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Competition for water is already a flashpoint in certain regions, and this is likely to intensify as the world warms and city populations grow. Joanne Beatty and George Watson explain how we engage with companies about their use of water, particularly in areas of scarcity.

Setting the scene

Water is critical for life on earth. It supports biodiversity by sustaining habitats, enables agricultural and industrial processes, and is a critical resource for human consumption and sanitation. But treating water as if it were an infinite resource can drain ancient aquifers dry and reduce rivers to little more than a trickle, hurting communities and farmers downstream. This can create tensions between companies and communities, or even between nation states, like the dispute between the US and Mexico over water from the Rio Grande and the Colorado River.¹

This article focuses on our engagements with companies about their use and management of water, rather than our discussions with water utilities, where we have engaged on water stress, quality and flood risk, as well as other climaterelated topics. Our engagements align with UN Sustainable Development Goal (SDG) 6, clean water and sanitation, and SDG 14, life below water.

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Themes: Climate Change, Natural Resource Stewardship george.watson@FederatedHermes.com The world's finite freshwater resources are coming under increasing pressure as the planet warms and populations grow. Some 10% of the global population resides in a country with high water stress, while nearly two-thirds of the global population experiences severe water scarcity at least one month of the year.² Two billion people do not have access to safe drinking water and 3.6 billion people lack access to safely managed sanitation.³

Companies must urgently adopt and accelerate their water stewardship plans to manage and conserve water responsibly. Given the urgency of the global water crisis, EOS is intensifying its engagement on water with companies, pressing them to identify their impacts and dependencies on water and to mitigate related risks, to ensure long-term business success and provide value to investors.

Key water risks

Companies face risks related to water withdrawal, consumption, and discharge. These include physical risks, regulatory risks and reputational risks, which all create financial risk for companies and investors. The sectors most impacted by these risks include food and beverage, apparel, chemicals, mining and industrials companies.

- ¹ <u>https://theweek.com/environment/us-mexico-rio-grande-water-war</u>
- ² Water Scarcity | UN-Water (unwater.org)
- ³ <u>Imminent risk of a global water crisis, warns the UN World Water Development</u> <u>Report 2023 | UNESCO</u>

Physical risks can disrupt a company's supply chain when there are volume issues, such as water scarcity or water flooding, and quality issues such as water pollution. Some 70% of global freshwater is used for agriculture, and crop yields are at risk when there is insufficient water, or an overabundance. Drought and flooding are exacerbated by climate change, and this water variability can impact commodity prices. A food and beverage company can also have a negative impact on water quality by polluting freshwater courses with fertilisers and pesticides, which are high in nitrogen, phosphorus and chemicals.

Companies also face reputational risks if their poor water management has a negative impact on communities or ecosystems. Reputational damage can impact brand value, sales and the share price. Conversely, companies can create opportunities and gain reputational benefits by proactively contributing to improved water security in some regions and working closely with communities and Indigenous Peoples.

Water-related regulatory risks are rising, which can create significant costs for companies. For example, effluent discharge limits can force companies to invest in better water treatment. Also, the new EU rule on the collection, treatment and discharge of urban wastewater introduces a responsibility for manufacturers to remove pollutants from wastewater.⁴ This will impact chemical, pharmaceutical or apparel companies that discharge per- and polyfluoroalkyl substances (PFAS), active compounds leading to antimicrobial resistance (AMR), and microplastics or dyes, into urban wastewater. Companies will have to cover the costs of enhanced treatment.

Despite these risks, the Ceres Valuing Water Finance Initiative (VWFI) inaugural benchmark report found that most companies, when setting water stewardship plans and related targets, failed to consider local watershed conditions such as water quality.⁵ The WWFI, an investor-led effort to engage 70+ at risk companies with large water footprints, found that company water risk assessments often lack local context. In addition, most companies are failing to adequately assess the water resource impacts resulting from their own activities. As we highlighted in our biodiversity white paper, *Our Commitment to Nature*, ambitious action is also needed to protect ecosystems critical to freshwater supplies.⁶

We expect companies to set water quality targets and ensure they have no negative impact on water quality across their value chain.

Our expectations of companies

Our approach to water aims to improve the protection of water systems and is informed by frameworks including the VWFI, the UN Global Compact's CEO Water Mandate and the UN SDGs, covering aspects such as water quantity, water quality, ecosystem protection, access to water and sanitation, board oversight and public policy engagement.



We expect companies to conduct water risk assessments across their value chains, to understand their impacts and dependencies on water at the local catchment level. These assessments should identify their key risk areas and serve as a first step towards developing a water stewardship strategy and plan. Companies can work with the available tools and external organisations such

as the World Resource Institute and the WWF Water Risk Filter to identify where their operations overlap with high-stress water regions.⁷

Targets on use

Once a company has a comprehensive understanding of its suppliers, operations, and/or regions at high water risk, we expect it to set time-bound, science-based or contextual water targets to address the impacts on water availability and quality across its value chain, and ensure it has no negative impact on water availability in areas where it is scarce. Companies can use the Science Based Targets Network's initial guidance on setting water targets and refer to the CEO Water Mandate and Pacific Institute guide, to help them set effective water targets informed by catchment context. These tools were developed in collaboration with the CDP, the Nature Conservancy, UNEP-DHI, World Resources Institute and the WWF.

nargets on water quality

We expect companies to set water quality targets and ensure they have no negative impact on water quality across their value chain. These targets should include a focus on reducing pollutants of concern. Chemical companies should set targets to reduce PFAS pollution in water, apparel companies should control dyes and microfibres in their effluents, and mining and industrial companies should focus on reducing heavy metals in water.

O Governance and stewardship strategy

To successfully reach their targets, we expect companies to develop a water stewardship strategy. This may include policies, sourcing commitments such as procurement standards, and engagement programmes to incentivise suppliers to mitigate water risks and adopt practices that reduce their impacts on water quality and quantity. Companies should consider the human rights impact of water targets in their supply chain and work closely with suppliers to promote responsible water use, and ensure that local communities have access to water.

- ⁶ EOS publishes biodiversity paper Our Commitment to Nature | Federated Hermes Limited (hermes-investment.com)
- ⁷ <u>Aqueduct | World Resources Institute (wri.org)</u>

⁴ New EU rules to improve urban wastewater treatment and reuse | News | European Parliament (europa.eu)

⁵ Valuing Water Finance Initiative Benchmark: Assessing Company Performance on Corporate Expectations across Four Water-Intensive Industries (ceres.org)

The water stewardship strategy and its implementation should be underpinned by good governance and public policy engagement. The company's board should oversee salient water issues and follow the implementation of water policies. Boards should discuss how water risks and opportunities are integrated in corporate risk management frameworks and decision making. Companies can also use water-related remuneration metrics to incentivise senior executives to reach water targets. Companies should ensure that their public policy engagement and lobbying activities are aligned with sustainable water resource management outcomes.

We expect to see transparent, regular reporting on water. We encourage year-on-year disclosures around progress against water targets. Companies should disclose the volumes of water withdrawn and used throughout their supply chain, at the asset level and in their operations. Companies can report on circularity programmes and treatment processes to reduce water use, increase water reuse and decrease wastewater pollution.

Our engagement

EOS engages on water through direct company engagement, collaborative initiatives such as the VWFI, and through our public policy advocacy work. Below, we highlight some of our engagements with sectors exposed to water risks, including food and beverage, apparel, chemicals, mining and industrials companies.

Food and beverage

We successfully engaged with the US fast food restaurant chain Domino's Pizza on water. We encouraged the company to conduct a water risk assessment covering water quality and quantity indicators throughout its entire supply chain, as a first step to setting water targets. After multiple engagements, the company agreed to perform the assessment and presented its findings in our next meeting. The results revealed areas of high-water stress, and we continue to engage with the company on developing targets to reduce its impacts on water availability and quality, and to define a clear strategy to work with suppliers on water.



⁸ Environment | Sustainability | ASAHI GROUP HOLDINGS (asahigroup-holdings.com)

We also raised the issue of water security and pressed for risk assessments and robust targets and strategies in engagements with Yum! Brands, Hormel Foods, Asahi Group and McDonald's. All four companies have conducted water risk assessments. Asahi has set a goal to identify 100% of its manufacturing sites located in water risk areas by 2030.⁸

We have engaged with agricultural commodity company Cargill on its target of enabling the restoration of 600 billion litres of water in water-stressed regions by 2030,⁹ encouraging it to consider setting targets across all of its watersheds. To date the company has restored 9.2 billion litres against its target and continues to take a prioritised approach to watershed selection.¹⁰

Apparel

We held engagements and sent a letter on water to the UKbased fast fashion company Boohoo, to press for water data collection and the development of water reduction initiatives. In its 2023 sustainability report the company said that it would announce goals on water as well as chemicals, biodiversity and microfibres.¹¹ We have had constructive discussions with the Swedish apparel company H&M on developing a water strategy in line with its biodiversity strategy and addressing microfibre pollution.

Chemicals and fertilisers

As water is used in most chemical processes, the chemical sector faces the dual challenges of water scarcity and quality, due to the emission of pollutants to fresh and marine water bodies. A strong focus on water stewardship by the sector is expected to reduce water stress on aquatic ecosystems and improve water quality and biodiversity.

We led a Nature Action 100 collaborative engagement with Dow on biodiversity and water. We welcomed the company's increased focus on water stewardship with the announcement of new ambitious water targets in 2024.

Dow has identified 20 priority water-dependent industrial sites representing around 90% of its water footprint; these were selected on the basis of expected business growth and increasing competition for water.

Dow wants each site to have an holistic water stewardship plan to mitigate the effects of water usage on the environment and local communities. By 2035 the intention is for all of its sites to have water stewardship plans in place. Dow's strategy is designed to support resiliency for its sites and the surrounding natural ecosystems, protecting them from unpredictable conditions such as drought and flooding.

Fertilisers play an important role in meeting global food demand but can also impact water quality. EOS has been discussing water stewardship with fertiliser producer Nutrien since 2019. The company has set a target to reduce its freshwater usage in its operations by 30 million cubic metres by 2030. Additionally, Nutrien has begun to work with a third-party verifier, WAVE, to shift from water management to water stewardship. This process involved WAVE independently verifying Nutrien's stewardship work, with water impact and risk assessments at 23 manufacturing sites and terminals across its North and South American operations.

⁹ <u>2023-esg-report.pdf (cargill.com)</u>

¹⁰ <u>2023-esg-report.pdf (cargill.com)</u>

¹¹ boohoo-sustainabilty-report-jun-2023.pdf (boohooplc.com)



More recently, we have begun to discuss eutrophication with the company. This is when fertilisers leaching into major water bodies create algal blooms that deplete the oxygen levels in the water. The company has told us it is trying to implement the "four Rs" of nutrient stewardship – right place, right time, right amount, right source – to reduce the amount of nutrients that are lost to runoff. We continue to push for more disclosure on the efficacy of this initiative.

Mining

Mining companies are exposed to water scarcity risks, as well as having operational impacts on water quality and local water rights. Water risks for mining companies can be extremely costly, whether this is due to litigation, clean-up costs from contamination, or the need to identify new water sources.

We first raised concerns with miner BHP on water stress in 2014. Water is integral to BHP's business and it recognises that clean water is a basic human right and essential to maintaining healthy ecosystems. The company's water stewardship statement developed in 2019 envisions a water secure world by 2030, consistent with the UN Sustainable Development Goals. The five pillars of BHP's water stewardship strategy involve managing water risks, valuing water in investment and operational decisions by considering all beneficial uses of water, disclosing performance, taking collective action, and innovation through knowledge and technology. We also engaged with mining company Rio Tinto on water. We encouraged the company to report detailed information on its water risks and impacts. We had a constructive dialogue with the company on reporting its water management practices and asked it to provide site-level information on its water risks and impacts.

In the course of our engagement, the company disclosed asset-level water risk data, covering water risk atlas baseline water stress, water resources, quantity and quality, dewatering and long-term obligations. We continue to engage and encourage the company to provide further detail on its performance at site-level.

Public policy and market best practice

EOS also conducts public policy advocacy on water. We responded to a consultation on the World Health Organization's guidance on wastewater management from antibiotic manufacturing.¹² We raised the need for this framework to support companies in the process of setting targets on limiting active components in wastewater and implementing the correct risk management plans in their operations and supply chains to prevent pollution.

Our recent public policy activities have focused on water quality and chemicals. We wrote in response to the EU Green Taxonomy, calling on the criteria to be truly sustainable to encourage the development of safer "do no harm" alternatives. We said we were concerned that the production and use of harmful chemicals were linked to major financial risks for investors and manufacturing companies, including costs and damages related to regulation, reputation, insurance, and litigation. This is in addition to the fact that they pose a major threat to human health and the environment.

In our role on the Investor Initiative on Hazardous Chemicals Steering Committee we are supporting the development of guidance and market best practices. The goal is to reduce the harmful impacts of hazardous and persistent chemicals on humans and the environment, including water bodies.



Looking forward

Globally, the demand for water is expected to continue to increase. Projections show that the gap between global water demand and supplies of fresh water is expected to reach 40% by 2030.¹³ At the same time, the cumulative impacts from pollution and emerging contaminants are threatening the quality of our water resources. In response companies must accelerate their efforts to advance water stewardship strategies and commitments.

We will continue to engage companies directly on our water stewardship expectations and through collaborative engagements such as the VWFI, Nature Action 100 and the 2018 UN PRI engagement on water risks in agricultural supply chains. Our focus will continue to be on sectors and companies facing water security, quality and regulatory risks, including food and beverage, apparel, chemicals, mining and industrials companies. Our engagement will seek progress beyond delivering against operational metrics, encouraging companies to ensure meaningful stewardship of local watershed conditions over the short, medium, and long term.

¹² <u>https://www.who.int/publications/i/item/9789240097254</u>

¹³ Freshwater demand will exceed supply 40% by 2030, say experts | World Economic Forum (weforum.org)

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