

# Sustainability Risks Policy

This Policy applies to investment portfolios managed on behalf of investors based in the European Union ("EU"). Hermes Fund Managers Ireland Limited ("HFMI") is appointed as the Manager for portfolios based in the EU, including funds and segregated mandates. Hermes Investment Management Limited ("HIML") and Federated Investment Counseling ("FIC") have contractual responsibilities where they are appointed by HFMI as sub investment manager for EU investment portfolios. HFMI, HIML and FIC are collectively referred to as "Federated Hermes" in this document. Hermes GPE LLP is not in scope of this policy. For those investment portfolios in scope of the EU Sustainable Finance Disclosure Regulation ("SFDR"), this Policy meets requirements to formalise and disclose how sustainability is integrated into the business and investment processes. This is considered through integration of sustainability risks into investment process and engagement. For a list of funds that are in scope of SFDR see Appendix A

With the exception of Hermes GPE LLP, the processes and approach outlined within this statement are also relevant across all Federated Hermes Limited funds and segregated mandates, including those not in scope of SFDR. As at 31st May 2022, this includes our real estate and private debt funds. Hermes GPE LLP has a separate sustainability risks policy.

## Definitions

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

**Active Ownership** means actively exercising shareholder rights by voting at meetings and engaging with companies to encourage responsible corporate behaviour.

**Sustainability risks** are environmental, social and governance (ESG) risks relating to our investee companies and assets. ESG issues constitute the three pillars of responsible investing.

**ESG Integration** is an investment approach that integrates sustainability and ESG related factors into the investment decision process.

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

## Sustainability Risks

Sustainability risks may emerge from internal issues (such as governance structures, how the board holds executives accountable, lack of board diversity, or reputational risks arising from health and safety, human rights or environmental violations) or external sources (such as supply chains, regulatory change caused by industry change or inequality). Inadequate sustainability practices of investee companies can lead to, among other things, inefficiencies, operational disruption, litigation and reputational damage. These factors

have the potential to adversely affect the value of investments and create more risks for investors.

The way in which we take account of the principal adverse impacts of our investment decisions on sustainability factors is described in our [Statement on Principal Adverse Impacts](#).

## Why we integrate sustainability risks and ESG and stewardship insights

Federated Hermes is guided by the conviction that responsible investing is the best way to create sustainable wealth. Our goals are to help individuals invest and retire better, to help clients achieve better risk-adjusted returns, and, where possible, to contribute to positive outcomes in the wider world, consistent with client objectives and applicable requirements.

While the most pressing material risks are those that will crystallise in the short term, we are long-term investors that strive to achieve sustainable, long-term wealth for our clients and the end beneficiary investor. We integrate our deep understanding of ESG and sustainability risks into our analysis of every company and our investment decisions. The consideration of ESG and sustainability factors involves the integration of risk factors including a company's relationship with its stakeholders as well as its impact, through both its operations and the products and services it offers, on the environment and wider society. For the largest systemic risks, such as climate change, we use our influence as active owners to drive positive change, working with other investors where necessary.

Federated Hermes does not see the integration of ESG and sustainability information into investment decisions as a separate category of investing. Rather, we believe that material ESG risks and opportunities should inform all investment decisions. That is why we integrate ESG and sustainability considerations into all of our products and across all parts of our investment processes, from idea generation and portfolio construction to exit. We have also invested in strong engagement and advocacy capabilities to seek to mitigate sustainability risks in our investments, as we describe further below.

## The role of engagement and advocacy in managing sustainability risks

Engagement and advocacy are key to managing sustainability risks. To effectively measure and manage sustainability risks, we aim to be a good steward and owner of companies and assets through our asset engagement and advocacy. These activities are resourced by extensive in-house technical expertise in our investment and stewardship teams and the Responsibility Office.

As a responsible owner, we actively engage with companies and the other assets we invest in to align their actions with the long-term interests of the end investor. This engagement encourages appropriate governance structures and behaviours and a clear business purpose and strategy, taking

into account the interests of all relevant stakeholders including the environment and society at large.

We have a well-established outcomes-based philosophy that underpins our approach to engagement and stewardship. There are clear and well-established protocols on how to identify engagement objectives, to escalate and to measure an engagement's effectiveness.

In public markets, the majority of dialogues that form Federated Hermes' engagement with investee companies are conducted by our stewardship services team EOS at Federated Hermes ('EOS'). Members of EOS may be joined by relevant portfolio managers or analysts from our investment teams. Our investment teams also regularly discuss salient ESG issues with company management directly. The Responsibility Office ensures that our investment teams and EOS work closely together with a joined-up approach. We adopt a systematic approach to identifying companies for engagement. We select companies and tailor the intensity of engagement based on the size of our investment, materiality of the risks and issues, and feasibility of achieving change through engagement. Our Global Voting Policy and Guidelines, which are aligned with EOS' Global Voting Guidelines, inform the voting decisions made by our investment teams. Our Guidelines are informed by a hierarchy of external and internally developed global and regional best practice guidelines. Voting rights are exercised with a view to achieving best practice standards of corporate governance and equity stewardship and with the aim to support the delivery of long-term value in our funds.

Within private markets, our Real Estate team has an extensive community and occupier engagement programme. The investment team works with our property and asset managers on site to engage with the delivery teams, tenants, occupiers and visitors. Our private debt teams focus on identifying current and potential meaningful ESG risks before investing, due to the difficulty of divesting and the capped upside. Because of a lack of third-party data, the teams use more qualitative information – often gained through dialogue with the borrower – as well as information contained in the due-diligence packs. Should an ESG issue arise during the life of the investment, the investment team will seek to engage directly with the borrower. The ESG subject matter expertise of EOS informs the investment teams' own engagements with investee companies and assets.

Our [Engagement Policy](#) sets out the details of how engagement is undertaken across asset classes.

In addition, we have a substantial advocacy programme, where we engage with public policymakers, regulators and industry bodies to enhance industry norms, market rules and regulatory requirements in relation to corporate governance, stewardship and environmental and social policy globally and regionally. We engage constructively to address environmental, social and other market failures that may prevent the financial system from operating in the best interests of its ultimate asset owners, including in relation to sustainability risks. We are involved in a wide range of industry initiatives. Through these initiatives we engage with others

both within and beyond the investment industry to promote responsible investment, including ways that the industry and our investees can respond to market-wide and systemic issues such as climate change. Our advocacy work also acts as a source of information to inform our engagement and investment processes.

More information on our advocacy work, the initiatives in which we are involved, our engagement and our voting activities is available in our Stewardship Report on our [website](#).

## Integration of sustainability risks and engagement insights in investment decisions

We integrate ESG considerations and engagement insights into our investment processes in all of our products, across all asset classes.

All investment teams incorporate ESG factors into their investment process by accessing quantitative and qualitative ESG and engagement information using our in-house expertise and proprietary and third-party research and by undertaking their own fundamental research. Research and analysis by all of our investment teams includes an evaluation of performance on strategy, financials, material risk and ESG factors, and the interplay between these elements.

Insights from engagement with company management, boards, subject specialists and other shareholders and stakeholders – including the extent of engagement progress – is a key input into this process and investment decisions at a portfolio and individual asset level. Such engagement is carried out in a co-ordinated manner both by our investment teams and by EOS to maximise the impact of our engagement. These factors influence decisions to invest and are also actively monitored after investment, with the potential to influence decisions to sell an asset or increase the size of our investment. Where concerns arise in relation to one of our existing investments, engagement is often a means to both raise concerns with the company and, where effective, reduce the investment risk and enhance the opportunity from the investment.

We believe that investors who want to authentically integrate sustainability risks in their investment decision making should not rely on quantitative data alone, as it is often backward looking and updated infrequently and with a time lag. As such, active ownership is an important pillar of our investment approach. The voting and engagement activities of our stewardship and investment teams can promote positive change within companies, unlocking hidden value and also providing a forward-looking view of ESG and broader performance that can lead to opportunities.

Whilst the philosophy and approach is consistent across all our investment teams, each investment team has developed its own methodology and framework for integrating ESG and engagement insights into its investment process that is compatible with its asset class and investment strategy.

## Public markets

**Our public markets investment teams** incorporate ESG and sustainability factors into their investment process through primary research and by using a range of in-house and team-specific proprietary stewardship, ESG and sustainability tools. These shed additional light on an investee company's or asset's ESG performance and sustainability risks and opportunities and the effectiveness of engagement in addressing these. This information is considered throughout the investment process in a way that is tailored to the specific investment strategy. ESG factors and engagement insights can be a component of a screen, a source of ideas, an input into fundamental analysis or an adjustment to valuation drivers and/or a portfolio construction factor. We continue to monitor these ESG factors post-investment.

Our proprietary ESG tools of particular note are:

- Our **ESG Dashboard** includes our proprietary Quantitative ESG (QESG) Score and identifies stocks with positive ESG characteristics and/or stocks demonstrating positive ESG change. The QESG score captures how a company manages its ESG risks.
- Our **Carbon Tool** enables fund managers and engagers to identify carbon risks in portfolios and companies that currently exist or may develop in the future. Importantly, the tool incorporates our stewardship activity and intelligence and is able to identify companies that are priorities for engagement and their progress against environmental objectives.
- The **Portfolio Snapshot** allows us to observe the aggregate ESG risks across our portfolios relative to their benchmarks. It also examines ESG ratings and controversies and identifies contingent risks. Our portfolio managers use this tool to evaluate a strategy's ESG performance over time. It also provides insights into engagement and the progress made, and our voting choices relative to the benchmark.
- Our **Corporate Governance Tool** provides a breakdown of corporate governance characteristics, such as information on board independence, diversity and audit tenure, etc. This tool compares the governance of companies to the expectations we have set and flags any companies that do not meet the expected standard.
- Our **Environmental Tool** assesses both portfolios and companies on their carbon, water and waste performance. It also looks to quantify the environmental cost of the impact via the following six lenses; carbon, water, waste, air pollutants, land/water pollutants and natural resource use. In addition, we have incorporated the temperature alignment of portfolios and companies alongside exposures to carbon intensive sectors; namely fossil fuels, mining and thermal coal.

Through these tools, along with additional EOS engagement information, the public equities and fixed-income teams have access to third-party ESG data, as well as insights on engagement carried out by EOS with investee companies and the broader investable universe. These sources are a valuable input into the investment process, as well as to the ongoing monitoring of and engagement with companies.

## Private Markets

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

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

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

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

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

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

For our **real estate** team, ESG is integrated into the investment strategy and working practices of all of our real-estate portfolios. A consideration of ESG principles is embedded into the property selection and investment

process, including through initial screening and due diligence and as part of the investment decision.

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

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

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

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

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

## Independent oversight

All of our investment activity is supported by our dedicated Investment Office and Responsibility Office, both of which report directly to our CEO in order to provide independence

from the investment process. The Investment Office provides a robust and transparent risk framework. On a look back, real time, and forward-looking basis the team actively monitors fund risk and helps to deliver sustainable risk-adjusted alpha, while acting as an early warning system to identify potential problem areas. It has overall responsibility for the consistency of performance and thus ensures that investment teams stay true to their processes, including oversight of ESG and engagement integration.

Our Responsibility Office is tasked with coordinating and supporting the development of our policies and their subsequent integration across our funds and stewardship services. The Responsibility Office is tasked with monitoring and overseeing every investment team's approach to integrating ESG and engagement insights into their investment decisions and the monitoring of investees. To that effect, the Responsibility Office meets with every investment team on a quarterly basis to review the portfolio holdings from a stewardship and ESG perspective and flag, if necessary, particular holdings which primary research or our third-party ESG data vendors might have highlighted as controversial.

The Responsibility Office also assesses each of the investment teams on their ESG integration approach using an in-house ESG assessment matrix. These three areas are then broken down further and reviewed to assess the following:

- **Investment process** – This assesses the philosophy of the team with regards to ESG, whether it has a good understanding of material ESG factors for its investment universe and reviews the activities the team undertakes to ensure it remains abreast of developments in the market on ESG topics. In addition, it also assesses where in the investment process the team integrate ESG and stewardship insights and how this impacts investment decisions.
- **Communication** – This assesses how clearly the investment team and the rest of the business articulate the ESG and stewardship approach of an investment strategy and how it reports on its ESG performance.
- **Advocacy** – This assesses if and how actively the teams are involved in initiatives, both internally and externally, on ESG themes as well as ESG and stewardship integration in asset management.

Additionally, our dedicated Reputational and Sustainability Risk team enhance the role of the second line of defence in providing independent oversight and challenge to our approach to corporate sustainability. Sustainability risk is integrated within the existing risk management framework to enable the business to identify and manage material ESG risks across our value chain. It is also considered as related to, and a driver of, established risk categories within this framework (e.g. credit, market and operational risks). The team also works alongside the Responsibility Office in overseeing that our business continues to, authentically and accurately, disclose our ESG objectives and activities in order to manage the associated reputational risks.

## Appendix A

The following funds are in scope of the EU Sustainable Finance Disclosures Regulation, as 31st March 2022:

Federated Hermes Global Emerging Markets Equity Fund  
Federated Hermes Global Equity Fund  
Federated Hermes Global Equity ESG Fund  
Federated Hermes Sustainable European Equity Fund  
Federated Hermes Global High Yield Credit Fund  
Federated Hermes Sustainable Europe ex-UK Equity Fund  
Federated Hermes Asia ex-Japan Equity Fund  
Federated Hermes US SMID Equity Fund  
Federated Hermes Multi-Strategy Credit Fund  
Federated Hermes Global Small Cap Equity Fund  
Federated Hermes Absolute Return Credit Fund  
Federated Hermes SDG Engagement Equity Fund  
Federated Hermes Impact Opportunities Equity Fund  
Federated Hermes Unconstrained Credit Fund  
Federated Hermes Global Emerging Markets SMID Equity Fund  
Federated Hermes Emerging Markets Debt Fund  
Federated Hermes SDG Engagement High Yield Credit Fund  
Federated Hermes China Equity Fund  
Federated Hermes US High Yield Credit Fund  
Federated Hermes Sustainable Global Equity Fund  
Federated Hermes Climate Change High Yield Credit Fund  
Federated Hermes Sustainable Global Investment Grade Credit Fund  
Federated Hermes Biodiversity Equity Fund  
Federated Hermes European Direct Lending II Fund

## 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](http://www.hermes-investment.com) or connect with us on social media:

