ESG Materiality Newsletter

Q1 2022

Olivia Lankester
Director, Responsible Investing & Sustainability
Federated Hermes Global Emerging Markets

Federated Hermes
Limited

www.hermes-investment.com
For professional investors only

Introduction

Welcome to our Global Emerging Markets' ESG Materiality commentary – a quarterly publication that demonstrates our engagement activity with portfolio companies and showcases holdings helping to create positive impacts in line with the UN's Sustainable Development Goals (SDGs).

In this issue, we reflect on 2021's COP26 climate change convention and ask: How do the global and emerging market contributions stack up? What are the implications for companies in the portfolio and beyond? We also have a focus on India – asking whether the goals and ambitions are sufficiently stretching and achievable.

As we have done over the past decade, we remain committed to acting as responsible investors by focusing on companies best placed to tackle sustainability challenges as they arise. We recognise that emerging markets have further to go in some areas, but as responsible investors, we can contribute to their evolution over time.

Our vision for responsible long-term investing in emerging-market equities

At a glance

- We aim to select companies with attractive business models and, if we identify material Environmental, Social or Governance (ESG) issues, we seek to improve them through engagement.
- In the case of companies with material ESG issues, management teams must be willing to confront sustainability challenges and enter the transformative process of engagement.
- We maintain a low carbon footprint and prioritise engagements with any holdings in the extractive industries or those with higher levels of emissions.
- We engage on strategic and/or ESG matters, including issues relevant to achieving the UN's Sustainable Development Goals, and our engagements seek a positive impact across companies' value chains.

Portfolio snapshot, Q4 2021

As of end of Dec 2021, we engaged with companies representing 88% of our AUM making progress in 41% of these engagements.

Percentage of AUM engaged by theme

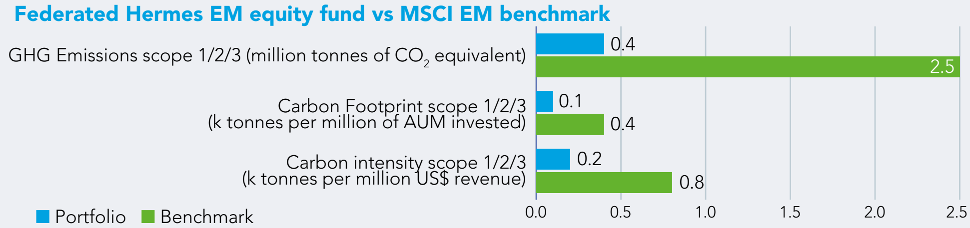
73%	65%	80%	54%
Environmental	Social and ethical	Governance	Strategy and communication

Source: Federated Hermes as at 31 December 2021.

Our portfolio's carbon footprint, Q4 2021

Our portfolio is considerably greener than the MSCI emerging-market benchmark in terms of scope 1, scope 2 and scope 3 greenhouse gas (GHG) emissions.[1]

Federated Hermes EM equity fund vs MSCI EM benchmark



Source: Federated Hermes as at 31 December 2021. The benchmark is the MSCI Emerging Markets Index.

[1] We adopt the methodology set by the Task Force on Climate-related Financial Disclosures (TCFD) to measure our portfolio's emissions, carbon footprint and emission intensity. See Implementing the recommendations of the Task Force on Climate-related Financial Disclosures for further information.

IN FOCUS:

Climate change & COP26: The emerging markets context

Climate change is one of the most significant challenges of the coming decades, with far-reaching socio-economic and environmental consequences including impacts on livelihoods, food systems, physical assets and natural capital. Six of the top ten emitters of greenhouse gases are now emerging market countries.[2]

As well as being significant emitters, emerging markets are particularly vulnerable to the negative impacts of climate change and therefore will need to take urgent steps to adapt to hotter conditions. The emerging markets most at risk (classified as 'significantly hotter and more humid countries') include India, Bangladesh, Nigeria, Pakistan, Thailand and Vietnam, followed by Indonesia, The Philippines and Saudi Arabia. China, Brazil and Chile are classified as 'diverse climate countries' with various levels of risk.[3]

Climate change particularly affects the most vulnerable people, many of whom live and work in the emerging economies. Those dependent on outdoor work, for example, in areas of increasing heat duress are extremely exposed – and they are often the most vulnerable, lacking savings and adequate income. While the theme of 'Just Transition' had less air time at COP26, it is rising up the agenda for corporates, NGOs and governments alike, with calls for re-skilling programmes for those whose livelihoods are impacted and other interventions to support at-risk communities.[4]

Federated Hermes expectations for COP26

In the run up to COP26, Federated Hermes[5] set out its expectations of policymakers, calling for:

- Countries to make more ambitious commitments in the form of Nationally Determined Contributions (NDCs), to reduce their emissions in line with 1.5°C, with clear short- and medium-term commitments.
- Finalisation of the Paris Rulebook (the rules needed to implement the Paris Agreement), including Article 6, which covers international carbon markets.
- Developed nations to meet and go beyond the existing pledge of $100bn each year to help developing nations accelerate the carbon transition.

The latter is critical for emerging markets, many of whom rightly highlight their dependence on financing from developed nations, whose economies have benefitted from fossil-fuel-powered industrialisation over the past century.

COP26 outcomes

In the days leading up to COP26 we witnessed a successful 'ratchetting up' of the NDCs, with over 75% of countries updating their national climate plan. While some countries failed to raise their national ambition, and two even reduced their ambition, 22 countries and the EU submitted stronger targets than in 2015.[6]

COP26 also saw the creation of new alliances and 'coalitions of the willing', with sectoral agreements involving commitments from countries, regions, and companies. These included:

- 109 countries committing to a 30% methane reduction by 2030, including many emerging markets but excluding China, India or Russia;
- 46 countries agreeing to a more rapid phase out of unabated coal use, including emerging markets Poland, Vietnam and Chile but excluding China and India;
- 130 countries committing to halt and reverse forest loss and land degradation by 2030, including Brazil, Indonesia and Russia;[7]
- Various governments, cities, manufacturers and financial institutions (including Federated Hermes) committing to accelerating the transition to zero emissions vehicles by 2040.

109 countries committing to a **30%** methane reduction by 2030, including many emerging markets but excluding China, India or Russia

In terms of emerging markets, at the conference itself, India's Prime Minister Narendra Modi made a surprise announcement on the first day of the World Leaders' Summit, saying that India would aim for net-zero emissions by 2070. China had already announced a goal to reach carbon neutrality by 2060 in September (and to peak emissions by 2030) with all other countries represented in the portfolio aiming at net zero by 2050 or 2060 (Russia, Indonesia) with the exception of Mexico (as yet to set a target).[8]

[2] China, India, Brazil, Russia, Iran, Indonesia. World Resources Institute. World's Top Emitters Interactive Chart I World Resources Institute (wri.org)

[3] Federating Hermes. Gemologist Q2 2020, Can we adapt to the new climate normal?

[4] Over 30 countries have signed the Just Transition Declaration developed by the COP26 Energy Transition Council.

[5] Federated Hermes also hosted a conference in Glasgow on 4th and 5th November, 'Further, Faster', to address three interlinked themes of climate, nature and social injustice.

[6] United Nations: 'Update to the NDC Synthesis Report', 4 November 2021.

[7] 30 investors representing US $8.7 trillion, including the International Business of Federated Hermes, also committed to address the risks of commodity-driven deforestation in investment portfolios.

[8] Climate Action Tracker. Net zero targets | Climate Action Tracker

By what year have countries pledged to reach net-zero emissions?

Already achieved	2030	2035	2040	2045	2050			2053	2060	2070
Bhutan	Barbados	Finland	Austria	Germany	Andorra	Jamaica	South Korea	Turkey	Bahrain	India
	Maldives		Iceland	Sweden	Argentina	Japan	Spain		China	Mauritius
	Mauritania			Nepal	Australia	Laos	Switzerland		Kazakhstan	
					Brazil	Latvia	UAE		Nigeria	
					Bulgaria	Liberia	United Kingdom		Russia	2nd half of 21st century
					Canada	Lithuania	United States		Saudia Arabia	
					Cape Verde	Luxembourg	Uruguay		Sri Lanka	Malaysia
					Chile	Malawi	Vatican		Ukraine	Namibia
					Colombia	Marshall Islands	Vietnam			Singapore
					Costa Rica	Monaco				Thailand
					Cyprus	Montenegro				
					Denmark	Nauru				
					Dominican Republic	New Zealand				
					European Union	Panama				
					Fiji	Portugal				
					France	Rwanda				
					Hungary	Seychelles				
					Ireland	Soloman Islands				
					Israel	Slovakia				
					Italy	Slovenia				

Net-zero target set in law or policy

Political pledge to reach net-zero

Source: What Happened During the UN World Leaders Summit at COP26 | World Resources Institute (wri.org)

Focus on India:

While there is a 20-year gap between India's 2070 net zero target and the scientific agreement on the need to achieve net-zero by 2050 globally, the Indian commitments will put the country on a low-carbon pathway and send strong signals to every sector about what lies ahead. As well as setting a net zero goal, India has set mid-term targets, committing to reduce its carbon intensity 45% by 2030 (versus 2005) and to cut carbon emissions by 1 billion tons between now and 2030.

