Public Engagement Report

GOING UP IN SMOKE
Can carbon capture ever deliver?

Green bonds boom boosts credit engagement

Asian regulators grapple with corporate governance reforms

Q1 2024

Federated Hermes
EOS

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Welcome to our Public Engagement Report for Q1 2024. In our cover feature this quarter, we take a deep dive into carbon capture, utilisation and storage (CCUS), which hard-to-abate industries are likely to rely on to help reduce their emissions to net zero.

To date, attempts to commercialise CCUS at scale have disappointed, and it has attracted criticism from those who see it as a fig leaf for business-as-usual. In their article, Michael Yamoah and Shoa Hirosato examine the evidence and weigh the arguments for and against CCUS. They set out how investors can challenge companies' claims through engagement, and how to monitor their progress.

Green bond issuance has boomed over the last five years, prompting greater regulatory scrutiny as well as more awareness and acceptance of bondholder engagement. In our second feature, Ross Teverson looks at the benefits of engaging across the capital structure, and how we have evolved our approach to credit engagement as the size of the sustainable bond market has grown.

Finally, Haonan Wu explores recent corporate governance reforms in Japan, South Korea and Greater China where regulators are trying to boost shareholder value, and assesses whether we are starting to see genuine improvements at the company level.

Claire Milhench
Associate Director – Communications & Content

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Is carbon capture the climate fix we need?

To date, carbon capture, utilisation and storage has been long on promises and short on delivery. But hard-to-abate industries are likely to rely on the technology to get to net-zero emissions. Michael Yamoah and Shoa Hirosato examine the implications for companies and investors.

Setting the scene

Proponents of carbon capture, utilisation, and storage (CCUS) argue that it will be a critical component in hard-to-abate sectors such as energy, cement, and other industrials. This is due to technical challenges related to high heat requirements and carbon emissions.[1] The International Energy Agency's Clean Technology Scenario, which is in line with the Paris Agreement ambition, estimates that one-fifth of emissions reductions needed across such industries will come from CCUS. However, to date, attempts to commercialise CCUS at scale have disappointed, and sceptics decry it as a fig leaf for business-as-usual.

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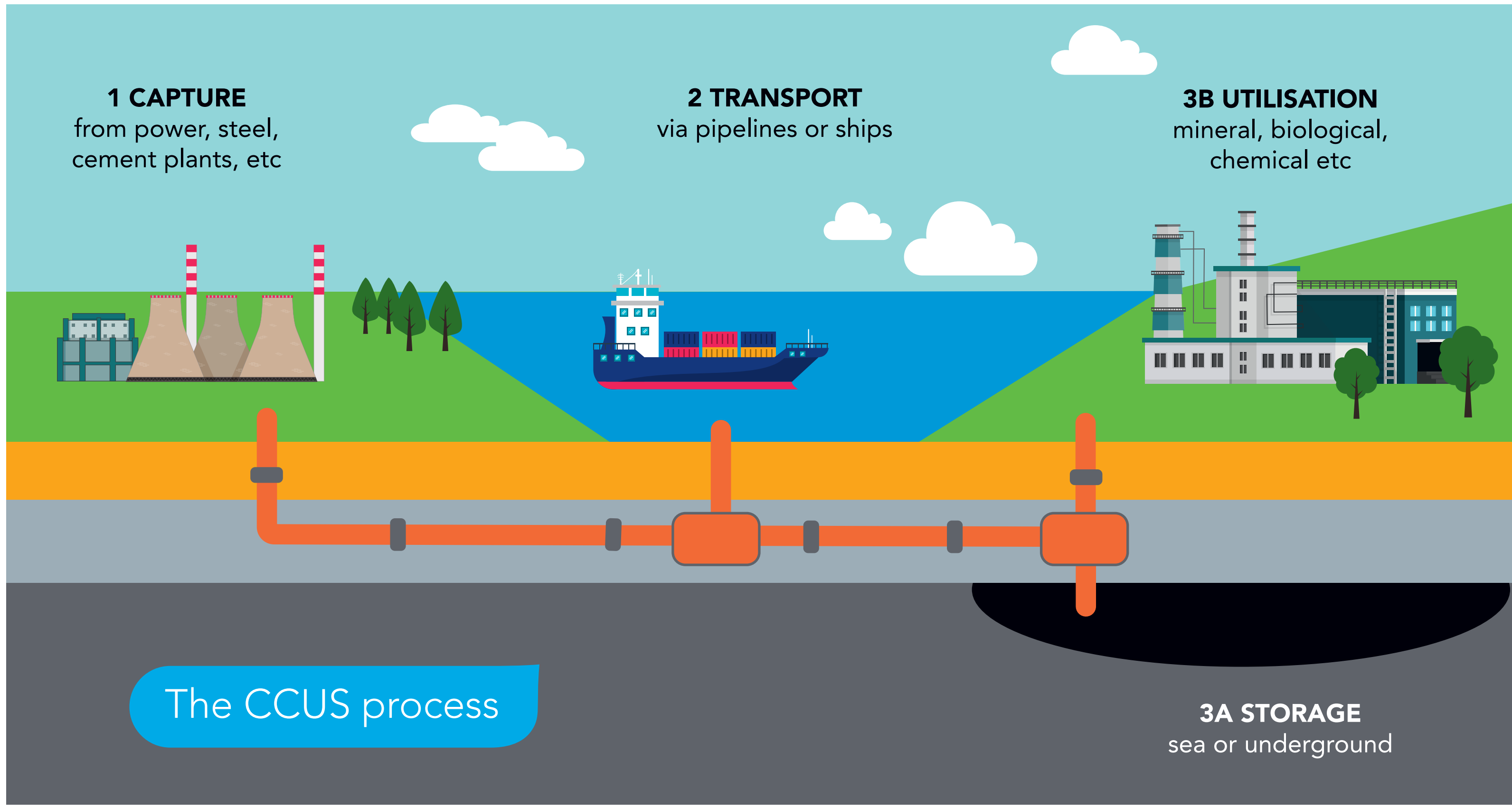
The world faces a significant challenge in limiting global warming to 1.5°C. Achieving this goal will require drastic reductions in greenhouse gas emissions, particularly CO_2 and methane, to reach near zero by mid-century. While essential, this transition presents major hurdles for certain sectors and regions due to technical and economic limitations. In this context, carbon capture, utilisation, and storage (CCUS) has emerged as a critical potential solution.

CCUS is a set of technologies capturing carbon from different sources such as power plant exhausts or directly from the air, which is then transported. This is either for use in various industrial purposes or for permanent storage underground. Most Intergovernmental Panel on Climate Change (IPCC) models aligned with the 1.5°C target rely on carbon dioxide removals (CDRs), which is why CCUS is seen as a crucial tool for tackling the climate crisis, particularly for hard-to-abate sectors.

[1] Scaling the CCUS industry to achieve net-zero | McKinsey



Source: International Association of Oil and Gas Producers https://www.iogp.org/blog/news/developing-low-carbon-technologies/

Where is CCUS expected to be needed?

Hard-to-abate industries such as steel, cement and other building materials, and chemicals require high temperature heat from the burning of fossil fuels and emit carbon dioxide from unavoidable chemical reactions. These industries currently lack commercially viable alternatives that can reduce carbon emissions in operations. CCUS technologies therefore present an opportunity to reduce emissions where fuel substitution or complete electrification is not feasible or cost effective, and can be retrofitted to existing facilities.

In the utilities sector, CCUS is considered as "an enabler of least-cost low-carbon hydrogen production".[2] Hydrogen is an emerging green energy solution, which can be produced from many sources, including natural gas and electricity from the grid. The most common type - grey hydrogen - is produced from natural gas but emits a significant amount of CO_2.[3] This has prompted interest in so-called blue hydrogen, whereby CCUS technologies are used to capture and store CO2 underground.

The oil and gas sector has made significant investment in various CCUS technologies. For example, natural gas processing makes use of CCUS technologies to separate CO_2 to form purer gas streams. Captured CO_2 is widely used in enhanced oil recovery (EOR) - injecting CO_2 into existing oil fields to increase pressure and oil yields,[4] and in some cases resulting in storage. With few decarbonisation alternatives, oil and gas companies are heavily reliant on CCUS to offset the unavoidable emissions. However, there is doubt that it will be used at scale. One study notes that "without EOR and [the] efforts of oil giants, CCUS technology would not survive as a mitigation option considering its poor project record."[5]

What are the pros and cons?

Besides being labelled the most cost-effective option for CO_2 emissions reductions in hard-to-abate industries, proponents also hope the technologies could help reduce other gases, such as sulphur oxides (SOx) and nitrogen oxides (NOx). These contribute to climate change due to their impact on the ozone layer.[6]

However, realising these benefits has proven challenging over the last 50 years, as a scalable and viable commercial solution for CCUS has remained elusive. Currently, there are fewer CCUS projects than are needed under the International

[2] A new era for CCUS – CCUS in Clean Energy Transitions – Analysis - IEA
[3] Hydrogen (irena.org)
[4] Can CO2-EOR really provide carbon-negative oil? – Analysis - IEA
[5] What went wrong? Learning from three decades of carbon capture, utilization and sequestration (CCUS) pilot and demonstration projects - ScienceDirect
[6] CCUS Technologies | AGCS (allianz.com)

Energy Agency's Net Zero Emissions scenario[7] and studies have shown significant failures in the number of demonstration and pilot projects over the past three decades.[8] Another scale challenge relates to the energy intensity requirements of some of the technologies, such as direct air capture. To make these projects efficient would require large scale use of renewable energy sources, otherwise they may end up producing more CO_2-using energy than would be captured from the air.[9]

The economic viability and business case dependencies have also been called into question. This is due to the low or negative internal rates of return that result without a reliably high prevailing price for carbon emissions. This has made it difficult to incentivise the required funding options, particularly from private capital.[10]

The safety of carbon transportation and storage has also been scrutinised. A 2020 accident in Satartia, Mississippi reportedly left residents convulsing, confused or unconscious due to a ruptured pipeline carrying compressed CO_2 mixed with hydrogen sulphide.[11]

What is the current state of development?

