Federated Hermes
EOS

Hermes Equity Ownership Services Limited
150 Cheapside, London EC2V 6ET
United Kingdom

+44 (0)20 7702 0888 Phone
+44 (0)20 7702 9452 Fax
www.FederatedHermes.com

Dear Sir/Madam,

EOS at Federated Hermes engages with companies around the world on behalf of global institutional investors, representing assets of US$1.34tn (December 31, 2022). We believe the purpose of investment is to create wealth sustainably over the long term. We therefore focus our stewardship on the issues with greatest potential to deliver long-term sustainable wealth for clients and their investors.

The war in Ukraine, uneven global post-pandemic recovery and the increasing severity of extreme weather events linked to global warming are contributing to an energy and cost of living crisis, increasingly disaffected employees, and increased risks of human rights violations worldwide. In this context, we have updated our expectations of companies in our 2023-2025 Engagement Plan and 2023 Japan corporate governance principles and we want to highlight the following expectations of companies this year.

Corporate governance, purpose, and capital allocation

Robust governance, led by effective boards, is an essential foundation for companies to succeed in the long-term and we encourage them to adhere to the highest standards, not limited to local regulations. A clear and meaningful purpose should guide company strategy and capital allocation, enabling boards and management teams to identify the right things to do in the short term – in particular at times of economic distress, such as during the current cost of living crisis – in order to fulfil their purpose and best support sustainable returns over the long term.

Companies should be guided by sufficiently independent boards that bring the right range of competencies, knowledge and experience to enable them to effectively carry out their duties and responsibilities. We believe diversity in the broadest sense – including of demographic characteristics such as race, gender, nationality and socioeconomic background – enhances the quality of board performance and corporate decision-making and so, in 2023, we will seek continued progress.

In Japan, we may recommend voting against the chair of nomination committee, chair of the board or CEO/President of the companies that do not meet the following minimum expectations:

- Companies listed on the Prime Market to achieve at least one third board independence
- TOPIX 100 companies where less than 15% of directors are female and all other companies where less than 10% of directors are female.

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Climate change and biodiversity

We expect companies to put in place strategies and actions aligned to the goals of the Paris Agreement, seeking to limit climate change to 1.5°C, with business models resilient to future climate change and financial accounts and political lobbying aligned to this strategy. In addition, in the light of the historic UN Kunming-Montreal Global Biodiversity Framework and commitments agreed at the end of 2022, we expect companies to identify, assess and measure their impacts and dependencies on biodiversity and ecosystem services, and aim for a net-positive impact on biodiversity.

We will consider recommending against support for the re-election of the chair or other responsible directors where we believe companies' actions are materially misaligned with the goals of the Paris Agreement or not responding sufficiently to the risks and opportunities posed by biodiversity loss. Indicators we will consider include:

- Companies identified as lacking robust medium-term greenhouse gas emissions reduction targets [insert date range] by the Climate Action 100+ (CA100+) benchmark[1]
- Companies identified as failing to appropriately reflect material or potentially material climate-related risks in their financial statements by the CA100+ benchmark[2]
- Companies scoring below 3 on the TPI Management Quality Score[3], or any oil, gas, coal, utilities or automotive companies scoring below 4
- Companies included on the Global Coal Exit List,[4] particularly those listed as expanding coal-related infrastructure
- Companies and financial institutions scoring very poorly on the Forest 500 rankings[5]

Human rights

We expect companies to acknowledge the likelihood that human rights impacts may be present within operations and supply chains and demonstrate appropriate board and executive-level governance of human rights, including a human rights policy in line with the UN Guiding Principles on Business and Human Rights (UNGPs). Following the recent publication of EOS' Digital Rights Principles,[6] we will intensify our focus on the protection of personal rights in the virtual world, including the right to data privacy, the right to freedom of expression and protection from unfair biases arising from artificial intelligence.

We may consider recommending against a relevant director, report or management discharge if a company is in clear breach of its human rights responsibilities and is not taking insufficient action to address this, including companies that appear to be in breach of the principles of the UN Global Compact or those scoring significantly lower than industry peers on the Corporate Human Rights

[1] Companies scoring 'No' on Indicator 3 (medium term targets) Net Zero Company Benchmark | Climate Action 100+
[2] We will begin by assessing this for companies in the EOS active engagement programme but will likely expand this to more companies in the coming years
[3] Tool - Transition Pathway Initiative Tool - Transition Pathway Initiative
[4] Home | Global Coal Exit List
[5] Forest 500 |
[6] The digital dilemma | Federated Hermes Limited (hermes-investment.com)

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Benchmark,[7] the Ranking Digital Rights Index,[8] the BankTrack Human Rights Index[9] or the Know The Chain Index.[10]

Human capital and executive remuneration

For most companies, the people in its business are together one of their most valuable assets. Against a context of widening income inequality, a global cost of living crisis and uneven post-pandemic recovery, we expect companies to provide good quality employment that protects employees' physical and mental health. We support the payment of living wages - or reward packages broadly equivalent in value and equivalently valued by employees, supported by robust evidence - across direct operations and supply chains.

We will be assessing executive pay against the same context, with particular scrutiny of any executive pay increases that appear misaligned with the workforce and any incentive schemes granted during the pandemic that are vesting now and appear to have produced undeserved 'windfall gains' for executives as markets rebounded. Boards will need to ensure fair pay across all levels of the organisation and ensure that senior executives are not disproportionately rewarded at a time when the wider workforce is under financial strain.

We also continue to make the case for simpler pay schemes based on long-term time-restricted stock and share ownership. In Japan, we are likely to oppose pay proposals with any of the following features (see our CGPs for more detail):

- Significant pay increases for executives without a robust justification
- Stock option unless the vesting period is at least three years or longer.

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

Yours sincerely

Engagement, EOS at Federated Hermes
haonan.wu@FederatedHermes.com

[7] Corporate Human Rights Benchmark | WBA (worldbenchmarkingalliance.org)
[8] The benchmarks considered include: Corporate Human Rights Benchmark, Bank Track, Know the Chain and Ranking Digital Rights.
[9] BankTrack – The BankTrack Human Rights Benchmark
[10] KnowTheChain – KnowTheChain