Although we would prefer a 2050 target for all markets, the longer time horizon reflects the fact that India is simultaneously developing its economy and lifting some 360 million out of poverty[9] with multiple challenges including energy reliability. Rural communities still face recurring power outages which impact delivery of essential services such as healthcare and education.

According to the World Resources Institute (WRI), energy consumption in India is expected to grow by almost 70% between now and 2040. Renewables are therefore critical for controlling emissions, a fact reflected in the government's aggressive renewables targets – increased to 500 GW – and supported by renewable friendly policies such as priority dispatch which grants market preference to clean energy plans.[10]

These efforts have paid off — clean energy has continuously surpassed coal in new capacity additions since 2017 and the WRI evaluates that the country is on track to meet its goal of providing 50% of its electric power capacity from non-fossil fuel sources by 2030.

Despite this progress, coal remains the dominant energy source and India pushed for the watered-down language around 'phasing down' rather than 'phasing out' coal in the Glasgow Climate Pact.

A successful clean energy transition in India will require significant investment over this decade – not just in renewables, but also in other key sectors including energy storage, grid infrastructure and demand-side measures such as energy efficiency. These are all necessary steps if India is to meet its long-term climate goals, though, as India itself points out, success will also depend on support from developed-country financing and investors alike.

According to the World Resources Institute (WRI), energy consumption in India is expected to grow by almost

70% between now and 2040.

[9] United Nations Development Programme (UNDP). The 2021 Global Multidimensional Poverty Index (MPI) | Human Development Reports (undp.org)

[10] World Resources Institute, How Can Asia Achieve a Clean Energy Transition? Examples from 5 Countries | World Resources Institute (wri.org)

How does it all stack up?

While India controversially made an intervention at the last moment to water down the language of the Glasgow Climate Pact on 'phasing out' unabated coal power to 'phasing down', the conference was seen by most as a significant advance forward, improving the global heating projection from an estimated 2.6°C outcome in 2020 to 2.1°C after COP26, according to analysis by Climate Action Tracker. India's pledge alone reduced the projected temperature by an estimated 0.2°C.

However, the new estimates are dependent on every single pledge being delivered and still leaves the world far from the desired 1.5°C scenario. Overall, countries' announcements were heavy on net-zero but light on further action in the near term and achieving net-zero in the coming decades will not be possible without robust 2030 emission reduction targets. They also depend on adequate financing for developing nations and, despite new pledges made at COP26, the target of US$100bn a year in climate finance is not estimated to be met until 2023.

> **Overall, countries' announcements were heavy on net-zero but light on further action in the near term and achieving net-zero in the coming decades will not be possible without robust 2030 emission reduction targets.**

What does it mean for companies in emerging markets?

Even if countries deliver on all their pledges, thereby keeping global warming to 2.1°C above pre-industrial levels, countries will need to adapt to a hotter planet with the attendant consequences for livelihoods, food systems, physical assets and natural capital. In particular, companies in emerging markets will have to adapt to increased water scarcity (particularly relevant for the semi-conductor industry), hotter temperatures and adverse weather events. As significant contributors to global warming, companies will also need to develop their own net zero transition plans to mitigate climate change with science-based targets hard-wired into company strategy and investment plans.

How will this impact our stock selection and engagement with companies?

We will be looking for companies that are well-placed to both adapt to global warming and manage the low-carbon transition. Note that our previous survey of portfolio companies in 2020 (reported in Gemologist Q2 2020) found a disappointing level of preparedness for a 2°C world. We have been engaging with companies over the last few years and, while some companies have accelerated their ambitions (e.g. Alibaba, AIA), emerging markets lag behind overall.

Even if countries deliver on all their pledges, thereby keeping global warming to

2.1°C

above pre-industrial levels, countries will need to adapt to a hotter planet with the attendant consequences for livelihoods, food systems, physical assets and natural capital.

As a signatory of the Net Zero Asset Managers Initiative, we expect all companies to have robust adaptation plans and ideally to commit to net zero emissions by 2050 or sooner. We aim to take companies up a ladder of ambition, with the initial net zero goal then supported by short, medium and long-term targets aligned with 1.5°C. These need to be underpinned by a comprehensive strategy and capital expenditure aligned to the Paris goals and good disclosure of progress in line with TCFD recommendations. The final step is for companies to become 'Aligned' by demonstrating good progress against these targets.

There are other important elements for engagement that will support these core objectives, including demonstrable board oversight of climate change, with executive remuneration aligned to delivering net-zero goals, no political lobbying contrary to the Paris Agreement goals, and ensuring a just transition for employees and other stakeholders.

> **As signatory of the Net Zero Asset Managers Initiative… we aim to take companies up the ladder of ambition, with the initial net zero goal supported by short, medium and long-term targets aligned with 1.5°C.**

We continue to look for companies who can benefit from the low-carbon transition opportunities and have several examples of companies at the portfolio level which are either tackling or providing solutions to climate change. These include:

- NARI Technology, China – upgrading the grid in China for the country's de-carbonisation plans;
- WEG, Brazil – providing components for renewable energy;
- EPIROC, Sweden – electric-powered excavating and drilling equipment helping mining companies to 'green' their operations;
- Techtronics Industries, China – disrupting traditional (gasoline) power tools with cordless battery technology;
- Delta Electronics, Taiwan – a leading global provider of power supplies and green energy applications.

ENGAGEMENT CASE STUDY

JD.com

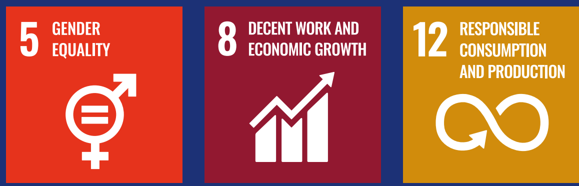
"Dialogue with the engagement team has allowed us to be better informed about global best practice in ESG and consider investor priorities." Andrew Wang, Investor Relations, JD.com, Inc.

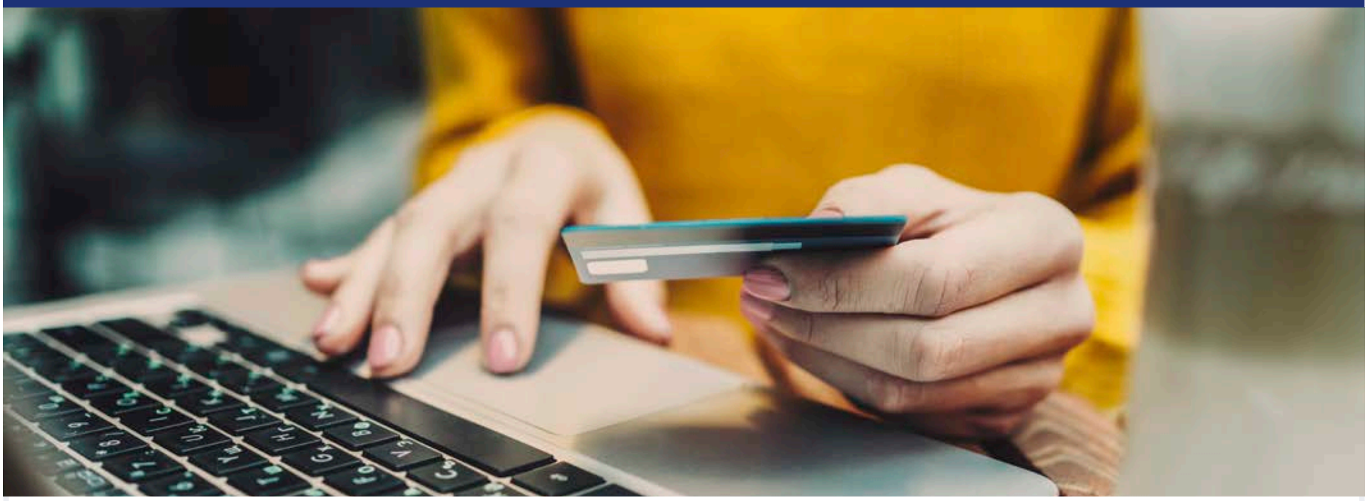
JD.com published its first ESG report in April 2021 and its second sustainability report in June 2021. JD also held its first shareholder meeting in June 2021 with appointment of its first female board director. We are pleased with its changes and, supported by our stewardship team, EOS at Federated Hermes, continue to engage with the company on furthering improvements on ESG issues.

Engagement objectives:

- Governance: Board composition – gender diversity
- Governance: Establish regular (annual) shareholder meetings

Sustainable Development Goals:





2017

- We began engagement on shareholder rights/holding shareholder meetings and lack of board diversity.

2018

- JD.com noted our concerns on board diversity and a lack of structure on feedback processes for minority shareholders but remained resistant to change.

2019

- The company acknowledged our concern again that the board lacked diversity.
- JD.com indicated that it was planning to hold a shareholder meeting later that year.

2020

- JD.com was unresponsive to our requests for engagement.

2021

- Personnel changes at JD.com allowed us to resume our engagement.
- JD.com held its first shareholder meeting.
- The company appointed its first female board director and published its first ESG report and second sustainability report.

Background

Since its initial public offering (IPO) in 2014, although JD.com had released a corporate sustainability report up until 2018, it had not issued a standalone ESG report or held an annual shareholder meeting. This was partly because there was no specific requirement from NASDAQ or the Securities and Exchange Commission to disclose ESG information, and US-listed companies that are registered in the Cayman Islands are not legally required to hold shareholder meetings. The lack of shareholder rights, lack of diversity on a male-dominated board and limited detailed ESG disclosure were key concerns for Federated Hermes. Engagement was initially challenging due to a lack of wider market pressure in the region. However, following the scandal regarding alleged misconduct of JD.com's founder in 2018, we stepped up engagement on governance, board composition, female diversity and inclusion.

Company overview

Founded by Qiangdong (Richard) Liu in 1998, JD.com is a Chinese supply-chain-based technology and service provider listed on NASDAQ and SEHK. It is one of the largest e-commerce companies in the world with over 500 million active customers, offering a wide selection of products through its website and mobile applications.

Our engagement

We began engaging with JD.com on shareholder rights in December 2017. We explained that holding an annual shareholder meeting allows minority shareholders to vote and elect independent directors aligned with their interests, in addition to voicing concerns and questions directly to the company.

We also raised our concerns on board composition, lack of diversity, lack of a structured feedback process and lack of ESG disclosures in March 2018. We intensified our engagement with the company by reiterating our concerns in September 2018, which were acknowledged. In addition, we urged the company to consider setting a plain and clear process to identify the right combination of skills and experience for board directors.

> **We also raised our concerns on board composition, lack of diversity, lack of a structured feedback process and lack of ESG disclosures in March 2018.**

Between 2018 and 2020, we had eight interactions with the company focusing on shareholder rights, diversity and ESG disclosure. We recommended the company provide an explanation of how human capital management, diversity and inclusion are linked to its core values and culture, along with quantitative and qualitative disclosure on diversity and inclusion. We shared best practice examples of disclosure focused on governance and culture, diversity and inclusion and organisation health, safety, and wellbeing.

Changes at the company

The company acknowledged our concerns over the lack of diversity first raised in 2018, during positive engagement in January 2019. The company informed us that prior to the IPO, it looked for a female director, but the candidate decided not to pursue the opportunity.

> **The company acknowledged our concerns over the lack of diversity first raised in 2018, during positive engagement in January 2019.**

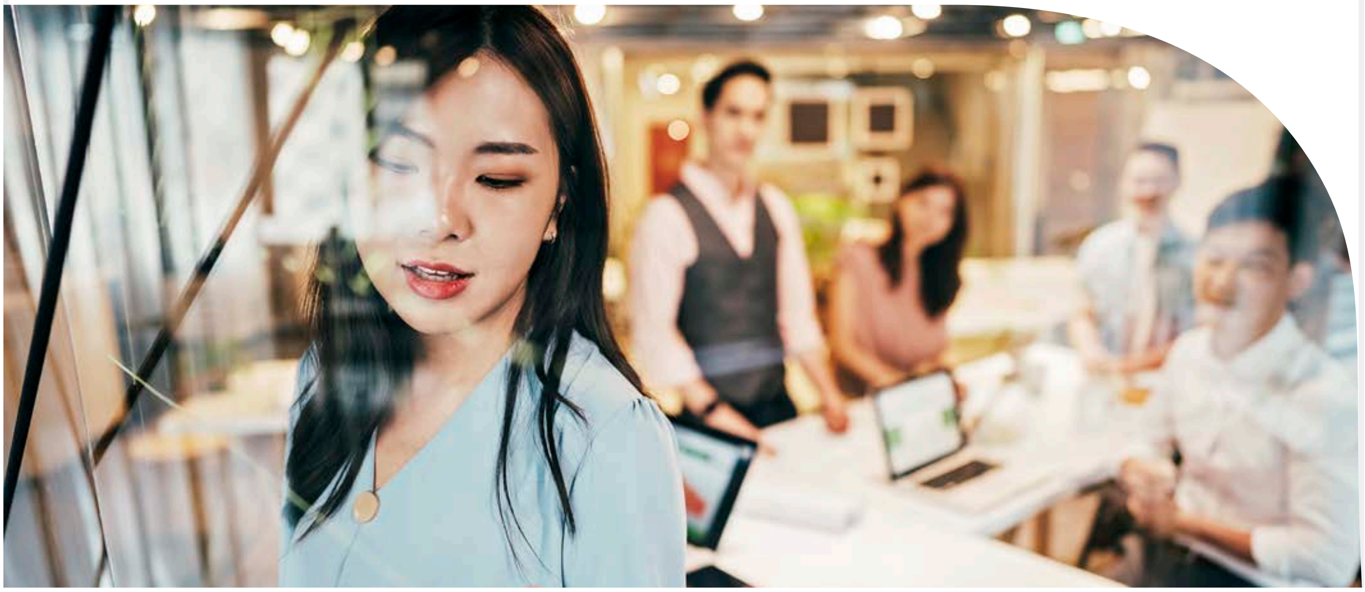
The company noted it was considering holding a shareholder meeting after we raised the issue in 2017. It also told us it would use the best practice ESG disclosures we shared and seek to apply global ESG reporting standards to its first standalone ESG report.

After the engagement with a senior executive in April 2021, the company published its first ESG report at the end of the month, covering topics discussed in our engagement. We welcomed its disclosure on corporate governance structure, data privacy and cybersecurity management, and commitment to achieve decarbonisation. The reports meet international standards, and we expect further disclosure on human capital management and employee turnover rates. The company also confirmed its arrangements for its first annual general meeting on 23 June, in line with our request. In addition, we welcomed the appointment of its first female director to the board this year, a good step towards improving board diversity, in line with our expectations.

> **In addition, we welcomed the appointment of its first female director to the board this year, a good step towards improving board diversity, in line with our expectations.**

Next steps

We welcome the improvements made by JD.com and continue to encourage further disclosure on ESG topics including plastic recycling, climate change, human capital management, diversity and inclusion and its dual share structure.



ENGAGEMENT CASE STUDY

Samsonite

Samsonite has launched a sustainability strategy to 2030, including plans to use 100% renewable energy and achieve operational carbon neutrality by 2025. On supply chain human rights, the company will expand existing social compliance programmes to identify, mitigate and remediate possible negative human rights impacts. We continue to engage the company on these issues.

Engagement objectives:

- Environmental: Climate change; product innovation and circularity
- Social: Supply chain human rights

Sustainable Development Goals:

Background and company overview

Samsonite designs, manufactures and sells luggage, outdoor and casual bags, business and computer bags and travel accessories. The company sells its products through wholesale and retail channels in more than 100 countries including through over 1,000 self-operated retail stores. It has a global manufacturing footprint, with three primary owned manufacturing sites in Belgium, Hungary and India as well as predominantly outsourced manufacturing in Asia. The company's sales are distributed across North America, Asia, Europe and Latin America. The company is listed on the Hong Kong exchange and is joint headquartered in the US and Luxembourg.

Our engagement

We have met extensively with Samsonite's management, including the chair, CEO, sustainability director, research and innovation director and others. We began discussions with the company about waste, product innovation and circular design and production in 2018 when we spoke with the newly appointed CEO. The CEO agreed this was important and told us that a range of products using recycled materials would be trialled soon. The plan at the time was focused on use of sustainable materials. When we enquired about end of life and recyclability of products, the CEO explained that a sustainability director was to be appointed and responsible for reviewing the strategy across all material sustainability issues.

Our introductory call with the sustainability director in 2018 gave us the opportunity to share our view of the company's material sustainability risks and opportunities and hear about its priorities and next steps. In 2018 we also met with the research and innovation director of Samsonite Europe, who explained how sustainability and circular economy issues are incorporated into the company's product development process. We discussed the recent eco-range of suitcases made using production waste; there are challenges to scaling the range, but there are some opportunities to replicate the same development principles elsewhere. We continued our conversations on this in 2018 and 2019 with a variety of senior management.

Improved climate change commitments have also been key aspects of our engagement.

Improved climate change commitments have also been key aspects of our engagement. Although it measured and disclosed emissions, prior to 2020, the company did not have any clear public targets and commitments to address climate change.

In addition, we have consistently raised the question of respecting human rights, in particular related to working conditions in the outsourced, global value chain. We have had useful discussions about the changes to the company's supply base and how best to approach risk management and due diligence when this has stabilised.

Changes at the company

We were pleased to see the commitment to circular economy as one of the key pillars of the company's sustainability strategy in 2020, in line with our discussions. This includes increasing materials with sustainable credentials, but also developing solutions to end-of-life of products, seeking to divert as many products as possible from landfill.

We spoke with the CEO after the strategy was launched in late 2020 and it was good to hear him give full support, despite the challenges of the pandemic. Examples of the progress the company has made towards its commitments include the launch of Proxis in 2020, its first travel collection using Roxkin, a patented material which is strong and light enough for luggage but also recyclable. When it comes to the end of life, Samsonite will collect and recycle for up to 20 years post purchase.

> **We were pleased to see the commitment to circular economy as one of the key pillars of the company's sustainability strategy in 2020**

It also launched its first range of backpacks made entirely from recycled fabrics. The company calculated that the carbon footprint of the backpack is less than half that of a conventional backpack. It also provides global repair warranties. As of H1 2021, approximately 15% of global sales across a range of its brands were from products with a 'sustainable attribute', compared to ~7% for FY2019.

On climate change, we were pleased to see the company detail specific carbon management commitments and quantitative targets in the strategy launched in 2020. These include:

1. To use 100% renewable energy.
2. To achieve operational carbon neutrality by 2025.
3. To reduce carbon intensity of operations 15% by 2025 (compared with 2017).
4. To estimate, track and support actions to reduce Scope 3 emissions.

During 2020, absolute emissions decreased significantly as a result of Covid-19-related reductions in production. More importantly however, was the group's recognition that its principal carbon footprint is upstream in its supply chain. It is positive therefore that the company in 2021 is conducting a pilot effort to estimate, track, and reduce Scope 3 emissions through engagement with key suppliers.

We were also pleased that the company has made a clear commitment to supply chain human rights. It has committed to expand the existing social compliance programme to identify, mitigate and remediate possible negative human rights impacts of the business. This will include enhanced due diligence processes, starting with a human rights country risk assessment, now that the supplier and country diversification work has completed.

In 2020 the company updated its Ethical Charter to be more comprehensive and aligned to new regulation, as well as being aligned to the International Labour Organisation's principles. The company also plans to expand due diligence to its top 100 tier-two suppliers, i.e., suppliers that provide components for the first tier of suppliers which produce finish goods.

Next steps

In the future, we hope to see the company develop and report against metrics which would demonstrate the scale of its progress in implementing circular production and innovation and allow it to target even greater integration into its product offerings.

We will continue to engage on the challenge of Scope 3 upstream in the supply chain, as well as how it might begin to consider the use of its products within Scope 3. We would also like to see the company consider science-based targets for its climate-change commitments.

We hope to see further progress on its supply chain human rights work. The company should report on how it aligns to the United Nations Guiding Principles on Business and Human Rights, disclose its salient risks, such as modern slavery, and provide more details about how it can design due diligence to assess any actual impacts of these risks and what remedy can be provided in order to ensure decent work for the people in its supply chain.

Federated Hermes Limited

Federated Hermes

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

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

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

All activities previously carried out by Hermes Investment Management are now undertaken by Federated Hermes Limited (or one of its subsidiaries). We still offer the same distinct investment propositions and pioneering responsible investment and stewardship services for which we are renowned – in addition to important strategies from the entire group.

Our investment and stewardship capabilities:

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

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

BD00931. 02/22 0012412

SAI GLOBAL
ISO 14001
Environmental