Most CCUS projects are still at the prototype or demonstration phase. Emerging research also shows that increasing the size of the CCUS project can lead to it being terminated or put on hold, as the failure rate leaps by nearly 50% when raising capacity by 1Mt CO_2 per year.[12] The vast majority of operational CCUS projects around the world are in the oil and gas sector.[13] This has raised concerns about CCUS projects under development enabling oil and gas activities that could lead to business-as-usual scenarios in the energy transition.

On a more positive note, government policies have emerged to help mobilise capital to demonstrate and drive CCUS market uptake. In the US, the Inflation Reduction Act (IRA) and the Infrastructure Investment and Jobs Act (IIJA),[14] have spurred activity in CCUS, especially in storage and direct air capture.[15] There are similar public policy regimes taking shape in other jurisdictions, such as the EU, China, and Japan, to identify and support CCUS projects.

The UK, Australia and Canada have also instituted tax credits and grant programmes to shore up private market interest. Various industrial hubs are being developed to bring together industry players to share knowledge, with the added benefit of driving down the cost of CCUS related activities. Innovations around CCUS are also increasing in the utility, chemical and iron and steel sectors, including Net Power's 50MW plant in the US, Net Zero Teeside Power's 860MW in the UK, and ArcelorMittal's CCU demonstration project in Belgium.

Implications for engagement

EOS has been engaging with companies across relevant sectors on their decarbonisation strategies and the role that CCUS plays within them. So far, we have discussed carbon capture with around 60 companies, particularly in the oil and gas, chemicals, utilities, and heavy industries sectors. Several companies, especially in the US, have recently committed to CCUS, potentially at scale, as part of their long-term operational emissions reduction. In our engagements, we have been asking for clearer disclosure on CCUS strategies and associated risks, while monitoring progress.

> **We have discussed carbon capture with around 60 companies, particularly in the oil and gas, chemicals, utilities, and heavy industries sectors.**

This is because we often encounter limited detail in companies' disclosures, and investors need detail to assure them of the credibility of the decarbonisation strategies. Through our engagements, we ask companies to provide investors with additional disclosures related to CCUS risks and opportunities. This may include solutions for commercialisation, risks relating to CO_2 storage, and the economic evaluation of these risks. Going forward, we believe that investors need to advocate for further insights, including:

- More detail on CCUS cost competitiveness and how it compares with alternative emerging low-carbon technologies, and the associated financial returns on projects.
- Ensuring that company disclosures address varying degrees of other socioeconomic and environmental risks that enhance the long-term sustainability of CCUS projects.
- How the company is leveraging industry collaborations, such as regional hubs across industries that support effective CCUS technology deployment.
- Public policy engagements essential to the scaling up of CCUS technologies and alignment with company decarbonisation and business strategies.

As we continue to engage with companies, particularly in hard-to-abate sectors, we expect companies to be able to demonstrate a credible pipeline of projects against these four areas and how they align with their decarbonisation strategies. We will also further these dialogues via collaborative engagements with investors, including Climate Action 100+.

[7] Carbon Capture, Utilisation and Storage - Energy System - IEA.
[8] What went wrong? Learning from three decades of carbon capture, utilization and sequestration (CCUS) pilot and demonstration projects - ScienceDirect
[9] Direct Air Capture: 6 Things To Know | World Resources Institute (wri.org)
[10] What went wrong? Learning from three decades of carbon capture, utilization and sequestration (CCUS) pilot and demonstration projects - ScienceDirect
[11] Go read the harrowing story of the world's first CO2 pipeline explosion - The Verge; and A pipeline rupture in Satartia, Mississippi has lessons for future CO2 projects : NPR
[12] What went wrong? Learning from three decades of carbon capture, utilization and sequestration (CCUS) pilot and demonstration projects - ScienceDirect
[13] Carbon capture/CCUS M&A market 2022: Oil and gas companies dominated the deal activities | S&P Global (spglobal.com)
[14] The Infrastructure Investment and Jobs Act (IIJA) passed in November 2021 included more than $10 billion for CCUS projects. See: 1 Introduction and Scope | Carbon Dioxide Utilization Markets and Infrastructure: Status and Opportunities: A First Report | The National Academies Press
[15] From Act to action: How the Inflation Reduction Act is accelerating decarbonization in the United States with carbon capture and storage – Clean Air Task Force (catf.us)

CASE STUDY

Occidental Petroleum

Occidental Petroleum's climate strategy is heavily dependent on the success of CCUS technologies. Back in 2018, we acknowledged that the company had a competitive advantage in carbon capture for enhanced oil recovery (EOR) but cautioned that its climate strategy should be more comprehensive.

In 2020, the company was confident that EOR was economically viable through its continued development of carbon capture and storage (CCS) technologies coupled with the US government's tax credit (45Q) and other carbon pricing mechanisms. We questioned whether CCS for EOR would only be economically feasible if oil prices stayed high, considering the uncertainties of future oil demand. It had also explored direct air capture as a possible solution, which we challenged due to the higher costs relative to capturing carbon from sources of concentrated CO_2.

In 2022, we recommended support for a shareholder proposal asking the company to set clear goals to reduce emissions in line with the Paris Agreement and report on its progress. We were still concerned by the company's heavy reliance on CCUS technology, which was unproven at scale, to achieve these goals. However, the company insisted that its CCUS plans were both economically viable and beneficial for the environment.

In 2023, Occidental highlighted its new CCUS project – Stratos/Direct Air Capture 1 (DAC1) – on which it was materially relying to achieve its emissions targets. We expressed concerns about it having no backup plan if DAC1 failed to meet expectations, but the company remained confident in its ability to deliver on this strategy. We continue to closely monitor the project's progress.

We regularly question the potential environmental and social risks of storing liquid carbon dioxide underground or in water, given safety concerns and the potential for earthquakes, as this technology is still being studied. The company cited its long experience with CCS of some 40 years, and argued that the environmental benefits of CCS outweighed the costs. It has already received some permits for these projects and pointed to existing research supporting the safety of these technologies.

CASE STUDY

Eagle Materials

Eagle Materials is a US-based producer of building materials, primarily cement and wallboard. Carbon capture is seen as a crucial component in addressing the majority of emissions linked to cement production. While there are currently limited scalable and economical solutions, there is potential for Eagle Materials to aid in the testing of various technologies to accelerate progress.

We welcomed the confirmation in 2021 that the company was to partner with Chart Industries, an engineering equipment firm, to pilot its carbon capture technology at scale. The technology being tested involves rapidly cooling the gases being emitted from the cement kiln, causing the CO_2 to freeze and separate from other gases.[16]

> **The goal is to prove that the system can capture over 95% of CO_2 from a source and produce a CO_2 stream that is more than 95% pure.**

The goal is to prove that the system can capture over 95% of CO_2 from a source and produce a CO_2 stream that is more than 95% pure. The technology, if it proves successful and is implemented, will increase cement production costs markedly. Chart Industries estimates an increase of 24%, although the contention is that this is significantly lower than that forecast for other carbon capture technologies. Testing is ongoing with assessments and conclusions about the technology's effectiveness to be reached in 2025.

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Head of Impact Engagement – Equities, FHL

[16] Frontiers | A mini-review on cryogenic carbon capture technology by desublimation: theoretical and modeling aspects (frontiersin.org)

Green bonds boom boosts case for credit engagement

We have engaged with companies on behalf of bondholders for many years, recognising that credit portfolios can be hard hit in the wake of serious controversies. Ross Teverson explains how we have evolved our engagement approach as the size of the sustainable bond market has grown.

Setting the scene

In 2018 and 2019, EOS and Federated Hermes Limited's credit team published a two-part paper, entitled *We Can All Get Along*.[1,2] This asserted that the shared interests of bond and shareholders in companies provide incentives to jointly engage with them – generating positive outcomes by doing so. Over the past five years, growing awareness of long-term sustainability considerations, developments in policy and market best practice, and our own experience of engaging with companies, have strengthened our conviction in the value of engagement across the capital structure.

Our original paper argued that the financial stake held in companies by bondholders and long-term shareholders gives them the legitimacy to engage, and arguably an obligation to do so. It also posited that the interests of financial stakeholders in the sustainable growth and long-term health of businesses are aligned, enabling them to jointly engage companies.

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Poorly managed ESG factors, including corporate governance, can destroy value for equity and bond investors, as demonstrated by the financial impact of Silicon Valley Bank's collapse in March 2023. A report for the US Federal Reserve and Federal Deposit Insurance Corp concluded that the collapse of the bank was driven in large part by risk management and governance failings.[3] The bank's failure also sent ripples of fear around the globe that ultimately triggered the downfall of Credit Suisse, long beset by governance troubles.[4]

In our Q1 2019 Public Engagement Report,[5] we also identified corporate governance shortcomings at Vale following the collapse of an iron ore tailings dam near Brumadinho in Brazil, and highlighted that bondholders who failed to take account of ESG risks or engage with issuers, did so at their peril.

Since we published that article, there has been strong momentum in sustainable bond financing, with the green, social, sustainable, and sustainability-linked bond (GSSSB) market expanding from just over US$200bn in 2018 to $946bn in 2023, according to Moody's.[6] With this increased issuance, we are seeing greater regulatory scrutiny of issuers' sustainability strategies.

From January 2024, the EU Taxonomy requires investors to disclose the proportion of their underlying investments that are taxonomy-aligned, initially covering climate change mitigation and adaptation. And in 2023, the UK's Financial Conduct Authority (FCA) sought investor comment on a paper that proposed improvements in documentation and practices relating to use-of-proceeds and sustainability-linked bonds.[7]

In our response to the FCA, we supported greater disclosure, which we believe would improve transparency, providing investors with more complete and accurate information. It would also reduce the risk that bonds' real-world impacts differ from their stated purpose, which could otherwise lead to allegations of greenwashing.

