

Dear Sir/Madam

EOS at Federated Hermes engages with companies around the world on behalf of global institutional investors, representing assets of US\$1.71tn (September 30, 2021). We aim to deliver sustainable wealth creation that enriches investors, benefits society and preserves the environment – for current generations and those to come. This aim informs our expectations of the companies in which we and our clients are invested.

It is our strong belief that companies can only create and preserve long-term, good quality returns for investors if they provide goods and services that sustainably solve societal needs, guided by a clear purpose that serves not only shareholders, but also other stakeholders, society and the environment. Doing this effectively requires robust governance, a healthy culture and leadership that sets the right tone from the top and emphasizes ethical values across the organization.

US Corporate Governance Principles

Our expectations are detailed in our enclosed 2022 US Corporate Governance Principles. We would like to highlight the following expectations for US-listed companies in 2022:

- **Climate change:** Earlier this year, the international business of Federated Hermes signed up to the Net Zero Asset Managers initiative (NZAM). As of November 15, 2021, this initiative now has the support of 220 signatory managers with \$57 trillion of assets under management¹ (55% of global AUM). Signatories to NZAM have committed to “implement a stewardship and engagement strategy, with a clear escalation and voting policy, that is consistent with [the] ambition for all assets under management to achieve net zero emissions by 2050 or sooner.” Additionally, the US Securities and Exchange Commission (SEC) provided climate disclosure guidance in 2010 and more recently has been reviewing if current disclosures provide adequate information.² In 2022, we will continue to hold the chair of the nominating and governance committee or other responsible directors accountable through our voting recommendations where we believe companies’ actions are materially misaligned with the goals of the Paris Agreement or where company disclosures or responsiveness are insufficient. We assess companies using a range of frameworks and benchmarks, including the Transition Pathway Initiative (TPI),³ the Climate Action 100+,⁴ Forest 500⁵ and others. In principle, we support the emergence of so-called ‘Vote on Transition’ or ‘Say on Climate’ resolutions and will support those plans aligned to the goals of the Paris Agreement, as indicated by short, medium and long-term science-based greenhouse gas reduction targets and a clear and credible strategy to achieve these.
- **Diversity, equity and inclusion:** Many companies continue to fall short of reflecting the diversity of society on their boards, in senior management and throughout the workforce. We strongly advocate for boards of diverse composition, in its broadest sense, and for the execution of meaningful workforce-level diversity, equity and inclusion strategies. In 2022, we strengthened our expectations on diverse

¹ <https://www.netzeroassetmanagers.org/>

² <https://www.sec.gov/news/public-statement/lee-climate-change-disclosures>

³ <http://www.lse.ac.uk/GranthamInstitute/tpi/the-toolkit/>

⁴ <https://www.climateaction100.org/progress/net-zero-company-benchmark/>

⁵ <https://forest500.org/>

representation and will consider recommending votes for relevant proposals or against the election of directors at companies that we judge to be making insufficient progress on diversity. At the largest companies, we expect 50% overall board diversity which could include characteristics such as gender, race, ethnicity, sexual orientation and disability. We expect at least 30% gender diversity and one or more ethnically or racially diverse directors within the 50%.

- **Human and labor rights:** How a company manages its human rights strategy is of critical importance to its license to operate, its impact on people's lives and ultimately its ability to create and preserve long-term holistic value. Starting in 2022, we will consider recommending votes for relevant proposals or against the election of directors, where a company is in clear breach of its applicable regulatory responsibilities or those outlined in the UN Guiding Principles on Business and Human Rights, and/or if there is sufficient evidence that a company has caused or contributed to egregious, adverse human rights impacts or controversies and has failed to provide appropriate remedy.
- **Executive pay:** We continue to make the case for simpler pay schemes aligned to long-term strategy and the desired culture in the organization, with an emphasis on long-term share ownership for executives. We seek to understand how executive remuneration decisions are made with consideration to a company's broader stakeholders and expect the board to intervene and apply appropriate discretion where pay outcomes do not align with these expectations. In the US, we continue to be concerned that executive pay is often far too high and not incentivizing appropriate long-term managerial behavior, corporate culture or financial outcomes. We expect executive pay to align with these expectations and to consider and respect the economic burden imposed on stakeholders by the pandemic. In 2022, we may recommend opposing pay schemes where the overall quantum of pay appears excessive. At the largest companies, we expect executives to hold 8 to 10 times their base salary in shares for at least two years past their departure.
- **Auditor Tenure:** High quality, effective audits are vital to ensure that markets trust and have confidence in the information companies report. Additionally, the auditors' role in assessing climate change impacts on asset valuation is gaining attention. We believe that auditor independence, and potentially audit quality, is at risk when the same assurance provider is maintained for too long. In 2022, we will begin considering recommendations against audit firm ratification and audit committee members if there has been no review or consideration of auditor rotation after 20 years.

We welcome any comments and observations on our 2022 Corporate Governance Principles and would be glad to answer any queries or concerns they may raise.

Yours sincerely

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Corporate Governance Principles

United States

Our expectations of
US-listed companies

**EOS at Federated Hermes
2022**

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Corporate Governance Principles: Our expectations of publicly-listed companies in the United States

2022

INTRODUCTION

EOS at Federated Hermes is a stewardship service provider representing a broad range of long-term institutional investors. EOS clients seek to be active stewards of their beneficiaries' assets by being active owners of shares or debt of the companies in which they invest. EOS engages with our clients' investee companies around the world to promote long-term, sustainable returns to investors, their beneficiaries, and other stakeholders.

These Principles express our expectations of board directors and companies across a number of important strategic and governance topics, focusing on areas which will inform the policies which guide our voting recommendations for 2022.

This document is not exhaustive. More detail on our expectations, particularly on environmental and social topics, can be found in our **Public Engagement Plan**,¹ which is updated annually.

COMPANY PURPOSE, CULTURE AND ETHICAL LEADERSHIP

Ethical leadership and company purpose

Principle

The board must set and find effective ways to oversee the integrity of the organization's ethical values. Ethical considerations must underpin every decision made by the board and management. For example, the board must ensure that its CEO has the highest ethical standards and should not accept any lapses in that expectation during the CEO's time in office or beforehand. Boards should perform sufficient due diligence and have strong contractual provisions to enable the board to take sufficient action, including clawing back pay and dismissal for cause, should unethical behavior come to light.

It is our strong belief that companies can only create and preserve long-term, good quality returns for investors if they provide goods and services that sustainably solve societal needs. To achieve this, we expect companies to be guided by a purpose that serves not only shareholders, but also other stakeholders, society, and the environment. Achieving this purpose will require a healthy culture and an emphasis on ethical values across the organization. The pursuit of a stakeholder-inclusive purpose in support of long-term societal interests will help protect the long-term interests of the savers and pensioners – current and future – invested in companies, who require sustainable

¹ The latest public version of the EOS Engagement Plan can be found at: www.hermes-investment.com/stewardship/eos-library

financial returns and an economy, society and environment which can provide a secure future. This will require review of those critical environmental, social and governance (ESG) related issues of concern to the company and its stakeholders, such as climate change or human rights, through an ethical lens.

A clear and meaningful business purpose should enable business leaders to identify the right things to do in the short term in order to fulfil their purpose over the long term. This is critical in a time of crisis – such as that caused by the Covid-19 pandemic – when difficult trade-offs arise, particularly between shorter-term financial returns and maintaining strong relationships with key stakeholders, including government, the workforce, customers, and supply chains. We expect companies to continue to follow SEC April 2020 guidance² on the importance of issuing forward looking stakeholder inclusive disclosures as the impacts of the Covid-19 pandemic continue, likely into the long term.

Our expectations

1. The board must ensure that a system exists to take various soundings of the culture in different parts of the organization and ensure that both the board and management take action to improve the culture where it is not aligned with the board's expectations. Such actions should include robust, accessible feedback and whistleblowing systems together with a demonstrable commitment to protect those who speak up from retaliation.
2. Companies need to be able to explain decisions affecting key stakeholders. This includes the most difficult decisions, such as layoffs, but also how they allocate capital, including dividend payments and share buybacks, and their public policy activity.
3. We expect boards to consider and disclose capital allocation policy in the context of a company's purpose and long-term strategy. We are concerned that buybacks and similar diversions from re-investment in key stakeholders may be chosen to improve the share price or other related metrics over the short-term but are not always the best use of capital to support the creation of long-term, sustainable returns.
4. We are supportive of alternative corporate structures that explicitly mandate the consideration of key stakeholders alongside shareholders such as a B Corporation or Public Benefit Corporation (PBC), where companies believe this to be beneficial in service of their purpose. Corporations do not necessarily need to convert to a PBC or similar, to enact purpose driven leadership. We believe corporations can demonstrate purpose and serve stakeholders other than shareholders through existing corporate structures.

² [SEC.gov | The Importance of Disclosure – For Investors, Markets and Our Fight Against COVID-19](https://www.sec.gov/News/Press/2020/20200413/secpr02020001)

5. The board, and in particular the independent directors, should own and publish the company's stakeholder-inclusive purpose. We hold boards responsible for ensuring that management fulfils the company's long-term purpose, given that strategic decisions should transcend management tenure.³

Stewardship and engagement

Principle

Investors must act as responsible stewards and promote long-term sustainable returns on investment through constructive engagement with companies and their directors. All substantive correspondence from major institutional investors' representatives should be shared promptly with all board members to help directors fulfil their role to safeguard the interests of all shareholders. Our experience has shown that dialogue between companies and committed, long-term investors on strategy, finance, risk management and material ESG issues can improve the governance and performance of companies. Developing relationships of trust with long-term shareholders can be invaluable for boards. We expect chairs and independent directors to make themselves available for investor engagement, beyond opportunities at formal shareholder meetings.

Our expectations

1. We expect companies to engage with long-term investors across a range of asset classes, including different types of corporate debt. Companies should now recognize that the expectations of debt investors are similar to those of long-term shareholders and substantially aligned in relation to governance, long-term strategy, capital allocation and environmental and social matters. Debt investors now expect accountability and constructive dialogue on opportunities and risks which might enhance or impair earnings and cashflow.
2. We expect companies to embrace shareholder rights positively and to use constructive shareholder engagement rather than procedural methods to stifle legitimate debate around governance, strategy, and sustainability matters.
3. Companies' developing and maintaining positive relationships with their long-term shareholders is the best way in which to mitigate shorter-term investors agitating for measures that may damage the company's longer-term strategy and undermine corporate purpose.

³ For more information and guidance for directors, see: <https://www.hermes-investment.com/us/eos-insight/eos/whats-the-purpose-of-business-purpose/>

BOARD COMPOSITION AND EFFECTIVENESS

Principle

The composition of the board contributes to its effectiveness. Having the right mix of directors who bring diverse perspectives, business and professional experiences and skills provides a foundation for robust dialogue and decision-making.

Our expectations

1. Board members should have strong ethics and diverse skills, along with the experience, perspectives, and psychological attributes, as well as sufficient independence and strength of character to challenge, advise and support executive management teams.
2. Boards should ensure their overall composition and individual membership is frequently reviewed and refreshed, and that directors are elected and re-elected by shareholders on a regular basis to ensure accountability.
3. Biographies and color photographs for all directors should be provided to shareholders, indicating which are considered independent and the attributes that they bring to the board.
4. This should be accompanied by an analysis of how the board as a whole displays the necessary skills, independence, diversity, and other attributes to meet the company's evolving needs. While more difficult to disclose, boards should also take account of directors' psychological characteristics and personal leadership styles.
5. Directors should be held accountable to shareholders by standing for election on an annual basis. We expect companies with a classified board to disclose a sunset date for this structure and will consider opposing standing members of the governance committee, or longest serving director, when such a sunset is not disclosed.

Effectiveness

Principle

Disclosure of measurable aspects of boards, such as those outlined below, are important but insufficient indicators of a board's functionality.

Engagement with board directors provides a valuable opportunity for investors to sufficiently assess how well a board is functioning. Our white paper, **Guiding Principles for an Effective Board**,⁴ highlights the factors that we consider to be most important in

⁴ <https://www.hermes-investment.com/wp-content/uploads/2020/04/guiding-principles-for-an-effective-board-april-2020.pdf>

determining board effectiveness, focusing on the human, relational, and behavioral elements that are more difficult to assess.

Our expectations

1. We expect genuine independence, diversity and inclusion on boards which enables the ability of directors to effectively question long-held assumptions and mitigate the risk of groupthink.
2. The role of the chair should be held by an independent director to support the overall conditions for board effectiveness, which include setting and enforcing the expectations for a board culture that is based on mutual respect, openness, and trust, and encouraging diverse voices and behaviors of independent thinkers.
3. We expect the board to allocate its time spent in board meetings and, equally important, between board meetings to strategy and other forward-looking activities such as committee work, site visits and stakeholder engagement.
4. The board's relationship with the CEO should ideally be characterized by transparency, trust, and constructive collaboration, and we expect the board to build relationships with the wider employee workforce through formal and informal channels and to receive periodic reports on grievances, non-compliance and whistleblowing.
5. We encourage a board commitment to continuous improvement supported by regular board evaluations, with disclosure of the evaluation process striking a balance between transparency and confidentiality.
6. We expect boards to disclose relevant skills, experience, and attributes that each director nominee brings to the board, including climate and other ESG skills and experience.
7. We expect directors to become highly knowledgeable about the company's strategy and material risks as part of a board's effectiveness in its decision-control function. Each director must satisfy themselves, within their independent business judgement, that the executive team is managing these risks prudently and with sufficient expertise, before ratifying management decisions and when making board-reserved decisions. If we deem a board to not be adequately overseeing or disclosing risks, we may recommend voting against individual directors. This includes climate, racial equity and human rights risks as well as other material environmental and social issues and risks stemming from the Covid-19 pandemic.

Evaluation

Principle

We believe boards should be constantly reflecting on their performance to support continuous improvement. We encourage boards across markets and corporate structures to conduct regular evaluations of themselves and their performance with the goal of enhancing board effectiveness. When conducted with this intention, and not simply as a compliance exercise, the evaluation process offers a unique opportunity for the board to pause, reflect and optimize its performance.

Our expectations

1. We expect the board to embrace the evaluation process as an opportunity to recalibrate focus, identify skills gaps on the board, highlight the need for succession, and raise concerns related to performance and culture.
2. Boards should conduct regular effectiveness and performance evaluations to signal to investors that it is open to constructive criticism and willing to improve. We recommend that independent external board evaluations are conducted at least once every three years, with internal evaluations conducted in the interim years. Boards should disclose to investors how the board conducts these self-evaluations on how the board, its committees and individual directors can improve ethical integrity, performance, composition, structure, and processes.
3. Disclosure should demonstrate how the board has taken the necessary steps to enhance performance and provide reassurance to investors about the quality of the board evaluation.
4. The board should implement an action plan and a clear timeline for addressing the points raised in the evaluation.
5. Nomination committees should carefully explore each director's and possible candidates' commitments and capacity before appointment, before approving other roles and at least annually as part of the board evaluation process.

Chair/CEO separation

Principle

We believe the chair should manage the board and the CEO should manage the business. We are concerned by the role of the combined chair and CEO, which by its very nature is conflicted and not independent. This concern is elevated when there is no Lead Independent Director in place. Combining these functions can confuse these very different roles and responsibilities, which require different attributes, and can overly concentrate power in one person, creating oversight, information flow, accountability, and succession concerns. We believe that the succession of a combined CEO and chair is harder to manage, and therefore riskier.

We are also concerned by the role of executive chairs for similar reasons; running the board, a body independent from management, should not be a full-time managerial responsibility and so an executive chair will likely interfere with management's separate responsibilities. We fear the blurring of the lines of responsibility between the role of executive chair and the CEO can decrease accountability, unnecessarily increase governance risk, and may make it harder for the board to scrutinize and challenge management's business decisions especially those made by the executive chair in a past management role.

Our expectations

1. Companies that have a combined chair/CEO should in the short term appoint an independent lead director with the necessary formal powers and character attributes. Over the longer term, companies should ultimately move to separate the roles. We recognize that it may be difficult to make changes to a combined role in the short term but expect that, no later than upon succession of the CEO, the board should split the roles and appoint an independent chair.
2. We expect boards to plan future succession to enshrine less power in one individual to reduce risk. We are concerned about incoming CEOs who wish to be appointed chair.
3. The board must explain how it has decided on the governance structure of the company, when it was last reviewed, when the structure will next be reconsidered and the factors this review will consider.
4. We generally support shareholder proposals advocating for independent chairs and expect these to be carefully evaluated by the board. If such a proposal is supported by a majority of shareholders voting, even if precatory, the board should move swiftly to appoint an independent chair. If the proposal does not receive majority support, we still expect the board to respond in all material respects to the points raised in the shareholder proposal.
5. Where chair and CEO roles are combined, we may, on a case-by-case basis, support boards where one individual holds both roles providing a permanent lead independent director role is in place, filled by a director with not only the right character, attributes and skills for the role, but also has strong and well-defined powers which we describe in the next section.
6. We oppose companies appointing former executives as chair, even if non-executive.

Independence and tenure

Principle

On all boards, we expect a substantial majority of independent directors, including an appointed lead independent director, to ensure that stakeholder interests are protected, to exercise objective judgement and, if necessary, to act as agents for change. This group should play an important role in guiding the boards' decision-making and in the recruitment and nomination of directors. It should be empowered to meet independently, including before and after board meetings, and should do so in practice. It should be granted unfettered access to members of management, information and resources as required.

Ensuring sufficient levels and quality of independence is particularly important for founder-led companies, those with executive or non-independent chairs, significant shareholder representatives on the board (which we believe can be useful and justified, provided minority shareholder interests are protected) or significant management representation on the board.

Our expectations

1. We expect more than half of the board directors to be independent in companies, regardless of whether it has a dispersed ownership structure or is a controlled company.
2. We do not expect executives, other than the CEO, to serve on the board, as we view the role of the board as providing independent challenge to and oversight of management.
3. In its disclosures, companies should clearly state which directors they consider to be independent and the criteria by which independence is determined.
4. Among the several aspects of director independence, the most important is independence from management.
5. When considering the independence of individual directors, companies should seek to exceed the standards of independence set by the Nasdaq Stock Market (Nasdaq) and the New York Stock Exchange (NYSE). Beyond these standards, an independent director should not:
 - a) Have any direct material relationship with the company, other directors, or its executives, which includes interlocking board memberships, including those of not-for-profits.
 - b) Favor any single or group of shareholders. We do not consider such "constituency directors", whose nominations are controlled by a certain group of shareholders, to be independent, and note that the fiduciary duty of these

directors requires them not to favor one shareholder over others if seated on the board.

- c) Have sat on the board for such a long time, particularly with other directors, as to compromise his or her independence of mind and ability to hold management to account. When two or more directors have served on the board together for more than 10 years, or have other long-term connections, we expect a board to thoroughly explain the benefit to long-term shareholders for these continuing appointments and how a possible weakening of independence is being managed and mitigated.
6. We expect a healthy mixture of tenures on boards, supported by regular board refreshment. We consider the overall composition of boards and recognize the value that long-serving directors can contribute. However, too many directors serving concurrently can increase the risk of groupthink and complacency.
7. We do not have rules for retirement or tenure and believe that experience and a detailed knowledge of a company can be helpful. However, boards with long-serving directors, including those with service at related companies or other links to other directors or management, can indicate over-familiarity and insufficient challenge to management and other board members. This is particularly the case when there is little evidence of recent board refreshment. Such longstanding directors also impede the welcome move to more diverse boards.
- a) Where there is long tenure and no recent refreshment with suitably qualified directors, we may recommend voting against some directors, including the chair of the nomination and governance committee.
 - b) Where the board has an established retirement age policy for directors, but then refuses beyond-age director resignations, or otherwise waives this policy, we expect robust disclosure of the board's reasoning for such waivers.

The role of independent directors as a group

Principle

On all boards, we expect important stakeholder interests to be considered, and for the board to exercise judgement independent of management and, if necessary, to act as agents for change. Independent directors as a group play an important role in guiding the board's decision making and in director recruitment. The group should be empowered to meet separately, including before and after board meetings, and should do so in practice. It should be granted unfettered access to members of management, information, and resources as they so require.

Our expectations

1. The independent chair or lead independent director must have formal powers and the necessary character to:
 - a) Call a special meeting of the board of directors or the independent directors in camera at any time, at any place and for any purpose, including to consider the removal of the chair or CEO from one or both positions.
 - b) Consult individually with the chair (if applicable), CEO and committee chairs on topics and schedules of meetings of the board and committees and to approve such schedules and board agendas.
 - c) Ensure that the board has the information it needs with sufficient time in advance of board and committee meetings to fulfil its duties and has the ability to obtain from management or independent, outside board advisors any information that the directors deem needed to reasonably inform director decision making.
 - d) Ensure that the whole board is aware of investor sentiment by requiring that all substantive correspondence and notes of meetings or contact by management or directors with investors is provided in the board materials before the next board meeting.
 - e) Require that any director has access to any employee or officer of the company, without other management present, if a director so requests.
 - f) Engage independent legal or other advice at the company's expense if judged necessary.
 - g) Preside over meetings when the chair is conflicted or absent.
 - h) Guide full board consideration of appointments, evaluations and succession of the CEO, the board and its committees.
 - i) Meet one-to-one with the CEO after every regularly scheduled board meeting.
 - j) Guide annual self-assessment of the board and the performance assessment of the CEO.
 - k) Issue a letter or statement in the proxy describing how the board operated during the year.
 - l) Engage with representatives of significant long-term shareholders at their reasonable request. Where this is unreasonably denied, we find it difficult to support some annual meeting agenda items, including re-election of relevant board members.

- m) Develop and/or maintain a program to proactively meet representatives of long-term shareholders on ESG, long-term strategy and capital allocation matters, to exchange views.
2. The independent directors are essential in adding different perspectives that improve decision making by the board. Their role as a group is not only to support and mentor but also to challenge management, and the board should demonstrate that it is doing so through disclosure to and dialogue with long-term shareholders. Such disclosure and dialogue should overtly signal that the independent directors assert the board's decision control role, separate from management's decision roles.

Committees

Principle

Board committees are another avenue for ensuring robust, independent oversight of a company's material risks and opportunities. While we do not have explicit expectations for the number of committees appropriate for company boards, we believe that an effective board is one which balances experience, expertise, independence, and tenure across its committees, and we support regular rotation and refreshment of the leadership and composition of each committee.

Our expectations

1. We expect larger boards (typically of eight or more directors) to have specific board committees covering audit, risk, executive remuneration and board nominations.
2. For some companies, additional committees may be required to cover other material issues, for example a sustainability committee for environmentally exposed companies. For those smaller boards that choose to address these matters at full board meetings, there should be clear narrative reporting to demonstrate these receive adequate time and attention.
3. We expect nominating and governance, audit, and compensation committees to be made up of independent directors. We may oppose the chair of the nominating and governance committee where these committees comprise less than 100% independent members.

Director attendance and commitment

Principle

Considering whether a director may be over-committed depends on a range of factors beyond the number of other roles they hold, including the size and complexity of the company and additional responsibilities, such as being a committee chair. We consider that certain industries such as banking (due to its business model and regulatory

complexity) and businesses with large and/ or complex operations will require site visits and therefore more time commitment.

Our expectations

1. As a broad guideline, we do not support directors holding more than five directorships at public companies and, in this context, we consider a non-executive chair role to be roughly equivalent to two directorships and, at complex companies, other committee chair roles, in particular the chair of the audit and risk committee, may be considered more burdensome than a typical non-executive directorship.
2. We expect board directors to be able to devote sufficient time to fulfil their duties, including to build and maintain a good understanding of the company and to fully absorb and be able to challenge the information presented to them by management
3. We expect companies to encourage their executives to take on a non-executive role (but not normally more than one) outside their own company to assist in their development, bring current experience to boards and to build a pipeline of future board directors.

Director compensation

Principle

We believe directors to have an important role for the company and that they should be compensated accordingly.

Our expectations

1. Directors should not be compensated in performance shares. Because directors hire the executives who drive performance, time-based shares are more appropriate.
2. Director stock ownership should also be encouraged.

Succession planning

Principle

Effective succession planning at the board and senior management level is essential for safeguarding the ability of companies to deliver long-term returns. It should involve contingency planning for the sudden loss of key personnel, as well as planning for foreseeable change such as impending retirement. It should include consideration of the current and future required diversity of skills, experience and other attributes required at board and senior management level, including the need for any candidate to demonstrate the highest levels of ethical integrity. Robust succession planning also can help to counter the tendency of many boards to over-pay current executives relative to the senior executive labor market and peers.

Our expectations

1. Overseen by the board, senior management should create a pipeline of suitable candidates from within the organization to become senior managers and executive directors.
2. All boards must select and replace the CEO. As part of this process, and to oversee the company effectively, the board must have relationships with members of the senior management team and advise the CEO on its perception of named executive officers' performance.
3. Boards of directors should have and disclose robust succession plans that provide for orderly and systematic refreshment of members accompanied by thorough disclosures articulating how skills, experience and other attributes contribute to the board's strategic needs and are matched to the specific roles or evolving needs of the board and nature of the company's activities, considering the long-term value role of employees, customers, communities, or other board-identified key stakeholders.

AUDIT AND THE ROLE OF THE AUDIT COMMITTEE

Principle

Shareholders in listed companies rely on the quality and robustness of the audited information those companies report to the market when making investment decisions, and when holding company management and boards to account. High quality and effective audits are vital to ensure the markets trust and have confidence in the information companies report.

Our expectations

1. Audits should provide assurance to shareholders that the financial statements present a prudent, true and fair view of the financial results, cash-flows and financial strength of a company.
2. In recent years, we have seen a spate of business failures following poor quality audits. These high-profile cases have raised questions about the quality, relevance, professionalism and independence of audits and external audit firms, and strengthened calls for reform.

Audit committees

Principle

Shareholders, regulators, and other stakeholders have increasingly focused on the role and performance of audit committees and how they discharge their duties.

Beyond the oversight of the financial reporting process and the appointment and oversight of the external auditor, audit committees have important risk and compliance oversight responsibilities, including oversight of internal audit and whistleblowing facilities, as delegated by boards, or as specified by laws or regulations. It is important that the board fulfills its mandated role to ensure audit quality through rigorous auditor selection, rotation, and especially vigilant auditor oversight. As such, we will hold the audit committee responsible for the quality of a company's audit. These are audit committee functions that cannot be delegated to management, and the board needs to ensure that the audit committee is performing its duty. However, we will hold the whole board accountable for the financial statements because of the board's oversight role of the audit committee and management's personal responsibility to ensure the quality of financial statements and of internal financial controls.

The audit committee's role in overseeing financial reporting risk is a significant one. The requirements imposed by Sarbanes-Oxley and related obligations mean that the audit committee will sometimes barely have enough time to carry out its regulatory obligations. Increasingly, audit committees say they are overloaded but at the same time reluctant to relinquish responsibility for non-financial reporting oversight duties with boards also resistant for them to do so. We have seen this with cyber security, data privacy, compliance, social and environmental risks and other non-audit oversight matters tasked to the audit committee. We do not expect audit committees to oversee risks beyond those related to financial reporting. Assignment of substantial non-audit-related oversight mandates to audit committees may be seen as a signal that the audit committee is overburdened, with the risk that duties are being delegated to management. A better course of action may be to set up a further committee of the board to address other material non-audit matters. When an audit committee is assigned oversight of non-audit matters, we may question the corporate governance guidelines in place and may ask the board to think about how best to perform its essential risk and strategy oversight function, as well as question the audit committee's practice of managing scope creep in their charter and reflect this concern in our voting recommendations for relevant audit committee members.

Our expectations

1. Shareholders, regulators, and other stakeholders have increasingly focused on the role and performance of audit committees and how they discharge their duties. Audit committees have important risk and compliance oversight responsibilities, as delegated by boards or as specified by laws or regulations. The requirements

imposed by Sarbanes-Oxley and related obligations mean the audit committee must ensure it has capacity and time to meet its regulatory obligations.

- a) We do not expect the audit committee to have any strategic oversight responsibilities beyond those closely related to audit.
 - b) Audit committee chairs and members should ensure they have sufficient time to fulfil their duties, which we expect to be significant, particularly for large complex organizations.
 - c) Audit chairs should seek to avoid sitting on an excessive number of boards, particularly in the role as audit chair.
2. In accordance with Sarbanes-Oxley and other regulations, we expect the audit committee to demonstrate that it both independently selects and engages the auditor separately from management and that the audit committee itself directly oversees the auditor. The company's internal audit team should report, as a practical if not administrative matter, to the audit committee rather than management.

Auditor rotation

Principle

Maintaining independent external assurance is a fundamental pillar of good stewardship and the fiduciary duty of a board of directors. Independence, and potentially audit quality, is at risk when the same assurance provider is maintained for too long – whether the audit partner or audit firm. Only by rotating the audit firm at regular intervals can auditor independence and quality be protected, in the interests of shareholders and other stakeholders. Our view is that audit firm rotation can also add value as it welcomes a new firm with a different approach and a new set of subject specialists with a fresh pair of eyes, challenge and opinions.

Our expectations

1. We wish to see companies establish policies of mandatory rotation of the audit firm after 20 years tenure, with an open and competitive re-tender process at the interim point of 10 years.
2. We encourage companies, when seeking the ratification of the independent auditor, to disclose the lead independent auditor partner, together with a statement that the external audit firm has complied with Sarbanes-Oxley rotation requirements.
3. In the US, the rotation of the lead audit partner every five years is not, in our view, sufficient to strengthen auditor firm independence. If an audit firm has been in place consecutively for a period greater than 20 years, we will consider

recommending a vote against all audit committee members and the auditor ratification if there has been no review or consideration of auditor rotation.

Non-audit services and fees

Principle

As part of overseeing the external auditor, the audit committee must establish and enforce a policy on what non-audit services the company can procure from the external auditor. We pay close attention to these services and related fees to ensure that they do not compromise auditor independence, which could compromise the integrity of the audit. The non-audit fees should normally be substantially lower than the audit fee.

Our expectations

1. As a guideline, non-audit fees should not exceed 15% of audit fees in any given year. If this is exceeded, there should be a clear explanation as to why it was necessary for the auditor to provide these services (for example, for certain services such as reviewing interim reporting or performing due diligence on transactions) and how the independence and objectivity of the audit was assured.
2. In cases where non-audit fees exceed 15%, we also expect the committee to take action to ensure this does not reoccur, either by tendering for a new audit firm or reallocating non-audit work to a different firm.
3. We expect audit committees to have a pre-approval policy and process in place for audit and permissible non-audit fees.
4. We recognize that audit quality cannot be ensured solely through regular rotation of external auditors or reducing conflicts caused by the payment of fees for non-audit work. We expect audit committee chairs and committee members to understand the organization, challenge management and external and internal audit teams, and to follow best practice guidance when appointing audit firms.

Accounting practices

Principle

We are concerned that accounting standards, as applied, do not always reflect underlying company performance. We encourage companies to apply accounting standards in a manner which is prudent and provides a true and fair view. Where application of the standards does not provide such a view, we expect companies and their auditors to make this clear to investors.

Our expectations

1. We expect companies to avoid aggressive accounting practices that represent the company's financial position in a short-term flattering light. This creates a reliance on the most optimistic of outcomes transpiring in subsequent years, which can easily compound up to the point that a preventable collapse finally occurs.

2. We expect companies to recognize liabilities in a timely fashion, and to only realize profits where there is a very high degree of confidence in their quality.
3. We also expect a clear indication of the quality of any unrealized profits found in the company's income statement.
4. We expect the board and management to monitor international and US accounting standards for changes incorporating environmental and social performance.

Oversight of climate change related accounting impacts

Principle

To the extent a company's financial statement does not adequately consider material climate risks and there is no corresponding explanation as to why, we may recommend a vote against the audit committee chair and auditor ratification. For more information on our corporate governance expectations related to climate change, please see the Climate Change section of these principle.

Our expectations

1. Where material or potentially material we expect companies to disclose climate and other environmental and social matters in its financial statements and clearly discuss the connection between accounting assumptions and the climate change impacts based on alignment to the Paris Agreement.
2. We expect the auditor to communicate climate and other ESG matters as critical audit matters to the audit committee where material and involving challenging, subjective and or complex auditor judgement.

DIVERSITY, EQUITY AND INCLUSION

Principle

Diversity, equity and inclusion (DE&I) is an ethical and business imperative. Expanding and improving upon DE&I, both at the leadership level and throughout the wider organization, creates enduring value by improving decision-making, attracting talent, enhancing workforce satisfaction and stimulating insight and innovation.⁵ A growing body of evidence supports the system-wide benefits of social and economic inclusion, and the risks of continued exclusion, by linking more diverse company leadership with greater financial performance.⁶

Tragic events, including Mr. George Floyd's murder in May 2020, have brought into focus glaring racial and ethnic injustices around the world that are reflected on boards and in workforces, including those of companies' suppliers and in unfair impacts from business

⁵ For example, [Delivering growth through diversity in the workplace | McKinsey](#)

⁶ For example, The 30% Club has compiled a list of studies examining the benefits of gender diversity <https://30percentclub.org/initiatives/investor-group>

practices on diverse communities. In many parts of the world, Mr. Floyd's death triggered difficult conversations that exposed barriers, in the workplace and elsewhere, faced by diverse groups, including but not limited to race, ethnicity, gender, sexual orientation, age, disability, nationality and socioeconomic background; and highlighted the additional challenges that individuals who belong to multiple diverse groups experience. It also focused attention on the need to build more inclusive company cultures that dismantle obstacles and enable all individuals to thrive and maximize their contributions to their companies, communities, and society.

In 2022, we will continue tightening our voting policies and thresholds on DE&I as we believe most companies need to improve their diversity towards representation of all groups throughout all roles and levels. We will hold boards accountable for more effective oversight of inclusive culture and diversity across all levels of the company's workforce and effects on the ecosystem upon which the company's long-term health depends, including suppliers, customers, and communities.

Our expectations

1. Boards should seek diverse composition in its broadest sense to support high-quality debate and decision-making, considering diversity of skills, experience, networks, psychological attributes, and characteristics (including, but not limited to, race, ethnicity, gender, sexual orientation, age, disability, nationality, and socioeconomic background).
2. Boards should give careful consideration as to how they can find members from outside of their typical networks and the breadth of attributes or perspectives that may be valuable to their decision-making. Boards should consider director candidates who have not previously been directors and should make senior management available to serve as independent directors at other companies.
3. Where boards have made insufficient progress on critical dimensions of diversity, including racial and ethnic or gender representation at board and/or senior management level, we will recommend opposing the re-appointment of relevant responsible directors.
4. Our expectations for S&P500 companies are 50% overall board diversity including gender, race and ethnicity and other diversity traits such as LGBTQ+ and disability. Within this 50% we also expect 30% minimum gender diversity and one or more ethnically or racially diverse directors. For ex-S&P companies, we expect at least 40% overall diversity. We will continue to review progress on overall board diversity among the S&P 500 and non- S&P 500 companies, potentially raising our expectations for diverse boards year on year.
 - a. We welcome recent regulatory mandates and voluntary commitments in some countries. For example, in August 2021, the US Securities and Exchange Commission (SEC) approved Nasdaq's Board Diversity Rule, which

requires disclosure of board diversity statistics and at least two diverse directors including one female and one under-represented racial minority or LGBTQ+ director.⁷

- b. Also in 2021, the Hong Kong Stock Exchange proposed changes to its corporate governance codes and listing rules to enhance diversity standards and support gender diversity;⁸ the Tokyo Stock Exchange updated its corporate governance codes to require increased diversity disclosures;⁹ and the Singapore Exchange Regulation published a consultation paper¹⁰ proposing that issuers be required to have a board diversity policy and provide disclosures on related targets, plans and timelines in annual reports.¹¹
 - c. We support initiatives such as the 30% Club, a global campaign,¹² encouraging boards to strategically prioritize diversity in its very broadest sense, with the US Chapter setting thresholds for gender representation at board and executive committee levels. We support the integration of targets for the representation of people of colour and women by the UK chapter of the 30% Club, which encourages boards to prioritize racially- and ethnically-diverse director recruitment, in addition to setting thresholds for gender representation at the board and executive committee levels.
 - d. We note that some racial and ethnic groups, such as Black or African American, Hispanic or Latinx, Asian (with many diverse sub-groups), Indigenous and people of two or more races, are much less likely to obtain board roles than others, reflecting societal bias. We expect boards to address these biases. We urge companies to additionally consider other diverse or underrepresented populations including those who identify as LGBTQ+ or those with disabilities.
5. We expect companies to clearly disclose board diversity as directors self-identify. Companies should create a culture where self-identification is possible.
 6. We expect boards not only to address their own diversity, but that of the whole organization and its impacts on stakeholders; and to provide meaningful disclosure assessing progress against complex challenges.

⁷ See Rule [Board Diversity Disclosure Five Things.pdf \(nasdaq.com\)](#)

⁸ See [Consultation Paper, Review of Corporate Governance Code and Related Listing Rules, HKEX](#)

⁹ See [Enhancing Corporate Governance, JPX](#)

¹⁰ See [Consultation Paper on Climate and Diversity, SGX](#)

¹¹ [Preparing for Potential Updates to HCM & Board Diversity Disclosure Requirements \(harvard.edu\)](#)

¹² [30% Club \(30percentclub.org\)](#)

7. When developing director voting recommendations, we will take into account a range of considerations. From a workforce perspective, these may include, but are not limited to:
 - a. Diversity of named executive officers, senior executive team members and talent pipeline.
 - b. The existence of a thoughtful DE&I strategy, targets and action plan rooted in rigorous analysis of underlying problems that incorporates employee survey data.
 - c. A board-driven process for evaluating management's inclusion performance and issues surrounding all strands of diversity across the employee lifecycle.
8. We expect to see urgent progress towards gender equality and greater representation of ethnic minorities, particularly those facing discrimination such as Blacks, Hispanic or Latinx and Indigenous, on boards and elsewhere in organizations, particularly in senior management roles.
9. We will consider and support on a case-by-case basis shareholder resolutions relating to DE&I and may file or co-file such resolutions where we believe them to be warranted.
10. We expect boards that receive precatory (advisory) DE&I related shareholder proposals to give deep thought to adopting them and/or recommending shareholder support, especially where the company feels it is already complying in all significant aspects with the shareholder proposal. For example, third-party racial equity audits can enhance board oversight ability, particularly at companies with prior diversity, equity, and inclusion issues, by providing additional information to thoroughly analyze root causes of complex and nuanced issues and more rigorously evaluate performance.

EXECUTIVE COMPENSATION

Culture and philosophy

Principle

We are increasingly concerned that executive compensation structures and practices in a number of countries are not fit for purpose, neither serving long-term investors nor aligning properly with the core long-term objectives of companies, and that poor practices are at risk of spreading to other countries where pay is more restrained. We believe that most current executive compensation practices play little positive role in embedding desirable corporate cultures, fairness, or the best ways of working for the long-term sustainability of the business.

Some of our key concerns relate to the limitations of 'pay for performance' models, which are common in countries like the US and the UK and which we see increasingly adopted in other countries. Although perhaps well-intentioned, this approach risks damaging, unintended consequences, including:

- Increasing quantum beyond the executive labor market median, and expanding pay disparities between executives and the broader workforce
- Encouraging short-termism or financial engineering, particularly in schemes which focus on share options or where large proportions of pay are subject to metrics like total shareholder return or earnings per share, which can focus executives on actions to drive up the share price in the short-term rather than on drivers of long-term strategic value. Focusing large portions of pay on incentive schemes risks strongly incentivizing executives to hit targets over relatively short time frames, regardless of whether these actions are best aligned to long-term, high-quality sustainable returns to shareholders and other stakeholders.
- Obscuring meaningful assessments of performance in the context of long-term value due to the use of complex, overlapping incentive schemes.
- Undeserved windfall gains for executives which can result from share-based incentive schemes, which has occurred at many companies as a result of the market rally that followed government interventions in the wake of the Covid pandemic.

We continue to make the case for switching to simpler pay schemes aligned to long-term success and the desired culture in the organization, based on a combination of fixed pay and long-term time-restricted stock, with an emphasis on long-term share ownership for executives.

While we do not automatically oppose all pay models that do not appear to align to our principles, we set various thresholds and requirements to guide our voting recommendations which are tailored to the context of each market. Through engagement with companies on these thresholds and requirements, we seek to improve market practice and encourage closer alignment with our principles.

Our expectations

1. Boards need to ensure that management is instilling and embedding the desired culture across the whole organization and into its value chain.
2. We expect clear disclosure on how a company's compensation policy and practice meet the compensation principles we outline below and promotes a cohesive productive culture where a diverse employee cohort thrives, driven by culture-based performance evaluation and where discretion is exercised the board.

3. Beyond such board discretion, when metrics and data are used, we expect these to emphasize long-term value creation through key stakeholder metrics.
4. The compensation committee should be directly accountable to shareholders through an annual advisory vote on compensation, that includes disclosures about the culture-driving features we describe under this principle. This advisory vote should lead to improved dialogue between compensation committees and investors about the link between executive compensation and company culture.

We expand on our views on executive pay in our paper, **Remuneration Principles: Clarifying Expectations**.¹³ The following sections detail our expectations across the five key principles: simplicity, alignment, shareholding, accountability, and stewardship.

Simplicity

Principle

We believe that current pay schemes are almost always too complex, resulting in variable compensation schemes that are almost guaranteed to pay out.¹⁴ We advocate for simpler pay schemes as we have concerns with methodologies that are not transparent and performance metrics that have the possibility of being gamed. Companies can reduce the complexity of pay schemes through a variety of ways such as majority fixed pay or majority variable pay tied to clear, robust, and strategic performance metrics that create genuinely variable pay outcomes and with high share ownership mandated.

Our expectations

1. Pay should be simple; for example, fixed pay (mix of cash and long-term shares) plus a single incentive scheme (an annual bonus). We expect the incentive schemes that determine variable compensation payouts to be based on understandable, rigorous, and strategic metrics, which have the genuine possibility of not paying out. We may be less supportive of pay schemes where the proportion of variable to base pay appears excessive, particularly if the underlying incentive scheme is overly complex and not well aligned to long-term value creation.
2. Pay schemes should be clear, transparent, and understandable for investors as well as executives. They should also be communicable to employees and other stakeholders. Boards should then write to all employees each year explaining the outcomes of executive pay and the alignment to and accountability for long-term value, and the company's strategy and purpose.

¹³ <https://www.hermes-investment.com/wp-content/uploads/2018/10/remuneration-principles-clarifying-expectations.pdf>. The principles contained in the paper are global in nature, but some of the specific references to structures are more applicable to certain markets such as the UK

¹⁴ [remuneration-principles-clarifying-expectations.pdf \(hermes-investment.com\)](https://www.hermes-investment.com/wp-content/uploads/2018/10/remuneration-principles-clarifying-expectations.pdf)

Alignment and quantum

Principle

Pay should be aligned to long-term strategy and the desired corporate culture, incentivizing long-term value creation, including wider social and environmental outcomes. Where metrics and targets are used in incentive pay, they should reflect strategic goals, rather than focus attention on total shareholder return, stock price appreciation or earnings per share.

Executive pay is often far too high and pay schemes often seem to pay out significant sums that appear to conflict with many shareholders' and other stakeholders' views of performance.

Executive compensation is tightly linked to executive selection and succession. If an already highly paid executive needs to be motivated by above-CEO-labor-market compensation, we would question whether the board has selected the right executive with the right character and motivational make-up to lead.

Our expectations

1. Typically, we expect CEO pay not to be significantly more than the average named executive officer pay. We believe that having a large disparity here can lead to problems with succession planning and damage corporate culture as one executive is valued far more than the rest of his or her team. Similar principles apply between different levels and areas of the company.
2. CEO pay should not be significantly more than the peer group average over the long term without strong justification and should not target compensation above the 50th percentile.
3. We do not think that there is a functioning market for CEOs. We therefore question the use of company-selected peer groups to help set CEO pay as its use has resulted in ratcheting up pay across each industry. Robust succession planning by the board can be an effective counter to being overly reliant on incumbent demand for increased pay.
4. We encourage the award of restricted shares instead of the use of options. The Covid-19 pandemic has served as a reminder of the limitations of pay schemes reliant on stock options or performance-based incentives schemes as share price volatility and limited visibility of the future meant boards in most industries have struggled to set meaningful targets. Meanwhile the ensuing rally in markets may lead to undeserved windfall gains for executives from re-priced option-based incentive schemes. We believe compensation in long-dated restricted shares better aligns management interests with those of shareholders and that options with short vesting periods incentivize the wrong executive behavior as these awards are

linked so closely to short-term changes in the share price, especially around the exercise date.

5. Boards should take ESG performance into account, using their judgement of overall performance, and explain through disclosures how they have done so; however, our expectation is that ESG performance is not used as a tool to engorge pay outs, and that boards also hold management accountable for negative performance or inaction by decreasing pay outs.
6. We expect clear disclosure of ESG-related performance pay metrics including the basis for their selection in terms of materiality, thresholds, and performance measurement so that investors can adequately assess the alignment of these metrics with long-term strategy and understand the criteria used to justify pay outs. We caution against including standalone ESG metrics that double count performance already captured in other strategic metrics.
7. Companies should disclose the three-year realized pay of all non-executive officers who served during the year.

Shareholding

Principle

Building on our strong belief in the alignment of pay to the long-term success of the company and the desired corporate culture, we believe this is best achieved through long-term share ownership by executives with minimal ability to use stock as collateral. Additionally, CEOs should be invested in, financially incentivized by and, intrinsically motivated toward their own successor's success, principally through the requirement of significant shareholding well past departure including retirement.

Our expectations

1. Management should become long-term stakeholders in the company's success through substantial shareholdings. We believe that significant shareholding requirements are ideally at least eight times base salary for executives and directors, with no material share sales allowed before shareholding requirements are met (net of any tax obligations from the award or vesting of shares or options). Unvested shares or options should not count towards minimum shareholding requirements.
2. Significant shareholding requirements should remain in place for at least two years following departure from the company.
3. There should be a robust policy to prohibit the hedging of equity-based awards by executives. We also expect strict controls over pledging of shares. We may accept immaterial pledging of shares, once minimum share ownership guidelines are met within very narrow limits, pre-approved by the board. We may consider supporting

legacy pledged exceptions if they are not identified as a material risk, with a supporting auditor opinion, and expect boards to require that such legacy pledged positions are to be gradually reduced over time.

Accountability

Principle

Pay outcomes should reflect outcomes for long-term investors and take account of falls in a company's performance or reputation. We believe that compensation committees should take a more robust and holistic view on pay, using business judgement and be accountable to shareholders for these pay decisions. The company should avoid paying executives more than is necessary and not place too much reliance on existing practices and benchmarking, as both help to perpetuate excessive ratcheting up of executive compensation that we seek to address.

Our expectations

1. The board should intervene and apply discretion whenever formulaic outcomes do not properly reflect business performance.
2. The potential pay outcomes under a policy should be rigorously scenario tested in advance, with a cap on the total possible pay published, to help reduce the risk of unintended consequences and windfalls.
3. There should be robust clawback provisions in place for executive compensation in the event of fraud, material financial misstatement, conduct or reputational issues, meaning that executives can be held accountable in the case of such events through the clawback of their previous compensation. We also believe the clawback policy should require disclosure to shareholders in the proxy statement about such recoveries.
4. Boards should also adopt a policy on bonus deferral which allows late-arriving information about risk taking and outcomes to alter payouts and reduces the need to claw back compensation already paid out in the event of misconduct.
5. We are concerned by the widespread use of adjusted Generally Accepted Accounting Principles (GAAP) metrics for incentive pay, as this can tilt the scales to unfairly help executives achieve their performance benchmarks. A company should provide clear disclosure in its annual 10-K management discussion and analysis (MD&A) reporting of any adjustments to GAAP performance metrics and reconcile these back to GAAP metrics, particularly when compliance costs related to illegal activity or settlement costs related to allegations thereof are excluded from financial performance metrics in the compensation framework.

6. We do not expect to see boards making special retention awards to CEOs. In our view these signal a material weakness in boards' succession planning role. Such awards may likely lead us not to recommend support for the re-election of certain directors, such as the chairs of the nominating and governance committees, the compensation committee or the independent chair or lead independent director.
7. We oppose repricing of shares or options within executive compensation plans, as this goes against the principle of accountability, can reward executives for poor performance, and is misaligned with the experience of long-term shareholders.
8. If executive remuneration plans include executive severance pay arrangements, the arrangements should be fair and provide sufficient protections for shareholders. Cash awards should be reasonable and in line with best practices. Unvested long-term performance incentives should be reduced to a prorated amount, and vesting should not be accelerated in the event of executive termination. Additionally, the arrangements should specify circumstances in which executive severance pay must be withheld or renegotiated, such as executives engaging in criminal behavior, gross negligence, harassment, and other behavior or conduct issues contrary to the companies stated employment policies, or that could otherwise bring reputational damage to the company. Compensation committees should be empowered to use discretion and business judgement to limit departure payments to executives for such failures, even if the departure is determined to be without cause.
9. We expect an annual say on pay vote.
10. Boards should engage with dissenting shareholders following a failed say on pay vote and disclose how shareholder feedback is taken into consideration in executive compensation changes.

Stewardship

Principle

Pay outcomes should be communicable to all stakeholders, including employees and the public. Boards should take into account wider workforce pay practices and ratios when judging the appropriateness of pay opportunities and outcomes. Executive compensation is not only higher but is usually structured with incentives often misaligned with how pay is considered elsewhere in the workforce, without any disclosures justifying this disparity. Pay disproportionality and incentive misalignment without justifying disclosure is damaging to companies' license to operate, culture and their long-term performance.

Our expectations

1. Boards should, in simple terms and plain language, justify to its stakeholders the rationale for the CEO's and the most senior management's pay. The rationale should take into account the pay, benefits and other employment conditions of the wider workforce, including those who do not have employment contracts.
2. Compensation committees should explain to all company stakeholders how the approach to executive pay helps to inculcate the desired culture in the organization, how it aligns to long-term value creation and the company's strategy and purpose.
3. Compensation plan structures should on balance also consider fairness along the entirety of the ownership chain.
4. Companies and investors should regularly discuss strategy, long-term performance and the link to executive pay.

Capital allocation, share buybacks and compensation

Principle

We believe that a board policy of regular, reasonable dividend payments is normally a better way to return cash to shareholders than a share buyback policy. We are also concerned about the hidden cost of equity compensation through the dilution of outside shareholders and managing this dilution by share buybacks, often at too high share repurchase prices. Moreover, executive compensation metrics such as return on equity and earnings per share can be flattered or even managed by share buybacks.

Our expectations

1. Companies need to clearly disclose the effect of share buybacks on its compensation plans, how the result of its plans would differ without taking buybacks into account and the adjustments made by the compensation committee as a result of the buybacks or other changes to the capital structure. Lack of such disclosure may cause us to oppose say on pay votes.
2. Given the potential effects of buybacks on longer-term investors, companies should also disclose how the board decides on buybacks in addition to other long-term capital allocation choices, whether such buybacks are directly or indirectly financed by debt and how this affects the future risk profile of the company, as well as the company's ability to invest in growth and employees. Lack of such disclosure may signal to us that executive compensation is too high or executive succession may be needed.
3. Companies should discourage executive stock sales in general, and, in particular, sales should be prohibited soon after buyback announcements to discourage executives from favoring stock buybacks at the expense of long-term investment.

PROTECTION OF SHAREHOLDER RIGHTS

Principle

We rigorously defend shareholder rights on behalf of institutional investors, including the right to receive good quality corporate reporting and material information on a timely basis, to vote at shareholder meetings on issues such as the annual election of directors, to propose new candidates to the board or other shareholder resolutions.

We support a single share class structure, with one share one vote, and oppose any deviation from this.

Hybrid or Virtual Shareholder Meetings

Principle

Annual and other shareholder meetings are a critical part of corporate governance. Its notice provisions, relative infrequency, voice given to minority and individual shareholders all help to protect important shareholder rights while also reinforcing the separation of the governance roles of management, the board, and shareholders. As well as being the highest decision-making procedure of the company, they allow shareholders to hear directly from the company about its performance and to challenge directors on important topics, supporting strong transparency and accountability.

We believe dialogue between shareholders and the board is enhanced by the in-person meeting format of annual meetings. Although formats vary around the world, when working well, it presents the opportunity for shareholders to make points to the whole board, the ability to ask questions immediately in response to board comments and to build on the questions asked by others. Further, it is more difficult for directors to avoid challenging questions or topics; directors must provide answers in a public forum and, accordingly, be accountable for them.

However, we recognize that the restrictions brought about by the Covid-19 pandemic rendered in-person meetings unviable for many companies and that there were already valid arguments in favor of adopting alternative formats to improve shareholder access and participation, for example, in geographically dispersed countries or for companies with a global shareholder register.

Given this, we are supportive of meetings being convened in a 'hybrid' format – where shareholders have the option to join the meeting via an online platform or to join in person, provided all shareholder rights are protected or enhanced in both formats. Online participation can increase opportunities for participation, while retaining the accountability of in-person meetings.

For further information please refer to our **Principles of Annual Meeting Good Practice**.¹⁵

Our expectations

1. We do not generally support 'virtual-only' meetings unless these are a temporary solution in response to restrictions on in-person gatherings, such as those prompted by the Covid-19 pandemic, or other exceptional circumstances. In those cases, we expect all shareholder rights to be protected and the meeting to be run as it should be in-person: giving ample opportunity for any shareholder to ask questions, and for these questions to be answered live by the board. We also expect a clear commitment to return to in-person or hybrid meetings as soon as restrictions allow.
2. We will generally oppose requests for the authority to hold virtual-only meetings unless we gain comfort that it is to be used in exceptional circumstances only, and that the rights and access of attending shareholders are comparable to those of in-person meetings. For smaller companies we may relax the expectation that virtual-only meetings are for exceptional circumstances.
3. For shareholder meetings held in any format, we expect the process of curation and selection of shareholder questions chosen to be voiced, in any manner, and answered by the board at the meeting, to be disclosed in the proxy.
4. We expect all directors to attend and preside over shareholder meetings and to answer questions asked of them by shareholders. We therefore expect a reasonable amount of time to be set aside at shareholder meetings for shareholder questions and for this to be included in the board's corporate governance guidelines and explained in the proxy statement. When there is insufficient time for all questions to be answered, the company should provide full written responses to all questions on its website.
5. We expect independent directors to play a significant role, and even lead, the annual meeting. The annual meet is a board-centric, not management-centric, event.
6. We expect companies to respect the votes that are cast and to not engage in delay or adjournment tactics.

¹⁵ <https://www.hermes-investment.com/ukw/wp-content/uploads/2021/03/eos-principles-of-annual-meeting-good-practice-february-2021.pdf>

Multiple class share structures

Principle

Multiple class share structures disenfranchise minority shareholders and often increase the power of one shareholder disproportionate to financial stake. We advocate for initial public offerings of companies with single class structures that provide a level playing field for all investors that equates voting power with financial stake. We normally recommend voting against the chair of the governance committee where multiple class share structures are in place without a disclosed plan to sunset this arrangement.

Our expectations

1. Issuers with multiple class share structures should adopt sunset provisions that put in place a one-share one-vote share structure. We will consider opposing the election of the chair of the governance committee where a sunset provision, or a commitment to establish a sunset provision, is not disclosed.
2. Independent directors, convened in executive session should annually meet with or write the super-voting rights-holders and directly ask them to agree to sunset these super voting multiple class share structures in favor of a one share, one vote single class structure.

Majority voting

Principle

Electing directors by a simple majority vote is a fundamental shareholder right. We are pleased that a significant and growing number of US companies have adopted some form of majority voting, thus increasing director accountability to shareholders.

Our expectations

1. Companies should provide the opportunity for shareholders to vote for or against directors through a majority voting standard, instead of going through the more cumbersome process whereby the shareholder right to determine who is elected to the board is passed to the other directors under director resignation policies. In place of resignation policies, directors not supported by a simple majority of shareholders should be removed through board action a reasonable time after the vote result is verified.
2. Companies should adopt a full majority vote standard, with exceptions limited to narrowly defined legal and regulatory requirements, such as the need for financial expertise on certain board committees. Issuers without majority voting provisions should adopt sunset provisions that put in place this structure.

3. Where a director does not receive majority support and is asked to remain on the board in a temporary-only capacity, the company should publicly commit to expediting a search for a replacement director and for the director to resign shortly following the new appointment.

Shareholders' right to call special meetings

Principle

The right to call a special meeting is another a fundamental shareholder right. In other jurisdictions, including Canada and the UK, shareholders representing 5% of the outstanding issue are entitled to call a special meeting. This is a reasonable threshold that strikes the right balance between ensuring that such meetings are not called capriciously and still being practicable for shareholders to exercise. We note that even in jurisdictions where the right to call meetings with 5% of the shares exists, such meetings are rarely convened. Providing the right for shareholders to call special meetings at a reasonably low level of aggregate ownership demonstrates that the board is committed to open and trusting shareholder relations and increases director accountability to shareholders.

Our expectations

1. We accept that this right is currently significantly restricted to a threshold significantly above the best practice 5% level in the US. Therefore, we can support a 10% special meeting threshold as a reasonable level in the interim.
2. We highlight that shareholders who successfully compel convening a special meeting still need to obtain a majority of all shareholders vote result at the special meeting itself to effect change.

Shareholder proposals

Principle

We support the selective use of shareholder resolutions as a useful tool for communicating investor concerns and priorities or the assertion of shareholder rights, and as a supplement to or escalation of direct shareholder engagement with companies. We will consider supporting well written, artfully crafted precatory shareholder proposals on a thematic basis and, where aligned with our engagement plan.

Our expectations

1. When considering whether or not to support resolutions, we consider factors including whether the proposal promotes long-term shareholders' interests; what the company is already doing or has committed to do; the nature and motivations of the filers, if known; and the efforts the board has made to engage with the

proponents and what potential impacts – positive and negative – the proposal could have on the company if implemented.

2. We consider proposals on a pragmatic basis, reviewing each proposal in its company-specific context and consider the extent to which the issue in question has been managed, usually in the case of larger businesses, following dialogue with the company on the issues arising from the proposal. In our experience, shareholder proposals can be a catalyst for related dialogue with issuers and we thus avail ourselves of these engagement opportunities, where appropriate, whether or not we support the resolution.
3. Boards should engage with serious, committed long-term shareholders, or their representatives, including ourselves. Where boards interact in a constructive manner with shareholders on issues that affect the long-term value of companies, we see less need to file or support shareholder resolutions.
4. We expect boards to take and disclose action addressing the issues raised by shareholder proposals that receive significant shareholder support or are otherwise potentially material to the long-term returns of the company.
5. In addition, we view any failure to implement a shareholder proposal that has received majority support as a clear indication of a board of directors that neither fulfills nor understands its obligations to shareholders and we will likely recommend not supporting the re-election of all such directors.
6. We expect and encourage companies to support shareholder proposals where the proposal is asking a company to do something that it is already doing versus using this as an argument to oppose.
7. We encourage companies to disclose withdrawn proposals on the ballot with a statement as to the agreement reached between the parties.
8. We expect companies to disclose outcomes for precatory shareholder proposals that received majority support in a timely way, including the action proposed to be taken.

Proxy access and the universal proxy

Principle

Shareholders in other jurisdictions may nominate director candidates on the board's slate. While proxy access in the US is increasing, the lack of its universal adoption contributes to the often transactional and defensive nature of corporate governance and of board-shareholder dialogue. This situation can lead to costly, distracting and divisive proxy contests.

We note that this developing standard in the US is still weaker than the rights that shareholders enjoy in nearly all developed markets. While boards should protect companies from the use of proxy access to gain creeping control, different groups of shareholders should have the right to nominate director candidates without restrictions beyond reasonable thresholds. We are therefore likely to support enhanced proxy access shareholder proposals that are substantially in line with our principles even if proposals do not yet have the support of a majority of institutional investors. We are also likely to oppose the election of the governance committee chair or the lead director if boards propose proxy access that make the use of proxy access more difficult than we believe is reasonable.

As experience has shown, we do not expect proxy access to be used often. However, we believe that its existence will help make boards more accountable and more responsive to dialogue with its long-term shareholders.

Our expectations

1. We encourage all companies to voluntarily implement the necessary by-laws and governance changes to enact the right of shareholder access to the director nomination portion of the proxy statement so that any candidate duly put forward for election by a group of shareholders is voted on by all shareholders.
2. Shareholders owning 3% of the outstanding shares for at least three years, with no limit on the number of investors that make up this 3%, should be able to nominate up to 25% of the board seats, as originally proposed by the SEC. This high threshold presents a significant hurdle to short-term shareholders attempting to nominate candidates to the board on their own. Even if such short-term holders are successful in gaining proxy access, directors so nominated can only be seated after receiving a majority vote of all shareholders. Hence, we see proxy access as a low risk of exposing the board to membership by short-term investors.
3. We do not expect boards to implement by-law provisions that make the use of the right of proxy access more difficult or cumbersome.
4. Furthermore, we do not want to see companies restricting shareholders from aggregating holdings on share retention requirements after any election, from share lending when there is reasonable right of recall or on restricting the compensation of shareholder-nominated director nominees (provided it is fully disclosed) beyond the compensation policies that apply to all directors.
5. We also do not expect to see onerous restrictions on previously nominated candidates that fail to win a majority of votes cast to prevent them from being nominated again.

SOCIAL, ETHICAL AND ENVIRONMENTAL RESPONSIBILITY

Principle

Taking a responsible and long-term approach to ESG issues is critical to the creation and preservation of long-term sustainable returns and should be reflected in the company's values, purpose, strategy and culture. Below we highlight two key environmental and social topics which will inform our vote policies in 2022: climate change, and human and labor rights. Further detail on our views on and expectations of companies with regards to a wide spectrum of environmental and social issues can be found in the EOS Engagement Plan.¹⁶

Our expectations

1. Companies must identify and disclose the most material social and environmental issues for the company and its significant stakeholders. They must seek to address the associated risks and opportunities through their core business strategy and value proposition.
2. We expect boards and management to have oversight of material sustainability issues and to be accountable to shareholders for effectively managing the associated risks and opportunities.
3. We support the UN Sustainable Development Goals (SDGs)¹⁷ and believe that the private sector has an important role to play in achieving them by the increasingly pressing deadline of 2030. Companies should assess the relevance of each SDG, identifying those that they can make a direct contribution to, and incorporate the most material SDGs into their strategies. We encourage companies to go beyond highlighting any SDG that the company could be connected to and to be purposeful in selecting those to which it intends to make an active, direct contribution, including through the allocation of resources and setting targets. We urge companies to report on their approach to the SDGs and to engage with its shareholders and civil society on how best to contribute to the SDGs.

Climate change

Principle

The breakdown of the climate is a systemic risk to the value of our clients' portfolios, due to the social, economic, and political consequences of climate change.

We strongly support the goal of the 2015 Paris Agreement¹⁸ – to limit global warming to well below 2°C and pursue efforts to not exceed 1.5°C of warming – and we expect companies to publicly do the same, as well as ensuring that any third-party organizations

¹⁶The latest public version of the EOS Engagement Plan can be found at: www.hermes-investment.com/stewardship/eos-library

¹⁷[Home | Sustainable Development \(un.org\)](https://www.un.org/sustainabledevelopment/)

¹⁸[The Paris Agreement | UNFCCC](https://www.unfccc.int/)

they support or are members of, such as trade bodies or lobbying organizations, are aligned to this goal.

We engage intensively with companies across different countries and sectors on climate change and reinforce this through the voting recommendations we make to our clients at shareholder meetings.

In 2022, we continue to hold the chair or other responsible directors accountable through voting recommendations where we believe companies' actions are materially misaligned with the goals of the Paris Agreement and/or where companies are not responding sufficiently to the risks and opportunities posed by climate change. We include a particular focus on companies that are involved in activities that are clearly incompatible with limiting global warming to safe levels, such as causing deforestation and the expansion of coal-fired power. We assess companies using a range of frameworks and benchmarks, including the Transition Pathway Initiative (TPI)¹⁹, the Climate Action 100+ benchmark²⁰, Forest 500²¹ and others.

In addition to the above criteria, we may also reflect other concerns about a company's response to climate change in our vote recommendations, for example, where a company has been unresponsive to investor concerns or where we have concerns about the views held by certain directors regarding the reality and urgency of climate change.

We will consider and support on a case-by-case basis shareholder resolutions relating to climate change and may file or co-file resolutions where we believe them to be warranted.

In principle, we support the concept of having a shareholder vote on climate change transition plans (so-called 'Vote on Transition' or 'Say on Climate' resolutions). We will support climate change transition plans which are aligned to the goals of the Paris Agreement, with indicators of alignment including science-based greenhouse gas reduction targets over the short, medium, and long-term, supported by a clear and credible strategy to achieve these.

Our expectations

1. Establish strong governance of the risks and opportunities presented by climate change and the energy transition. Boards should ensure that climate-related issues are included on the board agenda at least annually. We expect the board and senior management to engage with outside experts who can advise on strategic risks and opportunities that climate change presents, including challenging the company's approach if necessary. For those companies materially exposed to climate-related risks and opportunities, we expect the energy transition to be

¹⁹ <http://www.lse.ac.uk/GranthamInstitute/tpi/the-toolkit/>

²⁰ <https://www.climateaction100.org/progress/net-zero-company-benchmark/>

²¹ <https://forest500.org/>

clearly articulated in governance documents, including board committee charters and the articles of association.

2. Commit to achieving net-zero emissions by 2050 at the latest and set supporting short and medium-term science-based targets to reduce greenhouse gas emissions in line with the goals of the Paris Agreement. This should include material Scope 3 emissions associated with a company's value chain or use of products with an explanation of why any Scope 3 emissions are not included.
3. Integrate climate considerations into the forward-looking strategy for the company. Companies should consider the implications of the energy transition on their business, and what aligning to the goals of the Paris Agreement will mean for their strategy, minimizing the potential risks and capitalizing on the opportunities presented by climate change.
4. Adopt the framework set out by the Task Force on Climate-related Financial Disclosures (TCFD)²² for the management and reporting of climate-related risks and opportunities. Where the risks are particularly acute (for example in energy intensive sectors), this should include conducting scenario analysis to establish the potential financial and other impacts of climate change on the business at different levels of warming. Companies should ensure that the financial risks associated with climate change and the energy transition are appropriately reflected in reports and accounts. As outlined in the Audit section of these Principles, the audit committee should be responsible for ensuring these risks are accounted for and the external auditor should be engaged to provide an opinion on this matter.
5. Ensure board oversight and robust governance processes are in place to identify incidents of misalignment of views between companies and organizations of which they are members. Where issues are identified, all available avenues to influence these third parties should be used to encourage effective action on climate policy in line with the goals of the Paris Agreement. The company should be transparent about its governance procedures by describing the actions taken to reduce or eliminate any misalignment, and any progress made, in-line with the IIGCC Investor Expectations on Corporate Lobbying on Climate Policy.²³ Ultimately the board should be prepared to cease membership where misalignment persists without progress. Companies should also proactively support and advocate for positive action to mitigate climate change risks in their spheres of influence.

²² [Task Force on Climate-Related Financial Disclosures | TCFD](https://www.tcf.org/) (fb-tcf.org)

²³ <https://www.iigcc.org/resource/investor-expectations-on-corporate-lobbying/>

Human and labor rights

Principle

We believe that how a company manages its human rights strategy is of critical importance to its license to operate, its impact on people's lives and ultimately its ability to create and preserve long-term holistic value. We endorse and expect companies to align with the UN Guiding Principles on Business and Human Rights²⁴ (the UNGPs). The UNGPs framework outlines the corporate duty to respect human rights.

The concept of human rights is simply the universal right to human dignity. However, we acknowledge that human rights strategies and impacts may involve complex and sensitive aspects and seek to engage with companies on these considerations. We may recommend a vote against relevant meeting items, such as re-electing a director, discharging management or approving its reporting if:

- a company is in clear breach of its applicable regulatory responsibilities related to human rights (such as the UK's Modern Slavery Act²⁵) or responsibilities outlined in the UNGPs; and/or
- there is sufficient evidence that a company has caused or contributed to egregious, adverse human rights impacts or controversies and has failed to provide appropriate remedy.

Our expectations

1. Companies have a responsibility to disclose and act upon a policy commitment to human rights in their operations and value chains. This includes carrying out human rights due diligence to identify potential and actual human rights impacts; a plan to prevent, mitigate and account for how to address these impacts and providing or cooperating in the provision of remedy if a company has caused or contributed to adverse impacts.
2. Companies should have a governance structure for human rights which identifies board level oversight and executive accountability. They should report on obligations under the UNGPs, as well as under national legal requirements and relevant international frameworks.

²⁴ [GuidingPrinciplesBusinessHR_EN.pdf\(ohchr.org\)](#)

²⁵ [Modern Slavery Act 2015 \(legislation.gov.uk\)](#)

TRANSPARENCY AND TAX

Principle

We believe that the quality of narrative reporting reflects the board's strategic thinking, its line of sight into operations and how well it oversees the company.

Our expectations

1. Boards must report openly and transparently on the performance of the company and their stewardship of it over the year, acknowledging the challenges, as well as the achievements, the state of the market and the competitive landscape.
2. It is also fundamental that each company reports in a way that allows investors to understand the main risks that the board has identified for the business, along with how the company manages and mitigates them. This includes environmental, social and governance, as well as financial and strategic, risks.
3. We expect companies to follow the April 2020 SEC guidance on the importance of disclosure.²⁶

Tax

Principle

Companies should recognize the importance of taxation to the funding of public services on which they and their stakeholders rely and pay their fair contribution. The Covid-19 pandemic has emphasized the importance of companies paying their fair contribution as all businesses have directly or indirectly benefitted from government action to support the economy.

Fair payment of tax, based on the intention of tax law and in proportion to the location of economic value generated, is an important pillar of a company's social license to operate. We believe that companies that seek to aggressively minimize their tax payments will face increasing reputational and financial risks.

Our expectations

1. Compliance with the intention of tax laws and regulations in all countries of operation and pay taxes in-line with where economic value is generated.
2. Publication of a global tax policy describing their approach to tax risk, controls and oversight including any material variations across the entity. This should include policy on corporate structuring in low tax jurisdictions, intra-group transactions and the use of tax incentives from public authorities. Companies must also ensure their tax policies and practices do not damage their social license to operate in all jurisdictions in which they have a presence.

²⁶ [SEC.gov | The Importance of Disclosure – For Investors, Markets and Our Fight Against COVID-19](https://www.sec.gov/Investor/InvestorEducation/InvestorEducationPage.aspx?ID=1234567)

3. Public disclosure of the full extent of taxes paid or collected by them in each country. Reporting on each country should include the purpose of the local corporate entity along with comparable corporate data such as revenue, profit before tax and number of employees. We recommend use of the Global Reporting Initiative (GRI) reporting standard on tax.
4. Sufficient oversight of tax policy, risk and controls in board and board committee work.
5. Prohibit the use or promotion of aggressive tax avoidance strategies either for their corporate taxes or those of employees, contractors, or customers.

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.

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- **Active equities:** global and regional
- **Fixed income:** across regions, sectors and the yield curve
- **Liquidity:** solutions driven by four decades of experience
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Why EOS?

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

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



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