities, financial crime, information technology controls, procurement, Internal Capital Adequacy Assessment Process (ICAAP) process and the risk-appetite framework. Responsibility matters and the investment teams' ESG integration have been considered as part of the front-office audits, reflecting their integration into the core investment processes.

Bespoke 'responsibility accountabilities' have been defined for each business area within the organisation and, as appropriate, relevant goals will be part of each colleague's technical performance objectives. These 'accountabilities' set out what responsibility each business area has for supporting the delivery of our purpose. These responsibility accountabilities are reviewed every two years by the Responsibility Office with each business area and actions are identified where improvements can be made. The outcome of this review and key actions are reported to ExCo. Our next review will take place in 2021.

To maintain the quality of our public-markets engagements we have established a quality-assurance programme.

Day-to-day operations are managed by the EOS functional heads team, consisting of four directors within the EOS team – the Head of EOS, the Head of Stewardship, the Director of Client Service and Business Development, and the Director of Business Management.

There is also an Engagement Management Committee which considers engagement quality, continuity and coverage in the interests of clients. Engagers also hold engagement clinics to confirm engagement is focused on the right objectives and issues and review the proposed approach to engagement. In addition to engagement clinics, an annual review of objectives also takes place.

On an annual basis, the EOS voting recommendation process is assured by external auditors as part of a Report on Internal Controls prepared in accordance with the guidance described in ISAE 3000 and ISAE 3402 issued by the International Federation of Accountants and Technical Release (AAF 01/06). It assesses the internal controls over the processes that ensure that all ballots (both from the international business of Federated Hermes and EOS' third-party clients) have a recommendation instruction submitted prior to the deadline where possible. It also ensures that all instances where a late recommendation is submitted (as a result of these processes failing) are recorded with our Operational Risk team.

Our Responsible Property Management (RPM) team has a comprehensive monitoring programme to measure, monitor and report on our ESG performance. The results are published annually in our Responsible Property Investment (RPI) report, available to the public. All data used in RPM reporting are verified and assured by a third party in accordance with relevant industry standards.

The Real Estate RPM team completes Global Real Estate Sustainability Benchmark (GRESB) reporting to benchmark our real-estate assets against their peers. All data is managed and verified by a qualified third party and is submitted to the relevant certification scheme. This data output and analysis is fed back to the internal teams on a quarterly basis through update reports by property managers. We also have a checklist to ensure the appropriate sustainability due diligence is carried out on all ESG factors when acquiring new assets. In addition, we have an RPD Guide for new developments and building operations. This sets out requirements for the site teams to follow to ensure the relevant ESG principles are embedded into the design, construction and operations of the asset. We explore additional industry benchmarking and certification to ensure a third-party verified certification is carried out for specific assets to implement sustainability initiatives and to engage with tenants. We provide more detail on the outcomes of such certification processes under Principle 9.

[17] This includes checking and verifying clients' identities.

Our independent Responsibility Office meets quarterly with each of the investment teams to discuss their approach to ESG and engagement integration and to talk about how this has been applied to specific investments.

Fair, balanced and understandable stewardship reporting

As described above, we have internal and external assurance processes in place to ensure the quality of our stewardship. EOS also undertakes a peer analysis review on a regular basis. In the introduction to this report, we set out the steps we have taken to ensure that our reporting is fair, balanced and understandable.

Continuous improvements

We use these assurance processes and reviews and learnings from our investment and stewardship practices to continue to make improvements to our stewardship approach. This ensures we continue to provide best-practice services for our clients.

Changes following external consultancy review: Following an external consultancy review in 2019, EOS has started a business-change project to implement some of the recommendations. These include ensuring that our team has access to the right market-leading tools and processes to conduct engagement, as well as to evolve the processes which underpin our services to support the continuous improvement of stewardship practices.

Changes to the engagement management committee. We recently reviewed the EOS Engagement Management Committee structure and as a result of this we decided to add four engagement team members to the committee. Each of the engagers represent a different region of our work to ensure that we are applying a global perspective to support effective stewardship.

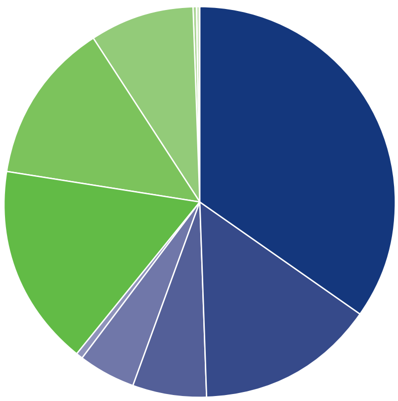
Further assurance. We are pursuing discussions with a view to securing assurance of some of our integration and stewardship activities. We view such assurance as an important way to demonstrate the high standards of our stewardship. We are in discussions with a number of providers, with the aim to develop an outcomes-focused assurance approach. While we explored this previously with an assurance provider, they unfortunately proposed to take a tick-box approach – something we did not feel reflected the high standards of stewardship that are reflected in the Stewardship Code. In the meantime, we continue to carry our own high standards of internal audit on processes.

Principle 6

Signatories take account of client and beneficiary needs and communicate the activities and outcomes of their stewardship and investment to them.

Our client base

Figure 12. The approximate breakdown of our client base



	Sum of AUM %		Sum of AUM %
Institutional	**60.90**	**Wholesale**	**39.10**
United Kingdom & Ireland	34.74	Europe	16.82
Europe	14.92	United Kingdom & Ireland	13.21
North America	6.03	North America	8.71
Asia Pacific	4.69	Asia Pacific	0.31
MENA	0.51	MENA	0.04
		Other	0.01

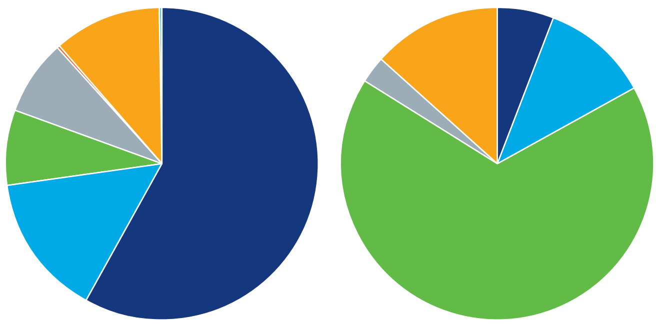
Grand Total 100.00%

Figure 12 includes the AUM of Hermes GPE. Hermes GPE is outside the scope of this report.

Source: Federated Hermes, as at 31 December 2020.

Our assets under management

Figure 13. The approximate breakdown of assets under management by asset class and geographies



	% of AUM
Equity	58.22
Real Estate	14.81
Infrastructure	7.87
Private Equity	7.79
Alternatives:	
Other	0.08
Fixed Income	11.21
Multi-Asset	0.02
Grand Total	**100.00**

	% of AUM
Asia ex-Japan	6.10%
Europe ex-UK	11.00%
Global	66.90%
North America	2.68%
UK	13.32%
Grand Total	**100.00**

Figure 13 includes the AUM of Hermes GPE (infrastructure and private equity). Hermes GPE is outside the scope of this report.

Source: Federated Hermes, as at 31 December 2020.

Our investment time horizons

Our approach is to seek opportunities to deliver long term sustainable wealth creation for investors. It is this understanding that informs our belief that we have a duty to consider the longer-term risks and opportunities when investing. This means carrying out extra work when analysing companies to understand externalities, governance practices, environmental impacts, treatment of workforces and the influence of operations on local communities. It also means using our influence to improve the behaviour of those companies in which we have invested, the operations of the assets that we directly manage and advocating for systematic improvements to the financial system in which we participate. Some engagement initiatives will take a number of years to come to fruition. As a result, the majority of our strategies have time horizons of more than three years. This aligns us with our pension-fund clients who typically invest over the long term.

How we have sought and incorporated our clients' views

We seek client views through a number of fora to ensure we understand how we can continue to best meet their needs. We meet regularly with our clients to seek their views and feedback and have continued to do virtually so while working remotely during 2020. Early in 2020, we held a meeting with a number of clients to discuss ideas for sustainable credit products. This allowed us to gather insights from them, which helped inform the development of new products that can directly meet their needs.

The majority of our clients have an appointed client team to meet their needs, which consists of relationship managers, sales managers and client-services managers. Several of the teams also involve members of senior management or other parts of the business. These client teams are responsible for developing a deep understanding of their client, their needs, views and approach. The client teams are trained to listen to clients, support them and develop new ideas in tandem with them.

Through this approach, we have developed two commingled funds with existing clients (and are in the process of developing a third with another client). These funds are a testament to our ability to work closely with our clients, take their views and needs into account and launch strategies that are appealing to like-minded clients.

In response to client demand and feedback, we are also developing a client sustainability training programme. This should help foster a greater understanding of sustainability criteria and is an opportunity to conduct conversations and generate ideas with clients through small, focused group sessions.

We also employ the services of third-party market-research agencies to help identify client demands and needs. This is conducted both for existing strategies and any new products. For example, when we looked to launch a sustainable credit strategy, we worked with the Wisdom Council to carry out research on both retail and institutional client demands and their understanding of sustainability. This helped us in the strategy-development phase and showed us the type of language we should use to ensure the clarity of our approach.

As we set out under Principle 1, we use our Customer Outcomes Group (COG) to conduct post-implementation annual reviews on an ongoing basis. This is to confirm that all products continue to meet a customer need, perform in line with their stated objectives and have continued commercial viability. Client feedback may be obtained by a third-party market-research agency or directly through the sales and client teams, and this feedback will be considered as part of the review. For example, during 2020 we reduced the fees of one of our funds after a review was conducted incorporating insight from existing clients and a review of the external competitor marketplace.

We continue to receive positive feedback from our clients on the service we provide, our thought leadership and the way in which we manage their assets. This is a strong indication that our clients feel that their views are being heard and that we are providing a service that meets their needs.

Finding the right fit

We offer a range of strategies across asset classes, each with their own investment style and stewardship approach, so that clients are able to invest in products that meet their needs. All of our products are high active share, integrate ESG considerations and engagement insights in investment decision making and deploy best practice stewardship. The stewardship approach will be informed and aligned to our firm-wide policy, as articulated in various policy documents. These include the strategy document Delivering Holistic Returns, which describes our approach as a responsible investor, owner and firm, our Responsible Ownership Principles, the EOS Engagement Plan, our Climate Change Expectations of Investee Companies and the Responsible Property Investment (RPI) Strategy. While each investment strategy is responsible for the investment and stewardship decisions it will apply on behalf of all clients in a fund, significant time is taken to listen to clients' views and inputs.

In addition to creating segregated mandates tailored to individual clients and their investment policies, we also offer pooled products with additional types of ESG approaches to suit client needs, including:

Exclusionary screening: Our Global Equity Screened ESG strategy uses a proprietary exclusion list – or screen – which is updated on a quarterly basis and incorporates investors' bespoke ESG preferences. The exclusion list includes companies:

- That EOS has identified are involved in providing controversial weapons;
- With a high severity rating for environmental and social risks in the EOS Controversial Companies report; and
- That generate more than 10% of their revenue from the gambling, tobacco, logging, nuclear energy or armaments industries.

For clients who have segregated mandates with us, we are also happy to work with client-supplied restricted exclusion lists and can easily tailor our investment approach to meet their specific requirements.

Positive tilting (best-in-class): Our Global Equity ESG strategy invests in companies with good or improving ESG track records, robust financial statements, competitive strengths and a proven ability to consistently beat revenue and earnings expectations. Our proprietary tool, the ESG Dashboard, alerts us to stock-specific ESG risks that are not specifically covered in fundamental analyses of companies.

Impact investing: Our Impact Opportunities, SDG Engagement Equity and SDG Engagement High Yield Credit strategies invest for the long term in companies that intend to make a positive and sustainable impact on society and which are succeeding commercially by doing so. Our impact strategies are also linked, explicitly or implicitly, to the specific targets detailed within each of the SDGs.

The EOS Engagement Plan was developed to provide clients with a clear articulation of the approach to engagement being carried out acting as a statement of our stewardship priorities and objectives on our clients' behalf. Under Principle 9, we identify our 12 key themes and 36 related sub-themes for the next three years. The Engagement Plan is developed utilising the engagement team's specialist expertise, and is informed by input from EOS' third-party clients and our investment teams. This ensures that the themes represent client priorities and those of their underlying beneficiaries. Through the EOS annual survey, we have seen that a consistent majority of clients say they that prefer our engagements to remain at a broadly similar level of intensity and focused on a similar number of companies.

To ensure that we continue to manage our assets in line with the approach we market to prospects and agree with clients, our Compliance department monitors fund guidelines – including objectives and constraints – through thinkFolio, an order management and trading system. All active portfolios undergo pre- and post-trade compliance. Where possible, pre-trade portfolio parameters, counterparty limits and other guidelines are coded into thinkFolio before investment. A member of the Compliance department undertakes the guideline coding, while another member conducts a second review. The thinkFolio programme is coded to prevent any trade in a prohibited counterparty or jurisdiction taking place before execution.

The Compliance team also runs a daily post-trade breach report in thinkFolio, which shows when investment guideline limits have been exceeded. This is irrespective of whether the breach has occurred as result of market movements or a corporate action.

The Investment Office monitors adherence to internal risk guidelines and provides an early warning of potential breaches. If any internal risk guidelines are reached, the situation will immediately be flagged to the appropriate investment team and the portfolio manager will usually adjust their position. However, in cases where investment teams believe it is more appropriate to continue with an outlying position or challenge the internal risk guideline, the situation will be escalated for discussion at the Portfolio Review Committee (PRC) to agree a resolution.

Communicating with our clients

We are committed to being open and transparent. As noted earlier, the Federated Hermes Pledge underpins our firm-wide commitment to always put clients first and to act responsibly. Our publicly available Annual Report and Accounts reflect this approach and go beyond the minimum disclosure expectations, with details and statistics on responsibility and ESG. We also report on corporate social responsibility-related activities – such as our carbon footprint – and outline future targets. This is included alongside our engagement activities and financial reporting.

Reporting is critical to demonstrate our activity on our clients' behalf. We have therefore developed a suite of high-quality, activity-based, qualitative and quantitative communications to support internal and external stakeholder communications.

We have published our annual Climate Related Financial Disclosures report, where we lay out our approach to identifying and managing climate-related risks and seizing opportunities as a business. These include how we are involved at the policy level in developing climate-related initiatives and how we ensure that everyone in the business factors the weight of the climate emergency into the work that they do.

We regularly publish detailed case studies that cover a range of asset classes, alongside thought pieces, blogs and podcasts on topical and emerging ESG issues. We also make publicly available a quarterly EOS engagement and voting recommendations report covering thematic ESG topics and EOS' annual report, which includes statistics, case studies and public-policy information.

Our Real Estate team publishes an annual Responsible Property Investment (RPI) report, which publicly discloses environmental and social outcomes for our real-estate funds. We have also published several reports to measure the social and economic outcomes of our real-estate placemaking initiatives. We have not published any reports in 2020 as the measures put in place during the Covid-19 pandemic have prevented us from measuring the impact of these developments. As a result, work is still ongoing to produce the next three reports for our developments in Paradise (Birmingham), Milton Park (Oxfordshire) and Skypark (Glasgow). Our most recent socioeconomic report was published in 2019 and covers NOMA, Manchester. The report provides an example of the style of reports we produce and the impacts we have had. It sets out quantified social and economic impacts, showing that the estimated construction investment of approximately £150m at the time of the report had supported approximately 2,250 construction workers over eight years, with 60% of the jobs filled by Greater Manchester residents. Over 1,000 construction workers received on-the-job training and over 80 apprentices were involved in the redevelopment. Around 70% of construction spend was with Greater Manchester based contractors.

Our Real Estate team is working on expanding reporting boundaries to provide more specific qualitative and quantitative details on the positive social, economic and environmental impacts of some of our investments, whether they are large urban regeneration projects or community engagement in existing buildings.

ESG analysis and engagement insights are integrated into all of our investment decisions across each of our strategies. We are continuously improving our reporting on ESG so that our clients can fully understand our approach to responsible investment. High level engagement and voting (for equities) information is incorporated into all of our client reports. We provide detailed quarterly and half-year reporting on both ESG and engagement information to the clients of our SDG Engagement and Impact funds. We do not yet publish this data systematically for all our other strategies, but we do share data on an ad-hoc basis with clients. We are able to provide examples from the ESG Dashboard, our bespoke company report for collating and viewing data on the most important ESG issues, the Portfolio Snapshot, which provides a portfolio perspective on ESG exposures and carbon reports. There is currently an internal project underway to update our reporting to incorporate both ESG and stewardship data at the fund level.

Typically, we offer clients annual meetings where the client director and portfolio manager review the portfolio and provide insight into ESG activities undertaken. However, we aim to meet the needs of each client and can be available to meet at more frequent intervals or via conference calls as required. When remote working became the norm due to the Covid-19 pandemic, we set up a weekly (and subsequently bi-weekly) fixed-income market-update call to inform our clients and prospects interested in our products. After a summer break, we launched Credit Pulse, a monthly call with our Head of Fixed Income and the Credit team with updates on the market and our fixed-income products. We also have a Meeting Room portfolio briefing webcast series which updates our clients and potential clients on the performance of our key funds on a monthly basis.

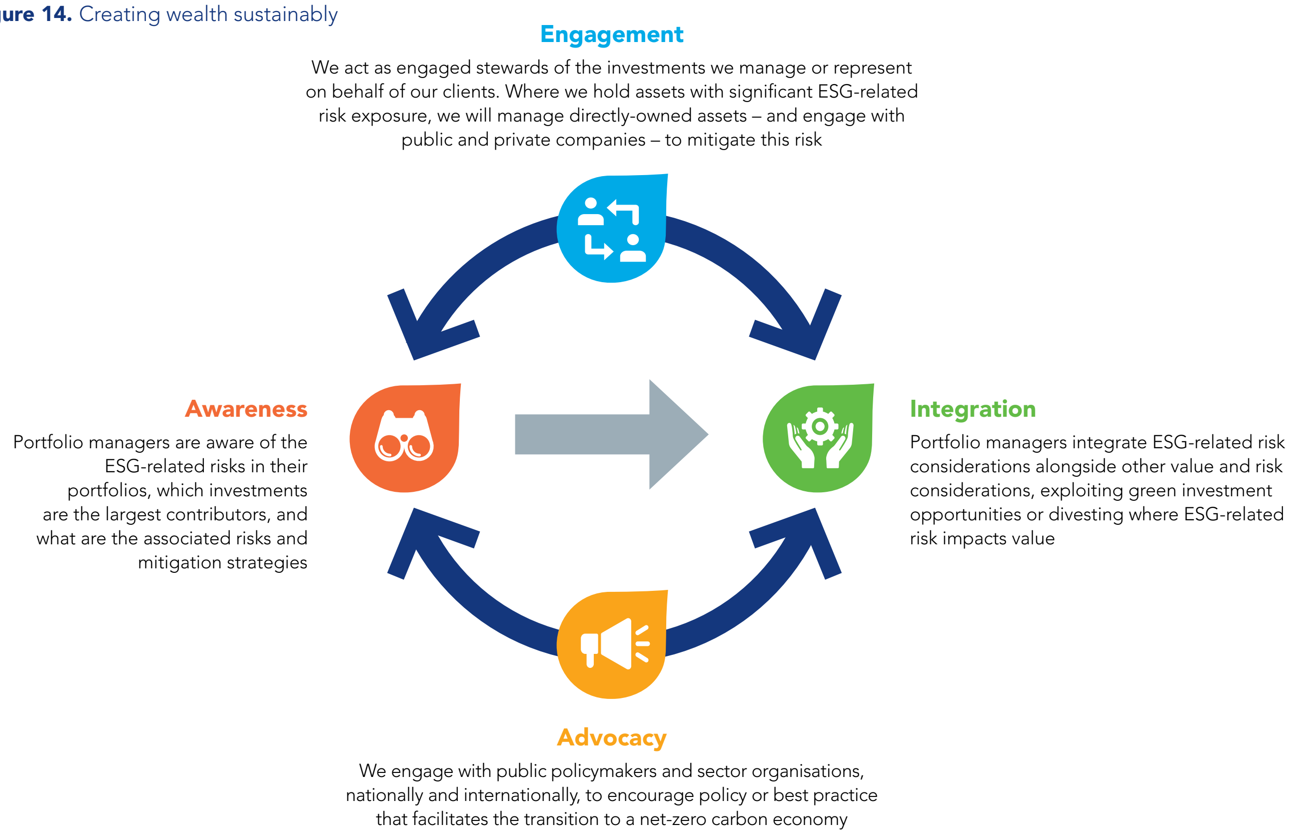
As we look towards the future of responsible investment, we want to become even more transparently accountable as a responsible firm. As such, we have developed our inaugural Responsibility Report, which is an annual publication that will provide clear information about our responsible business practices, our approach to responsible investing (specifically, what that means in practice) and our firm-wide advocacy activities. In our 2020 report, we examined two key topics – climate change and impact investing – to demonstrate how we integrate and engage on material issues across public and private markets. In addition, we explain how we advocate for the interests of our clients and the need for greater responsibility throughout the investment industry in our interactions with policymakers.

Principle 7

Signatories systematically integrate stewardship and investment, including material environmental, social and governance issues, and climate change, to fulfil their responsibilities.

At the international business of Federated Hermes, we believe there are two mutually reinforcing strands of responsible investment management: responsible investment and responsible ownership. Within these strands, we aim to generate sustainable wealth creation for the end beneficiary – the investor – by delivering superior investment returns and positive social and environmental impacts.

Figure 14. Creating wealth sustainably



Source: Federated Hermes, as at February 2021.

We do not see the integration of ESG and engagement insights within investment decisions as a separate category of investing. Instead, we believe that ESG risks and opportunities should inform all investment decisions. That is why we integrate ESG considerations and engagement insights into our investment processes in all of our products, across all asset classes. As our research has demonstrated, investors do not need to sacrifice returns to invest responsibly. On the contrary, our research shows that companies with good governance and social performance indicators tend to outperform others over the medium and long-term.[18] For this reason, we aim to ensure that investors' capital is deployed to create wealth sustainably, delivering sustainable long-term growth and helping to build a better society and planet for all – dual perspectives that we believe should not be separated, but considered as one.

Our mutually reinforcing responsible ownership work covers asset engagement, or the process of actively engaging with companies to request that they align their behaviours with the long-term interests of clients and their beneficiaries by improving the strategic, financial and ESG-related performance of companies and assets. It also includes advocacy, where we engage with public policymakers, regulators and industry bodies to enhance industry norms, and market rules and regulatory requirements in relation to corporate governance, stewardship and environmental and social policy globally and regionally.

[18] "ESG investing: a social uprising," published by Federated Hermes in October 2018.

Prioritising issues for assessment of investments

Taking an active approach is a central part of our investment proposition. As a result, our portfolio managers are able to take a selective approach by only investing in companies with the necessary characteristics, in the team's opinion, to be sustainably successful over the long term. This approach stems from our values and investment beliefs, which we described earlier under Principle 1. We consider all material investment factors, including those relating to material ESG issues.

While the most pressing material risks are those that will crystallise in the short term, we are long-term investors that strive to deliver holistic returns for our end investors. This means that our definition of materiality is necessarily wider. We believe that a wider range of risks will ultimately become material over a longer timeframe and that we need to engage proactively to mitigate them.

The key medium- to long-term risks – many of which may also present threats over shorter timescales – that we factor into our investment analysis and engagements include climate change, natural-resource scarcity, pollution, human rights, human capital and labour rights, conduct, culture and ethics, corporate governance and strategy, risk and communications. More detail about how we engage on these issues and the outcomes we seek is available under Principle 9.

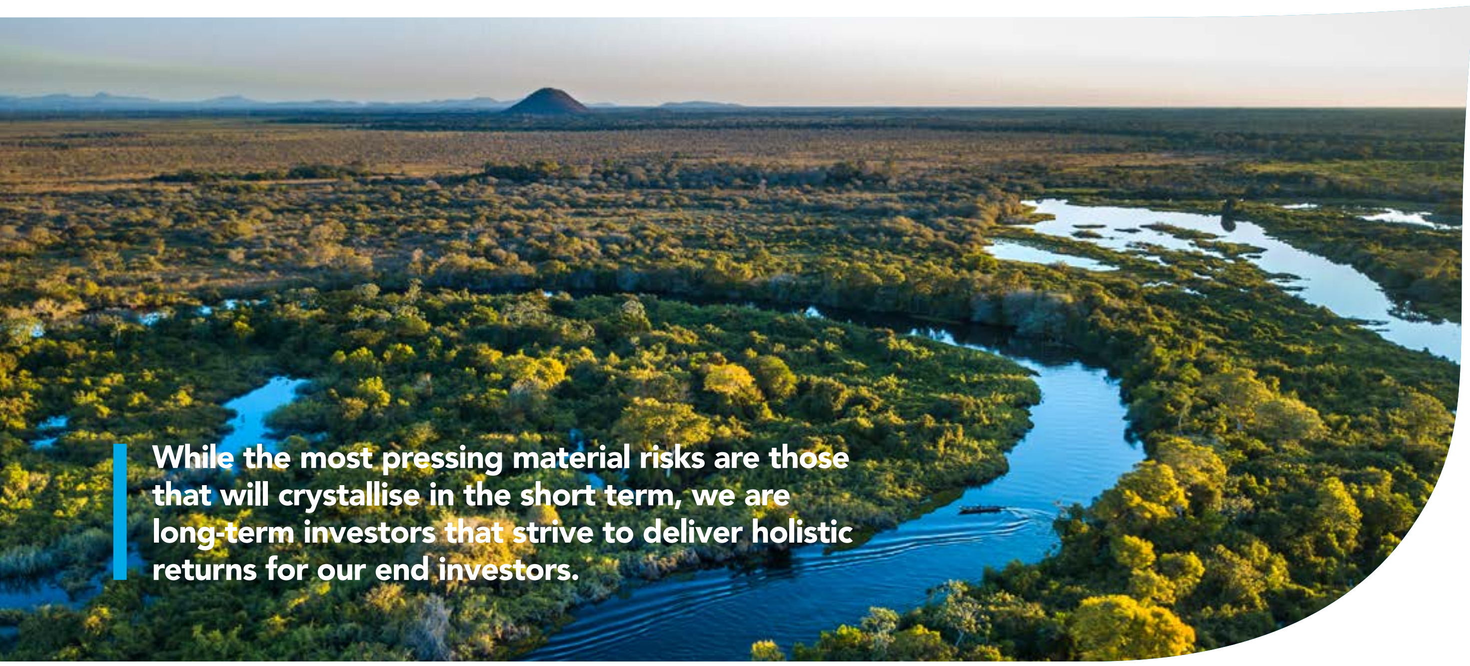
ESG issues will rarely be the sole or standalone driver behind any investment decision. Instead, material ESG factors are integrated into fundamental analysis and inform the teams' investment decision making. The presence of ESG risk does not necessarily preclude investment, but rather helps investment teams reach a more holistic view of the risk profile of a company. Investment teams may also identify opportunities in companies that are improving their ESG practices, particularly given our strong engagement capabilities.

ESG issues are prioritised at the sector level and we look at material areas of concern for each of the sectors and industries, with an overlay of material ESG issues by region. This is done by using the SASB Materiality Map, as well as insights from EOS. Relevant ESG issues – whether macroeconomic risks or those specific to that company – are then considered on a company-by-company basis, with implications for both inclusion and weighting in an investment portfolio, as well as engagement.

The ESG Integration team within the Responsibility Office also works very closely with the investment teams to help identify material ESG issues that are specific to the investment manager's strategy. The ESG Integration team organises sector-level knowledge-share sessions between EOS and the investment teams and also works with the investment teams to develop frameworks which assess the materiality of ESG risks at the company level. Finally, the ESG Integration team obtains data from third-party providers, which is overlaid in our proprietary tools by insights gleaned from our engagement with the company, and is also used by analysts and engagers in their company research.

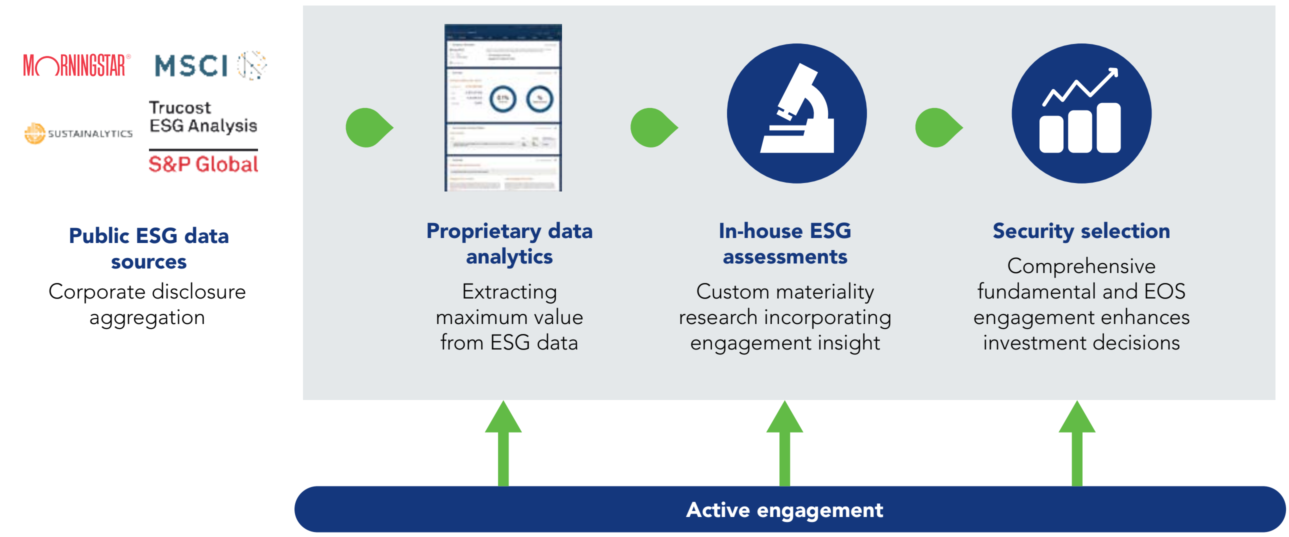
We encourage our fund managers to use their own expert judgement when considering ESG issues, just as they would with other factors – for example, the strength of a company's structural competitive position or the quality and depth of management.

Climate change was a key priority across our investment teams in 2020, demonstrated by the work of our Climate Change Working Group. In particular, we upgraded our carbon tool and obtained additional data on transition and physical risk to feed into our investment process. A more detailed explanation of our work on climate-change risk and opportunities is available under Principle 4.



How we integrate stewardship and investment across our products

Figure 15. ESG and engagement integration: leveraging market leading engagement capability to enhance investment performance



Source: Federated Hermes, as at February 2021.

A tailored approach with centralised support: All our investment activity is supported by our dedicated Investment Office and Responsibility Office, both of which report directly to our CEO. Regular meetings are held between the two offices and with the investment teams to ensure proper coordination and integration of ESG factors and engagement insights. However, it is the responsibility of our investment teams to effectively integrate ESG and engagement information into their investment processes and ultimately our fund managers have discretion on investment decisions. This ensures that ESG factors are fully integrated into investment analysis and decision making.

Developing a holistic view: Research and analysis by all of our investment teams includes an evaluation of performance on strategy, financials, risk and material ESG factors, and the overlaps between these elements. Insights from engagement with company management, boards, subject specialists and other shareholders and stakeholders – including the extent of engagement progress – is a key input into this process and investment strategy. Such engagement is carried out both by our investment teams and by EOS on their behalf. These factors influence decisions to invest and are also actively monitored after investment, with the potential to influence decisions to sell an asset. Where concerns arise in relation to one of our existing investments, engagement is often a means to both raise concerns with the company and seek to reduce the risk.

The nature of engagement, as described here and in Principle 9, varies between asset classes. Engagement is also influenced by sector and geography and each investment team tailors its own ESG and engagement integration approach to suit their investment philosophy (see Principle 6 for a breakdown of our asset classes). ESG factors can be a component of a screen, a source of ideas, an input into fundamental analysis or an adjustment to valuation drivers and/or a portfolio construction factor. But common across all of our funds is a set of shared investment beliefs, as set out in Principle 1, which influences every aspect of the investment process. ESG factors are integrated into investment decision making, whether it is deciding to avoid, buy, hold or exit a position.

The teams supplement fundamental financial analysis with information provided through a range of proprietary ESG and engagement tools, qualitative analysis and the insights gleaned through engagement. The Responsibility Office works with all investment teams across all asset classes to support them in integrating ESG and engagement insights into their investment decisions and the monitoring of investees.

For public markets, the firm's proprietary ESG tools are of particular note:

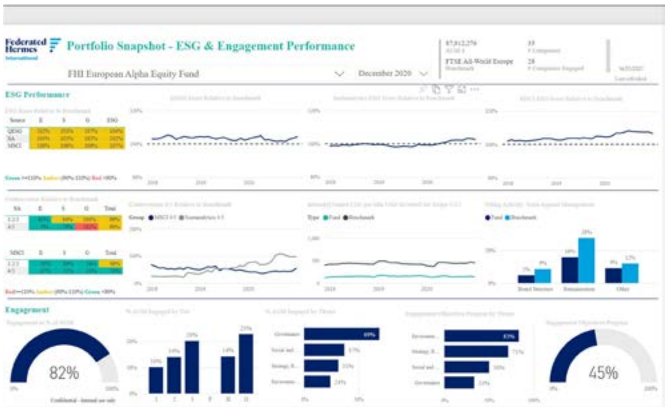
- Our **ESG Dashboard** includes our proprietary Quantitative ESG (QESG) Score and identifies stocks with positive ESG characteristics and/or stocks demonstrating positive ESG change. The QESG score captures how a company manages its ESG risks and whether it is improving.
- Our **Carbon Tool** (see Principle 4) enables fund managers and engagers to identify carbon risks in portfolios and companies that are or might become more exposed to carbon risks in the future. Importantly, the tool incorporates our stewardship activity and intelligence and is able to identify companies that are priorities for engagement and their progress against objectives.

- The **Portfolio Snapshot** allows us to observe the aggregate ESG risks across our portfolios relative to their benchmarks. It also examines ESG ratings and controversies and identifies contingent risks. Our portfolio managers use this tool to evaluate a strategy's ESG performance over time. It also provides insights into engagement and the progress made, and our voting choices relative to the benchmark.
- Our **Corporate Governance Tool** provides a breakdown of corporate governance characteristics, such as information on board independence, diversity and audit tenure, etc. This tool compares the governance of companies to the expectations we have set and flags any companies that do not meet the expected standard.

Figure 16. Carbon footprint – portfolio dashboard

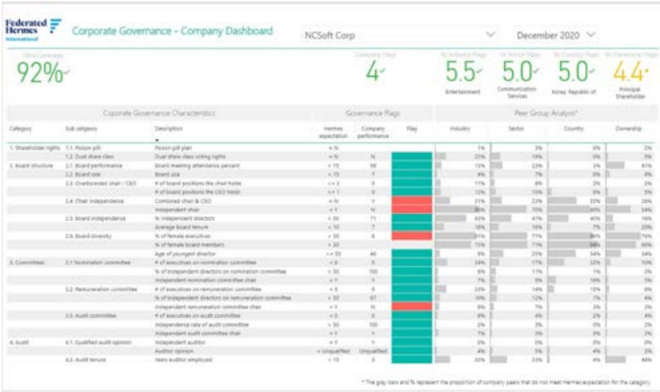
Source: Federated Hermes, as at February 2021. For illustrative purposes only.

Figure 17. Portfolio Snapshot – ESG and engagement performance



Source: Federated Hermes, as at February 2021. For illustrative purposes only.

Figure 18. Corporate governance – company dashboard



Source: Federated Hermes, as at February 2021. For illustrative purposes only.

Through these tools, along with additional EOS engagement information, the public-equities and fixed-income teams have access to third-party ESG data, as well as insights on engagement carried out by EOS with investee companies and the broader investable universe. These sources are a valuable input to the investment process, as well as to the ongoing monitoring of and engagement with companies. We believe that ESG-aware investors should not rely on ESG data alone. The information provided by companies may not be comparable with peers. In addition, it is often backward-looking, updated infrequently and with a time lag. As such, engagement activities and voting information can be used by our teams to provide a forward-looking view of ESG characteristics and the broader performance of a company. As well as accessing EOS' engagement portal – which includes the engagement history and progress against live objectives – portfolio managers can, and are encouraged to, attend engagement meetings with the engagers. The benefit of these joint meetings is substantial and results in more robust engagement that focuses on the relevant and material ESG risks and opportunities.

Our investment teams regularly interact with the relevant sector or regional lead within EOS to better understand the ESG issues within their investment universe, and also discuss specific companies with the relevant engager. Such interactions can help the portfolio manager discern whether a particular ESG issue is material or not, something which cannot always be gleaned from raw ESG research data. Therefore, we believe that to implement a credible and successful ESG integration approach it is of utmost important that engagement information is part of the ESG information universe.

Because our EOS engagement team engages globally with both our internal holdings and the holdings of EOS' third-party clients, its coverage extends beyond our own holdings. This coverage allows our analysts to benefit from these engagement insights when looking at prospects, as well as in relation to ex-post monitoring.

We list here examples of our how our public-markets investment teams make use of ESG and engagement information in the fashion most appropriate for their respective investment strategy:

- Our Global Equities team uses the ESG Dashboard and its proprietary stock sheet to outline a company's ESG risk based on ESG data and engagement notes. Monitoring makes extensive use of the ESG Dashboard and Portfolio Monitor.
- Both the Asia ex-Japan and the Global Emerging Markets teams consider ESG in their initial screening process, and ESG factors and engagement progress are incorporated into assessments of the valuation, risks and catalysts of a stock or country.
- Our European Equities team uses ESG considerations to help identify changes that present investment opportunities. These changes often come as a result of government policy, environmental changes or technology shifts. ESG and engagement insights help to determine the risks that individual companies face.
- Our Credit team has developed their own ESG scoring methodology. Analysts rank ESG risks from 1 to 5 and the ESG score appears on the cover of the credit tear sheet, alongside credit and value scores. The ESG score is informed by analysts' fundamental research, quantitative information from our QESG scores and qualitative insights gleaned by engagements by both EOS and the investment team directly. The fundamental question the team seeks to answer is whether it is being compensated for any risks to the enterprise value of a business and thus to the value of its bonds. The credit team, together with the Responsibility Office has also developed a proprietary ESG-risk pricing model after demonstrating a relationship between ESG factors and credit spreads.[19]

Our Responsibility Office is tasked with monitoring and overseeing every investment team's integration approach. To that effect, the Responsibility Office meets with every investment team on a quarterly basis to review the portfolio holdings from an ESG point of view and flag, if necessary, particular holdings which our third-party ESG data vendors might have highlighted as controversial. As such, the Responsibility Office and the investment teams regularly use our proprietary ESG tools to review the ESG performance and engagement coverage of our holdings.

While all of our strategies integrate engagement into their investment processes, we have a selection of strategies with a specific focus on selecting companies with engagement potential. Our SDG Engagement Equity Strategy and SDG Engagement High Yield Credit Strategy seek to achieve a meaningful social and/or environmental impact as well as a compelling return through investing in and engaging with companies to drive positive change in line with the relevant SDGs. The SDGs provide an ideal framework to identify ex-ante potential for creating positive societal and environmental change through engagement to create more impactful and profitable companies. Given the added focus on engagement for these strategies, we have dedicated engagers based in the relevant investment teams who focus solely on these strategies and work closely with EOS to ensure a consistent approach. All investments are formally reviewed by the lead manager and lead engager, while the relevant analysts and team members also provide input every six months. These meetings investigate whether the original engagement thesis is still valid and also measure progress towards any specific objectives.

We also consider the environment that an asset is operating in when assessing risks, including ESG risks. For example, because emerging markets are not as transparent as developed markets, the risks are higher. As a result, our Global Emerging Markets team recognises that investors need to be more prudent and seek a margin of safety – something that can be secured by integrating ESG factors. Similarly, for our Asia ex-Japan fund, assessments of corporate-governance factors are particularly important when considering potential investments in countries such as China and South Korea. The team has a varied and lengthy list of warning signs that they consider and seek to visit and/or speak directly to management prior to investing in a stock.

[19] https://www.hermes-investment.com/ukw/wp-content/uploads/2020/03/bd004922-pricing-esg-risk-in-sovereign-credit-part-ii.pdf.

CREDIT CASE STUDY

Cellnex

Headquartered in Spain, Cellnex Telecom SA engages in the operation of wireless telecommunications and broadcasting infrastructures.

The Credit team is currently using Cellnex as a defensive trade in two of its credit strategies. The team believes that the issuer is attractive given its non-cyclical business profile, relative resilience to Covid-19 and healthy organic growth. Cellnex has a strong credit profile and has also managed its ESG responsibilities well. When assessing the company, the team found that it has strong corporate governance, a number of achievements on key metrics related to the structure of its Board and a balanced approach to shareholders and creditors.

The Credit team holds Cellnex in the SDG Engagement High Yield Credit strategy, where engagement is a key factor in the decision to invest. Engagement lets the team assess the company's ability and willingness to contribute towards attaining the SDGs and also allows it to work in collaboration with the firm to see that contribution materialise.

Cellnex has shown that it is able to manage its material environmental issues. It has formally disclosed its commitments to reduce operational greenhouse-gas emissions, developed targets that will be recognised by the SBTi and has disclosed initiatives to measure and manage the risks posed by climate change. In support of these actions, Cellnex achieved Scope 1 neutrality in 2019.

The Credit team also recently met with the company management to discuss various credit and ESG-related topics and found that the management team was very engaged. Through engagement, the team was able to gain a greater insight into Cellnex's strategy to procure more renewable energy, including its first long-term renewable electricity agreement in Spain.

After speaking directly to the Global Head of Energy, the Credit team had much greater confidence in the company's ability to deliver on its climate-change commitments. This confirmation of the team's impact hypothesis feeds directly into the investment decision and portfolio weighting. As a result, the team gave the company high credit and ESG scores and increased its exposure to it.

Cellnex will publish a new five-year strategy in Q1 2021 and the Credit team will continue engage on additional material topics, including cyber security and diversity. The team also noted that the company's efforts are recognised across the industry: it has been included in the FTSE Russell FTSE4Good Index for four consecutive years and is part of the CDP's 'A-List' companies that are leading on action to mitigate the worst effects of climate change.

In private markets, ESG data is often less readily available. As such, the teams are heavily reliant on their due-diligence process and have developed their own frameworks for assessing ESG risks within their investments.

The private-debt teams consider ESG behaviours when carrying out credit analysis for each potential investment. ESG considerations are tabled at the Private Debt Investment Committee and are considered as part of the research presented for all new transactions. Material ESG issues will often form part of engagement with the company prior to investment and once invested.

For our Direct Lending team, the key is to identify meaningful ESG risks (both current and potential) before investing. Due to the difficulty of divesting and the capped upside, it is important to manage the downside ex-ante. The Direct Lending team undertakes enhanced due diligence on industries that are deemed controversial, such as energy, chemicals, forestry and agricultural commodities, manufacturing and mining and metals. They also undertake transaction-specific ESG analysis by carrying out an assessment on ESG risk for every investment opportunity. In addition, the team focuses acutely on the sensitivity of the company's cashflows to sudden damage that could arise from the identified potential ESG risks. With that in mind, the Direct Lending team will evaluate if investors are adequately remunerated for the ESG risk(s) of the transaction.

As with our direct-lending investments, it is important for our Asset Based Lending team to identify risks that may impact on a borrower's ability to repay their loan. We have integrated our responsible property investment (RPI) principles and programme into the debt-investment procedures. This is done as follows:

- **Underwriting and due diligence:** The focus of our responsibility programme is on ensuring a strong due-diligence process, including assessments of ESG and climate risks and opportunities before agreeing new loans.
- **Loan origination and documentation:** The business plan agreed is included in the loan documentation at the loan-origination stage. This includes all mitigation activities identified and detailed in the asset business plan, asset refurbishment plans and/or planned and preventive maintenance programmes.
- **Management and monitoring post closure, asset upgrade finance:** We collect and manage the sustainability information we hold on the borrowers and the underlying assets.

Where we provide capital for refurbishment in accordance with the business plan, refurbishment agreements include a review of our responsible refurbishment guide and minimum requirements.

RPI is integrated into the investment strategy and working practices of all of our real-estate portfolios. A consideration of ESG principles is embedded into the property selection and investment process, including through initial screening and due diligence and as part of the investment decision.

At the transaction stage, we use a number of procedures and tools that have been developed internally and through our sector engagement programme. This includes an initial screening, where the team assesses the risks and opportunities for value-add from ESG characteristics. This is then followed by a responsible investment due diligence for any new acquisitions, where surveyors and environmental consultants collect relevant data on the buildings to identify risks and opportunities. As part of our due-diligence process we inquire to understand the level of community and tenant engagement in the assets being considered. The findings from this then inform the asset-management plans and processes.

Sustainability regulatory risk assessments are then used to identify typical risks that should be incorporated when devising the parameters entered into the investment models (using discounted cash flow analysis). Typically, the team integrates ESG information that can affect investment fundamentals such as refurbishment budgets, risks of voids, lease lengths and obsolescence. ESG criteria and assessments are integrated into the investment decision papers submitted for approval to the Investment Executive Committee. The head of RPI sits on the Investment Executive Committee to review and ensure that ESG integration is appropriately covered.

ESG and engagement information continue to be integrated into the development and monitoring of our real-estate assets after purchase:

- **Setting ESG requirements:** through our internal RPD requirements we have set minimum requirements that assets must meet when undergoing refurbishment or new construction. This is monitored through an online platform.
- **Monitoring and data collection:** we work with our property managers, facilities managers and consultants to monitor ongoing implementation and improvements. This is reported back to the business on a quarterly basis. Annual key performance indicators (KPIs) are set and progress against them is measured.
- **Engagement:** we work with our property and asset managers on site to engage with the delivery teams, tenants, occupiers and visitors. Site-specific annual surveys and other engagement activities are carried out successfully.

For our Real Estate team's indirect and international investments, we carry out active engagement on governance matters and on ESG policies and strategies with property developers, property management teams, tenants, lawyers and agents. We include commitments to develop a joint RPI strategy on acquisitions for jointly managed assets.

The Responsibility Office oversees and supports all of the above ESG and stewardship integration activities. This is achieved through a number of different activities, such as coordinating knowledge-share sessions between teams (including EOS), working with the investment teams to develop frameworks to assess different ESG risks and coordinating conversations with EOS to ensure there is good engagement across the strategies. The investment teams also meet formally with the Responsibility Office at least every quarter to discuss their ESG and engagement integration activities.

How we have aligned our approach with client investment time horizons

Under Principles 1 and 6 earlier in this report, we set out our belief that the purpose of investment is to create wealth sustainably over the long term. This informs our view that we have a duty to consider the longer-term risks and opportunities when investing, which aligns with the goals of our pension-fund clients who typically look out over the long term. The majority of our strategies have time horizons of three years and above, which is reflected in our approach to responsible investment and stewardship.

All of our strategies look to deliver sustainable wealth creation over the long term and our combined approach to responsible investment and responsible ownership is the key to catalysing positive change within companies and generating financial gain over the long term. We believe we cannot deliver long-term returns without identifying and working towards mitigating material ESG risks and, where possible, seizing positive opportunities.

We consider our clients and potential clients' needs throughout the entire product-development process. As such, stewardship and ESG integration is built into the investment process at the outset and clearly articulated in any legal and marketing documentation for the strategy. The Customer Outcomes Group (COG) then uses this documentation to monitor the investment teams at least annually to ensure they are acting in line with the parameters they have set for themselves. More information about the COG and other processes that ensure we continue to meet client needs is available in our reporting under Principle 1.

Service providers

All of our stewardship is undertaken in-house by our investment teams and EOS, as described under Principles 7, 8 and 9. Likewise, the investment teams are responsible for integrating ESG and engagement information into their investment processes (with the support of the Responsibility Office, which ensures best practice).

We also use third-party data providers, as described under Principle 8. In some cases, we integrate this third-party data into our proprietary tools to enable our investment teams and engagers to access and compare a wide range of data quickly. The parameters for such services are clearly set out in the relevant contracts and the ESG Integration team within our Responsibility Office monitors the provision of such services on an ongoing basis.

As described in more detail under Principle 8, our Real Estate team use external property managers for all day-to-day property management. To ensure our expectations are clearly understood, ESG requirements and targets are included in their contractual service agreements. The managers are responsible for the implementation of our Responsible Property Management (RPM) programme and health-and-safety measures, as stated in their service agreement.

How we have used stewardship insights in our investment processes

The principal objective of stewardship is to maintain or enhance the value of an asset. The beneficial outcomes sought through engagement include those of a governance, strategic, environmental or social nature. Examples of these outcomes are provided later in this report under Principle 9.

In addition, engagements can deliver useful investment insights (although engagers and analysts must always seek to avoid acquiring any inside information). The investment teams assess and continue to monitor strategy, financials, risk, material ESG factors and the overlaps between these elements throughout the life of the holding. The monitoring of strategy, financial and non-financial performance and risk and capital structure is done through carrying out a financial analysis of company reports, attending analyst meetings and investor presentations, using media sources and third-party research and attending engagement meetings. Each investment team is responsible for looking at the financial performance, risk and capital structure of investee companies. As described earlier, all teams also have access to ESG data and proprietary tools, including engagement information. When there is a concern, this will inform engagement and investment decisions.

The information we gather through stewardship enables us to develop a more comprehensive view of both the risk and opportunities a company is exposed to and to factor this into valuations and investment decisions. Such assessments are not a one-off but rather form an ongoing feedback loop. Monitoring this information informs our engagements, while engagement insights inform our investment decisions. Our fundamental research benefits from our ongoing dialogue with investees, as well as that between our public-markets investment teams and stewardship arm. We invest time and resources to encourage companies to strengthen their governance, give our views on strategy and encourage companies to take a long-term view, particularly on sustainability issues. The insights we glean from these interactions help us to better understand a company's complex strategic challenges – something that ultimately helps us serve our clients. Research shows that changes in ESG and effective engagement on ESG issues can deliver excess returns.[20] This approach supports our aim to generate sustainable wealth creation for the end beneficiary investor, encompassing both investment returns and their social and environmental impact.

Examples of how stewardship information impacted investment decisions in 2020

Given the integrated approach of all of our investment teams, information gathered through stewardship directly informs our investment decisions (alongside other factors such as more traditional financial analysis). The following examples demonstrate how this information has influenced investment decisions across a range of asset classes in 2020:

- Our Global Emerging Markets fund was invested in a supplier of digital surveillance products. However, there were concerns that the firm's technology was being supplied to detention camps in Xinjiang. Through our conversations with the issuer, we discovered that it was engaged in operating the Uighur Monitoring Program. As a result, we divested from the stock.
- Our SDG Engagement High Yield Credit fund is invested in a global producer of bauxite, alumina, and aluminium products. The firm operates bauxite mining operations across four continents and its global refining system processes it into alumina. The company's value chain – focused on mining, smelting and refining – is resource intensive and has significant environmental impacts, something that remains a challenge for the company. Given the company's leading cost position among its peers, there is an opportunity to enhance its position further through strategic investments in production. These investments – often focused on doing more with less – can deliver positive benefits in terms of reduced or eliminated environmental impacts, as well as greater energy and resource efficiency in production. There is also a need for the company to carefully manage the health, safety and wellbeing of its employees, ensure positive and mutually beneficial relationships with many communities and carefully steward the ecosystem and biodiversity impact from its mining operations. Our Credit team is engaging with the company on a number of areas, including reducing carbon emissions, sustainable consumption and production and creating social value in its supply chain through stakeholder engagement programmes. The team only invests in companies where they see such engagement potential.

[20] https://www.hermes-investment.com/uki/insight/equities/esg-investing-a-social-uprising/; Hoepner, A.G.F., Oikonomou, I., Sautner, Z., Starks, L.T., and X.Y. Zhou. (2020). ESG Shareholder Engagement and Downside Risk. ECGI Finance Working Paper 671/2020.

- Our Direct Lending team reviewed the opportunity to lend to a UK equity release mortgage provider targeting the retiree market – a potentially vulnerable demographic. Our ESG analysis and engagement with management and shareholders allowed us to use in-depth analysis to understand whether historic industry mis-selling issues remained a key risk for this business. Through this analysis, we confirmed that the company's robust practices mitigated this risk. We then negotiated a loan structure with conditions to provide ESG protections coupled with above-market returns in order to provide financing. This was achieved due to the limited ability and resources of other lenders to undertake enhanced due diligence of the business. As part of the negotiations, the company agreed to use independent solicitors during the selling process to provide advice to customers and their family members – thus minimising the risk of mis-selling practices. This benefited:
  - Customers, by providing them with independent legal advice;
  - The company and lenders, by providing protection against litigation risk and the subsequent erosion of the borrower value on which the lenders are secured; and
  - The industry, by establishing better standards of market practice.

Principle 8

Signatories monitor and hold to account managers and/or service providers.

We do not use external engagement services. All voting recommendations to our investment teams are made internally by EOS and engagement activity across asset classes is carried out by EOS or the investment teams themselves. More detail on how we use ISS research to inform our voting decisions is available under Principle 12.

As noted earlier we use a number of external ESG data providers, as each data provider has developed their own methodology which can result in differing views. Taking this range of views into account, along with our qualitive fundamental analysis and insights from engagement by EOS or the investment teams, helps us to form a more comprehensive view of the company.

There have been instances during 2020 when companies were impacted by major ESG risks that had not been identified in advance by our data providers. For example, the allegations of poor conditions and below-minimum-wage pay at some of Boohoo's Leicester suppliers had not been identified by our data providers as a significant risk. Even after the news broke, there was a time lag before it was reflected in the relevant ESG scores. While we did speak to our data providers about this instance, the issue was largely difficult to avoid due to the retrospective methodologies used by many data providers. This reinforced our view that such third-party data sources can only be one input alongside our fundamental analysis and engagement insights.

We may also engage with data providers when we identify incorrect information. For example, while investigating the carbon emissions of an aluminium producer for investment this year, we found that the data providers failed to capture emissions from its subsidiary. Through engagement with the data provider, we were able to rectify the figures and capture the correct emissions data.

For our Real Estate team, all day-to-day property management – including rent and debt collection and active responsible property management – is dealt with by external property management agents. They are selected following a rigorous process that includes ESG considerations, while ESG requirements and targets are included in their contractual service agreements. The performance of property manager agents – and any other agents appointed for work on activities such as rent reviews, lease renewals, transactions property maintenance, health-and-safety issues and environmental issues – is closely monitored by our internal asset managers. The property managers are contractually responsible for implementing the Responsible Property Management (RPM) programme and health-and-safety measures, as stated in their service agreement. Their requirements include risk management, refurbishment and development, utilities measurement and reporting, RPM business plans, energy management, water management, waste management, transport, procurement and supply chain, environmental risk and management, stakeholders (tenants and community) and quarterly monitoring of progress against targets. In 2020, our property and asset managers have worked extremely hard to meet their annual KPIs. The national lockdowns have been particularly challenging, and we needed to carry out significantly more engagements with tenants during these periods. We worked with our property managers to achieve this, keeping in mind our fiduciary duty towards our clients and the need to meet our wider energy, sustainability and insurance targets.

In terms of our investment operations, our middle-office employees are responsible for monitoring outsourced functions on a day-to-day basis. Contractual agreements with all service providers are in place and we hold regular reviews of the service provided. Oversight is through regular scoring, management information systems, KPI analysis and service-review meetings. As part of the governance structure, significant or persistent issues can be escalated to a joint steering group made up of senior representatives from operations, risk and compliance. In addition to daily operational calls, monthly functional meetings and monthly service-review meetings are held. The main agenda items for these monthly meetings include a review of KPIs and key risk indicators (KRIs), any requests for a change to the service and potential new business. We monitor the KPIs and KRIs on a daily basis in order to identify early any deterioration in service. In addition to the service reviews previously mentioned, periodic on-site visits take place and the latest SAS70 reports (or equivalent controls report) and financial statements are reviewed. We have an Outsourcing Review Group, which is chaired by a senior member of the Risk team. This group formally reviews all outsourcing relationships on a periodic basis.

Principle 9

Signatories engage with issuers to maintain or enhance the value of assets.

How we identify issues for engagement and develop objectives

Our approach to engagement is driven by our purpose and investment beliefs. We believe that the purpose of investment is to create wealth sustainably over the long term and that investing responsibly is the best way to sustain long-term outperformance and contribute to beneficial outcomes for investors, companies, society and the environment. We aim to generate sustainable wealth creation for the end beneficiary investor, encompassing both investment returns and their social and environmental impact. As a result, our engagement is outcomes-driven and focused on ensuring that the companies we invest in are creating wealth sustainably. Given the time horizons of our strategies to meet our clients' needs (as described under Principle 6) we are able to engage on particular issues over multiple years to encourage fundamental change within our investee companies. We believe that this approach delivers the best results for our clients and end beneficiaries.

We adopt a systematic approach to identifying companies for engagement. We select companies and tailor the intensity of engagement based on the size of our investment, materiality of the risks and issues and feasibility of achieving change through engagement. We believe that this enables us to most effectively serve our clients' needs by focusing our efforts on where they are needed the most and can have the most impact.

Our Responsible Ownership Principles, which we developed in 2002 and updated in 2010 and 2017 by drawing on our extensive experience as an active and engaged shareholder, sets out a number of expectations which we believe should exist between owners, boards and managers to create a framework for communication and dialogue. Similarly, our Climate Change Expectations for investee companies set out very clearly our rationale for believing climate change is a material issue – and six key expectations of companies that range from setting Science-based targets to having a positive public policy position on the issue and committing to disclosing in line with the TCFD.

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

Public markets

EOS has established a detailed public markets engagement plan on a rolling three-year basis, with themes ranging from human and labour rights to pollution, waste and the circular economy. EOS focuses its stewardship on the issues that have the greatest potential for long-term positive outcomes for investors and their beneficiaries. The full taxonomy below identifies 12 key themes and 36 related sub-themes for engagement. This breadth of coverage across the whole programme is necessary to reflect the diversity of issues in our global Engagement Plan, which covers all regions and sectors, including those which are most material to the individual companies. The selection of these themes is developed in line with input from the investment teams at the international business of Federated Hermes, as well as EOS third-party clients.

Figure 19. Engagement themes for 2021-23

Source: Federated Hermes, as at February 2021.

Nonetheless, our work maintains a focus on the most material themes, with four priority areas being: climate change, human and labour rights, human capital management and board effectiveness. In addition, following the pandemic, we will focus on companies putting in place a business purpose and sustainable business model looking at corporate response to the pandemic in the near term and resilience to the next crisis in the longer term.

Specific environmental and social outcomes aligned to the SDGs that we seek include the following:

Environmental risks

Climate change:

- We are engaging to ensure that companies' strategies and actions are aligned to the goals of the Paris Agreement to limit climate change to well below 2°C and, ideally, to 1.5°C.

Natural resource scarcity:

- We are engaging on all aspects of the protection, preservation and restoration of natural resources, the importance of transitioning to sustainable food systems and taking measures against antimicrobial resistance.

Pollution:

- We are engaging on the establishment of fully circular business models; the prevention of contamination of the environment by harmful substances; and the avoidance of all industrial disasters.

Social risks

Human and labour rights:

- We are engaging with companies to ensure they respect all human rights linked to their operations, products and supply chains, including through the provision of affordable essential goods and services to help reduce poverty and ensuring no forced labour.

Human capital management:

- We are engaging on human-capital issues including diversity, inclusion and full representation of workers; fair wages, incentives and benefits; and health, safety and wellbeing.

Conduct, culture and ethics:

- We are engaging on developing corporate cultures that aspire to the highest ethical standards and to go beyond legal compliance. To enable delivery, we seek corporate decision making taken through an ethical lens, an end to corporate bribery and corruption; ethical use of data; and fair tax paid.

Governance risks

Corporate governance:

- We are engaging with companies to ensure that they have well-functioning boards with independent individuals that represent the diversity of the stakeholders they serve.
- We are engaging to align executive remuneration with the creation of long-term value while paying strictly no more than is necessary.
- We are engaging to establish and protect all material shareholder rights.

Strategy, risk and communications:

- We are engaging to articulate a company's purpose, in order to deliver long-term value to all stakeholders. This is supported by a sustainable business model and strategy that addresses the needs of a firm's different stakeholders.
- We are engaging on the development of robust risk-management practices that seek to protect long-term value.
- We are engaging on transparent, timely disclosures of reliable information that are sufficient for investors and wider stakeholders to make informed decisions on long-term investments.

Figure 20. 972 of the issues and objectives engaged in 2020 in public markets were linked to one of or more of the SDGs

Source: Federated Hermes, as at 31 December 2020.

[21] This is the total of unique SDG-linked objectives and issues engaged. Some of the objectives and issues may be linked to more than one SDG.

We annually review, develop and publish a rolling three-year engagement plan. The EOS engagement selection process is a key structure which enables us to support client stewardship. We select around 400 companies for the core EOS Engagement Programme, of which approximately 150 are held by the international business of Federated Hermes' equity and credit teams. These companies are formally identified on an annual basis, and intermittently throughout the year. The three key considerations are:

1. Size of holdings. EOS take into consideration the aggregate holding size of the international business of Federated Hermes and EOS clients.
2. Materiality of identified ESG and financial risks. This is assessed using quantitative and qualitative data sources, including inputs from external providers like Sustainalytics, MSCI, TruCost, CDP, BoardEx, Reuters Knowledge, FactSet, Factive and Bloomberg. EOS also considers the output from our quarterly screening tool, the Controversial Companies Report, which looks at the UN Global Compact Principles. It also uses the proprietary ESG Dashboard and QESG score, which captures how a company manages its ESG risks and whether it is improving. All this data is scrutinised by the EOS team, alongside insights from engagement and voting recommendations history, media flow, investment management intelligence, public policy and market best- practice trends.
3. Feasibility of engagement. We endeavour to allocate our engagement resources efficiently and towards companies where we can affect change.

This combination of analysis supports our pursuit of stewardship through our shared service model.

With regards to climate change, we use our own proprietary carbon tool alongside the PACTA tool to systematically assess which of our holdings are exposed to material climate-related transition risks. Where the risk is significant, we will add the companies into our core engagement programme.

Each company in our engagement programme is given an appropriate intensity tier, based on the likely impact of engagement and ultimate benefit to the value of the underlying investment. We then assess the required intensity or depth of the engagement needed to resolve the issues:

- **Tier 1** – Companies with material client holdings that have more significant or numerous long-term sustainability or corporate-governance issues. There is the opportunity to feasibly engage with these firms, although the engagements will require more time and effort to progress. This typically results in a more intense engagement and we expect at least five interactions a year.
- **Tier 2** – Companies with material client holdings and identifiable long-term sustainability or corporate-governance issues. There is the opportunity to feasibly engage with these firms and we believe that the efforts can be meaningfully pursued with an average amount of time and effort. We expect three to five interactions a year.
- **Tier 3** – Companies that represent significant client holdings but whose long-term sustainability is generally less at risk. Tier 3 firms also include those being monitored to see the implementation of previous engagement work. We typically set only a small number of objectives or pursue engagement issues rather than specific engagement objectives. We plan one to two interactions a year.

There are many companies that we engage with that sit outside of our formal engagement plan. These engagements relate to issues around voting at general meetings or are in reaction to events that cannot be predicted in advance. We reactively engage with around 600 companies, of which approximately 200 are held by the international business of Federated Hermes. There are also an additional 60 companies which are not in the core engagement programme. These are selected as EOS engagement targets by our investment teams based again on the size of our holding, the materiality of the issues and the feasibility of engagement. Although these engagement targets are selected by our investment teams, the output of these engagements are also provided to EOS third-party clients. The dedicated engagers in our SDG Engagement strategies engaged with a further 68 companies in addition to those companies engaged with by EOS. Our investment teams also conduct engagements with companies directly.

In addition, EOS provides voting recommendations for around 9,000 companies to both the international business of Federated Hermes and third-party clients, using engagement insights to inform its rationale where possible. Finally, EOS monitors around 17,000 companies held by the international business of Federated Hermes and third-party clients. Overall, these processes enable us to provide comprehensive stewardship coverage.

Our Engagement Management Committee reviews and advises on the design and implementation of our Engagement Plan and engagement programme, in addition to our voting recommendations and screening services. It considers engagement quality, continuity and coverage in the interests of clients.

Setting engagement objectives: Our stewardship team conducts engagements using specific milestone-driven objectives for most companies in its engagement programme.

We develop corporate engagement objectives initially at the thematic and sector level based on a top-down understanding of relevant thematic and sector risks. These are then reconsidered at the company level – or the bottom-up level – for materiality and feasibility, together with our company-specific knowledge on how well the risks are being managed. We then plan our approach to engagement, including how best to develop existing and new relationships with corporate representatives, seeking always to develop our relationships with the most senior management and board members where possible.

Measuring and monitoring progress on engagements is carried out by setting clear engagement objectives and systematically using the system we pioneered of measuring progress against four milestones. Our four-stage proprietary milestone system, outlined in the graphic below, was developed to demonstrate the impact of our engagement more succinctly. It allows us to track the progress of our engagement relative to the objectives set for each company. This is then all recorded in our Engagement Management System. Progress is assessed regularly and evaluated against the original engagement objective.

Figure 21. EOS' proprietary milestone system

Source: Federated Hermes, as at February 2021.

We have applied climate change, which is one of our Engagement Plan environment themes, and focused on the specific disclosure sub-theme to set a tailored objective for a British utilities company. We asked the firm to set and publish greenhouse-gas reduction targets for customers and detail below how we would recognise progress along our milestone stages:

- Milestone 1: Concerns raised at company that it should put in place greenhouse-gas emissions reduction targets for its customers.
- Milestone 2: Company acknowledges the need to put in place greenhouse-gas emissions reduction targets for its customers.
- Milestone 3: Company commits to setting greenhouse-gas reduction targets for customers and develops credible metrics.
- Milestone 4: Company publishes new metrics and targets for the reduction of emissions of its customers.

In this particular example, milestone 4 was achieved after several years of engagement.

Our milestones are specific and measurable, which helps us identify progress towards achieving the objective. An engagement objective can take up to three years to complete, depending on factors that include the nature of the issue and how receptive the company is to engagement. Engagement clinics are held with directors to review and challenge engagement strategy and tactics, to ensure that objectives are appropriate and also that milestone progress correctly reflects reality. In some rare instances, we will discontinue engagements on the basis that our engagement efforts have been met with strong resistance or the matter has dissolved.

Private markets

For our private-market strategies, engagements are prioritised according to the exposure of the portfolios. For example, in our Direct Lending strategy, the team engages with the sponsor and management team to remedy any ESG issue that arises during the life of a loan. This engagement is conducted in collaboration with EOS to ensure that the engagement is outcomes-focused and impactful.

Our real estate business is an industry leader in responsible asset management and has developed its own responsible property investment (RPI) principles. These focus on effective environmental management, a key component of our real-estate management proposition, and informs the issues we engage on. Following growing awareness in the investment industry, we believe that responsible investors need to go beyond standard KPIs and develop qualitative processes to assess the wider socioeconomic impacts of their investment programmes and occupier and tenant engagements.

Over the years, the increasing focus on RPI has demanded fresh thinking and new ways of working. The Real Estate team has been monitoring the sustainability performance of its directly managed assets since 2006 and has annual targets which are monitored and reported against in our public responsibility report. The team has also created a range of dedicated tools and procedures that cover all aspects of our real-estate operations. Our responsible asset and property management programme integrates the following RPI procedures and tools:

- Minimum sustainability requirements for refurbishments and developments. This includes a requirement that construction contractors comply with sustainability guidelines, environmental site-selection requirements, environmental site-development requirements, resilient building design and orientation and minimum requirements on pollution, sustainable materials, waste, energy, water, biodiversity.
- Dedicated Responsible Property Management (RPM) guidelines for our directly managed assets, covering the following ESG matters: water efficiency requirements, energy efficiency requirements, energy generation from on-site renewable sources, waste management plans at sites and occupier health and wellbeing requirements.
- Strategic and operational sustainability benchmarking of our real-estate funds.
- Active data management systems for utilities and waste.
- Ongoing monitoring of performance with continuous feedback between property managers, asset managers and sustainability experts.

- Stringent risk and safety requirements and supporting tools.
- Community and occupier engagement tools and programmes.

These tools enable us to assess, monitor and manage social and environmental risks and opportunities in the real-estate portfolio, and therefore informs the objectives of our engagement.

We are currently in the process of creating a new Development Design Innovation process and updating our existing RPD guidelines to reflect our growing appetite to deliver net-zero-aligned buildings that put human wellbeing and comfort at the forefront.

As part of our active RPI programme, Responsible Property Investment in Practice, we have been assessing what positive impact investment would mean for each step of our investment process. Our 'impactful intent' approach aims to deepen our RPI practice by intentionally seeking a defined positive environmental or social outcome in a particular place or market as a core focus of our responsible investment strategy, in addition to strong risk-adjusted financial returns. This involves using a purposeful framework to focus our real-estate operations on three specific impactful investment themes. For each of these investment themes we are committing to activities with measurable environmental, economic and societal outcomes, which ultimately support specific SDG targets. Out impactful investment themes are:

- Meaningful placemaking that creates civic pride;
- Healthy, engaged and productive communities that drive desirable social and environmental outcomes; and
- Climate and resource efficiency and achieving a just transition to a low-carbon, circular economy in order to help prevent further adverse climate change and resource scarcity.

At the heart of our approach is our commitment to creating a 'meaningful city' – or a place that people want to live and work in, and which foster a sense of belonging among inhabitants. Because most of our investment is concentrated in densely populated urban areas, it is inevitable that the way we manage these developments will have a deep, long-lasting effect on the cities and the people that live in them. During 2020, three placemaking projects that deliver social value have been ongoing. However, due to the ongoing pandemic-related restrictions, it has not been possible to collate all the data on these projects.

How we engage

Our public markets dialogue with investee companies is conducted through in-person meetings, calls, letters or emails, either directly or as part of a collaborative group. The nature and frequency of the dialogue depends on the location of the company, stage of engagement, severity of the issue and willingness of the company to engage. As evidenced by research, effective engagement that delivers value demands a specific skill-set that goes far beyond written activity or interaction with lower-level company representatives. Change is brought about by access at the board level gained by engagement professionals who have industry or professional experience, gravitas and specialist skills at challenging senior decision makers.[22] The majority of our dialogues are conducted with the board of directors (primarily the chair, lead independent director and chairs of board committees), corporate secretary, subject specialists or investor relations. Occasionally the dialogue is with executive teams, although only where we believe the concern justifies their time and attention.

Figure 22. Number of companies engaged at board/senior level in public markets

We have engaged 263 companies at board/senior management level,[23] including:

Senior management	
CEO	70
Chair	51
Company secretary	134
Executive management team	95
Other board director	42

Source: Federated Hermes, as at 31 December 2020.

We use our own relationship to initiate and progress engagements in the majority of cases, whether this is through the investment teams or EOS. This is in addition to attending meetings facilitated by intermediaries. Most public-markets engagements are carried out by EOS, who may be joined by relevant portfolio managers or analysts from our investment teams. The Responsibility Office ensures that our investment teams and EOS work closely together with a joined-up approach.

Making realistic and realisable demands of companies, informed by significant hands-on experience of business management and strategy setting, is critical to the success of our engagements. With all engagements, we seek to build a strong relationship with the company and are willing to be patient, remaining focused on achieving goals which are directed towards long-term success. Our proprietary systems enable us to track progress against specific objectives and remain outcomes-focused throughout the duration of our engagement with a company.

Both equity and bond holders have a shared interest in sustainable growth, increasing enterprise value and the long-term health of companies. EOS' breadth of engagement allows us to engage with companies for the benefit of all stakeholders. We believe that engaging simultaneously on

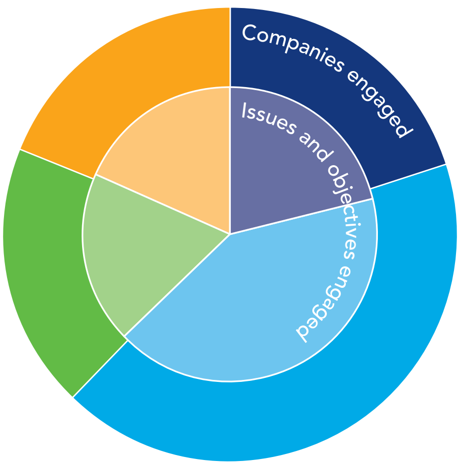
[22] https://www.hermes-investment.com/uki/press-centre/stewardship/new-research-shows-importance-board-level-contact-impactful-engagement/.
[23] Individual companies may be engaged at multiple levels of board or senior management.

equity and credit creates a common long-term voice, increases access and influence and shared resourcing to pool the priorities of like-minded investors. In a two-part paper over 2018-19, we asserted that the shared interests of bondholders and shareholders provide incentives to jointly engage companies – and generate positive outcomes by doing so.[24]

Engaging on sovereign bonds poses a particular challenge, as there is often a shortage of relevant data and little accessibility. However, we use what data we do have to assess ESG risks and their potential impact on the sovereign's ability and willingness to meet financial obligations. Momentum is building across the investment industry to improve the availability of data and engagement within this asset class.

Geographies: There are some nuances in how we engage with each market. EOS has developed 22 regional corporate governance principles which set out our fundamental expectations of the companies we invest in across a number of important governance, environmental and social topics. This regional approach reflects the variations in the markets in which the companies we invest in operate. They also inform EOS' Global Voting Guidelines, and the international business of Federated Hermes' Global Voting Policy and Guidelines which in turn guide EOS' voting recommendations and our investment teams' voting decisions for listed equities. EOS has intentionally built a diverse team of experienced and international voting and engagement professionals who have the expertise, language skills and cultural knowledge to work to deliver real beneficial change at companies. Our ability to engage in the local language and understanding of local culture and business practice are critical to the success of our engagement work. Within our team, we have nationals from 14 countries who are fluent in 16 languages.

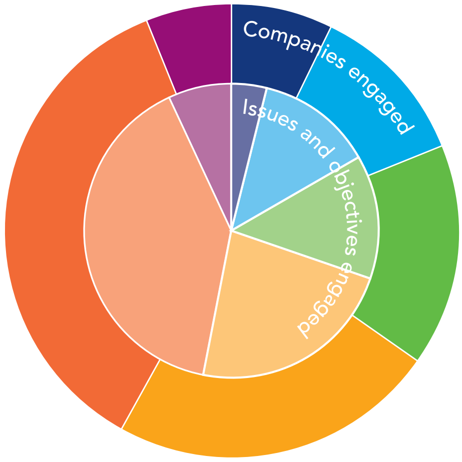
Figure 23. 2020 Engagement activity



	Companies engaged	Issues and objectives engaged
Environmental	239	426
Governance	500	830
Social and Ethical	224	376
Strategy, Risk and Communication	224	365
Total	**595**	**1,997**

Source: Federated Hermes, as at 31 December 2020.

Figure 24. Engagement by region in 2020



	Companies engaged	Issues and objectives engaged
Australia & New Zealand	44	78
Developed Asia	69	256
Emerging & Developing Markets	95	272
Europe	139	794
North America	213	794
United Kingdom	35	138
Total	**595**	**1,997**

Source: Federated Hermes, as at 31 December 2020.

Within private markets, our Real Estate team has an extensive community and occupier engagement programme across our retail and office assets that focuses on governance, skills, safety, culture and wellbeing. Retail and office assets represent, on average, about 50%-60% of our direct investment, depending on the fund. We aim to positively impact the health and wellbeing of our occupiers and local communities by establishing a constructive dialogue through a range of activities carried out during the life cycle of real-estate assets, including:

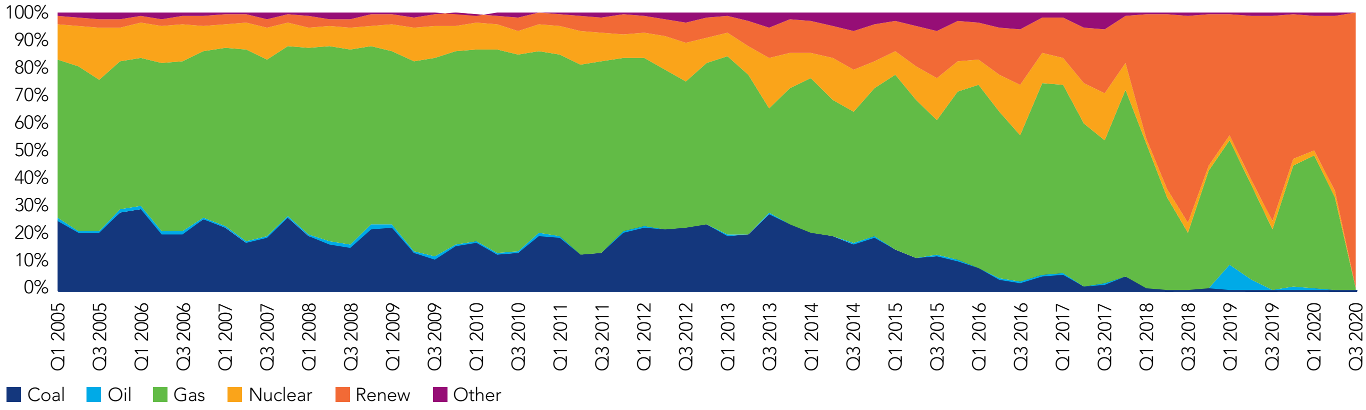
- Development and refurbishment: land decontamination, the use of safe and healthy materials and enforcing risk management and safety standards in development, refurbishment and property management.
- Asset management: actively managing wellbeing initiatives through our Collaborative Asset Performance Programme +, targeted greater occupier engagement, wellbeing and comfort.
- Attaining wellbeing certification: in 2020, we achieved world's first BREEAM In Use certificate for residential development at The Cargo building at Liverpool in addition to our ongoing programme of BREEAM in Use across our directly managed commercial estate, which has been running since 2017. We also achieved Fitwel certificates for two more developments in our portfolio.
- Participating or supporting initiatives that promote wellbeing among occupiers and communities: we have addressed sustainable transport, healthy living among occupiers and community health, and have implemented the UK Modern Slavery act through our activities and supply chain.

[24] https://www.hermes-investment.com/uki/insight/stewardship/we-can-all-get-along/ ; https://www.hermes-investment.com/uki/insight/fixed-income/we-can-all-get-along-part-ii/

- The team have also engaged with all occupiers during lease negotiations with the intention of including sustainability clauses in all lease agreements.

We have continued to focus on reducing the carbon footprint of our real-estate portfolios in 2020. As of 16 June 2020, our real-estate portfolio no longer relies on coal for power.

Figure 25. Coal is no longer an electricity fuel source in our real-estate portfolio



Source: Federated Hermes, as at June 2020.

GLOBAL EMERGING MARKETS CASE STUDY

Tencent Holdings Ltd

Our case study on engagement with Tencent Holdings demonstrates how we had to tailor our engagement to the Chinese market. Tencent operates the largest communication and social platforms in China, Weixin (whose overseas version is known as WeChat) and QQ, and provides users with digital content spanning online games, video and music to literature and news. Its FinTech services connect people with payment solutions and wealth management products. The group offers enterprises advertising solutions and business services. Tencent is also investing heavily in artificial intelligence (AI), especially in the healthcare sector where the firm has developed a medical imaging application.

Given the growth of the company and the industry as a whole, ESG themes from digital rights to climate change are increasingly relevant. Local authorities have started to focus on anti-trust issues and geopolitics has become part of the picture since the former US President Donald Trump announced a ban on any transaction that is related to WeChat[25] in the US. Our engagement with Tencent has prompted some encouraging responses – particularly, on board diversity – and we are also making progress on climate disclosure and digital rights.

According to data published by Washington-based research programme Ranking Digital Rights (RDR), most online platforms and telecoms evaluated globally have feeble records on freedom of expression and user privacy, with emerging market companies at the bottom of the RDR scale in part due to the political systems under which they operate. We have been engaging with Tencent on digital human rights for years. In April 2020 we discussed our concerns with the company about data privacy in the Tencent health code mini system in China. Specifically, we wanted assurance that health code user data is treated in compliance with applicable data privacy laws and best practice expectations. The company told us that the health code does not track location data without users' explicit consent; it is based on a user's self-declaration of personal health information collected by government online health surveys. According to Tencent, the health code information is only stored on user devices and the public health database run by the government, which Tencent has no access to and there is no copy in Tencent's cloud.

The Cybersecurity Law in China has also sparked change for the better in the country's data privacy settings. The Chinese regulations include requirements to protect personal information and individual privacy online. Furthermore, the rules require companies to be transparent about how and why they use any personal information.[26] Since the new regulations came into force, Tencent has made improvements to its privacy and security disclosures – especially by providing more clarity on the underlying purpose of personal data collection and how it processes that information. We suggested to Tencent that it could improve standards further through providing more clarity on how the company implements and monitors its privacy policies in offshore jurisdictions, where local laws and regulations differ from Chinese legal standards, especially around human rights.[27] A full case study along with our article focusing on human rights in the social media sector is available on our website.

[25] For more information, see https://www.whitehouse.gov/presidential-actions/executive-order-addressing-threat-posed-wechat/.

[26] Note: other requirements include the legalisation of data requests by authorities and the storage of data in local servers.

[27] Privacy policies of international products and services are publicly available.

REAL ESTATE CASE STUDY

Decoupling carbon emissions and portfolio growth

The international business of Federated Hermes has significantly exceeded its industry-leading 2020 target to reduce absolute landlord-controlled carbon emissions by 40% against its 2006 baseline. The team has achieved these results primarily through collaborating with property managers, occupiers and sustainability consultant Carbon Intelligence over several years, along with the rollout of smart optimisation. This success across a portfolio of 175 directly managed properties, up from 105 in 2006, demonstrates how carbon emissions can be decoupled from portfolio growth. Importantly, efficiency savings have gone hand-in-hand with wellbeing improvements.

We initially achieved the target in 2012 after disposing of a number of assets (reducing the number from 105 in 2006 to 85 in 2012). Since 2013, we have renewed our focus on this target and worked closely with property managers, occupiers, Carbon Intelligence and the other investment teams in our business to roll out innovations and initiatives to reduce operational emissions in each property. Decarbonisation of the National Grid has also contributed to emission reductions.

Carbon savings through asset upgrade: We have undertaken several refurbishment projects to upgrade buildings to improve their energy performance, informed by our Responsible Development and Refurbishment guidance. Some examples that contributed to the emissions reduction are:

- **Certification:** We rolled out BREEAM In-Use certification across 29 properties and have 15 assessments in the pipeline. The certification is focused on asset performance in operation and the data gathered is integrated into its asset-improvement plans.
- **Use of renewables in new and refurbishment projects:** In 2015, we installed 336m^2 of photovoltaic panels in our Crystal Peaks shopping mall and retail park. This produces over 90,000kwh per year, which is used on site and exported to the grid.
- **Innovation:** At Centre Milton Keynes, we installed 1,000m^2 of non-sedum carbon-neutralising roof with olivine. This will sequester nearly two tonnes of CO_2e in its lifetime, offsetting the embodied carbon of the new roof.

Carbon savings through use of technology: To improve energy efficiency in existing buildings, we used technology to allow visibility of the data, enabling operational efficiency and cost savings:

- Our **Collaborative Asset Performance Programme** (CAPP) has improved both building performance and engagement with stakeholders to reduce energy use and improve conditions for occupiers. First piloted in 2016, CAPP has now been implemented in 14 high-energy-consuming properties, with over £300,000 in annual savings.
- **Refurbishment:** Using technology, we identified a series of free and low-cost improvements. These include adjustments to building-management systems and boiler sequencing, lift-control changes, toilet refurbishments, LED upgrades and water-source heat-pump replacements. Collectively these have delivered significant cost savings. At Hammersmith Grove, an office development, we achieved £227,000 of verified energy savings (£152,000 net) and reduced energy consumption by 1.5 million kWh. At Centre Milton Keynes, this contributed to achieving 15% lower landlord-controlled emissions in 2019.
- **Smart meter technology** was installed in occupier areas as part of refurbishment projects. This allowed us to carry out a data analysis of utilities use to inform discussions with occupiers about reducing energy consumption.

Carbon savings through engagement activities: We have worked collaboratively with four property-management entities, CBRE, JLL, Savills and Workman, to implement our Responsible Property Investment (RPI) programme, including an annual forum for the managing agents to discuss key targets and share best practice and an annual RPI awards for managing agents, development teams and legal consultants. This introduces healthy competition, raises awareness of successful initiatives and encourages these entities to continuously improve.

Our engagement activities have also helped us reduce energy consumption across our assets. Some examples include working with property management counterparts on procurement of green electricity (JLL and CBRE currently procure 100% green electricity, accounting for 60% of the portfolio), green-building certification and engagement with all occupiers where feasible during lease negotiations. The intention is to include sustainability clauses in lease agreements.

Together, these activities resulted in £639,000 in total verified annualised energy-cost savings and £310,000 in net annual energy-cost savings across 14 buildings with smart optimisation.

Benefits

- Reduced absolute landlord-controlled carbon emissions across the directly managed portfolio in 2019 (compared to the 2006 baseline). This saved 29,273 tonnes of CO_2e.
- Achieved our carbon-reduction target a year early and supported the climate transition. This is increasingly important to stakeholders as the world progresses towards net zero.
- Delivered energy-efficiency savings to occupiers and reduced their carbon footprint to support their sustainability objectives.
- Contributed to occupier comfort and wellbeing by improving plant performance and building operations, including temperature and air quality.
- Improved investment value by increasing market appeal and reducing risk as climate legislation advances.

The full case study is available online.

Figure 26. Decoupling carbon emissions from portfolio growth

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
CO2e (tonnes)	52,949	59,750	64,516	65,809	66,939	38,584	29,929	33,389	51,004	55,980	55,748	39,407	30,945	23,676
Number of properties	105	139	141	141	162	86	85	92	167	189	197	191	183	175

Source: Federated Hermes, as at 2019.

We manage our community engagement programme through our property managers and have established a stakeholder engagement tool, which provides support to our property managers, sets minimum requirements and additional community engagement activities. Our property managers have continued to engage with our tenants during the pandemic, and this ongoing engagement creates a relationship with the tenants that helps us achieve some of our wider sustainability goals. Moving forward, the Responsible Property Management (RPM) team will place an increased emphasis on our tenant and occupier engagement.

It is naturally more challenging to engage with occupiers within the industrial and retail sectors, given the type of leases and structure of their activities. The full repairing and insuring (FRI) lease structure common in these types of assets offers the occupiers complete autonomy in how they manage and maintain the building and carry out procurement activities. This means that obtaining data and encouraging sustainable procurement choices can be challenging. In our indirect funds, the managing partners engage with the occupiers.

Meaningful cities provide a well-functioning backdrop that allows citizens to participate freely in social, economic, leisure and community-based activities. Cities designed around such holistic principles create a virtuous cycle, which flows on to benefits for individuals, communities, businesses and local and regional government authorities, while helping to preserve natural capital and ensuring the historic continuity of built environments. In turn, meaningful cities can likely sustain higher economic growth by attracting and retaining talent and capital, which provides a better return on capital for investors: a true win-win. Over the last two decades, we have undertaken eight large urban-regeneration developments across the UK. Such sites have provided the perfect opportunity to showcase our meaningful placemaking concept in action. But rather than relying on in-house perceptions, we engaged independent economic researcher Hatch in 2018 to provide an objective view on our placemaking performance. The series of reports produced by Hatch focused on social and economic stories and detail how each of our meaningful placemaking sites have delivered social value and economic benefits to local businesses and communities.

We monitor our community-engagement programme once a year and reward best performance among managing agents, development teams and legal consultants at our Responsible Property Investment annual awards. This introduces healthy competition, raises awareness of successful initiatives and encourages our counterparts to continuously improve. The pandemic means that the Responsible Property Investment (RPI) awards did not take place during 2020, as our priority was to engage with and support tenants.

For our Direct Lending and Real Estate Debt teams, the key is to identify both current and potential meaningful ESG risks before investing. Due to the difficulty of divesting and the capped upside, it is important to manage the downside ex-ante. Because of a lack of third-party data, the teams often use more qualitative information – often gained through dialogue with the borrower – as well as information contained in the due-diligence packs. The teams collaborate with EOS to ensure that their engagement is outcomes-focused and impactful.

Following the completion of an investment in the Direct Lending funds, the ESG risks – like all credit risks – are monitored for any changes. ESG ratings are reported to investors on a quarterly basis. Should an ESG issue arise during the life of the investment, the Direct Lending team will seek to engage with the sponsor and management of the borrower to rectify or improve the ESG issue.

We include information requirements in all of our real-estate debt loan documentation to ensure that the borrower passes on the relevant ESG information that they have to us, which we use to monitor ESG in our investments. Many of our real-estate debt loans support assets where a wider impact is delivered, such as refurbishments and regeneration. These factors are a strong consideration before investments are made, as are risks posed by ESG factors. As with our direct-lending investments, the key is to identify risks that may impact on a borrower's ability to repay their loan. We will also engage with the borrower where additional ESG issues arise during the life of the loan.

Outcomes of engagement in 2020

Public markets

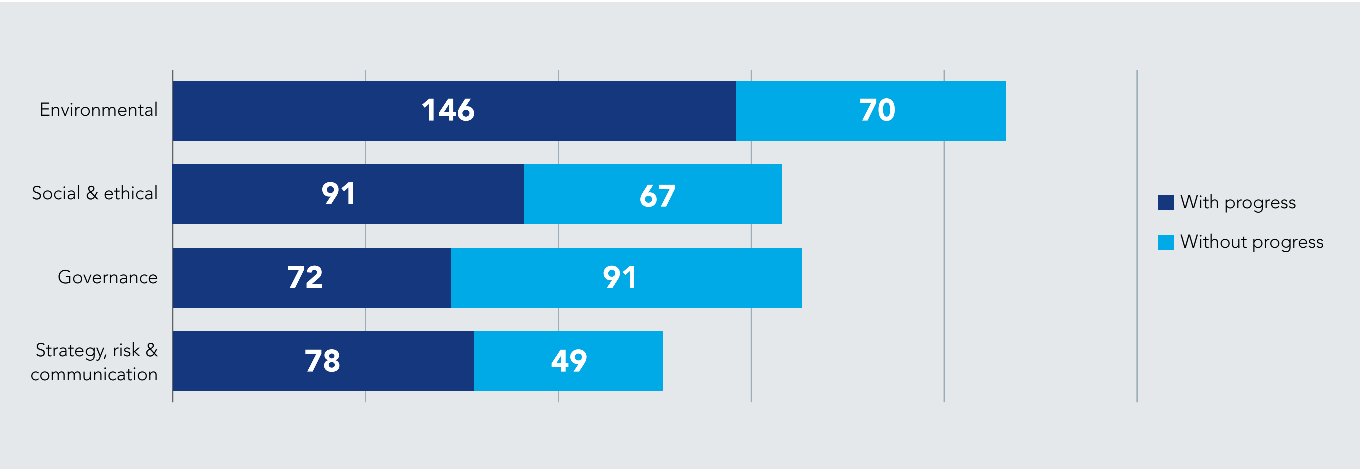
Through stewardship activities, led by EOS, in 2020, we engaged with **595** of our public-markets holdings, covering **1,997** identified objectives or issues, and we made progress on **58%** of all objectives related to our holdings. This equated to **78%** of our equity and credit AUA[28], an increase from **71%** in 2019.

Figure 27: Fund level engagement coverage for pooled equity funds during 2020

Account name	% AUA Engaged in 2020
Federated Hermes Asia ex-Japan Equity Fund	73.63%
Federated Hermes Emerging Asia Equity Fund S.P	60.18%
Federated Hermes Europe ex-UK Equity Fund	74.71%
Federated Hermes European Alpha Equity Fund	82.08%
Federated Hermes Global Emerging Markets Equity Fund	83.90%
Federated Hermes Global Emerging Markets SMID Equity Fund	55.50%
Federated Hermes Global Equity ESG Fund	86.09%
Federated Hermes Global Equity Fund	85.10%
Federated Hermes Global Small Cap Equity Fund	77.18%
Federated Hermes Impact Opportunities Equity Fund	77.42%
Federated Hermes SDG Engagement Equity Fund	99.50%
Federated Hermes US SMID Equity Fund	66.48%

We are currently in the process of automating the aggregation of our engagement statistics for our Credit funds and these will be published once available.

Figure 28. Progress made on our engagement objectives by theme in 2020



Source: Federated Hermes, as at 31 December 2020.

We publish case studies throughout the year on our website to demonstrate the approach we take and the outcomes of our engagement. EOS case studies are fact checked by the engagement companies and published on the EOS Insights website page.

[28] Our AUA refers to our public markets holdings for which EOS provides engagement services, and so excludes, for example, cash and derivatives.

CASE STUDY

Tesco

Tesco is the UK's largest food retailer, offering online retailing and brick and mortar supermarkets, selling branded and own-brand products across grocery and general merchandise categories. It also operates a food wholesaling business, Booker. As well as the UK, its home market, Tesco operates in the Republic of Ireland, Czech Republic, Hungary, Slovakia and Poland.

In September 2014, Tesco announced that it had uncovered an overstatement of expected profit in its results. EOS met with the senior independent director in October 2014 to discuss this issue. We continued to engage with the new CEO and CFO on the strategy for the company and addressed issues of supplier treatment, and with the new chair on board composition and effectiveness. We stepped up our engagement on its approach to risk management in January 2016, in a meeting with the chair of the audit committee. We sought an update on how the company was addressing broader strategic and cultural issues from the CEO and CFO in October 2017. We continued to monitor and in January 2019, we discussed the effectiveness of changes with the investor relations director.

In our discussion with the chair in February 2020, he confirmed that the company has worked hard to rebuild trust with stakeholders and reset its ways of working with suppliers. He believed changes made to financial risk management and audit have been effective. In our meeting with the audit committee chair in May 2020, he confirmed that the changes initiated in 2015 and 2016 were now established and working effectively and that he was satisfied that the specific issue of how commercial income is booked is unlikely to recur for the foreseeable future. The company's external auditor no longer raises it as a material concern, although it remains noted as a key audit matter.

We are satisfied with the effectiveness of the company's changes, emphasised through its response to the coronavirus pandemic in 2020. The link between strategy, conduct and culture, as well as human capital management and treatment of suppliers will remain important topics for our engagement with Tesco. Read the case study in full on our website.

SDG ENGAGEMENT EQUITY STRATEGY CASE STUDY

Alliant Energy

Alliant Energy is an integrated utility company supplying electricity and natural gas to retail and wholesale customers in the US. By investing to expand its clean-energy capacity, battery technology and infrastructure, the company should be able to transition away from its historically predominantly fossil-fuel (and principally coal) electricity generation.

In April 2018, we began engaging by writing to the chair and subsequently spoke with management about how the company is considering the Paris Agreement and its strategic plan to move towards renewables. Our objective is for the company to transition its energy-generation mix away from fossil fuels and towards renewable energy. We wish to see a clear strategy articulated with meaningful short, medium and longer-term targets for capital expenditure, with associated targets for its energy mix. Since we invested in Alliant, we have engaged with multiple individuals in the business, including both the current and former CEO (who was also the President). We are pleased with how receptive the management team has been, as well as – more pertinently – the progress made in a short period of time. In 2018, Alliant set its first public sustainability targets for 2030 and 2050. This summer, it revised these by bringing forward its goal to eliminate coal from its generating base from 2050 to 2040 and setting a new target to achieve net-zero CO_2 emissions from generated electricity by 2050. While Alliant has made very positive progress, we continue to believe there is scope for it to accelerate its decommissioning of coal assets, direct additional capital expenditure towards renewables and improve customer satisfaction – all topics that we will continue to explore with company management. Read the case study in full on our website.

SDG ENGAGEMENT EQUITY STRATEGY CASE STUDY

Brunswick

Brunswick is a global leader in recreational marine products, producing marine engines, parts and accessories, and recreational boats.

In March 2018, we began our engagement with Brunswick, led by our SDG Engagement Equity strategy. This started with a positive introductory meeting with management where it was agreed that the company needs to replicate the good work already in place at Mercury across the wider business. From 2018 through to 2020, our SDG-aligned engagements with Brunswick focused on:

1. Replicating Mercury's sustainability strategy across the wider group
2. Ensuring provision of decent pay and conditions
3. Developing solutions for end-of-life recycling of fiberglass vessels
4. Further 'green' product development
5. Aiming for carbon neutral production

Since the inception of the strategy, we have had multiple interactions with Brunswick, including a number of meetings with the company's management team, a visit to its principal manufacturing facility and considered exercising of our voting rights. We have been impressed by the human-capital management and sustainability practices of specific divisions, notably its engine business Mercury Marine. Pleasingly, the company has extended these practices across the group and is taking a leadership position on important issues for the industry. In May 2020, we received confirmation that the group has analysed its pay practices pertaining to both its direct employees and tier one suppliers and was able to confirm that it pays at least a living wage. The group now intends to extend this due diligence to its tier two and tier three suppliers. In its 2020 enterprise-wide sustainability report, the group established the goal of transitioning to 50% of electricity to be derived from renewable sources by 2030.

We are encouraged by the positive progress that Brunswick has made during the course of our engagements. Our focus going forward is to continue to engage constructively with management and, in so doing, encourage them to keep raising their ambitions. We remain particularly focused on developing options for more circular usage at the end-of-life for the fiberglass material in vessels, as well as further innovations to reduce the group's direct (production) and indirect (product usage) emissions impact. Read the case study in full on our website.

SDG ENGAGEMENT HIGH YIELD CREDIT STRATEGY CASE STUDY

Barclays

Through our long-standing engagement with Barclays – the holding company of Barclays Bank plc, a systemically important UK-based bank with sizeable international operations – we seek to ensure it is run in the interests of long-term investors and that it plays a role in building a more sustainable banking system by focusing on financing solutions that deliver a positive social and environmental impact.

We set an objective for Barclays to develop a strategy and lending policies to reduce its exposure to parts of the energy sector that are not aligned with the goals of the Paris Agreement, and which present long-term risks to the bank and society. We were heartened by the bank's climate-policy announcement ahead of its 2020 annual general meeting, although we acknowledge that the bank is behind where we would like it to be. Barclays asked its shareholders to vote on its ambition to become a net zero emissions bank by 2050 and on a commitment to align all of its financing activities to the goals and timelines of the Paris Agreement. This alignment will start with the energy and power sectors and will eventually extend to its entire portfolio. We have also engaged with Barclays on human capital management and corporate culture since the bank was involved in the 2012 LIBOR scandal. Our dialogue with the Chair and management team originally focused on creating a conduct framework, which sought to combat non-compliant or unethical risk-taking and which could be embedded into the culture of operational and strategic decision-making. Over the last few years, we have been impressed by the progress in embedding a 'values-based' culture across the bank, such as through dashboards which monitor cultural attributes across the firm. We will continue to pursue an objective for Barclays to solidify a culture which is responsible, customer-centric and aligned to stakeholders. Read the case study in full detail on our website.

In some rare instances, we will discontinue engagements on the basis that our engagement efforts have been met with strong resistance or the matter has dissolved.

Providing explanations for scenarios where engagement has stalled – that is, in instances where engagement is moving slowly or a company refuses to make changes – is more challenging because we conduct the majority of our engagements behind closed doors and we are cognisant of the relationships we have built with companies as well as our future engagements with them. For these reasons, we provide anonymised case study examples.

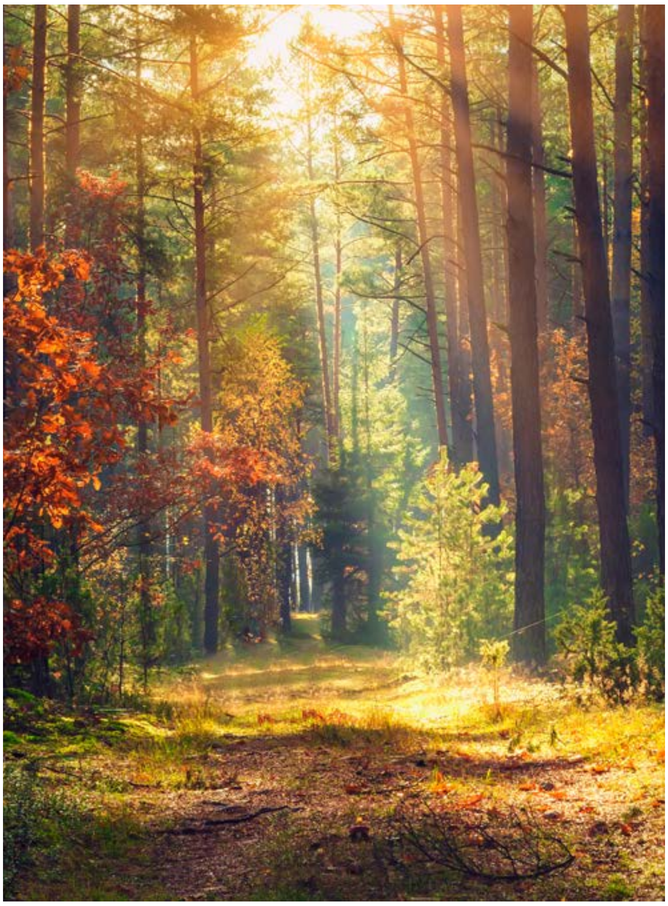
Private markets – Our Real Estate team publishes an annual Responsible Property Investment (RPI) report, which publicly discloses environmental and social outcomes for our real-estate funds. Through our placemaking activities, we have created significant social and economic growth in a number of our real-estate construction projects. This has been achieved through generating construction jobs, apprenticeships and local supply-chain spending. As we expand our reporting to cover the eight social hubs identified for real-estate placemaking initiatives, we are developing a comparative framework which will enable us to clearly measure and analyse the positive impact that the investment on social infrastructure has on the local economy and social infrastructure. Hatch have already produced several reports to measure the social and economic outcomes of each of these placemaking initiatives.

CASE STUDY

Discontinued objective

In Q1 2018 we reached out to a multinational technology company to seek improved transparency on remuneration policies and practices, especially about any pay inequity issues related to gender that may exist. In Q2 of that year, the company committed to fair and equitable pay in a blog that disclosed its pay equity analyses history and outcomes since 2012. It spent a one-off payment to address the issue. We followed up with questions on why pay inequity existed and plans to make systematic change to ensure fair pay.

Throughout 2018 to 2019, the company conducted a study to determine whether it was underpaying women and members of minority groups; it found that men were paid less money than women for doing similar work. However, we questioned the method of assessment as a former employee complained of artificial structural hurdles where women of the same qualification are urged to take up positions at a more junior category than men of similar background, education and expertise. In response to the study, one of its brands of subsidiaries gave additional compensation to nearly 11,000 employees in 2019. In 2020, the company told us that it will periodically make one-off payment adjustments if anomalies are spotted. As we will have no access to additional evidence to prove or disprove the existence of under grading women and members of minority groups, we have decided to discontinue the objective. However, we will continue to monitor this topic and other aspects of gender and racial and ethnic equity, diversity and inclusion.



We did not publish any of these reports in 2020, as the measures put in place during the Covid-19 pandemic have prevented us from measuring the impact of these developments. As a result, work is still ongoing to produce the next three reports for our developments in Paradise (Birmingham), Milton Park (Oxfordshire) and Sky Park (Glasgow). Our most recent socioeconomic report was published in 2019 and covers NOMA in Manchester. The report provides an example of the style of reports we produce and the impacts we have had. It sets out quantified social and economic impacts, showing that the estimated construction investment of approximately £150m at the time of the report had supported approximately 2,250 construction workers over eight years, with 60% of the jobs filled by Greater Manchester residents. Over 1,000 construction workers received on-the-job training and over 80 apprentices were involved in the redevelopment. Around 70% of construction spend was with Greater Manchester based contractors.

NOMA, Manchester:

Over **1,000** construction workers received on-the-job training and over

80 apprentices were involved in the redevelopment.

Around **70%** of construction spend was with Greater Manchester based contractors.

REAL ESTATE CASE STUDY

Meaningful placemaking

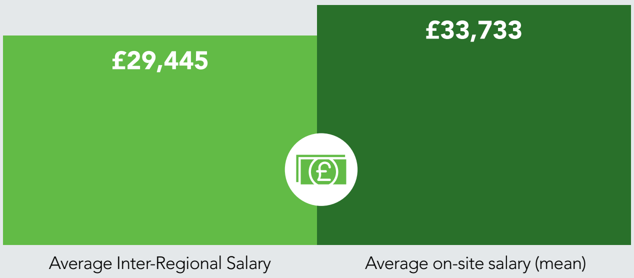
Over the last six years, we have undertaken eight large urban regeneration developments across the UK, spanning a combined 19 million square feet and £13bn of capital value.

To gain an objective view of the social and economic impacts of our meaningful placemaking approach, we engaged Hatch, independent economic consultants, to carry out benchmarking studies at three flagship developments: King's Cross in London, NOMA in Manchester and Wellington Place in Leeds.

Insights: Hatch explored a range of measures, including employment opportunities, skills development and community engagement. The research revealed some interesting findings.

Analysis of average wage measures highlighted that people employed by occupiers at King's Cross, NOMA and Wellington Place earn around 14% – or over £4,000 – more than average annual salaries in the given local region. This 'earnings bonus' functions as a rough proxy for the additionality delivered by the international business of Federated Hermes through its occupier selection, engagement and meaningful placemaking approach.

Figure 29. Average annual salaries of people employed in meaningful cities v local region



Source: Hatch, Better Buildings Partnership, as at March 2020.

The research also offered insight into the additionality of the social outcomes we contribute to as an investor in a particular community. King's Cross, NOMA and Wellington Place are surrounded by communities featuring a range of cultures, age profiles and histories. The benchmarking studies improved understanding of the social value generated by different community engagement approaches. Understanding these subtleties and recognising the value generated by diverse approaches supports us in tailoring projects to local needs.

The studies also identified how our placemaking process can spark positive change at different development phases – including design, construction and occupation. During construction, all three sites generated significant value in developing skills for the future. Some 1,230 apprentices and NVQs were involved in the construction of King's Cross, NOMA and Wellington Place, generating £2.6m societal benefit. Building on the success of the benchmarking studies, we are now looking to carry out studies at additional locations.

NOMA, Manchester

Benefits: The benchmarking studies have revealed that our meaningful placemaking approach often delivers results greater than the sum of its parts, including:

- Generating economic value in regions of the UK historically associated with post-industrial underinvestment.
- Creating job opportunities and training, growing clusters of high-skilled workers that can attract further capital investment and talent to an area, and providing entry-level roles that contribute to inclusive and diverse places.
- Restoring a sense of civic pride and belonging, bringing the 'meaningful city' concept to life.
- Conserving local heritage and ensuring it exists in harmony with modern structures.
- Introducing accessible urban spaces that function as a community and cultural mosaic. For instance, the new public square at NOMA hosts diverse events including outdoor fitness sessions, music and arts festivals and pop-up markets. It is also home to The Pilcrow, a pub built by 500 volunteers who made everything from stools to beer pump handles, encouraging local people to feel part of the NOMA community. In addition, there is a new space for creative practices to experiment, collaborate and grow, The Old Bank Residency.

Figure 30. Total Social & Economic Value Created: King's Cross, NOMA and Wellington Place:

Construction Impacts

Measurement	Total
Total value of construction contracts placed	£3,300,000,000
Total number of construction workers	2,758
Received On the job training (Number of Workers) – Absolute	1,000
Employees from local area – Absolute	1,700
Construction spend in local area – Absolute	£766,500,000
No. of construction apprentices and NVQs	1,230
Societal benefit from apprentices, NVQs and construction training	£2,607,850
Local GVA from construction jobs with multiplier impacts	£26,000,000
Total lifetime value from apprenticeships	£2,760,000,000
GVA from local construction employment	£33,000,000
Lifetime earnings from apprenticeships	£6,100,000

Placemaking & Community Impacts

Measurement	Total
Retail and leisure space delivered (m^2)	50,000
Public realm delivered (m^2)	115,000
Size of Estate (m^2)	411,139
No. of events held	1,713
No. of event attendees	375,000
No. of Art Exhibitions	20
No. of volunteers	2,000
GVA from each visitor	£510,000,000
No. of schoolchildren visited and/or engaged	5,300
No. of Schools engaged	100
Societal benefit from H&W exercise	£3,178,175
Willingness to pay for public realm	£215,000
No. of people placed into employment	1,199
No. of people received training & upskilling	256
Sponsored desk spaces	13
Value from volunteering	£6,249,000
Social value generated	£4,500,000
Community funding awarded	£35,000
No. of community groups funded	23
No. of community group members	31,700

Wages, Jobs & Fiscal Wealth Creation

Measurement	Total
Salary of employees on site	£598,200,000
Employee contribution to – Health	£23,808,360
Employee contribution to – Education	£14,356,800
Employee contribution to – Security + Police	£5,144,520
Employee contribution to – Welfare	£22,683,920
Employee contribution to – Pensions	£28,474,320
Employee contribution to – Public Transport	£5,144,520
GVA of employees on site	£1,060,000,000
Multiplier jobs created by employees on site	1,020
Wider GVA of multiplier jobs	£25,082,353
Total employees on site	17,900
No. of local jobs supported	680
Office occupancy rate (average)	87.33%
Contribution to council income from business rates	£6,708,000
Contribution to council spending on Highways	£462,000
Contribution to council spending on Environmental Operations	£184,800
Contribution to council spending on Public Sports & Wellbeing Facilities	£451,020
Contribution to council spending on Culture & Arts	£177,240
Contribution to council spending on Regeneration of Schools, Hospitals, Transport	£772,800
Contribution to council spending on Social Housing	£567,000
Contribution to council spending on Children's Services	£1,827,113
Contribution to council spending on Welfare	£609,444
Contribution to council spending on vulnerable adults & older people	£440,154
Council Spending on Education	£586,872

Source: Building Better Partnerships, as at March 2020.

Read our full case study online.

GRESB: GRESB – the global real-estate sustainability benchmark for real assets – is an investor-driven global sustainability benchmark and reporting framework for listed property companies, private property funds, developers and investors that invest directly in real estate.

The assessment is shaped by what investors and the industry consider to be material issues in the sustainability performance of real-estate investments. Scoring covers seven areas: management, policy and disclosure, risks and opportunities, monitoring and environmental management systems, performance indicators, building certifications and stakeholder engagement.

In 2020, GRESB had made significant changes to its methodology and scoring process. Nonetheless, our funds and assets performed well across the board – and particularly within development, which has its own rankings. Figure 31 shows both actual and theoretical scores for the 2020 GRESB entries. As the change in scoring makes comparisons with previous years challenging, GRESB provided a theoretical score which is based on the methodology used in 2019. All funds achieved higher or consistent theoretical scores compared to 2019.

Figure 31. 2020 GRESB scores

Portfolio	2020 Score	2020 Score (theoretical score using 2019 methodology)	2020 GRESB Star Rating
The Centre-MK	93	94	5
BTPS	83	86	4
MetroPut	68	72	3
HCLP	82	86	4
FHPUT	73	78	3
Vista[29]	68	70	2

Source: Federated Hermes, as at 31 December 2020.

In the overall ratings, centre:mk, the shopping centre in Milton Keynes that we manage on behalf of Australian Super and the BT Pension Scheme (BTPS), retained the five-star rating it achieved in 2019 – this recognises entities placed in the top 20% of the benchmark – and was listed number one in the UK retail shopping-centre sector. In addition, the BTPS portfolio retained its four-star rating and came second in its peer group.

Looking more closely at the development ratings, BTPS achieved a five-star score, ranked first among its peers for development and gained a green star, while our FHPUT fund was awarded four stars, ranked second among its peer group for development and also achieved a green star. Wellington Place – which makes up part of the BTPS score as a joint-venture fund – achieved a four-star rating, came first in its peer group for development and gained a green star.

Our positive results in the development category clearly reflect our Real Estate team's consistent approach to responsible property development, as well as its emphasis on asset-level active decarbonisation and data integrity – something that has been a consistent focus of ours since we first set carbon-reduction targets in 2006.

The success of our RPI approach can be seen in the certifications that our properties receive. In 2020, we achieved world's first BREEAM In Use certificate for residential development for The Cargo in Liverpool. We have also achieved Fitwel certificates for two more developments in our portfolio. This reflects our high standards of development, achieved through close collaboration and engagement with all stakeholders.

In 2020, we achieved world's first BREEAM In Use certificate for residential development for The Cargo in Liverpool. We have also achieved Fitwel certificates for two more developments in our portfolio.

[29] Vista has now rebranded as the residential platform Hestia. 2020 GRESB reporting was completed under the name Vista as it relied on data that pre-dated this rebranding.

Principle 10

Signatories, where necessary, participate in collaborative engagement to influence issuers.

We see value in both direct and collaborative engagement, and it is the combination of both which helps us influence issuers and carry out effective stewardship. Where there are shared objectives – in particular the promotion of long-term sustainable value – we use both formal fora and other more informal links to work collaboratively with other investors on a global basis. Such interactions can be ad-hoc or ongoing. Crucially, the primary concept of EOS' stewardship service is to provide a mechanism for like-minded asset owners to pool their resources and in so doing create a stronger and more effective stewardship voice. Any collaboration is done in line with applicable rules on antitrust, conflicts of interest and acting in concert. As described under Principle 4, we contribute to policy discussions both directly and in collaborative fora and initiatives. We are a member of a number of industry bodies and initiatives around the world, through which we conduct collaborative engagement both on thematic issues and with specific issuers.

Our collaborative engagements

Collaborative engagement with issuers

We may collaborate with other investors in our engagement with companies when this may be beneficial for the engagement and could influence the actions and governance of investee companies. We seek collaboration where interests are aligned and the objectives are based on material issues. Any collaboration is done in line with applicable rules on antitrust, conflicts of interest and acting in concert.

In order to succeed in the long run, we believe that companies will need to effectively manage relationships with key stakeholders. They also need to be mindful of their impact on the environment and their role in both the communities in which they operate and society as a whole – something that grants them their licence to operate. As a result, we are interested in and seek (if necessary) to influence a company's management of these wider risks, where they have been raised. While we do not generally communicate directly with stakeholders, we will feed back their concerns – once verified – to company management through our position as shareholders. This is because we believe that we have a duty to use our influence to improve the behaviour of the companies in which we invest, which should benefit society as a whole. Our stewardship activities may also include discussions with relevant stakeholders of investee companies, such as industry bodies, policymakers, regulators, customer groups, employee groups and civil-society organisations. All of our activities are supplemented by our belief in transparency, and our public reporting may also be of value to relevant stakeholders.

We list here examples of how we have collaborated with other investors to engage with issuers in 2020:

- In collaboration with investors and the Farm Animal Investment Risk and Return (FAIRR) Initiative, we signed a letter to 25 companies in the restaurant and food sector calling on them to demonstrate a comprehensive approach to protein diversification. The Intergovernmental Panel on Climate Change's August 2019 report, 'Climate Change and Land', stated that current land use and global food systems are exacerbating climate change, land degradation, biodiversity loss and other environmental threats. It is crucial for companies to adopt a comprehensive global evidence-based approach to diversifying protein offerings to mitigate supply-chain risks and capitalise on opportunities. We are encouraging companies to take a proactive approach to addressing the impacts of their animal protein sourcing, and to clearly articulate their strategy to expand their offering of plant-based food and alternative proteins. We are asking companies to disclose information on their intentions to transition their protein portfolios in line with climate science. The answers will be used to assess their progress against FAIRR's evaluation framework.
- We co-signed letters alongside other long-term investors to the audit committee chairs of some of the largest European companies to draw their attention to the IIGCC paper 'Investor Expectations for Paris-aligned Accounts' which clearly sets out that investors expect directors and auditors to deliver Paris-aligned accounts – accounts that properly reflect the impact of getting to net zero emissions by 2050 for assets, liabilities, profits and losses. This followed our involvement in an informal coalition of investors, led by Sarasin & Partners, which engaged with the 'Big Four' UK audit firms asking them to explicitly incorporate climate considerations into the audit of companies that are materially exposed to transition risk through decarbonisation.

Real Estate

We work with other the investors within our real-estate joint ventures at both the ownership and asset-management levels. The boards of our joint ventures have representatives from both us and the other investor. We work alongside this other investor within the decision-making framework of the Partnership Agreement. At the asset-management level, the joint-venture board appoints us (or MEPC, the UK commercial real-estate developer and asset manager that we acquired in January 2020) for the investment management and/or development management of the asset. The appointed team reports to the board and is responsible for the day-to-day running of the asset, engaging with both owners within the joint venture to suggest and progress initiatives. It is at this level that our Responsible Property Management approach strongly influences the delivery of the asset and property management services.

Collaborative engagement on thematic issues and public policy

We also participate in debates on public-policy matters. Through these we aim to protect and enhance value for our clients by improving shareholder rights and boosting protection for minority shareholders, as well as to tackle thematic issues that impact the assets that we invest in. This work is carried out by both our Responsibility Office and EOS.

This work extends across company law, which in many markets sets a basic foundation for shareholder rights. It also covers securities laws, which frame the operation of markets and ensure that value creation is reflected for shareholders. Finally, it encompasses codes of best practice for governance and the management of key risks and 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. We seek to fill this gap.

By playing a full role in shaping these standards, we can ensure that they work in the interests of our clients and ultimate beneficiaries 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.

We are a member of a number of industry bodies and initiatives around the world and are founders of many of them. We take on advisory roles in many of these organisations to share our practical expertise. Given the global nature of our investments, this work spans asset classes and geographies. Such work often involves collaborative engagement on thematic issues and public policy that will impact issuers.

In addition to 1600 interactions (including meetings, phone calls and letters) with our public market holdings in 2020, EOS also had 173 interactions with regulators, standard-setters and other third parties in the pursuit of public policy and market best-practice objectives. It also made 52 public policy consultation responses or proactive equivalents such as letters.

Examples from 2020 include:

- With our track record on anti-corruption engagement via the PRI and elsewhere, we were invited to provide input to a PRI publication on speak-up programmes and whistleblowing. We urged the PRI not just to identify anti-corruption disclosure standards, but to argue that companies should provide more qualitative insight into corporate culture. We shared some of the indicators and how they are used at companies that are actively attempting to measure and improve their ethics and culture. Following publication of the PRI's paper, a member of the EOS team was a panellist on a related webinar where we received positive feedback on our comments on how whistleblowing provides an important insight into the culture of an organisation, how whistleblowers find the experience and what they report. We shared our view that most disclosure on the topic provides very little insight into how whistleblowing facilities work in practice and even the best disclosures should be supplemented by engagement to glean insight into the culture. We believe that an ethical and learning culture is the bedrock of sustained success for any company.
- We co-hosted a thematic workshop on the changing landscape of human-rights due diligence and workforce reporting in the context of Covid-19. Our co-host was the Workforce Disclosure Initiative (WDI), of which we are a signatory. The event allowed companies and investors to learn more about the WDI and speak candidly about the challenges and opportunities faced when conducting human-rights due diligence. We presented our engagement approach on human capital and labour rights and shared our engagement experiences of company actions as a result of the ongoing pandemic. We also discussed the best way to prepare for upcoming legislation on the topic and the links between company and investor due diligence. Over 60 participants joined the virtual workshop, including a number of engagement company contacts.
- We were members of the Advisory Group, which contributed to the development of the Investor Toolkit on Human Rights. This was co-ordinated by the Investor Alliance on Human Rights and was published in May.
- In our engagements, we consider how purpose is expressed, supported by our Statement of Purpose guidance. We also consider how purpose is enacted, seeking clarity on how strategy and capital allocation are aligned with purpose, and how it is embedded into organisational behaviours. Our work with the Enacting Purpose Initiative (EPI) supports this. The initiative, which we co-lead along with Oxford Said Business School, University of California Berkeley Law School and others, brings together academic research with insights

from company directors and executives to provide practical guidance for boards on embedding purpose in organisations. EOS distributed invitations and helped to secure director participants from approximately 20 European and 30 North American companies. The initiative published its first report in November 2020, which provided a European perspective.

More information on our advocacy and involvement in industry initiatives – including on climate change and deforestation – is available under Principle 4.

The outcomes of our collaborative engagement

We monitor the progress of our collaborative engagements with specific issuers in the same way we monitor our direct engagements. We do not categorise our engagements with specific issuers into either collaborative or individual/staff engagements.

Each quarter, EOS publishes a Public Engagement Report which details its collaborative work on public policy and best practice over that period. These are publicly available on the EOS library page of the website.

CASE STUDY

BHP Billiton

Although we had long engaged with BHP on climate change, our engagement as a member of the Climate Action 100+ investor group on its climate change mitigation plan and its contribution to the achievement of the goals of the Paris Agreement commenced in 2019. BHP adopted a collaborative approach, proactively seeking our input in various meetings with the sustainability team in 2019 and 2020, as it progressed the development of its medium-term carbon emissions reduction target. Through engagement, we emphasised the importance of using science-based targets and discussed decarbonisation options, mainly diesel replacement, the use of renewable energy and how to secure a stable and reliable supply. Although we acknowledged that 20% of emissions may be hard-to-abate with available or prospective technologies, we emphasised that the use of offsets should be kept to a minimum and independently overseen. In Q3 2020, the company announced its scopes 1 and 2 carbon emissions reduction target of 30% by 2030 relative to 2020, using the science-based absolute contraction method. We continue to engage on the plan for the reduction of scope 3 emissions, particularly initiatives related to shipping and steelmaking.

Principle 11

Signatories, where necessary, escalate stewardship activities to influence issuers.

Our engagements across all asset classes are outcomes-focused, although the nature of escalation varies depending on both the rights we have available and the specific context.

Public markets

The companies identified for the core engagement programme at the beginning of each year are assigned an engagement intensity tier, although this is subject to change throughout the year as individual company circumstances change.

We escalate the intensity of an engagement activity over time, depending on the nature of the challenges each company faces and the attitude of the board towards our dialogue. Generally, our engagement activity becomes more active where we believe that engagement will lead to an increase in or prevent/limit a decrease in the value of a company over the long term.

Engagements on some objectives may involve only a small number of meetings, although others are more complex and will entail multiple meetings with management and board members over several years. Such activity often requires persistence. Our long-term and diverse perspective enables us to persist with the more difficult and time-consuming engagements to bring about changes in either strategy, financial structure, operational or risk management or governance, including in relation to ESG risks. Any change we encourage a board or management team to make will be with the intent of improving a company's long-term performance.

While we can be robust in our dealings with companies, the aim is to deliver value for clients, not to seek headlines which could undermine the trust that we believe should otherwise exist between a company and its owners. As a result, we generally prefer to conduct engagement privately rather than taking a public route when seeking change at companies, although (as described earlier under Principle 7) details of all engagement meetings of our stewardship team with companies are shared across investment teams and EOS third-party clients. In our experience, working constructively with boards and management in private is the most effective way to achieve positive change as it allows us to build trusted relationships with companies, which results in more open and frank discussions.

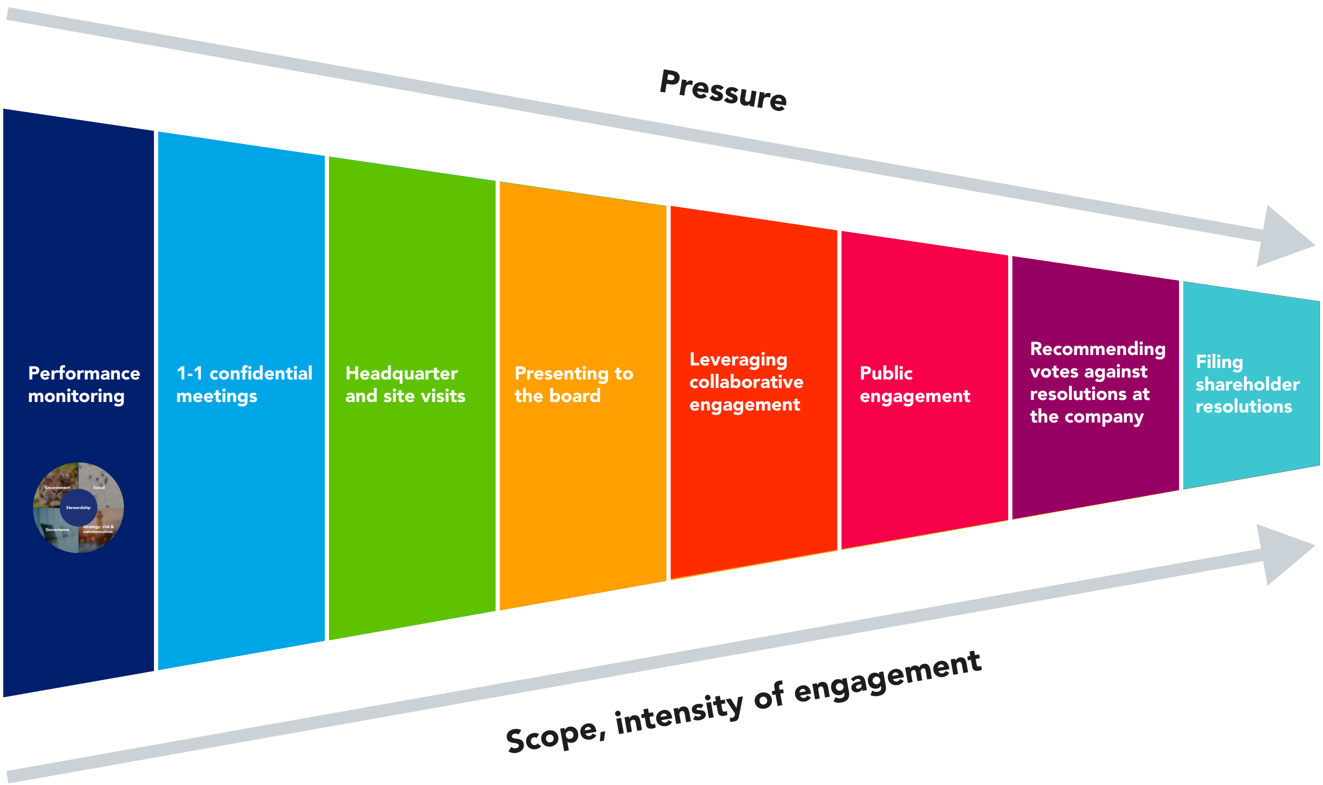
We escalate the intensity of an engagement activity over time, depending on the nature of the challenges each company faces and the attitude of the board towards our dialogue.

However, on the occasion that we should not be able to achieve success by using our usual methods of conversations behind closed doors, we may escalate our engagement by choosing to speak publicly or at the company's annual general meeting (AGM) – to garner additional investor support and add further pressure. When doing so, we would normally notify a company in advance. We may also vote against a resolution or management/the board at a company's AGM – we consider this choice carefully as we only want to use this technique if our usual engagement has consistently stalled and we are not confident that the company is taking any action to address our concerns – and we disclose a number of these instances under Principle 12. Given the assets we represent, this sends a strong signal to the company and can help progress our dialogue with it. Similarly, we have demonstrated a willingness to use the full range of rights that we have at our disposal, including the tabling of resolutions at shareholder meetings or collaborating with others to co-file shareholder resolutions when necessary (as described under Principle 12).

EOS identifies the following engagement tools at its disposal to escalate engagement over time. In addition, Figure 32 demonstrates how different tools are selected as the scope or intensity of the engagement increases in tandem with pressure for change on the company.

- Performance monitoring
- 1:1 confidential meetings
- Headquarter and site visits
- Presenting to the board
- Leveraging collaborative engagement
- Public engagement
- Recommending votes against resolutions at the company
- Filing shareholder resolutions

Figure 32. Engagement tools employed by EOS



Source: Federated Hermes, as at February 2021.

If our usual private engagement approach has not been successful, EOS will sometimes escalate an engagement. When this happens, the relevant portfolio managers are notified about it immediately – something that allows them to factor this information into their investment decisions. Companies that consider changing their practices as a result of escalation show a willingness to engage and listen to shareholders. This indicates the potential for positive change, which may enhance the investment case. On the other hand, a red flag is raised when a company is not willing to engage with its investor base or is resistant to change even after an escalation. If a company is unwilling to make changes in relation to material ESG or strategic issues, this may be an indication that it is less likely to create sustainable wealth over the long term.

Our case studies provide detailed insights into how our engagement escalates over time and can lead to change and completion of our objectives.

CASE STUDY

Alphabet

Alphabet is a collection of businesses. It operates through the Google and Other Bets segments. In April 2018 we began engaging with Alphabet on how its technologies manage the prioritised content of Google Search and on YouTube, to avoid human rights concerns arising through the application of artificial intelligence (AI). We encouraged the company to go beyond publishing AI principles, to demonstrate how the principles are being applied. After multiple touchpoints, we stepped up our engagement, including writing to the chair of the board, asking for further disclosure on content governance and recommending a feedback system in its AI ecosystem. At the 2019 annual stockholder meeting, in addition to supporting one of the shareholder proposals aimed at better addressing societal risks, we voiced our concerns relating to AI governance directly to the executives and board.

With regard to our request for demonstration of how the AI principles are being applied, in January 2019 the company published a 30-page white paper on AI governance. In January and February 2019, YouTube took a series of actions to improve transparency and accountability. Since 2019, the company has made improvements to tools to measure fairness, transparency and explicability of AI which also helped satisfy our request. It has also improved stakeholder engagement and communications with regard to how AI social impact is assessed and measured. In November 2020, Alphabet changed its audit committee to become an audit and compliance committee (ACC). The ACC's charter now includes sustainability, data privacy and civil and human rights risks as items which must be reviewed by it – becoming closer to meeting our request for enhanced board oversight. We continue to engage with the company through a human rights lens to encourage board accountability over the responsible use of AI. Read the case study in full on our website.

Private markets

For most of our private-markets teams, a lack of liquidity means that it is not easy to divest or decrease exposure to investments. As a result, investments in this space are considered to be a long-term relationship and it is down to the investment team to conduct appropriate due diligence prior to investing to ensure that the firm is willing to work with us to drive positive change. At this point, positive behavioural changes in relation to ESG risks can be included as a requirement in the documentation. However, it is not always possible to envisage all ESG risks that could arise during the life of the investment. In these situations, our private-debt teams would engage with the borrower, often with the help of EOS, to escalate and resolve any issues through dialogue. Our Direct Lending team may also involve the private-equity shareholder. There can be additional points at which we have a significant ability to influence the company's behaviours, primarily when the borrower seeks to alter the loan terms – for example, because the company wishes to make an acquisition. As described under Principle 12, while we have enforcement rights when a borrower defaults on a loan and breaches the agreed terms, we use these rights only as a last resort. In the first instance, we seek to negotiate a positive outcome for all parties involved, although we will always act in our investors' interests in line with our fiduciary duty.

Principle 12

Signatories actively exercise their rights and responsibilities

Our rights and responsibilities as an investor

As we set out under Principle 1, we believe that the purpose of investment is to create wealth sustainably over the long term, and that investors must behave in a way that is consistent with solving the world's problems rather than compounding them. Intertwined with this is the belief that, consistent with client objectives and applicable requirements, investors must be responsible stewards of capital in order to contribute to positive outcomes for our clients and beneficiaries, as well as society and the environment. Throughout this report, we have sought to demonstrate how we have responded to these responsibilities through active stewardship across all of our products and asset classes. Investor rights are themselves an asset and we view the exercise of these rights as part of our fiduciary duty and a responsibility of effective stewardship.

For listed equities, our voting and engagement are co-integrated as part of our overarching approach to stewardship. As such, our voting decisions – as well as EOS' recommendations to third-party clients on voting decisions – are informed by the insights and experience from engagement with the investee company. We may attend the AGMs of investee companies or arrange for representation at the AGMs by the EOS team. This can include asking questions or making statements to the board. We may also file or co-file shareholder resolutions. The exercise of all such rights is based on an evaluation of materiality and an analysis of costs and value. EOS engagement professionals go through a training and onboarding process which involves shadowing more experienced colleagues to ensure they sufficiently understand the voting policies and how shareholder rights differ according to the markets involved. Senior engagement professionals dedicate time to handling escalated votes and discuss market developments. We set out in more detail how we have exercised our shareholder rights for listed equities, including voting rights, in the following section.

For our fixed-income products, the rights we have vary between the type of assets we invest in and even between individual investments. We seek to achieve mutually beneficial outcomes while protecting our clients' interests in line with our fiduciary duty. For our Credit team, documentation is a governance factor and the quality of the documentation and the information contained within it is a direct indication of how a company's management thinks about its stakeholders. As part of the investment process, we therefore see both the covenants and the quality of bond and loan documentation as indicators of governance strength or weakness.

As investment agents, we use the rights granted to us by our real-estate client mandates to improve the value of the assets in our portfolios in line with our fiduciary duty. The rights and responsibilities we have vary between mandates and depend on the level of client involvement in the decision-making process. For all our mandates, our investment strategies reflect market conditions and consider ESG factors. Our asset-management activities seek to improve the assets – including by improving their ESG profiles and through tenant engagement – and thereby deliver positive social and environmental outcomes and benefit our clients and their end beneficiaries.

Listed equities: voting approach

We are fully cognisant that we, as shareholders, are granted a wide range of rights which both offer us a level of protection and enable us to fulfil effectively our stewardship responsibilities. In particular, we consider the vote as part of the asset and accept that we have a responsibility to exercise this right in a considered fashion.

Our voting policies

EOS' Global Voting Guidelines act as a policy to inform EOS' voting recommendations to our investment teams as well to EOS clients who request to receive voting recommendations. The international business of Federated Hermes Global Voting Policy and Guidelines, which are aligned with EOS' Global Voting Guidelines, inform the investment decisions made by our investment teams. Our Guidelines are informed by a hierarchy of external and internally developed global and regional best-practice guidelines. The most of important of these are our EOS-developed regional corporate-governance principles, which are available on our website. We have 22 of these guidelines, which set out our fundamental expectations of the companies our clients invest in. We have also taken into account the Organisation for Economic Co-operation and Development (OECD)'s Principles of Corporate Governance and the ICGN's Global Corporate Governance Guidelines, as well as our own Responsible Ownership Principles, which we developed by drawing on our extensive experience as an active and engaged shareholder.

The primary policy-development cycle for our voting guidelines is an annual process and runs in conjunction with the policy-review process at ISS, which informs its benchmark research. EOS considers changes made at ISS in view of resolution-level data for past voting seasons in order to consider what additional changes are warranted. This includes integrating feedback from clients and evolving best practice in each market. Our Engagement Plan provides further input and identifies thematic priorities for engagement. This can often be boosted by enhanced vigilance and potentially escalation through our voting recommendations. EOS completes its major policy changes before the main voting season in each market. Once changes are applied, the policy is monitored to ensure it is having the desired effect and adjusted further where appropriate.

In addition, EOS has developed very detailed country-specific customised voting recommendation policies for over 50 key markets. Voting guidelines differ by country to reflect the differing regulatory, legal and corporate governance codes and best practices that exists.

EOS has developed very detailed country-specific customised voting recommendation policies for over **50** key markets.

Voting decisions

Voting rights are exercised with a view to achieving best-practice standards of corporate governance and equity stewardship and with the aim to support the delivery of long-term value in our funds. Ultimately our investment teams make all voting decisions, based on EOS recommendations. EOS engagers, who are well versed in the policies, make recommendations to our investment teams based on our voting guidelines, as well as any further information that they receive through their research, engagement and specialist knowledge of the company.

While it is difficult to provide a general description, EOS will typically recommend a vote against management when it considers that a vote with management would not serve the best long-term interests of shareholders. For example, this may be either with respect to a proposed remuneration policy or when EOS believes the board does not have the skills govern the company effectively. There may also be specific instances when a vote in favour of management would be actively detrimental to the company – for example, in the case of a proposed merger or acquisition that does not look to be in the long-term interests of the firm.

EOS use ISS to provide research on all the companies that it provides voting recommendations on, which comes to almost 10,000 a year. The recommendations that our investment teams and EOS third-party clients receive are, in the first instance, based on ISS's research using our voting guidelines. This is then overlaid with our intelligent voting approach.

EOS has a value-add and cost-effective mix of automated and manual voting recommendations, which focuses resources on key topics and companies with significant holdings and/or contentious issues or ongoing engagement objectives. Engagers add insight and value to a specific subset of these meetings – those on EOS' watchlist – by considering the voting recommendation approach in light of the specific company context and the engagement. Our equity holdings are added to the EOS watchlist at the beginning of the year, which means that the majority of voting recommendations made to our investment teams are manual. EOS endeavours to engage around the vote with all companies on the watchlist – this comprises about 1,000 companies, including about 400 in the engagement programme – for which we are considering a vote against. EOS will also discuss such cases with the relevant portfolio manager. We receive research from ISS on those companies but also have access to our own information (including engagement history) on our electronic platform, which captures meeting notes and documentation relevant to the engagements and objectives.

EOS will also engage to identify any further relevant information that might inform the voting recommendation and has regular conversations with our investment teams about the reasons for their views on particular votes. We will vote by exception to our voting policy when we judge that we will further the engagement and likely achieve beneficial change by doing so.

Votes are escalated – including to the executive team where needed – when they are especially significant for the company, complex, or when a disagreement or potential conflict of interest arises with the recommendation received from EOS. For our investment teams, the voting recommendation provided by EOS will inform their assessment, but they will make their final judgement independently with a view to their fiduciary obligations to their clients. On the rare occasion that there are disagreements between investment teams and/or EOS on the appropriate voting action, the matter is logged and escalated for consensus to be reached at the director level. It is expected that votes cast by our investment teams would be consistent with the voting recommendations we provide to our stewardship clients who request to receive voting recommendations other than in limited circumstances. In such cases, the rationale for divergence will be documented. As described under Principle 3, we have escalation processes in place when there are different views between EOS and our investment teams, or when conflicts of interest arise in the course of fulfilling our commitment to acting as good stewards of those companies in which we invest.

Clients of segregated mandates have the option to carry out the voting themselves or to benefit from the voting recommendations and decisions of the relevant investment team, based on EOS' recommendations.

Securities lending

We do not as, a matter of course, participate in securities lending transactions. We endorse best-practice principles, such as the Securities Lending Code of Best Practice issued by the ICGN.

Listed equities: 2020 Voting

Our 2020 voting records and rationale

Our voting records are published online in arrears. This ensures that we are transparently accountable, but that our dialogue with companies around voting issues is not compromised. The records include all voting decisions of the international business of Federated Hermes. Company meetings where we have recommended voting in line with management on all resolutions are condensed. In 2020, we cast votes at 730 meetings involving 8089 resolutions.

Figure 33. 2020 voting statistics

- Total meetings voted in favour **38.5%**
- Meetings where voted against (or voted against AND abstained) **44.7%**
- Meetings where abstained **0.5%**
- Meetings where voted with management by exception **16.3%**

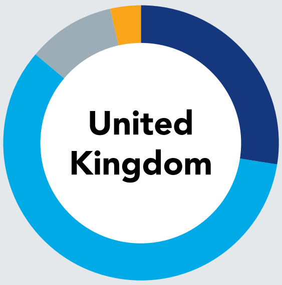
Source: Federated Hermes, as at 31 December 2020.

Votes against the board: We provide the rationale behind our decision when we have voted against management on one or more resolutions. We seek to be supportive of boards and to recommend votes in favour of proposals unless there is a good reason not to do so in accordance with our voting policies and global or regional governance standards, or if by doing so we are striving to protect long-term shareholder interests.

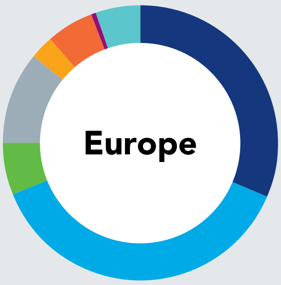
Figure 34. Breakdown of votes against

- Board structure **34.8%**
- Remuneration **29.6%**
- Shareholder resolution **14.3%**
- Capital structure and dividends **10.1%**
- Amend Articles **4.6%**
- Audit and Accounts **4.2%**
- Poison Pill/Anti-Takeover Device **0.1%**
- Other **2.4%**

- Board structure **65.1%**
- Remuneration **3.2%**
- Shareholder resolution **3.2%**
- Capital structure and dividends **9.5%**
- Amend Articles **2.4%**
- Audit and Accounts **16.7%**

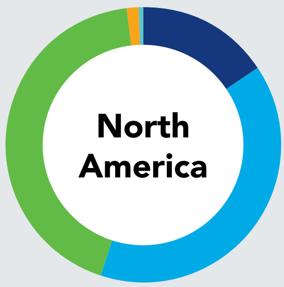


- Board structure **27.6%**
- Remuneration **58.6%**
- Capital structure and dividends **10.3%**
- Amend Articles **3.4%**



- Board structure **31.6%**
- Remuneration **37.3%**
- Shareholder resolution **6.2%**
- Capital structure and dividends **10.7%**
- Amend Articles **2.8%**
- Audit and Accounts **5.6%**
- Poison Pill/Anti-Takeover Device **0.6%**
- Other **5.1%**

- Board structure **48.9%**
- Remuneration **10.9%**
- Shareholder resolution **1.5%**
- Capital structure and dividends **21.2%**
- Amend Articles **9.1%**
- Audit and Accounts **3.6%**
- Other **4.7%**



- Board structure **15.8%**
- Remuneration **39.2%**
- Shareholder resolution **43.1%**
- Amend Articles **1.5%**
- Other **0.4%**

- Board structure **16.5%**
- Remuneration **64.2%**
- Shareholder resolution **7.3%**
- Capital structure and dividends **5.5%**
- Amend Articles **6.4%**

Source: Federated Hermes, as at 31 December 2020.

Votes not in line with our policy: We retain the ability to go against our high-level policy when warranted. This is on the basis of particular company circumstances or engagement insights and is in line with what we believe to be in the best interests of long-term shareholders such as ourselves. If EOS engagers are considering whether to recommend a vote that is not in line with our policy – and there is not a clear and well-understood reason for this (see below on voting by exception) – then they escalate this to a more senior team member. In these cases, engagers record in our Engagement Management System that they have consulted a senior engager. When a potential conflict is identified, the matter is escalated in line with our conflict-of-interest policy and process outlined earlier under Principle 3.

On occasions when our policy may suggest a vote against management but engagement with the company had provided additional insight – for example, a company that has committed to making a change but that will not implement it until the following year – we may vote for, by exception to our policy. These instances are highlighted in our voting disclosures and are within the scope of our overall voting policy. In 2020, the coronavirus pandemic was also important context in determining votes for, by exception. Examples included:

- Recognising the critical role of leadership in periods of crisis management, we revised our voting guidelines during the pandemic (as described under Principle 4) to recommend 'for, by exception' rather than 'against' the re-election of chairs and committee chairs where we had concerns about issues such as a lack of diversity or independence. We continued to communicate our concerns and expectations for change and made clear any allowances were temporary. Where we had serious or urgent concerns, we opposed as normal. For example, at Morrisons, we had concerns about persistent poor board gender diversity. And at Ocado Group, we voted against the re-election of a non-independent non-executive due to an overall lack of independence on the board as well as the re-election of the company secretary due to concerns of potential conflict of interests as they also serve as an executive director. In part due to the circumstances of the pandemic, we did however vote for, by exception for re-election of the chair to support a level of continuity.
- We looked for appropriate reductions to salaries and incentive pay and for boards to use their judgement to ensure executives were not being unduly insulated from the impacts of the crisis where others were not. We opposed pay proposals where we did not believe appropriate adjustments had already been made, such as at JPMorgan Chase & Co, Disney and Delta Airlines.

- We use the Transition Pathway Initiative (TPI) management scoring pathway to assess the management of climate change risks and opportunities for larger and more exposed companies. We take an engagement-led approach to understand the reasons for poor management scores and whether a company will commit to making progress. Where we do not receive satisfactory responses, we may recommend voting against the re-election of the chair or other relevant committee chairs. Recognising that the climate crisis is also an urgent and critical issue, generally we did not amend our usual approach during the pandemic. However, for companies with indications of imminent and severe financial distress (such as in the airline and shipping sectors), or where we believed there was a reasonable prospect of positive engagement on climate change over the longer term, we considered amending our voting recommendation to 'for, by exception', with clear communication of our expectations for change. We took this approach at Berkshire Hathaway, for example.

Shareholder resolutions: We support the selective use of shareholder resolutions as they can be a useful tool for communicating investor concerns and priorities, asserting shareholder rights or supplementing or escalating direct engagement with companies. We consider such resolutions on a case-by-case basis and encourage boards to engage with serious, committed long-term shareholders like ourselves. When considering whether or not to support resolutions, we consider factors which help to ensure that the proposal promotes long-term shareholders' interests. These include what the company is already doing or has committed to do, the nature and motivations of the filers (if known) and what potential impacts – positive and negative – the proposal could have on the company if implemented. When boards interact in an active and engaged way with shareholders on issues that affect companies' long-term value, we will see less need to file or support shareholder resolutions.

In our experience, shareholder proposals can be a catalyst for related dialogue with issuers and we avail ourselves of these opportunities, where appropriate, whether or not we vote in favour of the resolution itself. We expect boards to address the issues raised by shareholder proposals which receive significant support or where they are material to the company. In addition, we view any failure to implement a shareholder proposal that has received majority support as a clear indication that the board of directors is not fulfilling its obligations to the owners of the company.

When we vote in favour of a shareholder resolution in the cases that there is no management recommendation, this is classed as a vote against management in our disclosures. This is to ensure that we do not underreport conflicts, although in some instances it may not be voting against what management would have wanted.

We also initiate shareholder proposals in markets where it is relevant to do so, typically in Germany and the US, either as lead filer or as co-filer alongside other investors. Consistent with our intelligent voting approach, this typically forms part of a wider engagement with the company and is used as a tool for leverage in EOS' dialogue with management.

Examples from 2020 include:

- EOS was one of four lead filers of a proposal at Alphabet, calling for the board to establish a committee to oversee human rights risks at the company, which we consider to be material and currently inadequately overseen by the board. This is an action we collaborated on with others, following a private letter sent to the company in November 2019. This was signed by over 80 institutional investors, representing nearly $10 trillion in assets under management and advice. The letter asked for a dialogue on these issues, which was denied. The company's share structure meant the proposal was very unlikely to pass, with approximately 53% of the company's voting shares controlled by executives and board members. However, it received approximately 45% of the independent votes – including the international business of Federated Hermes – which we considered a very positive outcome, in support of our ongoing engagement.
- JPMorgan Chase & Co responded to pressure from shareholders and their representatives, including EOS, by announcing that its lead independent director would step down from his role and be replaced by the end of September. The individual, at 81 and beyond retirement age, is a former CEO of ExxonMobil with a controversial track record as a climate change denier. Another shareholder proposal that called on the bank to further disclose its fossil fuel lending activities attracted almost 50% support, including from the international business of Federated Hermes, despite opposition from the JPMorgan board.

Other notable votes: There are other instances when votes are notable due to the outcome of the resolution, or the level of dissent. The shareholder resolutions described above are examples of this, as is the following example:

- **Voting against management with high shareholder dissent:** Ahead of the 2020 AGM, we contacted a company on its proposed remuneration framework for the executive directors. In particular, we raised our concern about the lack of disclosure of the variable remuneration outcomes in the short-term incentive plan, the severance arrangements, and the potential significant change of control payments. With regard to the severance arrangements for the executive directors, these are in excess of one-year base salary as is common best practice, with high payments for 'change of control'. We voted against the two remuneration proposals. These were defeated at the AGM, with 65.8% and 61.5% of shareholders voting against the Remuneration Report and Remuneration Policy respectively. The vote on the remuneration report was advisory only. The company will revert to its former remuneration policy.

The proportion of shares voted and votes withheld

We aim to vote either in favour or against a resolution and only to abstain in exceptional circumstances, such as when our vote is conflicted, a resolution is to be withdrawn or there is insufficient information upon which to base a decision. We voted 99.53% of all votable shares.[30] There are a very small minority of meetings where we may not vote any resolutions. In 2020, this included meetings where Powers of Attorney were missing or late as well as instances of share-blocking where we chose not to vote in order to avoid the risk to trading. There was also a rejected vote in November which was submitted late due to an operational complication.

Monitoring our shares and voting rights

As highlighted previously, EOS' approach is to focus engagement resource on the meetings of greatest interest and materiality to our investment teams and its third-party clients. Each year we compile a list of the highest-priority companies where we want to ensure that our engagers are manually reviewing each agenda item for any vote that comes up. These are known as watchlist companies and are comprised of our engagement programme firms, companies of particular interest/sensitivity or those where our investment teams or EOS third-party clients represent significant holdings (in absolute terms or as a percentage of the company's voting rights). The voting watchlist represents a majority of EOS' AUA by value. EOS uses ISS to identify the meetings for which we have voting rights. EOS ensures accounts are suitably set up for voting.

Monitoring service providers

We use the services of ISS to provide research on all companies for which EOS makes voting recommendations. EOS leverages and builds on ISS research and infrastructure (including the ISS ProxyExchange platform) and seeks to add value primarily by selectively escalating the most important or difficult voting recommendations (based on the materiality of holdings and the nature of the issues under consideration), engaging with companies and operating voting policies and approaches that more closely align to our views than ISS's benchmark policy.

The recommendations that our investment teams and EOS third-party clients receive are, in the first instance, based on ISS's research using our voting guidelines. This is then overlaid with our intelligent voting approach. Engagers are deployed to add insight and value to a specific subset of these meetings – those on EOS' watchlist – by considering the voting recommendations approach in light of the specific company context and the engagement. As described earlier, our equity holdings are added to the EOS watchlist at the beginning of each year. As a result, the majority of the voting recommendations made to our investment teams are manual.

Fixed income: how we use our investor rights

Our Real Estate Debt team does not habitually buy into deals that have already been structured. As a result, we have the opportunity to negotiate transaction documents ourselves. We seek to find mutually beneficial outcomes, while protecting the interests of our clients. Our approach to seeking amendments differs case to case, depending on the nature of the amendment. We aim to embody the values captured in the Federated Hermes Pledge in all of our dealings.

Meanwhile, our direct-lending loan agreements are bespoke agreements that are negotiated between the lender and the borrower after we have conducted our due diligence. We construct the loan documentation to align it to the specific borrower and their behaviours, including issues identified in our ESG due diligence. Each loan contract is different, and we may require the borrower to change certain behaviours (including in relation to ESG risks) as part of the conditions. The key point at which we can seek to influence the company's behaviour after the contract has been agreed is when the borrower seeks to alter the loan terms – for example, because the company wishes to make an acquisition. Otherwise, we will engage with management or the private-equity shareholder through the resources we have internally to influence behaviours through dialogue. However, we are not able to amend the conditions of the loan.

For credit and structured-credit markets, the chance to influence such documentation comes at the time of primary issuance. If the documentation is unfavourable to the interests of creditors, this is a risk factor and we will engage with the company to improve it. If we are unable to achieve these changes, they will become a factor in our investment decision and will influence how we choose to allocate our risk. For example, we may reduce our planned exposure, invest in the security with the lowest risk (in the case of structured credit, this would involve a security further up the capital structure) or avoid the investment altogether. For example, governance concerns meant that we decided not to invest in a bond issuance of an elevator company. Even after the terms were revised and became closer to a typical sponsor deal, we believed the aggressiveness of the entire deal process raised concerns about the firm's corporate governance.

Within structured credit, an essential part of the due-diligence process is to review the prospectus and transaction documents. These govern the noteholders' relationship to the special purpose vehicle (SPV), the assets within and the related counterparties. We pay particular attention to the ability of the SPV to pay interest and the principal on notes under multiple stress scenarios, which includes an assessment of the triggers and covenants in the deal and our enforcement rights over the assets in the collateral pool. We also ensure the transaction complies with all relevant regulation and any

[30] Individual shares may be double counted where there were multiple meetings during 2020.

appropriate safeguards for future changes to regulations. Once the prospectus and transaction documents have been thoroughly reviewed, we work alongside the issuers, originators, sponsors and/or arranging banks to secure any amendments in the documentation that we feel are necessary to protect our position as a noteholder in the capital structure.

We seek access to information provided in all documentation through engagement with the company. The more information we have, the less the uncertainty there is. This in turn may increase our willingness to take on more risk.

Impairment and enforcement rights

The relevant rights for real-estate debt are enforcement rights, which are available when there is a breach of documentation. We only use enforcement as a last resort and first seek to engage and agree an alternate approach where possible with the party in breach. As we are often the sole lender, we are able to hold these bilateral conversations directly with the recipient of the loan. During 2020, we have been lenient when the pandemic crisis resulted in breaches of the agreed terms. For example, some of our loans have conditions that rental income must remain a specified percentage higher than the interest cost. However, we did not seek enforcement action when rental income dropped due to poor rental-market conditions. However, our actions must ultimately be in the best (long-term) interest of our clients, meaning that Covid-19-related issues could potentially lead to enforcement if the recovery of the loan is at risk.

As each of our direct-lending loan agreements is bespoke, our specific rights can vary. If a borrower defaults on a loan – for example, if an interest payment is missed or the borrower fails a covenant test – our Direct Lending team will enter into a negotiation with both the shareholder and the management team of the borrower. We will seek a positive outcome for all parties involved in the negotiation, although we will always act in our investors' interests in line with our fiduciary duty. We have a right to take security over the shares of the borrower in such circumstances but will always seek to find other solutions before taking this action.

In a distressed situation, value is impaired and will be redistributed among financial stakeholders. When we invest, we seek to understand what our recovery risk associated with the impairment of assets would be. If a company is in distress, an organised group of bondholders can decide whether to enforce their rights or not, although this is very rare. We want the appropriate right to recovery of a failed business. In some cases, bond documentation is written so that there is a carveout or 'trap door', meaning that the assets which support the that bond we are buying can be transferred outside of the restricted group. This would be a significant disincentive to invest and we would communicate this to the bank or company. Under certain situations we would not invest, as we would not have what we deem to be appropriate rights under a distressed scenario.

Annex – Shareholder Rights Directive II Annual Reporting

This report fulfils the reporting requirements for the international business of Federated Hermes ('Federated Hermes') – including Hermes Investment Management Limited, Hermes European Equities Limited, Hermes Fund Managers Ireland Limited and Hermes Alternative Investment Management Limited as asset manager – under Annex C of the EU Shareholder Rights Directive II (SRDII) and as required by the Financial Conduct Authority (FCA) Conduct of Business Sourcebook (COBS) 2.2B.

To meet the requirements of the SRDII and FCA COBS 2.2B, we maintain a separate Engagement Policy, available online. The following disclosure sets out how we meet the other requirements of SRDII and FCA COBS 2.2B, including reporting against this Engagement Policy. Where the requirements are not already fulfilled by the information contained earlier in this report, we have included the required disclosures later in this Annex.

As per FCA COBS 2.2B.5, a firm must disclose on an annual basis how its engagement policy has been implemented. These disclosures are included in the following location in the earlier reporting:

- How we have integrated shareholder engagement in our investment strategy is described under Principle 7.
- How we have monitored investee companies on relevant matters – including strategy, financial and non-financial performance and risk, capital structure and social and environmental impact and corporate governance – is described under Principles 7 and 9
- How we have conducted dialogues with investee companies is described under Principles 7 and 9.
- How we have exercised voting rights and other rights attached to shares is described under Principle 12, with relevant information about how we engage and escalate under Principles 9 and 11.
- How we have cooperated with other shareholders is described under Principle 10.
- How we have communicated with relevant stakeholders of the investee companies is described under Principle 10.
- How we have managed actual and potential conflicts of interest in relation to our engagement is described under Principle 3

As per FCA COBS 2.2B.7, a description of our general voting behaviour and how we have cast votes in the general meetings of companies in which we hold shares is included under Principle 12. We do not use proxy advisors, as explained under Principle 8.

As described further Principle 6, to ensure that we continue to manage our assets in line with the approach we market to prospects and agree with clients, our Compliance department monitors fund guidelines.

As per FCA COBS 2.2B.9, a firm must make certain disclosures available to its institutional investor clients. The international business of Federated Hermes has chosen to do so by including the relevant disclosures in this report. The required disclosures are included in the following location:

- How our investment strategy and the implementation of it contributes to the medium- to long-term performance of the assets for our investors is described under Principles 6 and 7, where we explain the length of time horizon we consider appropriate to deliver to the needs of our clients and how we have aligned our investment approach accordingly. Our approach is in line with our investment beliefs as set out under Principle 1.
- The key material medium- to long-term risks associated with the investments are predominantly covered under Principles 4 and 7 (particularly in relation to the issues prioritised for assessing investments) although the description of our investment beliefs under Principle 1 is also relevant.
- Portfolio composition, turnover and turnover costs are included later in this annex.
- The extent to which proxy advisors are used is covered under Principle 8, with relevant information also included under Principle 7 in relation to the use of service providers. Under Principles 5 and 12, we describe the use of ISS research in relation to the inputs to our voting recommendations and decisions.
- Our policy on securities lending and how this is applied to support the firm's engagement activities if applicable, particularly at the time of the general meeting of the investee companies, is described under Principle 12.
- How we make investment decisions based on an evaluation of medium- to long-term performance of an investee company, including non-financial performance, is covered under Principle 7.
- Potential conflicts of interests that have arisen in connection with engagement activities and how the we have dealt with these instances is described under Principle 3.

Portfolio composition, turnover and turnover costs.

As required by the regulation, for pooled funds, information regarding turnover rates, top portfolio holdings and transaction costs is included below. For segregated mandates, information is provided to the relevant clients directly and is not disclosed publicly without specific client permission.

A) Turnover and portfolio composition

Account name	SEC Turnover Annual* 12 months to 31/12/2020	Top 10 Portfolio Holdings as at 31/12/2020
Federated Hermes Absolute Return Credit Fund	19.8%	BHP Billiton: 2.00% Telefonica: 1.97% CNH Industrial: 1.97% NXP Semiconductor: 1.96% ArcelorMittal: 1.92% Telecom Italia: 1.85% Lennar: 1.80% Crown Americas: 1.76% Abbvie: 1.74% General Motors: 1.64%
Federated Hermes Asia ex-Japan Equity Fund	50.7%	Samsung Electronics: 8.75% ASE Technology: 4.33% Taiwan Semiconductor Mftg: 4.10% CK Hutchison: 3.71% Alibaba (ADR): 3.39% Baidu (ADR): 3.36% JD.com (ADR): 3.25% Yunnan Baiyao: 3.17% Kumho Petrochemical: 3.11% Tingyi: 2.94%
Federated Hermes Emerging Asia Equity Fund S.P	71.3%	Samsung Electronics: 9.28% Alibaba (ADR): 4.27% JD.com (ADR): 3.64% Kisco: 3.39% Cosco Shipping International: 3.37% Kerry Logistics: 3.34% ASE Technology: 3.27% JD.com: 2.86% Metropolitan Bank: 2.55% Sinopec Engineering: 2.50%
Federated Hermes Europe ex-UK Equity Fund	23.6%	ASML: 5.96% Orsted: 4.30% Novo Nordisk: 4.12% Adidas: 4.02% Sika: 3.86% Siemens Gamesa: 3.62% Merck: 3.62% ASM International: 3.58% Hella GMBH: 3.42% Lonza Group: 3.23%
Federated Hermes European Alpha Equity Fund	18.6%	ASML: 6.08% Adidas: 4.30% Lonza Group: 3.97% Novo Nordisk: 3.91% Merck: 3.78% Siemens Gamesa: 3.75% Sika: 3.65% Pandora: 3.60% Deutsche Boerse: 3.38% Amadeus IT: 3.22%

Account name	SEC Turnover Annual* 12 months to 31/12/2020	Top 10 Portfolio Holdings as at 31/12/2020
Federated Hermes Global Emerging Markets Equity Fund	27.8%	Samsung Electronics: 8.92% Taiwan Semiconductor Mftg: 6.75% Tencent: 6.55% Alibaba (ADR): 5.52% Delta Electronics: 3.25% Techtronic Industries: 2.57% Nari Technology: 2.44% Sberbank: 2.34% AIA: 2.32% Grupo Financiero Banorte: 2.32%
Federated Hermes Global Emerging Markets SMID Equity Fund	35.4%	Delta Electronics: 4.59% SINBON Electronics: 3.69% Accton Technology: 3.43% SITC International: 3.38% Shenzhen International: 2.54% Samsonite: 2.48% Baozun (ADR): 2.31% LandMark Optoelectronics: 2.28% NC Soft: 2.27% Techtronic Industries: 2.21%
Federated Hermes Global Equity ESG Fund	16.5%	Apple: 3.98% Amazon: 3.22% Microsoft: 2.93% Samsung Electronics: 2.47% Walt Disney: 2.39% ASML: 2.12% Lonza Group: 2.03% Thermo Fisher: 1.98% Abbott Laboratories: 1.87% Taiwan Semiconductor Mftg: 1.80%
Federated Hermes Global Equity Fund	15.2%	Apple: 3.86% Microsoft: 3.64% Amazon: 3.00% Walt Disney: 2.06% ASML: 2.05% Alphabet A: 2.04% Procter & Gamble: 1.33% Visa: 1.33% AIA: 1.32% Accenture: 1.31%
Federated Hermes Global High Yield Credit Fund	31.7%	Toll Brothers: 1.88% Enbridge: 1.82% BHP Billiton: 1.77% Ball Corporation: 1.72% Lennar: 1.65% Ardagh Packaging: 1.55% Enterprise Products: 1.46% Ally Financial: 1.39% Anglo American: 1.33% Barclays: 1.29%
Federated Hermes Global Small Cap Equity Fund	16.6%	IMCD: 2.66% Nifco: 2.55% Brooks Automation: 2.43% RPM International: 2.32% WD-40: 2.31% Brunswick: 2.25% Yaoko: 2.18% Silicon Laboratories: 2.17% Jungheinrich: 2.17% Aalberts: 1.98%
Federated Hermes Impact Opportunities Equity Fund	18.9%	Orsted: 4.98% Hannon Armstrong: 4.60% Siemens Gamesa: 4.41% DexCom: 4.11% Lonza Group: 4.01% Xylem: 4.00% Qiagen: 3.98% Agilent Technologies: 3.87% Novo Nordisk: 3.74% ANSYS: 3.65%

Account name	SEC Turnover Annual* 12 months to 31/12/2020	Top 10 Portfolio Holdings as at 31/12/2020
Federated Hermes Multi Strategy Credit Fund	51.6%	Ford: 3.18% Abbvie: 2.86% Kinder Morgan: 2.80% BHP Billiton: 2.71% ArcelorMittal: 2.58% Toll Brothers: 2.53% Lennar: 2.52% HCA Holdings: 2.45% Enterprise Products: 2.39% Telecom Italia: 2.22%
Federated Hermes SDG Engagement Equity Fund	11.2%	AptarGroup: 3.08% Techtronic Industries: 3.06% IMCD: 2.96% AMN Healthcare Services: 2.91% RPM International: 2.88% Brunswick: 2.82% Huhtamaki: 2.77% The Cooper Companies: 2.77% Nifco: 2.73% Silicon Laboratories: 2.73%
Federated Hermes SDG Engagement High Yield Credit Fund	0.0%	Ziggo: 1.91% Telecom Italia: 1.85% Ball Corp: 1.79% Petrobras: 1.59% Grifols: 1.54% Ardagh Packaging: 1.53% Virgin Media: 1.50% Crown Holdings: 1.50% Berry Global: 1.48% IQVIA: 1.40%
Federated Hermes Unconstrained Credit Fund	66.0%	BHP Billiton: 1.85% Telecom Italia: 1.77% Fiat: 1.67% Ziggo: 1.59% Ball Corporation: 1.50% Abbvie: 1.50% Virgin Media: 1.46% Ardagh Packaging: 1.43% EDF Energy: 1.39% Berry Global: 1.37%
Federated Hermes US High Yield Credit Fund**	***	Ford Motor Co.: 2.6% Bausch Health Cos, Inc.: 2.3% CSC Holdings LLC: 2.1% Charter Communications, Inc.: 2.1% Occidental Petroleum Corp.: 1.7% HCA Holdings, Inc.: 1.5% Centene Corp.: 1.5% TransDigm, Inc.: 1.4% Tenet Healthcare Corp.: 1.3% Hub International Ltd.: 1.2%
Federated Hermes US SMID Equity Fund	42.0%	PTC: 2.83% Teradyne: 2.73% Wintrust Financial: 2.70% Brooks Automation: 2.56% Palomar: 2.55% CarGurus: 2.41% Silicon Laboratories: 2.40% Fortune Brands Home & Security: 2.36% Power Integrations: 2.30% Terminix Global: 2.30%

Note: for credit funds listed above, we have provided the top 10 issuers of the portfolio rather than the top 10 holdings. All top holdings/issuers listed are absolute.

* SEC Turnover = (Lesser of Purchase or Sales)/Average Market Value (Excluding Cash and Futures).
** Federated Investment Counseling has been appointed by Hermes Fund Managers Ireland Limited as the Investment Manager for this fund.
***This fund was launched during 2020, and therefore annual turnover figures for 2020 are not available.

B) Transaction Costs

The cost disclosures below are those prescribed under MiFID regulation.

Account name	Currency	Total Transaction Cost * 12 months to 31/12/2020	Total Transaction Cost – % of Investment ** 12 months to 31/12/2020	Implicit Cost *** 12 months to 31/12/2020	Implicit Cost – % of Investment ** 12 months to 31/12/2020	Explicit Cost **** 12 months to 31/12/2020	Explicit Cost – % of Investment ** 12 months to 31/12/2020
Federated Hermes Absolute Return Credit Fund	USD	0	0.00%	0	0.00%	0	0.00%
Federated Hermes Asia ex-Japan Equity Fund	USD	5,497,497	0.22%	549,094	0.02%	4,948,403	0.20%
Federated Hermes Emerging Asia Equity Fund S.P	USD	463,187	0.30%	0	0.00%	463,187	0.30%
Federated Hermes Europe ex-UK Equity Fund	EUR	320,650	0.45%	260,274	0.37%	60,375	0.08%
Federated Hermes European Alpha Equity Fund	EUR	48,962	0.04%	0	0.00%	48,962	0.04%
Federated Hermes Global Emerging Markets Equity Fund	USD	9,109,170	0.17%	3,175,067	0.06%	5,934,103	0.11%
Federated Hermes Global Emerging Markets SMID Equity Fund	USD	322,875	0.16%	103,014	0.05%	219,861	0.11%
Federated Hermes Global Equity ESG Fund	USD	1,409,496	0.13%	931,537	0.08%	477,959	0.04%
Federated Hermes Global Equity Fund	USD	38,761	0.15%	28,921	0.11%	9,840	0.04%
Federated Hermes Global High Yield Credit Fund	EUR	0	0.00%	0	0.00%	0	0.00%
Federated Hermes Global Small Cap Equity Fund	USD	48,902	0.06%	28,665	0.03%	20,237	0.02%
Federated Hermes Impact Opportunities Equity Fund	USD	938,452	0.33%	730,613	0.25%	207,839	0.07%

Account name	Currency	Total Transaction Cost * 12 months to 31/12/2020	Total Transaction Cost – % of Investment ** 12 months to 31/12/2020	Implicit Cost *** 12 months to 31/12/2020	Implicit Cost – % of Investment ** 12 months to 31/12/2020	Explicit Cost **** 12 months to 31/12/2020	Explicit Cost – % of Investment ** 12 months to 31/12/2020
Federated Hermes Multi Strategy Credit Fund	USD	941,610	0.14%	913,902	0.13%	27,708	0.00%
Federated Hermes SDG Engagement Equity Fund	USD	2,883,410	0.36%	2,266,509	0.28%	616,900	0.08%
Federated Hermes SDG Engagement High Yield Credit Fund	USD	401,849	0.10%	394,442	0.10%	7,406	0.00%
Federated Hermes Unconstrained Credit Fund	USD	934,088	0.16%	703,224	0.12%	230,864	0.04%
Federated Hermes US High Yield Credit Fund*****	USD	76,455	0.90%	76,455	0.90%	–	0.00%
Federated Hermes US SMID Equity Fund	USD	4,130,360	0.54%	3,793,702	0.50%	336,658	0.04%

Note: Negative transaction costs have been rounded up to zero.

* Transaction costs are the costs associated with buying and selling the securities within the fund. There are two types of transaction costs: explicit costs and implicit costs.

** Average value of portfolio for the 12 months to 31 December 2020 is used as investment amount to calculate the percentage of transaction cost/implicit cost/explicit cost.

*** Notional costs of buying and selling underlying assets. Implicit Costs are not an actual discrete cost charged to a fund, implicit costs under the Arrival Price methodology relate to the cost differential between the mid-market price of an asset immediately before the order is placed in the market and the price that the deal is struck at. It represents the cost of taking an asset into a fund.

**** Explicit cost is actual costs incurred buying and selling underlying assets.

***** Federated Investment Counseling has been appointed by Hermes Fund Managers Ireland Limited as the Investment Manager for this fund.

Sustainability and investment glossary

Active ownership
Actively exercising shareholder rights by voting at meetings and engaging with companies to encourage responsible corporate behaviour.

Carbon footprint
A measure of a group, individual or a company's total greenhouse gas emissions.

Carbon pricing
The economic cost of emitting CO_2 into the atmosphere, either in the form of a fee per unit of emissions or an incentive for reducing emissions.

COP
An annually held UN conference. The Paris Agreement was negotiated at the 21st conference in 2015.

Corporate governance
The system of rules, practices and processes by which a company is managed, directed and controlled.

Corporate responsibility
A company's duty to operate in a manner that does not harm the environment or society, and to take responsibility for its actions and their impact on employees, stakeholders and communities.

Divestment
A form of negative screening through the process of selling investments that are not aligned with ESG objectives.

Engagement
A purposeful, long-term dialogue between a company and its shareholders that aims to change or influence the way in which a company is run, in order to enhance the value of the firm and generate positive environmental and social outcomes.

ESG
Environmental, social and governance issues that constitute the three pillars of responsible investing.

ESG integration
An investment approach that integrates sustainability and ESG-related factors into the investment decision-making process.

Exclusion
The process of excluding sectors or companies from a portfolio if they do not meet specific ESG-related criteria.

Fiduciary duty
Fiduciary duties ensure that those who manage other people's money act in the interests of beneficiaries, rather than serve their own interests.

Green bond
Debt securities which are used to fund projects with environmental benefits.

Greenwashing
The act of making a product, service or organisation seem more environmentally friendly than it actually is.

Impact investing
Investing in order to achieve a measurable, positive impact on the environment or society, in addition to generating financial returns.

Integrated reporting
Company reporting that integrates both sustainability and financial information in one source.

Negative screening
An investment approach that excludes some companies or sectors from the investment universe due to their policies, actions, products or services.

Paris Agreement
An international accord, agreed at COP 21 in Paris in 2015, that aims to keep the rise in global average temperatures below 2°C compared to pre-industrial levels, while pursuing efforts to limit the increase to 1.5°C.

Positive screening
An investment approach that seeks to include companies from the investment universe due to their policies, actions, products or services.

Principles for Responsible Investing
Developed by investors, the six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a set of possible actions for incorporating ESG issues into investment practices.

Proxy voting

A ballot cast by one person on behalf of the others. As many shareholders cannot attend annual and special meetings, companies allow shareholders to cast proxy votes.

Responsible investing

An investment approach that considers ESG-related factors and incorporates engagement and stewardship activities to better manage risk, create positive societal impacts and generate sustainable, long-term financial returns.

Shareholder activism

A form of public engagement by which investors use their shareholdings to promote change at a company and achieve certain goals.

Shareholder Rights Directive II

A directive from the European Union that aims to strengthen the position of shareholders and to ensure that decisions are made for the long-term stability of a company.

Social bond

Debt instruments that raise funds for projects with positive social outcomes.

Stewardship

A dialogue between shareholders and boards that aims to ensure that the firm's management and strategy are effective and aligned with shareholders' interests. A focus on ESG issues helps to mitigate risk and produces positive outcomes for society and the environment.

Stewardship codes

Codes that offer guidance on investor engagement and transparency about how investors should exercise their ownership and governance responsibilities. The first stewardship code was introduced in the UK in 2010 and almost all OECD jurisdictions now have national codes or principles.

Sustainable Development Goals

Published by the UN in 2015, the Sustainable Development Goals are a set of 17 objectives that aim to improve human society, ecological sustainability and quality of life.

Sustainable investing

A long-term, active approach to investing that is efficient and intergenerationally fair to all beneficiaries and stakeholders, combining an analysis of ESG factors and active ownership.

UN Global Compact

A global corporate sustainability initiative that calls on companies, investors and other participants to align their strategies and operations with universal principles on human rights, labour, the environment and anti-corruption.

Federated Hermes

International

Federated Hermes

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

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

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

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

Our investment and stewardship capabilities:

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

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

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SAI GLOBAL
ISO 14001
Environmental