We highlighted our view that the FCA's proposed disclosures would be conducive to the ongoing internal review and evaluation of issuers' sustainability goals. This would help to ensure that boards and management teams are appropriately mitigating environmental and/or social risks and capturing emerging opportunities in a manner that is in the best interests of all stakeholders.

The growing significance of sustainable bond finance and the accompanying regulatory scrutiny are creating greater awareness and acceptance of bondholder engagement.

Benefits of engaging across the capital structure

EOS makes it clear to companies that we engage the value of assets under advice for the equity and the bond holdings that we represent. Speaking on behalf of an increased asset base across multiple asset classes gives us greater leverage – a view echoed by the Institutional Investors Group on Climate Change (IIGCC) in its *Net Zero Bondholder Stewardship Guidance Toolkit*,[8] to which Federated Hermes Limited contributed. This recommends integrating bondholder stewardship into existing equity engagements and stewardship strategies as a first step towards increasing the effectiveness of bondholder stewardship.

There is a sound rationale for combining the two. Business strategy and capital allocation affect a company's ability to create value for shareholders and to service current or future debt. Improved governance and mitigated risks have the potential to create value for shareholders and bondholders alike, as well as management, employees and wider society.

Evolving our engagement approach

Credit and equity engagements focus on the same long-term ESG risks and opportunities. For example, when considering climate change and the associated risks and opportunities, there is rarely a need to differentiate between equity and bondholder interests. However, over the last few years we have been reflecting on how best to evolve our approach to credit engagement to ensure we consider the specific circumstances that exist for any given company.

One development has been to incorporate credit-related data into our research notes. This includes a figure for the bond refinancing due for a company in the coming 12 months, because

CASE STUDY

Enel

Italy's Enel is a generator and distributor of electricity and a distributor of natural gas. It generates power from renewable and non-renewable sources, operates power networks, and supplies energy to homes and businesses.

Enel is a significant issuer of Sustainability-Linked Bonds (SLBs) and was an early adopter of this structure with its first issuance in 2019. Over the course of 2021 and 2022 the company issued several sustainability-linked bonds, totalling $10.8bn, making use of a sustainability performance target for Scope 1 emissions intensity in 2023. If this target was not met, the bonds would be subject to a 0.25% step-up, potentially resulting in an annual increase of $27m to the company's interest payments.

> **Enel is a significant issuer of Sustainability-Linked Bonds (SLBs) and was an early adopter of this structure with its first issuance in 2019.**

In our engagement with the company in 2023 it said that, while it remained confident about its ability to achieve longer-term emissions reduction targets, there was a reasonable chance that the 2023 target relevant for these SLBs would be missed. This would depend on the availability of water for hydropower generation and the price of natural gas, potentially resulting in higher coal-fired generation than expected. We continue to emphasise the importance of the company maintaining and delivering on its ambitious decarbonisation strategy, which will help to support the ongoing credibility of its SLB issuance.

Owen Tutt
Theme lead: Climate Change

[1] We can all get along | Federated Hermes Limited (hermes-investment.com)
[2] We can all get along (part II) | Federated Hermes Limited (hermes-investment.com)
[3] Highlights from US regulators' reviews of SVB, Signature failures | Reuters
[4] What Happened at Credit Suisse, and Why Did It Collapse? (investopedia.com)
[5] Public-engagement-report-q1-2019.pdf (hermes-investment.com)

[6] Global sustainable bond issuance to reach US$950 billion in 2024: Moody's, ESG - THE BUSINESS TIMES
[7] Non-equity securities – Engagement Paper 4 | FCA
[8] IIGCC-Net-Zero-Stewardship-Guidance.pdf (hubspotusercontent-eu1.net)

an awareness of the timing and size of refinancings may provide an opportunity to intensify engagement. The aim is to speak to management when they may be most receptive to the messages we are conveying on behalf of our clients.

When we consider the potential levers for engagement, voting can be important. However, for tightly-controlled companies or state-owned enterprises, it is worth noting that the voting decisions of minority shareholders will have a minimal impact, whereas the refinancing of bond debt may be critical. In these circumstances, bondholders clearly have the potential to exert greater influence.

When it comes to issuing bonds, the approach taken by companies varies. At one end of the spectrum, investment grade issuers tend to consider refinancing regularly and proactively based on changing market rates and credit spreads. At the other end, while high-yield issuers can refinance their debt at any time, they are more likely to be receptive to investor expectations and engagement when they need to refinance a significant proportion of their debt.

For investment grade issuers, reminding management of the company's recurring presence in the capital markets may provide a constructive context for an engagement, while for a high-yield issuer, highlighting its reliance on a key refinancing event is likely to be more effective.

Ahead of engaging with a company, we may consider its credit rating and its credit default swap (CDS) spread - a measure of insuring against default on a company's debt. One might assume that engagement should be triggered by widening CDS spreads, declining credit ratings, or share price falls. However, we believe that in most cases engagement should be long term and ongoing rather than reactive. At the same time, we acknowledge that we may need to escalate engagement on the back of a certain event, which will impact bond and equity prices.

Who to engage

We may consider speaking to the CFO and company treasury department, rather than investor relations or a company's sustainability team, if we believe this would help to complement wider engagement with the board and senior executive team. At times, we will engage beyond the company level, in the broader credit ecosystem, if we believe that we can achieve greater impact by doing so.

We have also found that management teams have become more receptive to credit engagement on the whole. This is because the legitimacy of bondholders to engage on longer-term business strategy and sustainability has been strengthened by changing policy and market best practice. The issuance of bonds increasingly requires companies to go beyond the consideration of the short- and medium-term financial metrics, which may be the focus of a treasury team, and to articulate the strategy for ensuring the long-term sustainability of the business. There may also be opportunities for companies with well-planned, long-term sustainability strategies in place to secure advantageous rates of financing through green and sustainable bond issuance – an area which we intend to monitor and explore further.

CASE STUDY

Pemex

Petroleos Mexicanos (Pemex) is Mexico's 100% state-owned integrated oil company, operating through the business segments of exploration and production, industrial transformation, logistics, drilling and services, ethylene, fertilisers, cogeneration and services.

The company has a poor track record in terms of its accident rate, fuel theft causing environmental damage, corruption, and insufficient action to mitigate climate change. The excessive debt burden, underinvestment in safety and pipeline integrity, political interference and high turnover of executives deteriorates the performance and makes investor engagement challenging.

For example, in a July 2023 interaction with a board member as part of a Climate Action 100+ engagement, we expressed our concern about the deterioration of Pemex's safety performance. The board member said that although every accident is investigated and recommendations for improvement are made, a lack of financial resources impacted the safety performance. Pemex is the most indebted oil company, with approximately US$100bn in financial debt, predominantly in the international debt capital markets. The company relies on the bond markets with regular bond issuance to refinance its debt.

In our engagement with Pemex, we have emphasised that poor ESG performance increasingly feeds into the company's ability to access the international debt markets and a potentially higher cost of capital. Following elections in Mexico in 2024, a new government will be inaugurated in early 2025, and is likely to make changes to Pemex's board and management.

Jaime Gornsztejn
Theme lead:
Board Composition and Effectiveness

Improving corporate governance in Asia

Regulators across Asia are trying to boost shareholder value by addressing some longstanding corporate governance issues. But are we seeing genuine improvements at the company level or a tick box approach? Haonan Wu examines the evidence.

Setting the scene

At its core, corporate governance relies on the right arrangement of checks, balances, and incentives. The purpose is to prevent one group from expropriating the cash flows and assets of others, and to provide a structure to support long-term value creation. History is littered with examples of company collapses arising from poor corporate governance practices. Poor governance impedes economic growth and increases financial market volatility.

A lack of focus on shareholder value, conflicts of interest, limited board independence and poor internal controls have contributed to high-profile scandals in South Korea and Japan, but attempts to reform both markets are now underway.

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Japan's stock market hit a record high in February after a lengthy 34-year wait as exuberant investors flooded back. The recovery in the market following years in the doldrums has been partly driven by optimism that corporate governance reforms will finally unlock value.[1] Perhaps unsurprisingly, South Korea responded by unveiling its own reforms in February, hoping to eradicate the stubborn Korea discount.[2] Expectations are high that regulators are starting to grapple with some longstanding issues that have stymied company performance. But will these measures herald genuine change or will vested interests in South Korea prevent real progress?

The Asian financial crisis of the late 1990s served as a previous watershed moment, prompting a profound re-revaluation of corporate governance practices across the region. As economies grappled with widespread financial turmoil and corporate failures, policymakers and market participants recognised the urgent need for comprehensive reform to address underlying weaknesses in governance structures. In the aftermath of the crisis, governments, regulatory bodies,

1 Japanese reforms ignite investor optimism | Federated Hermes Limited (hermes-investment.com)
2 South Korea unveils reforms to unlock value of listed companies (ft.com)

and industry stakeholders embarked on initiatives aimed at enhancing transparency, accountability, and investor protection within Asian companies.

We have engaged directly with companies on corporate governance since the early 2000s and as part of the Asian Corporate Governance Association (ACGA). Over this period, we have witnessed an evolution in regulation and best practice in Asia. Across the region, regulators have tried to improve board independence and diversity, particularly in Japan, South Korea and Greater China. However, this has also raised the risk of companies taking a "tick box" approach, with board effectiveness potentially lacking the substance to ensure long-term value creation. How well is each market doing and where could they improve? And what role could investors play in this?

Japan

The strong executive influence on the board of directors is a noticeable feature of Japan's corporate culture. Boards often consist mainly of employees who have spent their entire careers at the company, with a combined board chair and CEO still the norm. The widespread practice of cross-shareholding, where companies hold shares in each other, can lead to the entrenchment of management and a reduced accountability to shareholders. Japanese companies often prioritise the interests of other stakeholders over shareholder value creation, which can dilute the focus on maximising returns for investors

Our engagement: Olympus

EOS has been engaging with optical equipment manufacturer Olympus since 2011, when a massive accounting fraud was exposed in which investment losses had been hidden for years.[3] The scandal highlighted the importance of effective board governance and curtailing the influence of a CEO.

> **We have engaged directly with companies on corporate governance since the early 2000s and as part of the Asian Corporate Governance Association (ACGA).**

Almost 80% was wiped from the company's stock market value, six banks sued for compensation[4] and Olympus was threatened with delisting.

We urged the company to improve its board composition by adding more independent directors, but also by introducing concrete measures to enhance board functions and oversight. This included establishing key committees such as a nomination and remuneration committee, increasing transparency in the selection process of outside directors, and carrying out a review of the company's governance structure. We also encouraged a move towards at least a majority of independent directors on the board.

The company acknowledged our concerns and appointed a majority-independent board at the 2012 EGM. Olympus also moved to a three tier committee structure in 2019, consisting of an audit, nomination, and remuneration committee. In addition, three non-Japanese directors were appointed to the board.

[3] Olympus scandal - Wikipedia
[4] Japan's Olympus sued by six banks over accounting fraud - BBC News

Reforms

Japan's Corporate Governance Code was established in 2015 and revised in 2018 and 2021. Board size and cross-shareholdings have now significantly reduced, and board independence at prime market listed companies has increased. The appointment of at least one female director to the board is expected, and in June 2023, the government adopted a policy for women to account for over 30% of directors on the boards of Japanese companies listed on the Tokyo Stock Exchange's prime market by 2030.

The regulator has also taken steps to boost shareholder value, with companies urged to achieve a price-to-book ratio of above one. This approach has led to a genuine drive by many companies to improve capital management practices, as evidenced by an increase in share buybacks by companies with inefficient balance sheets.[5]

EOS has been engaging with the regulator in Japan since 2010. Most recently we joined in-person meetings organised by ACGA with the Financial Services Agency (FSA), Tokyo Stock Exchange (TSE) and the Ministry of Economy, Trade and Industry (METI). We expressed our expectations for improved capital allocation practices, board independence and director skills. We also co-signed an open letter pushing for higher requirements on board gender diversity, which was followed by a change in policy.

South Korea

In South Korea, family-controlled companies known as chaebols wield significant influence in the economy. The complex ownership structures and interlocking business relationships can lead to conflicts of interest and undermine transparency and accountability. Ensuring fair treatment of minority shareholders and reducing chaebol dominance remains a challenge.[6] The continued scandals generated by chaebols have cemented our concerns about corporate governance and shareholder rights in South Korea.

Our engagement: Samsung Electronics

EOS has been engaging with Samsung Electronics since 2013 on governance and we escalated our engagement following the bribery and embezzlement conviction of the Samsung heir Lee Jae-yong in 2016.[7] During the engagement, we urged the company to establish a board-driven anti-bribery and corruption culture, and to strengthen the resources and influence of the corporate social responsibility (CSR) committee and sustainability team. We maintained the pressure on the board as the scandal continued to unfold at the company.

The company created a risk management council within the CSR board committee to make sure that sufficient resources were being dedicated to making practical improvements on CSR. In 2018, after our continued engagement on board composition, we welcomed the significant improvements that the company had made to its board. These included the appointment of three new independent directors - one woman and two men with the relevant industry and international experience, in line with our requests.

Reforms

The latest iteration of South Korea's Corporate Governance Code in 2022 introduced several amendments to strengthen board independence, and enhance transparency and disclosure. We have seen an increase in companies with a majority-independent board and the appointment of women to boards, which is now a requirement for large companies.

Recent proposals to address the Korea discount by initiating a "Corporate Value-up Programme", and a requirement for stricter disclosure obligations on a company's handling of treasury shares, demonstrate positive momentum. It is not yet clear whether regulatory initiatives in South Korea will be sufficient to drive a sustained improvement in corporate governance practices and therefore a lessening of the Korea discount, but what is clear is that Japan provides South Korea with a blueprint for instigating meaningful change.

EOS has been engaging with the regulator in South Korea since 2010, discussing a range of topics including poison pills, the corporate governance regulatory framework, and disclosure requirements. We will continue to engage with the regulator on director training requirements, effective capital management (encompassing treasury shares) and what we consider to be the sub-optimal level of dividend pay-outs.

> **In South Korea, family-controlled companies known as chaebols wield significant influence in the economy. The complex ownership structures and interlocking business relationships can lead to conflicts of interest and undermine transparency and accountability.**

[5] Japan firms' share buybacks expanded to a record $65bn in 2023 - Nikkei Asia
[6] The unpersuadables? | Federated Hermes Limited (hermes-investment.com)
[7] Lee Jae Yong: Samsung heir gets prison term for bribery scandal - BBC News

Greater China

The Chinese corporate landscape is dominated by state-owned enterprises (SOEs), introducing complexities in governance. State interference may compromise decision-making independence, leading to inefficiencies and opacity. The protection of shareholder rights, particularly those of minority shareholders, remains a contentious issue in China with dual-class share structures at some companies, and shareholders unable to vote on director elections.

Our engagement: JD.com

EOS began engaging with JD.com in 2017, focusing on the company's governance structure, as the CEO/founder held 80% of the voting rights despite only holding an economic interest of 15%. In addition, as the company is registered under Cayman Islands law, there was no requirement to hold an annual shareholder meeting. We also raised our concerns about board composition, board diversity and the inability to give structured feedback.

We intensified our engagement on board governance, composition and diversity following a scandal regarding alleged sexual misconduct by founder Richard Liu in 2018. The case was settled out of court; founder Liu denied any wrongdoing.[8] Between 2018 and 2020, we had eight interactions with the company raising our concerns about shareholder rights, board composition and diversity. In 2021, the company held its first shareholder meeting and appointed its first female board director. It appointed a female CEO in 2023.

> **The protection of shareholder rights, particularly those of minority shareholders, remains a contentious issue in China with dual-class share structures at some companies, and shareholders unable to vote on director elections.**

Reforms

Changes in corporate governance practices in China and Hong Kong have been aimed at enhancing transparency, and strengthening investor confidence. The Chinese Securities Regulatory Commission has identified the improvement of corporate governance as a priority, and the development and revision of the Company Law in China has helped to address the issues of related-party transactions and effective board governance. The publication and revision of the Corporate Governance Code in Hong Kong has also contributed to the increase in independent board directors and women on boards, with one-third independence a requirement.

Progress assessment

Although we have seen significant changes and improvements on corporate governance in Asia, it is still widely viewed as an area of structural weakness, when compared with European and North American markets. The increase in independent directors is a positive trend, but in some instances we continue to face challenges in getting access to these directors for engagements.

The lack of relevant business expertise or sufficient knowledge in key areas among some independent directors raises concerns about their effectiveness. As executive directors often hold more power on boards in Asia, we require more effective independent directors to act as a counterbalance and to challenge the executive team. We will continue to encourage companies to build a corporate culture and business strategy that will support long-term value creation.

Our key expectations

- Board member skillsets and experience must be aligned with a company's strategic priorities, and each director should educate themselves on the sector and the company. Evidence suggests that diverse boards enhance the overall performance of a company in the long term.
- We expect independent directors to take an unbiased approach when making decisions, rather than simply agreeing with management. They should also have the behavioural attributes to enable them to contribute to board functionality. Tension and conflict play an essential role in effective boardrooms. Robust debate, open dialogue and tackling uncomfortable issues head-on can benefit a board's decision-making and serve as a supervisory function to company management. A board culture that promotes independent thinking is critical, but independent directors must aim to fulfil their duties and exercise sound judgement even in the absence of such a culture.
- Independent directors should extend their contribution beyond boardroom deliberations by engaging with employees, investors, and wider stakeholders to ensure sound governance practices and long-term value creation.

The company, at its core, is about people, and the key to exercising effective governance is having the right people on the board with the relevant skills and experience. This should be coupled with the right culture to enable each of them to contribute effectively, while incorporating the opinions of wider stakeholders.

[8] JD.com's billionaire founder settles rape lawsuit two days before planned US trial | CNN Business

Company engagement highlights

A selection of short company case studies highlighting areas where we have completed objectives or can demonstrate significant progress.

Overview

Our approach to engagement is holistic and wide-ranging. Discussions range across many key areas, including business strategy and risk management, which includes environmental, social, and ethical risks. Structural governance issues are a priority too. In many cases, there is minimal external pressure on the business to change. Much of our work, therefore, is focused on encouraging management to make necessary improvements.

The majority of our successes stem from our ability to see things from the perspective of the business with which we are engaging. Presenting ESG issues such as climate change or board effectiveness as risks to the company's strategic positioning puts things solidly into context for management. These short company engagement updates highlight areas where we have recently completed objectives or can demonstrate significant progress, following several years of engagement.

Veeva Systems

Engagement theme:
Business purpose

Lead engager: Joanne Beatty

12 RESPONSIBLE CONSUMPTION AND PRODUCTION

Following the announcement in 2020 that Veeva Systems was exploring conversion to a public benefit corporation (PBC), we met the company's founder and CEO to share our views. We challenged the CEO on how the board intended to provide transparency and accountability to its stakeholders. We also shared a guidance document for directors setting out the value of publishing a statement of purpose and making practical suggestions on its content.

Veeva is a cloud-based software developer for the life sciences industry, founded in 2007. It went public in 2013 as a traditional for-profit Delaware corporation. A Delaware PBC is one that has also adopted a public benefit purpose. At its January 2021 special meeting, Veeva obtained shareholder approval for its conversion to a PBC, becoming the first US-based publicly-traded company to do so. It committed to providing a progress report annually and to making this publicly available.

We met the CEO again after the special meeting and he thanked us for our contribution. We asked how the CEO would demonstrate accountability and transparency as a PBC, and were pleased to hear that the board wanted to use concrete examples of how it balanced the interests of stakeholders when making significant decisions. We obtained reassurance that the company was in the process of hiring a dedicated resource to lead its PBC reporting efforts.

Outcomes and next steps

In September 2022, we welcomed the publication of the inaugural PBC report within the company's 2022 proxy statement and annual report. The company had developed four objectives to support its PBC statement, publishing these together with a progress report. The PBC report illustrates how Veeva operates, with examples of practices and key decisions from the past fiscal year.

We met the PBC investor relations lead in Q3 2022 to share our thoughts on the PBC report. We welcomed the company's second PBC report in Q2 2023, which again provided meaningful examples of board decisions that promote its public benefit purpose. This included the commitment to employees that the company did not foresee layoffs for at least the next three years. We will continue to review the company's reporting and accountability mechanisms.

Kinder Morgan

Engagement theme: Climate lobbying
Lead engager: Diana Glassman

In early 2019, we began engaging with US pipeline operator Kinder Morgan on climate lobbying. We encouraged it to report on how it manages its relationships with trade associations, regarding their positions on climate change. We shared a climate lobbying report best practice example and asked the company to demonstrate that it is governing its membership of trade associations robustly.

Through our co-lead role of the Kinder Morgan Climate Action 100+ collaborative engagement, we laid out our top priorities consistent with achieving a goal of net-zero emissions by 2050, which included trade association alignment. In response to our feedback, the company included information on political contributions and lobbying expenses in its 2020 ESG report.

In 2021, we urged the company to build on its recent lobbying disclosure by adding how it manages its relationships with trade associations, particularly when they do not align with the company's position on climate change. We followed up on this in 2022, asking the company to disclose trade association public policy actions related to the US Environmental Protection Agency (EPA) proposed methane rule.

Outcomes and next steps

In a recent engagement with a director, the company clarified that it does not have a public position on the goals of the Paris Agreement, but its trade associations reflect its positions and do not oppose Paris Agreement or methane regulations. The director added that the company leaves trade associations that do not align with its positions and that it chairs the Interstate Natural Gas Association of America. This has an aspirational industry commitment to net zero by 2050 for Scopes 1 and 2 emissions. We will

continue engaging with the company on enhancing its climate lobbying disclosures to include its recent improvements on trade association alignment.

Compass Group

Engagement theme: Conduct and culture
Lead engager: Justin Bazalgette

At the time of our initial engagement in 2015, the company's strategy was to expand its operations in regions with the potential for growth in the food service market. This included high-risk emerging markets, where the food service market remained self-operated. We began our engagement seeking reassurances about the robustness of the compliance programme, and whether appropriate policies, processes and oversight were in place.

In 2017, our meeting with the chair of the corporate social responsibility (CSR) committee did not provide comfort that the board was effectively overseeing the company's management of bribery and corruption risk. Our concern mounted when, despite operations in over 50 countries, the number of calls to the company's whistleblowing helpline relating to corruption risk were so few that they were not reflected in its reporting. Compass said it would take on board our suggestion to provide examples of case management in its reporting.

From 2018 to 2020, we had numerous calls and meetings with Compass on the revision of its code of conduct, which the company supported. During a call ahead of the 2020 AGM, the company secretary confirmed that the review of the ethics and compliance programme was progressing well, and a new version of the code of conduct would be published in 2020.

Outcomes and next steps

In 2020, Compass confirmed that since the new CEO had taken the reins in 2018, the sustainability agenda had become a priority and a new role of group head of ethics and integrity had been created. In 2021, Compass relaunched its 'Speak Up, We're Listening' programme, along with a comprehensive training programme. Accessible internally and externally, and managed by the group's ethics and integrity function, the programme aimed to empower anyone to raise concerns or allegations of potential misconduct.

Feedback from biannual training and employee surveys showed the effectiveness of training, and that the level of awareness of issues and reporting processes had improved along with the willingness to report concerns, and the observance of integrity-driven decisions. We will continue to focus on how Compass keeps its code of conduct relevant and up-to-date.

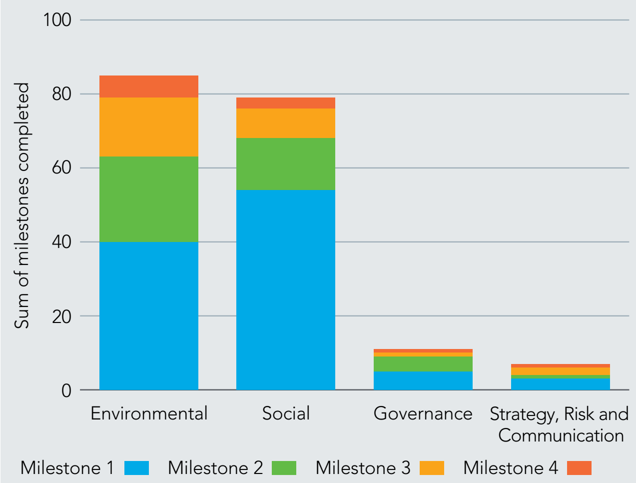
General Electric

Engagement theme: Reduction of customers' greenhouse gas emissions
Lead engager: Joanne Beatty

In 2017, we began engaging with General Electric (GE) on setting Scope 3 targets for its sold products to help reduce the greenhouse gas emissions of its customers. We considered these Scope 3 emissions to be more material for the company than those generated from its own operations. By setting Scope 3 targets for its products, we hoped it would send a powerful message to its customers and the sector. Many of the competitive advantages of GE's products come through maximising efficiency, and we believed that Scope 3 targets would provide greater direction to the company and its decarbonisation strategy.

In 2021, we engaged GE on its progress towards developing Scope 3 emissions targets related to product use. At the time, it was considering its response to a related shareholder proposal that management had supported, on how it would set a net-zero target that included Scope 3 emissions. We

Milestones completed by stage Q1 2024



Source: EOS data

highlighted the importance of short- and medium-term greenhouse gas reduction targets that were aligned with the goals of the Paris Agreement and encouraged disclosures in line with the TCFD recommendations and the Climate Action 100+ benchmark. We also recommended that GE should put forward carbon intensity targets for its different business units.

Outcomes and next steps

In 2021, GE announced an ambition to be a net-zero company by 2050 including for its sold products. Building on its past actions, the company worked with external advisers and experts to refine its business unit focus on Scope 3 product emissions for power turbines and aircraft engines, which account for most of GE's greenhouse gas emissions across all reporting scopes.

GE's 2021 sustainability report, released in June 2022, included a 2030 Scope 3 target for new gas turbine and steam turbine products sold, and a commitment to advance technologies to reduce the carbon intensity of its aviation products. We will continue to engage with GE on progress towards its climate ambitions.

CASE STUDY

Netflix

As of 2018, Netflix lacked disclosure and targets for greenhouse gas emissions reductions and diverse representation, and we were concerned that this prominent entertainment services company was not effectively managing these risks.

Our engagement

We first engaged with Netflix on environmental and social topics in 2018 through a collaborative letter that encouraged the adoption of science-based emissions targets. Following a withdrawn 2019 shareholder proposal asking for material ESG disclosure, we shared detailed expectations for the company on Paris Agreement-aligned climate targets and a diverse and inclusive workplace.

During a meeting with the assistant corporate secretary in 2020, we welcomed the company's first sustainability report but challenged Netflix to be more ambitious by setting a climate target and providing evidence of a diverse and inclusive culture. We continued our discussions with Netflix in 2021, where it expressed a strong commitment to transparency, and diversity and inclusion in its workforce and content. However, it did not appear proactive in addressing our request to set diverse representation goals.

Changes at the company

The company's first ESG report, published in early 2020, was an important first step towards better management of its environmental and social risks, as the report disclosed energy use and some workforce diversity information. Netflix was receptive to our feedback on how to improve disclosure and actions, and has continued to publish an annual ESG report.

We also welcomed the company's first inclusion report, published in early 2021, which disclosed workforce representation data, showed improving global gender and US racial/ethnicity representation trends, and described Netflix's efforts to create a diverse and inclusive culture. The report also outlined a plan to increase representation, but did not set explicit representation targets.

In March 2021, Netflix announced a target to achieve net-zero greenhouse gas emissions by the end of 2022, and every year thereafter. While it had aligned its Scopes 1 and 2 targets with the Paris Agreement, this was not yet validated by the Science Based Targets initiative (SBTi), and we encouraged this.

In a follow-up announcement in September, Netflix said it had validated its targets with the SBTi. Scope 3 emissions are included in the net-zero commitment, and Netflix also pledged that 70% of its suppliers, as measured by emissions, covering purchased goods and services, capital goods, upstream transportation and distribution, and business travel, will have science-based targets by 2025. In 2022, the company upgraded its Scope 3 target to an intensity-based emissions reduction target, and this was validated by the SBTi.

Next steps

In 2022 the company also implemented several long-requested governance reforms. Netflix has now eliminated the supermajority standard and provided shareholders with the right to call a special meeting. It is also eliminating the classified board and changing the voting standard for its directors in uncontested elections. We are now seeking for the company-wide diversity efforts to be reflected in the composition of the board and named executive officer team.

Read more about these issues in the full case study at:
https://www.hermes-investment.com/uk/en/intermediary/eos-insight/stewardship/netflix-case-study/

Engagement objectives

5 GENDER EQUALITY
13 CLIMATE ACTION

Social
– Diversity and inclusion

Environmental
– Carbon reduction targets

Velika Talyarkhan
Sector lead:
Retail and Consumer Services

INSIGHT SPOTLIGHT

Crowded out – Asian species feel the heat

Asia is rich in biodiversity but the risk of nature degradation is high due to rapid urbanisation, agricultural expansion and overfishing. Sonya Likhtman explores the risks facing the region and the implications for engagement with companies in Asia.

Six of the world's 17 megadiverse countries[1] – those considered the most biodiversity-rich – are located in Asia: China, India, Indonesia, Malaysia, Papua New Guinea and the Philippines. It contains a range of spectacular and biodiverse ecosystems, including tropical rainforests, coral reefs, wetlands, temperate forests and mangroves.

But Asia is also the biggest and most populous continent, and urbanisation has been rapid and sometimes unplanned. This has increased pressure on land, energy and other resources. Economic development has lifted many people out of poverty, but often at the expense of nature.

Approximately 90% of the world's rice is grown in Asia, alongside[2] cash crops such as tea, rubber, palm oil, and coconuts. Agricultural expansion has put pressure on biodiverse habitats, especially where intensive agricultural practices and monocropping are dominant. Meanwhile, marine biodiversity is threatened by overfishing and destructive fishing practices such as bottom trawling, which are often linked to illegal and unregulated fishing in South-East Asia. Plastic pollution also continues to be a challenge.

More recently, the demand for critical minerals to power batteries in electric vehicles has given rise to renewed risks of biodiversity loss. For example, the rapid growth of nickel mining in Indonesia has been linked to deforestation, pollution and the displacement of local communities.

Implications for engagement

The private sector has an important role to play in addressing biodiversity loss in Asia, alongside governments and other stakeholders. Investor engagement on nature-related topics should complement ongoing engagement on governance, climate change and other material issues for companies in Asia.

Companies should assess and disclose their nature-related impacts, dependencies, risks and opportunities in line with the Taskforce on Nature-related Financial Disclosures (TNFD) recommendations. The insights from the TNFD assessment should be used to develop a strategy, with timebound targets, to address the most material nature-related risks and impacts. Companies should focus on strengthening supply chain oversight and the governance of nature-related issues, including ensuring robust understanding at the board-level and the alignment of lobbying positions.

In Asia, focus areas include deforestation, regenerative agriculture, sustainable proteins, and plastic pollution. For example, we have engaged with Inner Mongolia Yili Industrial Group and China Mengniu Dairy, the Chinese dairy producers, on their approach to biodiversity and disclosure in line with the TNFD recommendations. In Japan, we have engaged with Yakult Honsha and trading house Mitsubishi Corp on supply chain deforestation risks, with the former publishing a commitment on deforestation and conversion-free sourcing in 2023. We will continue to engage on sustainable fishing with Mitsubishi Corp, partnering with FAIRR under the Seafood Traceability Engagement initiative.

We have also started to engage with financial institutions in Asia, including AIA, DBS Group and Sumitomo Mitsui Financial Group on the biodiversity impacts and dependencies of their financing activities. This builds on our experience engaging on palm oil financing with Bank Rakyat and Bank Central Asia in Indonesia. We welcomed the disclosure of Sumitomo Mitsui Financial Group's inaugural TNFD report in 2023.

We expect companies to prepare for emerging nature-related policy and regulation, both domestically and internationally. For example, the EU's deforestation due diligence regulation will impact Asian companies that trade palm oil, cattle, wood, coffee, cocoa, rubber and soy on the EU market. Companies must trace commodities back to source and conduct enhanced due diligence to demonstrate no links to deforestation.

It is equally important for companies outside Asia to consider their Asian supply chains, which may be where their most material nature-related risks and impacts are located.

Read the Insights article in full at:
https://www.hermes-investment.com/uk/en/intermediary/eos-insight/stewardship/crowded-out-asian-species-feel-the-heat/

Sonya Likhtman
Theme lead:
Natural Resource Stewardship

1 https://biodiversitya-z.org/content/megadiverse-countries.pdf
2 https://www.britannica.com/place/Asia/Manufacturing

Public policy and best practice

EOS contributes to the development of policy and best practice on corporate governance, sustainability and shareholder rights to protect and enhance the value of its clients' investments over the long term.

Overview

We participate in debates on public policy matters to protect and enhance value for our clients by improving shareholder rights and boosting protection for minority shareholders.

This work extends across company law, which in many markets sets a basic foundation for shareholder rights; securities laws, which frame the operation of the markets and ensure that value creation is reflected for shareholders; and codes of best practice for governance and the management of key risks, as well as disclosure.

In addition to this work on a country specific basis, we address regulations with a global remit. Investment institutions are typically absent from public policy debates, even though they can have a profound impact on shareholder value. EOS seeks to fill this gap.

By playing a full role in shaping these standards, we can ensure that they work in the interests of shareholders instead of being moulded to the narrow interests of other market participants, which may differ markedly – particularly those of companies, lawyers and accounting firms, which tend to be more active than investors in these debates.

Banking sector guidance consultation response

Lead engagers: Owen Tutt and Howard Risby

EOS was invited to join the working group informing the development of the Transition Plan Taskforce (TPT) banking sector guidance. This document is intended to set out best practice expectations for the development of climate transition plans for banks, and builds on the sector-neutral guidance previously developed by the TPT.

We contributed to regular working group meetings with representatives from financial institutions, industry bodies, and NGOs. We also provided final feedback on the draft that was put out for consultation. We expressed support for the guidance overall and welcomed the inclusion of our previous feedback. This included the suggestion that banks clearly state which business activities their exclusion policies and financing conditions apply to.

We made some suggestions for further improvements in clarity and substance, including how and why just transition principles can support transition plans, and broadening credit risk references to balance sheet risk, to capture equity and other asset classes held on the balance sheet. We also encouraged an emphasis on the importance of banks defining clearly their engagement activities with clients.

The draft guidance is out for consultation, with final publication expected in 2024. The UK Financial Conduct Authority (FCA) has committed to consulting on the introduction of disclosure requirements aligned with the TPT Framework within the FCA Handbook. The TPT Framework is designed to be consistent with, and build on, the final climate-related disclosure standard (IFRS S2) issued by the International Sustainability Standards Board.

Response to survey seeking views on biodiversity credits

Lead engager: Sonya Likhtman

We responded to a survey about biodiversity credits that was initiated by the International Advisory Panel on Biodiversity Credits (IAPB). We emphasised that biodiversity credits cannot replace the action that is needed by all stakeholders to reduce harm to nature and ensure the sustainable use of biodiversity.

The priority is for companies to address biodiversity impacts in their business models and supply chains. They should assess impacts, dependencies, risks and opportunities in line with the Taskforce on Nature-related Financial Disclosures recommendations and use the insights from the assessment to develop strategies, with time-bound targets, to address their most material risks and impacts. This requires a transformation in operating and sourcing practices in a way that prioritises nature and addresses all five drivers of biodiversity loss.

Following the mitigation hierarchy is critical in company responses to biodiversity loss. Biodiversity credits should be a last resort, rather than the primary way in which companies address their nature-related risks and opportunities. We stressed that the biodiversity credits market would need robust governance and independent oversight and that we should learn from the ongoing challenges of the carbon credits market. This will help to avoid greenwashing, eliminate double counting, ensure permanence, and deliver high integrity credits with verifiable real world impacts.

We suggested developing a globally-accepted methodology that can be adapted to local biodiversity and ecosystems. We explained that credits should take into account five main drivers of biodiversity loss, rather than just carbon, and that there should be a liquid and sizeable market.

We also provided additional input on governance, measurement and other aspects. We focused on Indigenous peoples' rights in our response. In our view, Indigenous groups should be invited to participate in the IAPB and should be consulted throughout all stages of project design and implementation. They should also be involved in the governance of biodiversity credit schemes. We recommended referencing appropriate international standards and best practices, with a focus on consultation and consent. We also highlighted the risk of conservation evictions, through which communities may be relocated for the purpose of conservation projects.

WHO consultation on AMR wastewater pollution

Lead engager: Zoe de Spoelberch

As part of our work on antimicrobial resistance (AMR) we provided input to a consultation on the draft World Health Organization (WHO) Guidance on waste and wastewater management from pharmaceutical manufacturing with an emphasis on antibiotic production. We expressed our support for this much needed guidance.

We highlighted the need for this framework to support companies in setting targets to limit the active components in wastewater, and in implementing the correct risk management plans in their operations and supply chains to prevent pollution. Due to gaps in the global regulatory landscape governing manufacturing effluence containing antibiotic residues, we suggested the guidance should recommend that risk assessments be required at each stage of the antibiotic production value chain.

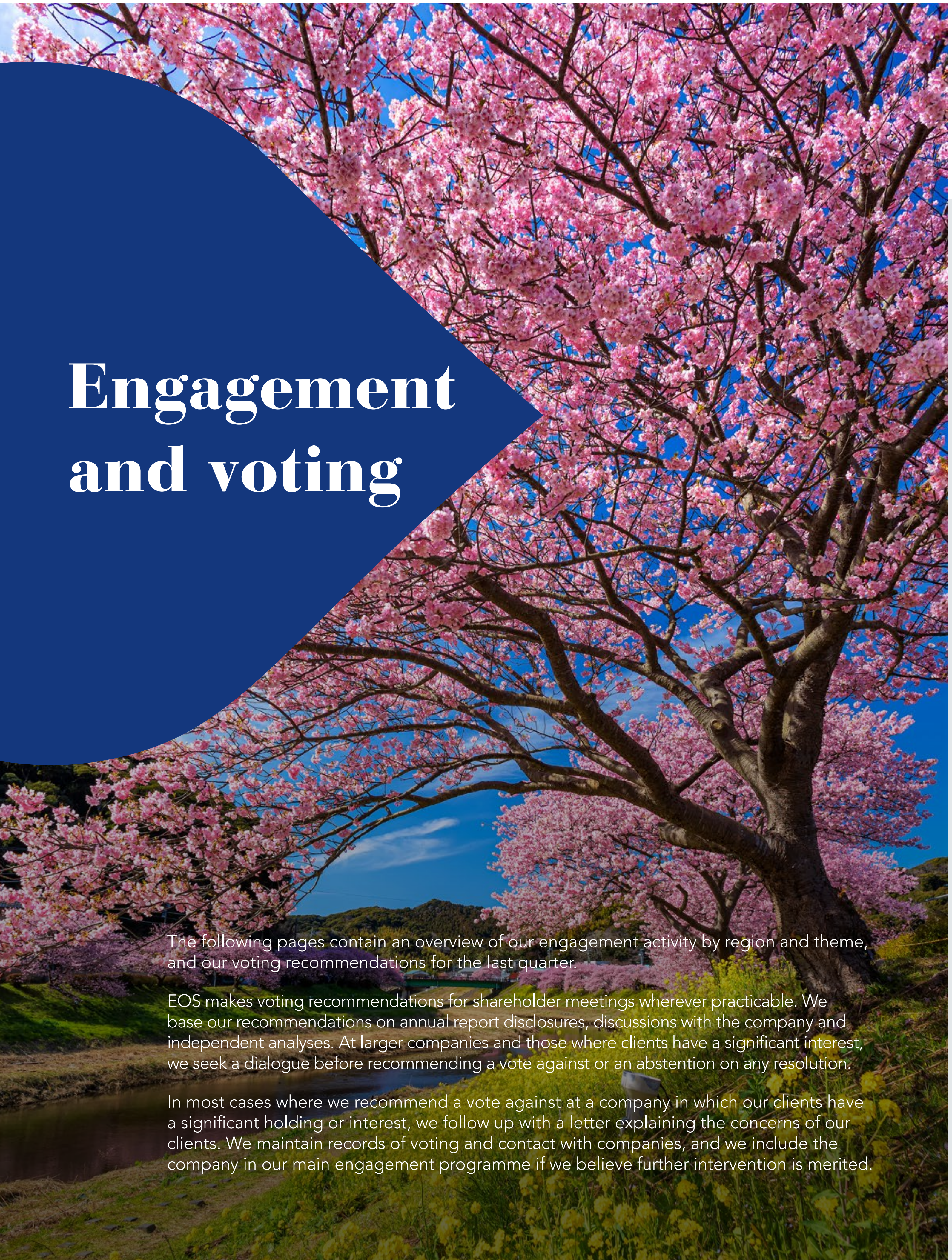
We said the guidance should require publicly available information on antibiotic pollution, as transparency enables us to gauge whether a company has sufficiently robust practices in place to manage the risks associated with antibiotic residues entering the environment and the development of AMR. We suggested that this publicly disclosed information be updated annually and include the names and locations of manufacturing facilities and how antibiotic pollution is managed. It should also include antibiotic emission levels, targets and any progress towards these targets, as well as details of independent third-party verification.

WEF AI Governance Alliance project

Lead engager: Nick Pelosi

We participated in a community meeting of the World Economic Forum (WEF) Artificial Intelligence (AI) Governance Alliance project on responsible AI stewardship for investors. The objective of this project is to help institutional investors and other large capital providers play an active role in accelerating the adoption of responsible AI. It will adopt a multi-stakeholder approach involving the investor community, business, academia, and civil society to ensure that diverse perspectives and interests are represented and considered.

During the community meeting, WEF presented the initial findings of a draft paper on responsible AI stewardship for investors. We talked about our own experiences engaging with companies on this topic, and shared our recently published case studies and our rationale for prioritising sectors for engagement.



Engagement and voting

The following pages contain an overview of our engagement activity by region and theme, and our voting recommendations for the last quarter.

EOS makes voting recommendations for shareholder meetings wherever practicable. We base our recommendations on annual report disclosures, discussions with the company and independent analyses. At larger companies and those where clients have a significant interest, we seek a dialogue before recommending a vote against or an abstention on any resolution.

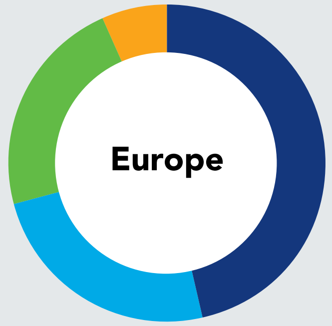
In most cases where we recommend a vote against at a company in which our clients have a significant holding or interest, we follow up with a letter explaining the concerns of our clients. We maintain records of voting and contact with companies, and we include the company in our main engagement programme if we believe further intervention is merited.

Engagement by region

Over the last quarter we engaged with 441 companies on 1,485 environmental, social, governance and business strategy issues and objectives. Our holistic approach to engagement means that we typically engage with companies on more than one topic simultaneously.

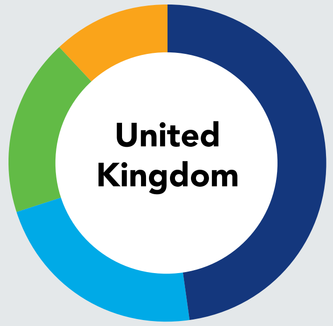
We engaged with 441 companies over the last quarter.

- Environmental **44.2%**
- Social **27.1%**
- Governance **22.5%**
- Strategy, Risk and Communication **6.3%**



We engaged with 104 companies over the last quarter.

- Environmental **46.6%**
- Social **24.5%**
- Governance **22.4%**
- Strategy, Risk and Communication **6.5%**

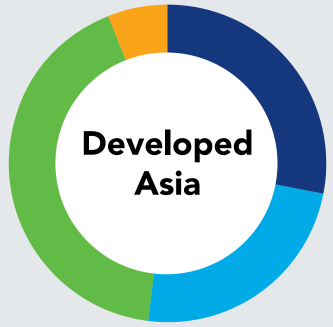


We engaged with 21 companies over the last quarter.

- Environmental **47.8%**
- Social **22.4%**
- Governance **17.9%**
- Strategy, Risk and Communication **11.9%**

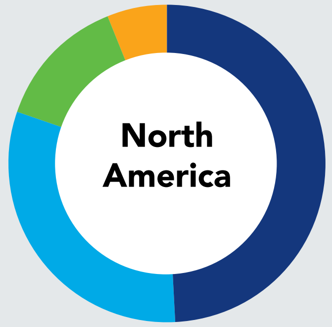
We engaged with 45 companies over the last quarter.

- Environmental **42.9%**
- Social **24.0%**
- Governance **28.6%**
- Strategy, Risk and Communication **4.6%**



We engaged with 68 companies over the last quarter.

- Environmental **28.2%**
- Social **23.9%**
- Governance **42.0%**
- Strategy, Risk and Communication **5.9%**



We engaged with 192 companies over the last quarter.

- Environmental **49.4%**
- Social **31.1%**
- Governance **13.5%**
- Strategy, Risk and Communication **6.1%**

We engaged with 11 companies over the last quarter.

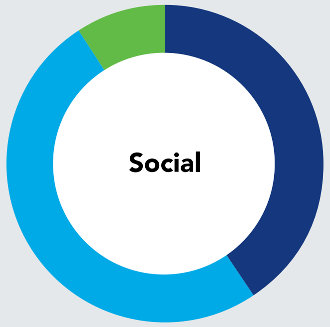
- Environmental **42.9%**
- Social **28.6%**
- Governance **19.0%**
- Strategy, Risk and Communication **9.5%**

Engagement by meta-theme

A summary of the 1,485 issues and objectives on which we engaged with companies over the last quarter is shown below.

Environmental topics featured in 44.2% of our engagements over the last quarter.

- Circular Economy & Zero Pollution **8.2%**
- Climate Change **69.1%**
- Natural Resource Stewardship **22.7%**



Social topics featured in 27.1% of our engagements over the last quarter.

- Human & Labour Rights **40.8%**
- Human Capital **50.2%**
- Wider Societal Impacts **9.0%**

Governance topics featured in 22.5% of our engagements over the last quarter.

- Board Effectiveness **51.2%**
- Executive Remuneration **31.1%**
- Investor Protection & Rights **17.7%**

Strategy, Risk and Communication topics featured in 6.3% of our engagements over the last quarter.

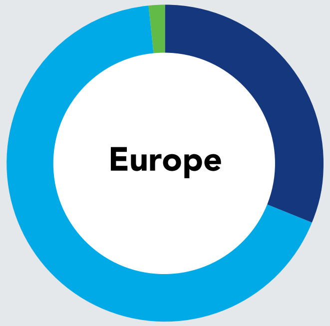
- Corporate Reporting **51.6%**
- Purpose, Strategy & Policies **26.9%**
- Risk Management **21.5%**

Voting overview

Over the last quarter we made voting recommendations at 2,063 meetings (16,559 resolutions). At 1,175 meetings we recommended opposing one or more resolutions. We recommended voting with management by exception at 13 meetings and abstaining at 10 meetings. We supported management on all resolutions at the remaining 865 meetings.

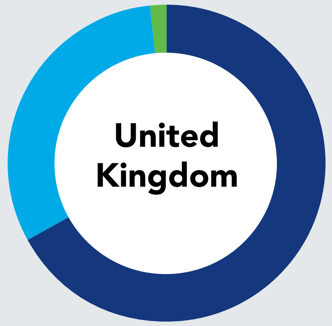
We made voting recommendations at **2,063** meetings (**16,559** resolutions) over the last quarter.

- Total meetings in favour **41.9%**
- Meetings against (or against AND abstain) **57.0%**
- Meetings abstained **0.5%**
- Meetings with management by exception **0.6%**



We made voting recommendations at **249** meetings (**3,804** resolutions) over the last quarter.

- Total meetings in favour **31.3%**
- Meetings against (or against AND abstain) **67.1%**
- Meetings abstained **1.6%**



We made voting recommendations at **73** meetings (**874** resolutions) over the last quarter.

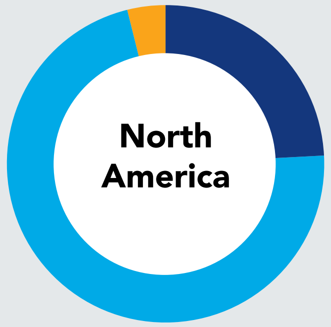
- Total meetings in favour **67.1%**
- Meetings against (or against AND abstain) **31.5%**
- Meetings abstained **1.4%**

We made voting recommendations at **986** meetings (**5,894** resolutions) over the last quarter.

- Total meetings in favour **48.8%**
- Meetings against (or against AND abstain) **50.4%**
- Meetings abstained **0.5%**
- Meetings with management by exception **0.3%**

We made voting recommendations at **532** meetings (**4,212** resolutions) over the last quarter.

- Total meetings in favour **37.4%**
- Meetings against (or against AND abstain) **62.2%**
- Meetings with management by exception **0.4%**



We made voting recommendations at **213** meetings (**1,736** resolutions) over the last quarter.

- Total meetings in favour **24.4%**
- Meetings against (or against AND abstain) **71.8%**
- Meetings with management by exception **3.8%**

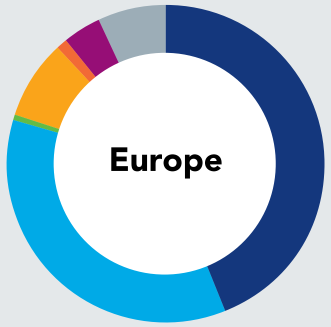
We made voting recommendations at **10** meetings (**39** resolutions) over the last quarter.

- Total meetings in favour **60.0%**
- Meetings against (or against AND abstain) **40.0%**

The issues on which we recommended voting against management or abstaining on resolutions are shown below.

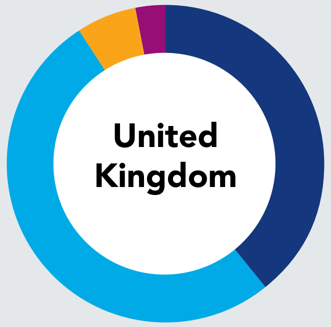
We recommended voting against or abstaining on **3,035** resolutions over the last quarter.

- Board structure **52.1%**
- Remuneration **19.4%**
- Shareholder resolution **4.3%**
- Capital structure and dividends **4.6%**
- Amend articles **11.0%**
- Audit and accounts **4.9%**
- Investment/M&A **0.3%**
- Poison pill/Anti-takeover device **0.2%**
- Other **3.2%**



We recommended voting against or abstaining on **518** resolutions over the last quarter.

- Board structure **44.0%**
- Remuneration **35.7%**
- Shareholder resolution **0.6%**
- Capital structure and dividends **7.9%**
- Amend articles **1.2%**
- Audit and accounts **3.9%**
- Other **6.8%**

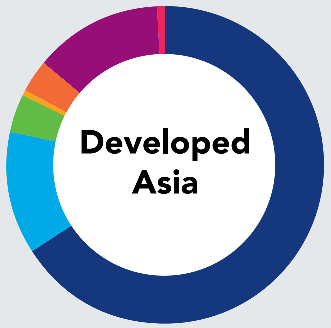


We recommended voting against or abstaining on **33** resolutions over the last quarter.

- Board structure **39.4%**
- Remuneration **51.5%**
- Capital structure and dividends **6.1%**
- Audit and accounts **3.0%**

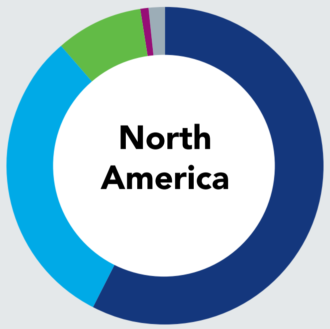
We recommended voting against or abstaining on **1,458** resolutions over the last quarter.

- Board structure **47.3%**
- Remuneration **13.6%**
- Shareholder resolution **5.0%**
- Capital structure and dividends **6.5%**
- Amend articles **20.9%**
- Audit and accounts **2.1%**
- Investment/M&A **0.5%**
- Other **4.0%**



We recommended voting against or abstaining on **724** resolutions over the last quarter.

- Board structure **66.0%**
- Remuneration **12.4%**
- Shareholder resolution **4.0%**
- Capital structure and dividends **0.4%**
- Amend articles **3.3%**
- Audit and accounts **13.1%**
- Poison pill/Anti-takeover device **0.7%**



We recommended voting against or abstaining on **294** resolutions over the last quarter.

- Board structure **57.5%**
- Remuneration **31.3%**
- Shareholder resolution **8.8%**
- Audit and accounts **1.0%**
- Other **1.4%**

We recommended voting against or abstaining on **8** resolutions over the last quarter.

- Board structure **37.5%**
- Remuneration **62.5%**

The EOS approach to engagement

EOS at Federated Hermes is a leading stewardship service provider. Our engagement activities enable long-term institutional investors to be more active owners of their equity and fixed income assets.

This is achieved through dialogue with companies on environmental, social and governance issues. We believe this is essential to build a global financial system that aims to deliver improved long-term returns for investors, as well as better, more sustainable outcomes for society.

Our services

Engagement

We engage with companies that form part of the public equity and corporate fixed income holdings of our clients to seek positive change for our clients, the companies and the societies in which they operate.

Voting

We make recommendations that are, where practicable, engagement-led and involve communicating with company management and boards around the vote. This ensures that our rationale is understood by the company and that the recommendations are well-informed and lead to change where necessary.

Public policy and market best practice

Engaging with legislators, regulators, industry bodies and other standard-setters to shape capital markets and the environment in which companies and investors can operate more sustainably.

Screening

We help our clients to fulfil their stewardship obligations by monitoring their portfolios to regularly identify companies that are in breach of, or near to breaching, international norms and conventions.

Advisory

We work with our clients to develop their responsible ownership policies, drawing on our extensive experience and expertise to advance their stewardship strategies.

The EOS advantage

- **Relationships and access** – Companies understand that EOS is working on behalf of pension funds and other large institutional investors, so it has significant leverage – representing assets under advice of over US$1.8tn as of 31 March 2024. The team's skills, experience, languages, connections and cultural understanding equip them with the gravitas and credibility to access and maintain constructive relationships with company boards and executive management teams.
- **Client focus** – EOS pools the priorities of like-minded investors, and through consultation and feedback, determines the priorities of its Engagement Plan.
- **Tailored engagement** – EOS develops engagement strategies specific to each company, informed by its deep understanding across sectors, themes and markets. It seeks to address the most material ESG risks and opportunities, through a long-term, constructive, objectives-driven and continuous dialogue at the board and senior executive level, which has proven to be effective over time.

Our Engagement Plan is client-led – we undertake a formal consultation process with multiple client touchpoints each year to ensure it is based on their long-term objectives, covering their highest priority topics.

EOS team

Engagement

Leon Kamhi
Head of Responsibility and EOS

Richard Adeniyi-Jones
Sectors: Consumer Goods, Financial Services, Industrial & Capital Goods

Dana Barnes
Sectors: Oil & Gas, Utilities, Technology

Justin Bazalgette
Sectors: Consumer Goods, Industrial & Capital Goods

Joanne Beatty
Sectors: Chemicals, Industrial & Capital Goods, Transportation

George Clark
Voting and Engagement Support

Emily DeMasi
Sectors: Financial Services, Pharmaceuticals & Healthcare

Zoe de Spoelberch
Sectors: Retail & Consumer Services, Consumer Goods

Bruce Duguid
Head of Stewardship, EOS

Elissa El Moufti
Sectors: Financial Services, Mining & Materials, Oil & Gas

Will Farrell
Sectors: Utilities, Chemicals, Financial Services

Diana Glassman
Sectors: Oil & Gas, Financial Services, Technology

Jaime Gornsztejn
Sector: Mining & Materials

Hannah Heuser
Sectors: Oil & Gas, Utilities

Ellie Higgins
Sectors: Utilities, Retail & Consumer Services, Consumer Goods

Shoa Hirosato
Sectors: Financial Services, Transportation, Utilities

Lisa Lange
Sector: Transportation

Pauline Lecoursonnois
Sector: Pharmaceuticals & Healthcare

Sonya Likhtman
Sectors: Transportation, Consumer Goods, Financial Services

Earl McKenzie
Voting and Engagement Support

Claire Milhench
Communications & Content

James O'Halloran
Director of Business Management, EOS

Navishka Pandit
Sectors: Financial Services, Technology, Consumer Goods

Xinyu Pei
Sectors: Oil & Gas, Utilities, Mining & Materials

Nick Pelosi
Sectors: Mining & Materials, Financial Services, Technology

Howard Risby
Sectors: Financial Services, Mining & Materials, Oil & Gas

Velika Talyarkhan
Sectors: Utilities, Consumer Goods, Retail & Consumer Services

Ross Teverson
Sectors: Retail & Consumer Services, Technology

Kenny Tsang
Sector co-lead: Consumer Goods

Judi Tseng
Sectors: Financial Services, Technology

Mark Turner
Voting and Engagement Support

Owen Tutt
Sectors: Mining & Materials, Oil & Gas, Utilities

George Watson
Sectors: Chemicals, Financial Services, Consumer Goods

Haonan Wu
Sectors: Transportation, Chemicals, Retail & Consumer Services, Technology, Utilities

Michael Yamoah
Sectors: Technology, Oil & Gas, Utilities, Financial Services

Client Service and Business Development

Mike Wills
Head of Client Service and Business Development, EOS

Diego Anton
Client Service

Amy D'Eugenio
Sustainability Director

Andrew Glynne-Percy
Communications and Marketing

Alishah Khan
Client Service

Jonathan Lance
Client Service

William Morgan
Client Service

Alice Musto
Client Relations Lead

Federated Hermes
EOS

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, where possible, to contribute to positive outcomes that benefit the wider world.

Our investment and stewardship capabilities:

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

Why EOS?

EOS enables institutional shareholders around the world to meet their fiduciary responsibilities and become active owners of their assets. EOS is based on the premise that companies with informed and involved investors 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: