OUTCOMES BEYOND PERFORMANCE

PUBLIC ENGAGEMENT REPORT

From data privacy to device addiction -
The challenges for the tech sector

Q2 2018

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HERMES
EOS

This report contains a summary of the stewardship activities undertaken by Hermes EOS on behalf of its clients. It covers significant themes that have informed some of our intensive engagements with companies in Q2 2018.

The report also provides information on voting recommendations and the steps we have taken to promote global best practices, improvements in public policy and collaborative work with other long-term shareholders.

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Engagement by region

Over the last quarter we engaged with 428 companies on 880 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.

Global

We engaged with **428** companies over the last quarter.

- Environmental **17.6%**
- Social and ethical **16.5%**
- Governance **49.8%**
- Strategy, risk and communication **16.1%**

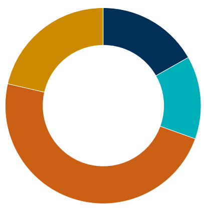
Australia and New Zealand

We engaged with **two** companies over the last quarter.

- Social and ethical **33.3%**
- Strategy, risk and communication **66.7%**

Developed Asia

We engaged with **65** companies over the last quarter.



- Environmental **16.8%**
- Social and ethical **13.7%**
- Governance **48.1%**
- Strategy, risk and communication **21.4%**

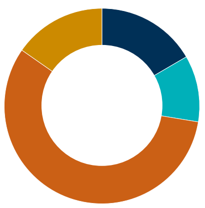
Emerging and Frontier Markets

We engaged with **47** companies over the last quarter.

- Environmental **25.7%**
- Social and ethical **23.8%**
- Governance **26.7%**
- Strategy, risk and communication **23.8%**

Europe

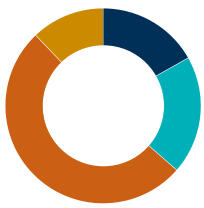
We engaged with **83** companies over the last quarter.



- Environmental **16.6%**
- Social and ethical **11.0%**
- Governance **57.1%**
- Strategy, risk and communication **15.3%**

North America

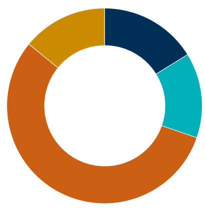
We engaged with **130** companies over the last quarter.



- Environmental **16.8%**
- Social and ethical **19.6%**
- Governance **51.4%**
- Strategy, risk and communication **12.1%**

United Kingdom

We engaged with **101** companies over the last quarter.



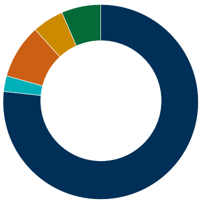
- Environmental **16.2%**
- Social and ethical **14.1%**
- Governance **55.6%**
- Strategy, risk and communication **14.1%**

Engagement by theme

A summary of the 880 issues and objectives on which we engaged with companies over the last quarter is shown below.

Environmental

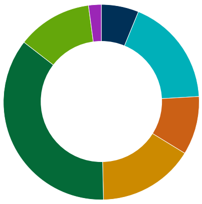
Environmental topics featured in **17.6%** of our engagements over the last quarter.



- Climate change **76.8%**
- Forestry and land use **2.6%**
- Pollution and waste management **9.0%**
- Supply chain management **5.2%**
- Water **6.5%**

Social and ethical

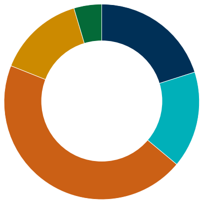
Social topics featured in **16.5%** of our engagements over the last quarter.



- Bribery and corruption **6.2%**
- Conduct and culture **17.9%**
- Diversity **9.7%**
- Human capital management **15.9%**
- Human rights **35.9%**
- Labour rights **12.4%**
- Tax **2.1%**

Governance

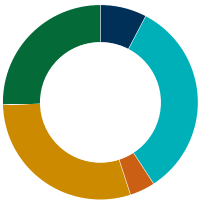
Governance topics featured in **49.8%** of our engagements over the last quarter.



- Board diversity, skills and experience **20.1%**
- Board independence **16.0%**
- Executive remuneration **45.0%**
- Shareholder protection and rights **14.4%**
- Succession planning **4.6%**

Strategy, risk and communication

Strategy and risk topics featured in **16.1%** of our engagements over the last quarter.



- Audit and accounting **7.7%**
- Business strategy **33.1%**
- Cyber security **4.2%**
- Integrated reporting and other disclosure **29.6%**
- Risk management **25.4%**

Environmental

Full cycle – Investing for a circular economy

A linear economy appears to work well from an economic perspective. But from a resource depletion and pollution perspective, it is problematic.

Setting the scene

Plastic is ubiquitous. As well as being used in packaging, toys, furniture and consumer goods, plastics are in wrapping paper, ribbon, nappies, wet wipes, chewing gum and teabags; it also forms the lining in crisp packets, paper cups and food and drink cans, and is used in heavier manufacturing for products including window frames, building insulation and numerous car parts such as bumpers, body panels and interior trim. It was never meant to be recycled, as part of an economic model in which products are effectively produced, used and then simply thrown away. This means that it presents a challenge for a more recycling aware world. And with the production of plastic set to increase, it has become all the more important to find a solution.

Recent media coverage has highlighted how society's demand for plastics is pushing the environment to the limit. But behind the 'demonisation' of plastic lies the need for a shift in the way we produce and consume goods – to one in which we can participate as investors as well as consumers.

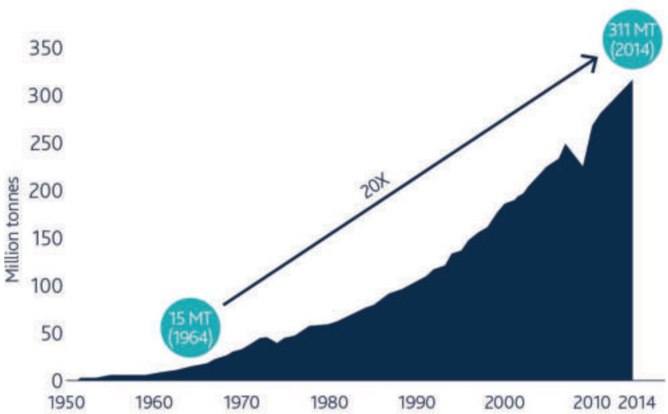
Despite the recent media focus on plastic as an environmental issue, its popularity continues to rise. Half of the total amount of synthetic plastic resins and fibres ever manufactured have been produced in the past 13 years,[1] and experts estimate that production will increase by a further 40% over the next decade.[2]

Plastic – the facts

There are reasons for the ongoing ubiquity of plastic: it is cheap, lightweight, waterproof and requires less energy to manufacture than many other materials.

Unfortunately, another advantage of plastic is also the reason it creates such an issue: its durability. Plastic has become emblematic of the problems inherent in the traditional consumption led economic model because its durability and visibility mean we are now literally seeing it everywhere.

The underlying issue is that the global economy is overwhelmingly linear. Essentially, a linear economy is an economic system in which goods are produced, used and then disposed of. From an economic perspective, a linear economy appears to work well. However, from the point of view of resource depletion and pollution, it is problematic.



Source: Ellen MacArthur Foundation

Towards a circular economy

A circular economy is focused on sustainability from the outset, with the maximum value of a product being extracted before it is repaired, reused or recycled. It requires products to be designed so that their creation, use, and reuse or recycling has minimal impact on the environment.

A truly circular economy calls for businesses not just to maximise recycling and minimise waste but to re-engineer their products and services with a so-called 'cradle-to-cradle' approach. It involves intensive resource efficiency relating to water, energy and materials, reduced packaging and high recycling rates, and asks consumers to consider sustainability as a critical factor in their purchasing decisions.

Case study – Fairphone

Fairphone is an example of a product (and company) which has been created around a circular economic model. Described as 'the world's first modular, ethical smartphone', it is built to be repaired and improved, rather than disposed of, and uses clean cobalt in its construction.

One of the biggest issues with traditional smartphones is longevity – in developed economies upgrading to the latest phone every 12-18 months is common. The Fairphone uses modular architecture which allows components to be updated or repaired without discarding the whole handset.

The company also operates a takeback recycling programme and uses ethically sourced materials, with a focus on ethical labour and efficient manufacture. https://www.fairphone.com/en/.

There can be technological barriers to a more circular approach. However, consumer demand and investor sentiment can act as key drivers towards a tipping point at which a circular model becomes advantageous from a business perspective.

Circular food

Food waste is an area which the large chains have understandably been drawn to due to its high visibility to consumers. We have pushed for a formal waste production programme to reduce food waste in supply chains and stores, while also engaging on a more sustainable approach to packaging.

Case study – Tesco

Tesco chief executive Dave Lewis chairs a coalition called Champions 12.3, a group dedicated to achieving the UN Sustainable Development Goal target to halve global food waste at the retail and consumer level per capita and reduce food losses in production and supply chains by 2030. It has put in place partnership agreements with 25 suppliers representing over £18bn worth of Tesco sales to achieve these targets.[3]

The company has also become the first retailer to publish food waste data for its own operations and is pursuing initiatives such as simplified use of date codes to help reduce levels of food wastage.

Meanwhile, as part of its 'Little Helps Plan' the company aims to make all packaging either recyclable or compostable by 2025.[4] In addition, Tesco recently undertook a consultation with its suppliers and developed a preferred material list for product packaging. The goal is to remove plastics that are most difficult to recycle, ban bioplastics that cannot be recycled and prioritise materials where recycling is straightforward. Tesco will also collaborate with industry and government to find alternatives to packaging materials which currently cannot be recycled.[5] https://www.tescoplc.com/little-helps-plan/.

Our engagement objectives focus not just on the environment, but also on social and ethical issues; corporate governance; strategy, risk and communications; and stewardship. We will always look for ways to help companies go further; in our engagement with Tesco, we suggested it set intermediary targets to help track progress and further improve its reporting.

Circular questions

The transition to a circular economy raises a number of questions. In any engagement exercise it is therefore important to avoid assumptions about sustainability, understand what should be aimed for and identify the best approach.

Take, for instance, the reintroduction of glass milk bottles. The environmental benefits are debatable – waste charity Wrap suggests that from a carbon perspective a glass bottle would need to be reused at least 20 times to be a better environmental option than plastic.[6] However, where a sustainable source is used, glass or wood based packaging can be a viable option, particularly for localised use where the impact of higher transportation costs is lower.

Commercial imperatives

While companies like Fairphone are founded around a circular economy model, others make a virtue out of necessity.

Case study – China Mengniu Dairy

China Mengniu Dairy is a major dairy producer which sources milk from small farms across China. We first started engaging with the company in 2008, trying to encourage better dialogue at a time when Chinese firms talking to overseas investors was very unusual.

The company was one of 22 caught up in the 2008 milk scandal in China, in which milk powder was contaminated with melamine.[7] The incident triggered a major review of the company's culture, with sustainability emerging as a core value.

Danone invested in the company, bringing new ideas in terms of global best practice, including an understanding that the quality of the firm's product is determined by the quality of the source.

A major challenge was that the company's milk supplies are sourced from small local farms in remote regions which typically have poor access to electricity and a clean water supply. This led the business to adopt a circular economy approach almost out of necessity: many farms have started to convert cow waste into biomass energy, and all types of waste are separated according to potential use.

Since we began our engagement with the company, it has increased the number of independent directors from three to five. More recently, we have focused on the climate change impact of its business and are seeking to improve its disclosure of environmental performance. http://www.mengniuir.com/html/index.php.

Conclusion

The benefits of a circular economy for society, the planet and businesses are clear: resource productivity is maximised; the environmental impacts of production and consumption are minimised; and waste becomes a resource rather than refuse.

Through our engagements, we have started to discuss the concept of a circular economy with companies, clarifying that greater recycling and less waste are only the first steps towards adopting a more circular business model.

Investors can also support the development of a circular economy in several ways:

- By engaging with companies on improving resource efficiency, waste reduction and maximising recycling
- By engaging with policymakers and industry bodies to support regulations or incentives which encourage circular production
- By investing in businesses with good return prospects and which demonstrate a clear commitment to the principles underpinning a circular economy

As with all sustainability issues affecting the global economy, the transition to a circular model will require coordinated action from consumers, governments, NGOs and businesses. But investors also have a key role to play in creating a sustainable economic future.

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[1] https://www.ncbi.nlm.nih.gov/pmc/articles/PMC5517107/: Geyer, R; Janbeck, J R, Law, K L, Production, use, and fate of all plastics ever made, published in Science Advances, July 2017
[2] https://www.theguardian.com/environment/2017/dec/26/180bn-investment-in-plastic-factories-feeds-global-packaging-binge
[3] https://www.tescoplc.com/news/news-releases/2017/food-waste-suppliers-champions-123-dave-lewis-tesco/ (since updated)
[4] https://www.tescoplc.com/little-helps-plan/foundations/
[5] https://www.tescoplc.com/little-helps-plan/products-packaging/preferred-material-list/
[6] http://www.bbc.co.uk/news/business-43724314
[7] http://www.bbc.co.uk/news/world-asia-pacific-11372917

Social

Disarming America – Engaging with gun retailers and manufacturers

We are seeking board level dialogue with companies on their oversight of policies and practices in relation to firearms.

Setting the scene

School shootings seem to have become a tragic and too regular occurrence in the US. While politicians, companies and investors already promised reforms after the 2012 Sandy Hook Elementary School shooting, little appears to have been done, as these incidents keep occurring. According to statistics by news channel CNN, as at 21 May 2018, school shootings have averaged one a week in the US since 2009.[8] After the shooting in Parkland, Florida, in February 2018, which killed 17 students and adults, again there was a public outcry, protest marches and calls for the introduction of increased gun control, despite ongoing political support for the US gun lobby. However, this has been followed by more school and university shootings, including the one at Santa Fe in Texas, which killed 10. In addition, according to the US Bureau of Alcohol, Tobacco, Firearms and Explosives, the number of firearms manufactured in the US grew almost threefold between 2007 and 2016.[9]

The proliferation of firearms in the US contributes to a range of social harms, including many unnecessary deaths and injuries, as well as an increase in the cost of security, prevention and medical care. Research estimates that gun violence costs the US economy at least $229 billion every year, including $8.6 billion in direct expenses such as for emergency and medical care.[10] Gun violence costs more than $700 per US citizen every year, more than the total economic cost of obesity and almost as much as the entire Medicaid programme annually.

Changing environment

While the notion of a changing environment regarding regulations for the manufacturing and merchandising of guns is nothing new, this time change really appears to be on the horizon.

Politics aside, there have been signs that investors are taking it more seriously. US institutional investors have approached the issue of gun violence in a variety of ways, with some restricting investments in companies with exposure to firearms, while others seek to engage with firearm manufacturers and retailers on assault weapons and product safety.

The California State Teachers' Retirement System (CalSTRS), for example, now prioritises engagement with the manufacturers and retailers of firearms that are illegal in California and may divest from them if its engagement efforts fail.[11]

Questions for companies

- Who within the management of your organisation is responsible for the formation, ongoing review and enforcement of firearms policies and practices? How does the board oversee them?
- How are the interests of company stakeholders, including investors, customers, local communities and suppliers, considered when developing and implementing these policies and practices?
- How are the Sandy Hook Principles[12] and other publicly discussed measures to curb gun violence considered in the formation and ongoing review of these policies and practices?
- How are employees trained and monitored to ensure the company's policies and practices are followed?

This follows previous action taken by the pension fund. Following the Sandy Hook Elementary School shooting in December 2012, CalSTRS divested from firearms makers Sturm, Ruger & Co and Smith & Wesson. In 2015, the pension fund exited an interest in Remington Outdoors, which was part of a private equity investment, and in February of this year, it liquidated its investments in Vista Outdoor because the company added a line of firearms that violate CalSTRS' policy.

Company actions

Two major retailers – Dick's Sporting Goods and Walmart – have stopped selling assault style weapons and pledged not to sell any firearms to customers under the age of 21. Another, Kroger, announced the phase out of the sale of guns altogether in its Fred Meyer stores, citing declining sales.

In particular, we welcomed the change in policy and introduction of age restrictions and background checks by Walmart[13], with which we have had longstanding engagements on other issues. Because of its scale, the retailer has an influence on its peers and has promised to do more in this area.

Our view

It is our view that to be sustainable over the long term, companies must create and preserve value not only for their shareholders but for stakeholders as well. We expect companies to have a long term purpose beyond short term shareholder value, which benefits society as a whole and shareholders' beneficiaries in the long run.

We recognise the control of firearms is a highly debated and contested public policy matter in the US but the recent school shootings have highlighted the need for investors to engage with companies on their firearms policies and practices as they affect important stakeholders, particularly customers, employees and others who interact with them.

Engagement

Together with Northern Trust, we have contacted retailers to further understand the evolution and path of their policies and practices on firearms and ammunition.

Our engagement will focus on how their policies seek to protect their employees, customers and wider communities from gun violence and whether these policies can be enhanced to reduce the risk to their stakeholders – including shareholders.

Engagement with the manufacturers of firearms is more difficult. Some – such as Remington Arms – have filed for bankruptcy, while others are held by private equity companies or have a policy of not talking to their shareholders.

On a different note, in the US we back shareholder proposals calling for the disclosure of a company's lobbying activities 90% of the time, either directly or indirectly through third parties such as the National Rifle Association (NRA). Through our engagement, we aim to increase oversight of firearms policies and practices by company boards and the public disclosure of this in their annual reporting, and for businesses to take action well before the annual election of directors.

ICCR support

Together with investors representing $634 billion in assets under management, we have also signed the statement on firearms in the US by the Interfaith Center on Corporate Responsibility (ICCR). The statement – an enhancement of the Sandy Hook Principles[14] – provides best practice guidelines for gun manufacturers, retailers and other companies with a presence in the US.

It urges gun manufacturers to publicly endorse the Sandy Hook Principles; stop the sale, production, design or conversion of military style semi-automatic assault weapons and associated accessories and components for use by civilians; develop technology enhanced safety measures for all other guns; and support a federal universal background check system for all gun and ammunition transactions.

Distributors and retailers meanwhile should stop the sale of military style semi-automatic assault weapons for use by civilians, limit gun and ammunition sales to purchasers aged 21 and over, reinforce background checks, end the sale of realistic toy guns and air rifles marketed to children and implement comprehensive gun safety education.

As providers of credit, payment platforms and insurance products, financial institutions can adopt safety measures to ensure they are not facilitating illegal or unauthorised gun sales or otherwise contributing to gun violence. The statement therefore calls on them to prohibit the lending or the use of credit cards/payment systems to gun manufacturers that produce these weapons or ammunition and prohibit lending to gun manufacturers and sellers that do not support federal universal background checks and/or endorse the Sandy Hook Principles. Insurance companies should cease any liability coverage for owners of assault weapons and cease the financing or underwriting of gun shows and/or NRA-sponsored events.

Encouragingly, we are also seeing others taking action in this space, such as banks. US bank Citigroup decided to no longer lend to gun retailers and manufacturers, while others have imposed limits or cut ties with members of the NRA.

The chair of Bank of America announced that the financial services company would engage the small number of clients it has that manufacture military style firearms for non military use and exit their relationships unless the companies would cease such manufacture.

In addition, all companies, not just retailers and firearms manufacturers, should thoroughly investigate their direct operations, trade relationships and supply chains and assess where potential firearms related risks may exist so they can take the necessary steps to mitigate them.

The ICCR also filed a shareholder proposal at Sturm & Ruger calling for the company to report on its efforts to promote gun safety in pursuit of concrete evidence that the board is properly assessing risks to the long term viability of the business. A 70% majority of the company's shareholders, including ourselves, backed the resolution. It has also filed the same proposal at the AGM of American Outdoor Brands in September 2018.

A resolution filed by Mercy Investments asking Dick's Sporting Goods for a report on what actions it had taken to curb gun violence was withdrawn after the retailer agreed to stop selling assault weapons and raise the minimum age for gun sales.

Insurance company Chubb meanwhile contested the filing of a shareholder resolution calling on it to stop underwriting an NRA-branded insurance policy that would cover the insured if they shot someone in self defence. The Securities and Exchange Commission allowed the company to exclude the proposal because the proponent did not provide sufficient proof of shareholdings. However, following the Florida school shooting in February 2018, Chubb dropped the NRA-utilised product line.

Overall, it is clear that the pressure on gun manufacturers and retailers to take action has increased and will continue to do so. Institutional investors can contribute to this by holding the companies to account, thus increasing the chances of curbing gun violence in the US.

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[8] https://edition.cnn.com/2018/05/21/us/school-shooting-us-versus-world-trnd/index.html
[9] https://www.atf.gov/resource-center/data-statistics
[10] https://www.motherjones.com/politics/2015/04/true-cost-of-gun-violence-in-america/
[11] https://www.calstrs.com/news-release/calstrs-moves-forward-engage-firearms-makers-and-retailers
[12] https://www.phila.gov/pensions/PDF/Sandy%20Hook%20Principles%20Exhibit%20A%20FINAL.pdf
[13] https://news.walmart.com/2018/02/28/walmart-statement-on-firearms-policy
[14] http://www.phila.gov/pensions/PDF/Sandy%20Hook%20Principles%20Exhibit%20A%20FINAL.pdf

Of overboarding and independence – The challenges of the non-executive director role

Non-executive directors have a crucial function on the boards of companies and their role is evolving.

Setting the scene

Companies globally have different governance and board structures in place, ranging from the one tier board structures typically found in the UK and the US to the two tier structures which, for example, prevail in Germany, the Netherlands and China. Depending on the structure of the company and regional preferences, board compositions vary. However, over the last decade, pressure has been mounting on companies to improve their governance. While it is difficult to define exactly what good corporate governance looks like, appropriate board composition can strengthen oversight and accountability and help to ensure that a company is well run; the non-executive directors on the board play an important role in this.

One of the key roles for company boards is setting the company's values and ethical standards. Its directors should lead by example and ensure that good standards of behaviour permeate throughout all levels of the organisation. They ought to provide oversight of management, hold individuals to account, give advice and have responsibilities towards shareholders. This is designed to support the delivery of the long term success of the company as well as help prevent misconduct and unethical practices.

While non-executive directors (NEDs) often have the same general legal duties, responsibilities and potential liabilities as executive directors, NEDs are expected to bring a different perspective to their role. They should scrutinise the performance of management in meeting agreed objectives and monitor the reporting of performance. They are also responsible for determining appropriate levels of remuneration of executive directors and have a prime role in appointing and where necessary removing executive directors and in succession planning. They should contribute by providing constructive criticism and advice and are expected to focus on board matters and not stray into executive direction. In terms of personal attributes, they should question intelligently, debate constructively, challenge rigorously and decide dispassionately.

The number of NEDs varies by country. In the two tier system such as Germany, the supervisory board consists of NEDs only, while in the one tier system there is a mix of executive directors and NEDs.

We want to see a majority of non-executive directors on the boards of companies and ideally an independent non-executive chair.

Evolution of the role

As governance codes and regulations have increased, the focus on NEDs acting as a monitor rather than a partner or adviser to a company and on backward looking financial information has increased. Their role has become more of a tick-box exercise and thus meant less involvement in forward looking strategies.

The Senior Manager Regime in the UK with its focus on additional personal liability, for example, requires NEDs in the financial services sector to have a detailed knowledge of operations, and thus an increased time commitment. The focus on processes and compliance, in particular on issues such as audit, remuneration, nominations and risk management, as well as on backward looking financial information has led to the role of the NED being centred on monitoring, instead of providing support to foster entrepreneurial leadership of the company. It also means that the rise in time commitments limits their ability to explore additional sources of information, thus making them reliant on information from executives.

In our view, NEDs should have a more forward looking, strategic role in the company and develop and review the business strategy, as well as bring new ideas and challenges to the board by virtue of their independence from the management of the company and any of its interested parties. This also reflects that the monitoring of executives is increasingly conducted by wider stakeholder groups rather than the board only.

Encouragingly, more companies have developed introduction programmes for their NEDs, and they are increasingly involved in strategy days and collaborating with management to develop business strategies. In order to fulfil their role, NEDs must be well informed about the business, the environment in which it operates and the issues it faces. Developing such knowledge cannot be done within the confines of the boardroom alone.

Skills

NEDs are usually chosen for their breadth of experience and personal qualities. They also tend to sit on committees, such as audit and risk. Often this requires specialist financial knowledge, which is what tends to drive the selection of NEDs. However, it is important to bear in mind that these or sector specific skills are not the only requirement for a NED. They also need to have strong interpersonal skills; have integrity and high ethical standards; be of sound judgement; and have the ability and willingness to challenge, in particular as their role is to avoid groupthink.

In our engagement, we press boards, including their NEDs, to become more diverse in terms of gender, nationality, ethnicity, experience, skill-sets and socio-economic background. We also advocate companies undertake externally facilitated independent board assessments to find out what is working or not on their boards and draw up a skills and experience matrix for their directors to find the relevant skills necessary in a NED. But while such a skills matrix is now well established in UK markets, it remains uncommon in emerging markets.

As part of best practice, we want companies to publish their skills matrices in their annual reports and/or proxy materials, in particular ahead of board refreshments.

Overboarding

Over the last few years, we have been increasingly engaging on overboarding. As part of our dialogue with companies, we question whether NEDs can commit sufficient time to their role or whether they may have too many other commitments elsewhere.

This is important as many companies, particularly in emerging markets such as Russia, still value 'trophy boards' consisting of high profile individuals who lack the time to fully contribute.

Some companies have realised the importance of having fully committed NEDs. HSBC Holdings, for example, has made it an explicit part of its requirements that each director is capable of contributing the time expected of board members and making a valuable and active contribution to their role. The bank requires them to devote 35-40 days to its main board business and 15 days per year to each committee they sit on, as outlined by its previous chair.[15] Anglo-Australian mining company BHP has also been putting pressure on its NEDs to give up other time commitments and board positions and states that it requires at least 50 days a year from its NEDs.

We take into account the overall number of positions individual board directors hold when making our voting recommendations for their election. If they appear overboarded, we typically ask for an explanation of the specific circumstances. We also look at the size and complexity of the companies where the candidate is sitting on the board, as this can make a big difference to his or her time commitments.

Independence

Most important is the degree of objectivity NEDs can bring to the board through their independence from the management of the company and any of its interested parties.

In some countries, such as Mexico, there tends to be a cosy, over-familiar club of NEDs who end up sitting together on company boards, making it difficult for outsiders to be selected to the board.

The UK Corporate Governance Code requires company boards to identify in their annual reports each NED they consider to be independent. The board should determine whether the director is independent in character and judgement and whether there are relationships or circumstances that are likely to affect the director's judgement. Unfortunately, proxy voting agencies have often interpreted the code's limit of a nine year tenure as a hard rule, with their standard policies often leading to automatic votes against the re-election of directors who have served more than nine years, regardless of the company's explanation. We are more flexible in our approach to tenure. In our view, a NED who has been on the board for more than 20 years, for example, can still be more independent than someone with a tenure of two years.

We believe that companies should seek to improve their explanations and investors and their service providers should be more willing to accept them when they are more convincing than the boilerplate that is often written. Having one or two directors with a tenure of more than nine years, particularly at complex companies, can strengthen a board, as their knowledge of corporate history through the business cycle can be highly valuable. Through an overly rigid application of the nine year limit, we are in danger of creating a problem of insufficient experience on boards.

As part of best practice, a board should appoint one of the independent NEDs as senior independent director (SID, also known as the lead independent director) to be a sounding board for the chair and to serve as an intermediary for the other directors where necessary. The SID should also be available to shareholders if they could not adequately resolve their concerns through the chair, CEO or any other executive director. This could be the case in circumstances where there are concerns about the chair or the issue is succession.

Succession planning

Good succession planning at the board and senior management level is an important measure that should help to safeguard long term value at any organisation. It ought to involve contingency planning for the sudden loss of key personnel, as well as planning for foreseeable change, for example future retirement or likely change following long tenure. Boards should always have a portfolio of potential non-executive directors who could be considered for appointments. We also prefer to see a staggered refreshment at companies for executive and non-executive directors to avoid losing all the knowledge and insight at once. Encouragingly, BHP, which is in our engagement programme, is well ahead with its recruitment process, with succession planning underway even for NEDs whose retirement is still several years away.

We encourage companies to make their senior management and executive directors available, where appropriate and where it does not lead to overboarding, to serve as non-executive directors at other companies as part of their development. This helps to develop a pipeline of suitable candidates for companies to draw from when selecting candidates for board positions.

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[15] http://www.bvalco.com/wp-content/uploads/2016/07/A-CONVERSATION-WITH-DOUGLAS-FLINT-JULY-2016.pdf

From data privacy to device addiction – The challenges for the tech sector

We are engaging with technology companies on a variety of issues, including data privacy, diversity and device addiction.

Setting the scene

One of the biggest scandals to emerge this year, which rocked the confidence of Facebook users, was the harvesting of the personal information of millions of users without their permission by data analytics companies including Cambridge Analytica. Facebook apologised publicly and has since been investigated for violation of privacy agreements. In addition, addiction to digital technology, such as mobile phones, the internet and video games, and the related impact on mental health has become of increasing concern. The World Health Organization recognises addiction to gaming as a mental health disorder and the UK's National Health Service has made its first diagnosis of computer game addiction.

Our engagement with technology companies that have a manufacturing base, such as Hon Hai Precision Industry, has often revolved around labour rights, supply chain and health and safety issues. With those in new technology – the likes of Facebook, Apple, Amazon, Netflix and Google's parent company, Alphabet, the so-called FAANG stocks – the focus is on data privacy and increasingly social issues. In addition, we have engaged with these on governance issues.

Governance

Many technology companies, such as Alibaba, Alphabet, Amazon, Baidu, Facebook, Hon Hai and Tesla are founder led and often have preferential voting rights structures in place that allow them to remain in control. We, however, firmly believe in the principle of one-share one-vote, which ensures proportionality between equity ownership, voting powers and economic risk bearing. We have therefore supported shareholder proposals in the US that pressed for a shift to the one-share one-vote principle.

Through our engagement, we attempt to improve minority shareholder rights by encouraging companies to improve their board diversity and transparency of the director nomination process.

In addition, we push for independent, competent boards, that help to deliver the purpose of the company and provide constructive challenge to the founders.

Many directors, on the board of Alphabet, for example, have served for more than 10 years. While two new independent directors have been appointed over the last four years, we believe that board refreshment should accelerate and be more transparent, which is why we continue to engage on this. We were pleased that the board replaced the chair with an independent one in December 2017.

Diversity

Progress must also be made across the sector on diversity. In Silicon Valley, most highly paid jobs remain occupied by men and there is evidence of widespread cultural biases.

We have been engaging with Alphabet on gender pay inequality and the disclosure of any gender pay gap, as the company is facing a class-action lawsuit that alleges it underpaid women in comparison to their male counterparts. We have urged the company to improve disclosure on pay inequality and any pay gap that may exist.

However, we welcomed that in its 2018 Diversity Report, Google – for the first time – included data on hiring, attrition, and the intersection of race and gender. Although disclosure has improved, progress made on overall workforce representation has remained stagnant in the US. Women of all ethnicities are less represented in the company's workforce than men of the same ethnicity although the number of women in leadership at the company globally has increased since 2014 from 20.8% to 25.5%. Attrition rates are highest for black employees and the company is working to ensure that all staff, but especially the under-represented groups, find the company an inclusive workplace. While the introduction of gender-neutral parental leave is groundbreaking in the US, the uptake of this will be reflective of the culture. We continue to engage with the company to set targets for its ambitious diversity programmes.

In relation to governance, we will also, for example, monitor the board composition of Chinese technology company Tencent over a three-year period to address the lack of gender diversity on its board. This is reflected in our regional Corporate Governance Principles, which expect Chinese companies to be made up of at least 20% women by 2020.

At Baidu, we set an objective on board composition, including diversity in 2016, due to concerns that its combined founder, chair and CEO is too dominant on the board. When a former Microsoft executive joined the company as president and COO in 2017, we monitored his performance and were encouraged by his ability to improve the business focus and operations of the company, which was reflected in the delivered outcomes. At the company's quarterly results conference calls, he progressively took on more responsibility to answer questions from investors, with satisfactory results. We were therefore disappointed that he abruptly decided to resign in 2018. Although he remains the board's vice-chair, the company's failure to announce a succession plan for such an important role is of great concern to us. We asked the company for clarification and highlighted the significant impact on staff morale and renewed uncertainties with regard to strategy and operations, which have gone through major positive changes under the departed COO. Unfortunately, the company confirmed that it has no immediate plans to announce a successor for him, only stating that the founder will resume a more hands on role.

Data privacy

Human rights obligations for technology companies include protecting the rights of its customers and users of its products to privacy and to freedom of expression, at the same time as protecting the public and, in particular, the most vulnerable from crime, such as terrorism, child abuse and human trafficking.

As part of our engagement with Microsoft, we met its data ethicist who was able to give insights into how the company is thinking about data privacy as well as wider issues regarding big and deep data, machine learning and artificial intelligence. We were also pleased that the company found the time to seek our views and discuss with us in detail the complexities of the issues it faces and how it works hard to minimise the adverse human rights effects of its activities and products. After a thorough review of its policies and processes, we were able to close our engagement on data management, with the company playing a leading role on safeguarding human rights in the technology industry in handling requests for data from government and law enforcement agencies as well as in relation to minimising other human rights harms that can arise from the use of its software.

In our engagement with other technology companies, we have been encouraging them to demonstrate a similar openness and willingness to address human rights.

In the third quarter of 2017, Apple meanwhile launched a privacy website and, for the first time, stated its commitment to data privacy protection explicitly and publicly, covering a range of its products. The audit and finance committee of the board assists the board with the oversight and monitoring of privacy and data security, which allowed us to complete our engagement on data privacy.

Technology companies also need to become increasingly mindful of tighter laws on data privacy. The EU's General Data Protection Regulation (GDPR), which came into force in May 2018, will punish those that refuse to comply, adding to the pressure on technology companies in relation to data privacy. It is therefore in their own interest for companies to act responsibly and be open, fair and transparent to their customers about the use of their data and for this to be at the heart of their business models.

Content management

Another controversy surrounding social media site platforms has been the emergence of false information in an attempt to influence users and even sway elections. The publication of so-called fake news, targeted advertising and the algorithms behind it have been part of our dialogue with companies such as Google and Facebook.

The companies risk regulatory action unless they take prompt action on these issues and are quick to remove false and/or offensive content, even if this is at a cost to their business.

In our engagement with companies, we encourage them to provide more transparency on how they manage this issue. We recommended, for example that Google report on major global content management controversies to address concerns about the possibility of abuse of its platform with the intention to misinform. This goes beyond its existing guidelines on content reporting and removal and would allow the company to demonstrate the accountability that goes with its dominant position in the market.

Addiction

In our engagement with Apple, the company promised to take the appropriate steps to combat this issue. We were subsequently encouraged when the company announced in June 2018 an upgrade to its operating system, which enables users to set advanced notifications to limit device use or screen time. The screen time app will provide users with in-depth insights into what they are spending their time on. It also has an added function, a downtime app, which enables parents to set device time allowances for juniors. Apple said it had taken on board stakeholder feedback in its decision to upgrade the operating system. However, we continue to question whether the company has yet done enough.

We will engage with the company to ensure it goes beyond technological enhancements to also focus on processes.

Voting

At Facebook, we supported a number of shareholder proposals at the company's shareholder meeting. One sought the abolition of its dual-class share structure, while another called for a simple majority vote to allow for the introduction of changes to the company's constitution. The third one we supported asked the company to produce a report on the data privacy controversies facing the company, while the fourth sought disclosure on the company's efforts to reduce the disparity between male and female employees' median earnings.

At Amazon, meanwhile, we recommended voting against the company's say on pay proposal and supported the compensation committee chair by exception due to poor disclosure on pay. We also supported one shareholder proposal seeking a shortlist for board candidates that includes ethnically diverse and female candidates and another calling for the appointment of an independent board chair.

In addition, we opposed a number of board proposals at the shareholder meeting of Alphabet. These included the say on pay vote, the re-election of the compensation committee members after sustained concerns about its pay practices and the election of the governance committee chair as a result of the existing multiple share classes. We also supported a number of shareholder proposals seeking better disclosure on a number of issues, including the gender pay gap, and requesting the company move to a single class of shares to enable one-share one-vote.

At Netflix, we recommended voting against the re-election of the three members of the governance committee as the company had consistently ignored substantial votes in favour of governance reform. We also opposed its say on pay proposal as a result of poor policy and practice, including no minimum ownership requirements for senior executives and no limits on borrowing against shares or hedging against falls in the stock price. Furthermore, we supported a number of shareholder proposals seeking greater shareholder rights and other governance reforms.

Due to the digital world we live in, the challenges technology companies face will only increase. It is therefore crucial that shareholders and stakeholders continue to hold these companies to account by engaging with them on these difficult issues and reflecting this in their voting.

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Engagement on strategy

Business strategy and structural governance issues are at the heart of many of our most successful engagements.

Overview

Our approach to engagement is holistic and wide ranging. Discussions cover many key areas, including business strategy and risk management, which encapsulates environmental, social and ethical risks. Structural governance issues are a priority too. We both challenge and support management, accordingly, on its running of the company and approach to ensuring the company's long term future. In many such 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 we are engaging with. Presenting environmental, social and governance issues as the risks they are to the company's strategic positioning puts things solidly into context for management. The issues may, of course, also present opportunities. For instance, businesses may benefit from fresh thinking at board level. Similarly, a change of chief executive can be the catalyst for enhanced business performance and the creation of long term value for shareholders.

Examples of recent engagements

Access to healthcare and sustainability disclosures

Lead engager: Will Pomroy

We were encouraged by our engagement with a US healthcare-equipment company that is prioritising long term value creation, employee safety and supply chain management. While the chief executive acknowledged that there was room for improvement with regard to sustainability disclosures, he also explained that the company has a strong focus on maintaining global safety standards above the regulatory minimum. He updated us on investments made in this area to further raise standards, following acquisitions. We will continue to engage with the company about its potential to support healthcare workforce training and access to necessary sterilisation equipment in less developed markets, to help countries in these areas avoid deaths from hospital acquired infections.

Business strategy and remuneration

Lead engager: Roland Bosch

Following a successful collaborative engagement with a global consumer goods company, where we provided extensive input, the board hosted its first shareholder engagement day. The new chair, committee chairs and sustainability executives provided insights into the company's strategy, capital allocation and sustainability objectives. In addition, governance and risk featured high on the agenda, given the product safety issues and disruptive cyber attacks experienced by the company. The new chair and committee chairs have acknowledged the need to embed a culture of responsibility throughout the organisation and have added this to its core values. In addition, beyond significant improvements made within its safety, quality and compliance functions, the company is integrating sustainability across business teams, under a new operational leadership. Elsewhere, the highly leveraged executive remuneration framework, which has attracted much dissent in recent years, will be adapted with the inclusion of an additional performance metric (beyond earnings per share). We will seek further meetings with the company directors, including the chair of the sustainability committee and the newly appointed head of sustainability, to assess the execution of the more stakeholder oriented strategy and the robustness of board oversight.

Disclosure on corporate governance practices

Lead engager: Jaime Gornsztejn

We were pleased to hear that the board of an Indian financial services company had decided to undertake an independent investigation into allegations of conflict of interest involving the chief executive. In a recent letter to the chair, we had raised concerns about the earlier rejection of an independent investigation. We had also pressed for clarity about the board's previous dismissal of the allegations made against the chief executive. We were, therefore, encouraged by the announcement that a fully independent investigation was being commissioned and that the chief executive had been asked to step aside during the process. Our plan is to follow up with the company once the investigation is complete.

Geographical diversity on board and board accountability

Lead engager: Sachi Suzuki

An electronics company in Japan made changes to its governance structure following our engagement. The company has abolished senior adviser positions held by retired senior executives; we had questioned these due to concerns about transparency. Although the company will retain two of its former senior management team as special consultants, it made it clear that they will have an external focus. It also reported that they will receive no benefits from the company. We welcomed the appointment of the first non-Japanese director, which is also in line with our request, with respect to the company's global operations. We reiterated our concerns, however, about the two outside directors who represent two of the company's major shareholders and business partners. In addition, we drew attention to the long tenure of one of the directors, which may also jeopardise his independence. We would also like to see the company escalate its efforts to reduce cross-shareholdings. The investor relations executive agreed to raise our concerns with management.

Remuneration policy and board refreshment

Lead engager: Bruce Duguid

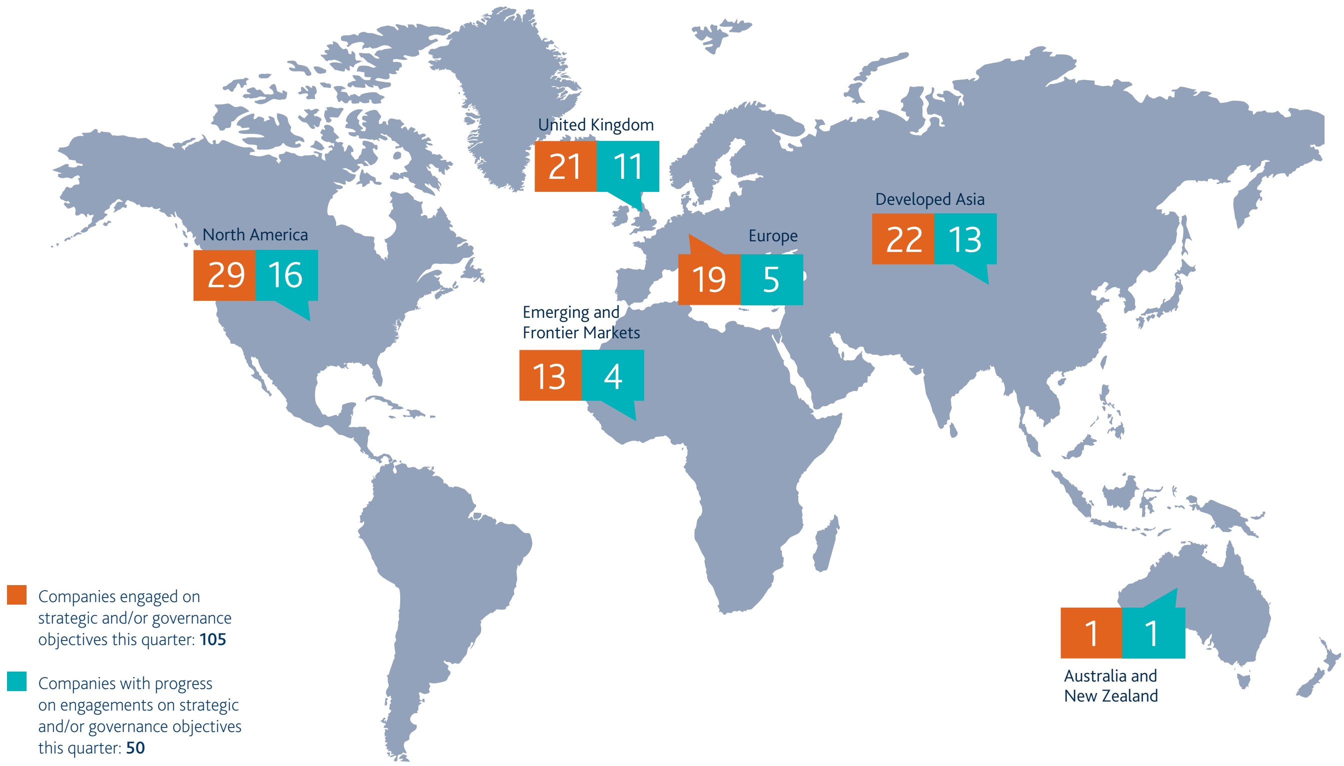
We have been engaging with a US based energy company, which reported to us that its latest remuneration policy is now in line with market expectations. The policy also meets our guidelines. Positive features include a share price underpin to help align pay and performance, and a cap on the maximum influence of total shareholder return on pay. As a follow up to our engagement, we highlighted the need for further board refreshment, including the appointment of more women. We also proposed that board members should have regulatory and policy experience commensurate with the company's increasing shift towards regulated returns. The company explained that five of its 12 non-executive directors will change over the next five years as they approach the mandatory retirement age and appointing additional women to the board is one of its priorities. Finally, the company updated us on its management of water risks, noting that it considers this to be one of its main environmental concerns. The company indicated that it has a comprehensive water risk strategy and we agreed to discuss this in detail at our next meeting to ensure that it takes account of the more material long term risks. We will also follow up on whether nuclear risk should be included as one of its main environmental risks.

Strategic shareholdings

Lead engager: Masaru Arai

A Japanese company delivered the positive news that it had decided to reduce its cross-shareholdings, including those held by group companies. It also reported that it had reduced the total holdings of the company and its largest subsidiary by nearly 40%, equal to about JPY46 billion, at the end of the first quarter of 2018. We have been recommending the reduction of cross-shareholdings to the Japanese companies that we engage with for many years. This scale of reduction is, however, unprecedented. In response to our query about its reasons for taking this course of action, the company said that it had given serious consideration to the Japanese Corporate Governance Code which requests that companies reduce strategic holdings. The company explained to us that the negotiations with the counterparties on the reduction of shares was much easier than it had initially envisaged, partly helped by the currently favourable stock market environment. We recommended that the company should make a public announcement because it had only indicated the amount of profit made by sales of these shares. We also believe that the company's large scale reduction of strategic holdings could encourage other Japanese companies to follow suit.

Engagements on strategy and/or governance



Public policy and best practice

Hermes EOS contributes to the development of policy and best practice on corporate governance, sustainability and shareholder rights to protect and enhance the value of the shareholdings of its clients 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 developing 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. Hermes 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 whose interests may be markedly different – particularly companies, lawyers and accounting firms, which tend to be more active than investors in these debates.

Highlights

Contribution to the UN Working Group on Business and Human Rights

Lead engager: Lisa Lange

We provided input to the UN Working Group on Business and Human Rights for the 2018 report on corporate human rights due diligence. The report will be published in October and will provide a basis for discussion for the UN General Assembly. We gained insights into the key findings of the upcoming report, including the continued lack of awareness within the majority of businesses, as well as lack of government pressure and guidance. Challenges include communicating with stakeholders in the global south; meaningful reporting and measuring performance; the prevalent framing of human rights as a risk issue; and the need to translate the legalistic human rights narrative into material issues such as health and safety, and integrity. The report should improve coverage beyond the largest companies and ensure alignment with the UN Guiding Principles and OECD due diligence guidelines; recognise adaption to specific local context; strengthen the access to remedy; level the playing field between companies; and encourage coordination among governments. The report stressed that human rights due diligence has positive impacts on companies and stakeholders, and that this is how the issue should be framed when engaging with companies.

Firearms policy

Lead engager: Tim Goodman

As referred to on page seven, our US public-policy activity included signing the ICCR's statement on firearms. The statement sets out best-practice guidelines for gun manufacturers, retailers and other companies. While we did not have the opportunity to make any changes to the statement, the ICCR did make a concession. It agreed that in its engagement with companies, it would refer to our suggestion that they should publish their firearms policies. We believe that this would enable stakeholders to understand how companies are managing the risks that firearms pose to employees, customers and others affected by their operations, and could encourage better practice more widely.

Gender pay gap

Lead engager: Natacha Dimitrijevic

We welcomed the requirement for UK companies to publish gender pay gap information. We believe that the requirement to calculate and publish this will lead companies to acknowledge gender imbalance within their organisation and in comparison to others; to formally analyse it; and to take action. In addition, we expect that the data will over time provide a valuable insight into companies' commitment to bridge the gap, and will also help attract, retain and engage each company's workforce. While the data has its limits, we view it as an important indicator of a company's corporate culture, and approach to diversity and inclusion. We believe that the gender pay gap will encourage companies to discuss in a more holistic fashion how their businesses manage human capital – one of the vital strategic contributors of sustainable value for shareholders and other stakeholders. Finally, while the data is still new, and yet to be thoroughly assessed, there have been many anomalies. We would therefore support an additional requirement for the largest companies to provide audited or certified data.

Responsible mineral supply chains

Lead engager: Claire Gavini

The Organisation for Economic Co-operation and Development held a forum on responsible, mineral supply chains, which we attended, to gain insight on recent developments. Our contribution included holding a meeting with a range of stakeholders, including a representative from local communities in the Democratic Republic of the Congo, investor representatives and non-government organisations such as Amnesty International, to discuss the issue of child labour. As child labour is mainly due to poverty and poor access to education, children tend to go work in the mines with their parents, because of the lack of alternatives. We discussed ways to address this, including the creation of other ways of generating income; developing accessible healthcare and schooling programmes; and improving the working conditions of miners by defining their status in the mining code.

Other work in this quarter included

- The deputy chief executive officer of the Securities and Futures Commission, which regulates securities and futures markets in Hong Kong, sought our advice on **best practices in non-financial disclosure**, with specific reference to the EU Directive on disclosure of non-financial information. We made suggestions on guidance, based on our UK experience.
- We shared our experience on **ESG integration**, at the Global Green Finance Leadership Programme in Beijing, which was sponsored by the International Finance Corporation and the CFA Institute, and hosted by the co-head of the G20 Green Finance Study Group. We quoted current examples from the equity, debt, real estate, infrastructure and private equity sectors. We emphasised the importance of using green criteria as an engine for building sustainable communities and cities, taking into account work-life balance, job opportunities and the provision of other social goods, such as quality healthcare and education.
- Together with 25 other investors, we signed a declaration on **reducing plastic pollution**, by non-governmental organisation As You Sow, which promotes corporate accountability through shareholder action. The signatories have formed a plastic solutions investor alliance to engage with publicly traded companies within the consumer goods sector.
- We attended the launch of the third global Access to Nutrition Index, which ranks the world's 22 largest food and drink companies on how they are addressing **nutritional issues**. One of the main findings of the new index is that on average, food and beverage companies have stepped up efforts to encourage better diets. However, there were some concerns about the healthiness of the companies' products. We will engage on this topic using these latest results.
- At the invitation of a search firm specialising in recruiting board directors and providing board assessment services, we presented to a small group of non-executive directors of Swiss and French large-cap companies, on our expectations as institutional investors. We provided insights on our engagement methodology and the key issues we seek to address. Our presentation was followed by in-depth discussions on the practicalities and 'roadblocks' when seeking to establish **fruitful communication with board members**. These enabled a greater understanding of each other's priorities and processes. We were invited to present at another similar event in December 2018.
- The OECD invited us to participate in the Latin American Roundtable on Corporate Governance in Buenos Aires. We provided an institutional investor's perspective on the challenges facing equity markets in Latin America, particularly in terms of board composition and effectiveness; lack of engagement between boards and investors; and quality of reporting. We expressed our concern about how board members are selected, ie without a process that ensures the alignment of the candidate's skills with the company's strategy. We emphasised the importance of developing a **culture of stewardship** in the region and highlighted the example of the Brazilian Stewardship Code. The OECD survey identified that companies consider their reporting to be of high quality, whereas investors consider that this is one of the main areas for improvement. We commented at the roundtable that many companies consider the publication of raw data as sufficient demonstration of transparency. However we expect the board and the management to provide a narrative on the company's performance – a view that was supported by various regulators attending the event.
- We joined the Board Diversity Hong Kong Initiative to extend our support for the 30% Club's Hong Kong chapter; an activity which is also in line with our regional corporate governance principles. We will set a list of collaborative engagement targets to push for **improved gender diversity** on the boards of Hong Kong listed companies.
- An international law firm invited us to present our expectations of what companies should disclose in response to the **Modern Slavery Act** and the French duty of care regulations, within the frameworks of the UN Guiding principles and the OECD Guidelines for Multinational Enterprises. We focused on due diligence processes, which we view as the fundamental first steps that most companies still need to undertake.
- We signed an investor statement calling on all companies operating within the scope of the **Securities and Exchange Commission Conflict Minerals Rule** to file annual reports in accordance with the law. The process for signing the statement is being coordinated by the Investor Alliance for Human Rights.
- Following our participation at the OECD's Latin American Corporate Governance Roundtable, we were invited by the president of the Argentina Stock Exchange to comment on the draft rules for a new listing segment, for companies with **higher corporate governance standards**. We recommended that at least one third of the board should be independent directors, in line with our corporate-governance principles for Brazil and Mexico. We agreed with the company's proposal to require at least one female director, but recommended that she should be independent.
- We signed an investor statement setting out investor expectations on addressing the issue of forced labour in global supply chains. It allows investors to publicly demonstrate support of the United Nations Sustainable Development Goal 8.7, to **eradicate forced labour** and lays out expectations of investee companies. The statement is co-sponsored by the Investor Alliance for Human Rights and KnowTheChain, an organisation which helps companies and investors address forced labour risks.
- In our response to the Association Française des Entreprises Privées consultation on the revision of the French Corporate Governance Code, we welcomed a suggested increased focus on **material ESG issues**, executive remuneration and the strategic analysis of risks and opportunities. However, we noted that a change of companies' statutory purpose may not be required, as we believe that corporate responsibilities already encompass considerations to deliver sustained returns not only to shareholders but to other stakeholders.
- We presented our recommendations on **corporate disclosure** to the Council of the Japanese Financial Services Agency. Our recommendations primarily concern the guidelines on better strategic reporting and related disclosures. We made comparisons with the Financial Reporting Council's strategic reporting guidelines, which were recently updated in the UK, highlighting the recent shift towards more reporting on business purpose, together with analysis of anticipated future material corporate risks arising from a changing business environment.

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

In most cases of 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.

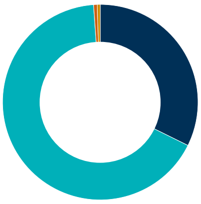
Hermes EOS makes voting recommendations at companies all over the world, wherever its clients own shares.

Voting overview

Over the last quarter we made voting recommendations at 6,577 meetings (75,189 resolutions). At 4,382 of those meetings, we recommended opposing one or more resolutions. We recommended voting with management by exception at 34 meetings and abstaining at 38. We supported management on all resolutions at the remaining 2,123 meetings.

Global

We made voting recommendations at **6,577** meetings (**75,189** resolutions) over the last quarter.



- Total meetings in favour **32.3%**
- Meetings against (or against AND abstain) **66.6%**
- Meetings abstained **0.6%**
- Meetings with management by exception **0.5%**

Australia and New Zealand

We made voting recommendations at **52** meetings (**273** resolutions) over the last quarter.

- Total meetings in favour **44.2%**
- Meetings against (or against AND abstain) **53.8%**
- Meetings with management by exception **1.9%**

Developed Asia

We made voting recommendations at **1,528** meetings (**15,231** resolutions) over the last quarter.

- Total meetings in favour **45.5%**
- Meetings against (or against AND abstain) **53.9%**
- Meetings with management by exception **0.6%**

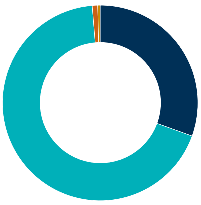
Emerging and Frontier Markets

We made voting recommendations at **1,619** meetings (**17,884** resolutions) over the last quarter.

- Total meetings in favour **30.5%**
- Meetings against (or against AND abstain) **68.4%**
- Meetings abstained **1.0%**
- Meetings with management by exception **0.1%**

Europe

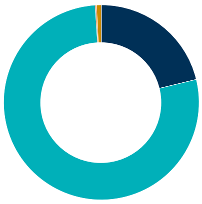
We made voting recommendations at **1,003** meetings (**14,894** resolutions) over the last quarter.



- Total meetings in favour **30.5%**
- Meetings against (or against AND abstain) **68.2%**
- Meetings abstained **0.9%**
- Meetings with management by exception **0.4%**

North America

We made voting recommendations at **2,020** meetings (**21,352** resolutions) over the last quarter.



- Total meetings in favour **21.2%**
- Meetings against (or against AND abstain) **77.7%**
- Meetings abstained **0.2%**
- Meetings with management by exception **0.8%**

United Kingdom

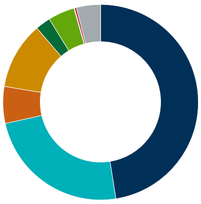
We made voting recommendations at **355** meetings (**5,555** resolutions) over the last quarter.

- Total meetings in favour **49.6%**
- Meetings against (or against AND abstain) **47.6%**
- Meetings abstained **2.3%**
- Meetings with management by exception **0.6%**

The themes of the resolutions on which we recommended voting against management or abstaining are shown below.

Global

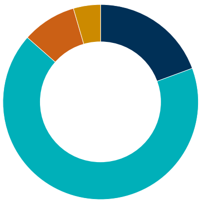
We recommended voting against or abstaining on **11,931** resolutions over the last quarter.



- Board structure **47.5%**
- Remuneration **24.0%**
- Shareholder resolution **6.1%**
- Capital structure and dividends **11.1%**
- Amendment of articles **2.5%**
- Audit and accounts **4.4%**
- Investment/M&A **0.1%**
- Poison pill/Anti-takeover device **0.3%**
- Other **4.0%**

Australia and New Zealand

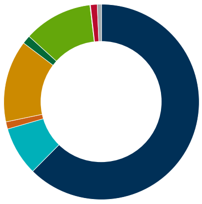
We recommended voting against or abstaining on **67** resolutions over the last quarter.



- Board structure **19.4%**
- Remuneration **67.2%**
- Shareholder resolution **9.0%**
- Capital structure and dividends **4.5%**

Developed Asia

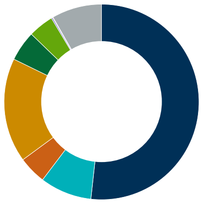
We recommended voting against or abstaining on **1,756** resolutions over the last quarter.



- Board structure **62.5%**
- Remuneration **8.1%**
- Shareholder resolution **1.2%**
- Capital structure and dividends **13.6%**
- Amendment of articles **1.4%**
- Audit and accounts **11.4%**
- Investment/M&A **0.1%**
- Poison pill/Anti-takeover device **1.1%**
- Other **0.7%**

Emerging and Frontier Markets

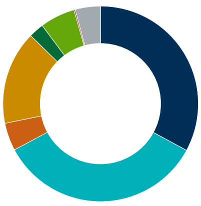
We recommended voting against or abstaining on **3,889** resolutions over the last quarter.



- Board structure **51.8%**
- Remuneration **8.6%**
- Shareholder resolution **4.6%**
- Capital structure and dividends **17.3%**
- Amendment of articles **5.0%**
- Audit and accounts **4.2%**
- Investment/M&A **0.2%**
- Poison pill/Anti-takeover device **0.1%**
- Other **8.3%**

Europe

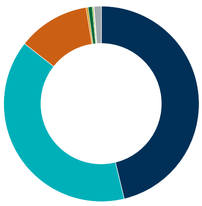
We recommended voting against or abstaining on **2,460** resolutions over the last quarter.



- Board structure **32.9%**
- Remuneration **34.3%**
- Shareholder resolution **4.6%**
- Capital structure and dividends **15.5%**
- Amendment of articles **2.5%**
- Audit and accounts **5.8%**
- Poison pill/Anti-takeover device **0.2%**
- Other **4.2%**

North America

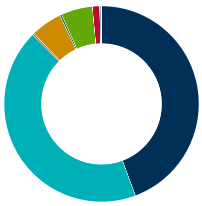
We recommended voting against or abstaining on **3,434** resolutions over the last quarter.



- Board structure **46.2%**
- Remuneration **39.3%**
- Shareholder resolution **11.9%**
- Capital structure and dividends **0.3%**
- Amendment of articles **0.7%**
- Audit and accounts **0.2%**
- Poison pill/Anti-takeover device **0.1%**
- Other **1.2%**

United Kingdom

We recommended voting against or abstaining on **325** resolutions over the last quarter.



- Board structure **44.3%**
- Remuneration **43.1%**
- Shareholder resolution **0.3%**
- Capital structure and dividends **5.2%**
- Amendment of articles **0.3%**
- Audit and accounts **5.2%**
- Poison pill/Anti-takeover device **1.2%**
- Other **0.3%**

What is Hermes EOS?

Hermes EOS helps long-term institutional investors around the world to meet their fiduciary responsibilities and become active owners of public companies. Our team of engagement and voting specialists monitors the investments of our clients in companies and intervenes where necessary with the aim of improving their performance and sustainability. Our activities are based on the premise that companies with informed and involved shareholders are more likely to achieve superior long-term performance than those without.

Pooling the resources of other like-minded funds creates a strong and representative shareholder voice and makes our company engagements more effective. We currently act on behalf of over 40 clients and £346.3/€392.6/$455.2 billion* in assets under advice.

Hermes has one of the largest stewardship resources of any fund manager in the world. Our 28-person team includes industry executives, senior strategists, corporate governance and climate change experts, accountants, ex-fund managers, former bankers and lawyers.

The depth and breadth of this resource reflects our philosophy that stewardship activities require an integrated and skilled approach.

Intervention at senior management and board director level should be carried out by individuals with the right skills, experience and credibility. Making realistic and realisable demands of companies, informed by significant hands-on experience of business management and strategy-setting is critical to the success of our engagements.

We have extensive experience of implementing the Principles for Responsible Investment (PRI) and various stewardship codes. Our former CEO led the committee that drew up the original principles, and we are engaged in a variety of workstreams through the PRI Collaboration Platform. This insight enables us to help signatories in meeting the challenges of effective PRI implementation.

How does Hermes EOS work?

Our company, public policy and best practice engagement programmes aim to enhance and protect the value of the investments of our clients and safeguard their reputation. We measure and monitor progress on all engagements, setting clear objectives and specific milestones for our most intensive engagements. In selecting companies for engagement, we take account of their environmental, social and governance risks, their ability to create long-term shareholder value and the prospects for engagement success.

The Hermes Responsible Ownership Principles[16] set out our fundamental expectations of companies in which our clients invest. These cover business strategy, communications, financial structure, governance and management of environmental and social risks. The engagement programme we have agreed with our clients, as well as the Principles and their regional iterations, guide our intervention with companies throughout the world. Our approach is pragmatic, as well as company- and market-specific, taking into account the circumstances of each company.

We escalate the intensity of our engagement with companies over time, depending on the nature of the challenges they face and the attitude of the board towards our dialogue. Some engagements involve one or two meetings over a period of months, others are more complex and entail multiple meetings with different board members over several years.

At any one time around 400 companies are included in our core engagement programme. All of our engagements are undertaken subject to a rigorous initial assessment and ongoing review process to ensure that we focus our efforts where they can add most value for our clients.

While we can be robust in our dealings with companies, the aim is to deliver value for clients, not to seek headlines through campaigns which could undermine the trust that would otherwise exist between a company and its owners. We are honest and open with companies about the nature of our discussions and aim to keep these private. Not only has this proven to be the most effective way to bring about change, it also acts as a protection to our clients so that their positions will not be misrepresented in the media.

For these reasons, this public report contains few specific details of our interactions with companies. Instead, it explains some of the most important issues relevant to responsible owners and outlines our activities in these areas.

We would be delighted to discuss Hermes EOS with you in greater detail.

For further information, please contact:

Head of EOS Dr Hans-Christoph Hirt on +44(0)207 680 2826

* as of 30 June 2018

[16] https://www.hermes-investment.com/ukw/wp-content/uploads/sites/80/2018/03/final-responsible-ownership-principles-2018.pdf

Hermes EOS team

Engagement

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Head of EOS

Frédéric Bach
Sectors: Chemicals, Financial Services, Industrials, Technology

Dr Emma Berntman
Sectors: Chemicals, Industrials, Pharmaceuticals

Roland Bosch
Sector lead: Financial Services

Dr Christine Chow
Sector lead: Technology

George Clark
Voting and Engagement Support

Natacha Dimitrijevic
Sector lead: Pharmaceuticals

Bruce Duguid
Head of Stewardship, Sector lead: Utilities

Katherine Frame
Sectors: Oil and Gas, Consumer Goods, Retail

Claire Gavini
Sectors: Consumer Goods and Retail, Pharmaceuticals

Tim Goodman
Sector lead: Oil and Gas

Jaime Gornsztejn
Sector lead: Industrials

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Lisa Lange
Sectors: Automotive, Financial Services, Technology

Pauline Lecoursonnois
Sector co-lead: Consumer Goods and Retail

Kimberley Lewis
Sectors: Pharmaceuticals and Healthcare

James O'Halloran
Head of Voting and Engagement Support

Nick Spooner
Sectors: Automotive, Financial Services, Oil and Gas

Sachi Suzuki
Sector lead: Automotive

Amy Wilson
Sector co-lead: Consumer Goods and Retail

Janet Wong
Sectors: Technology and Financial Services

Tim Youmans
Sectors: Financial Services, Industrials, Technology

Business Development and Client Service

Amy D'Eugenio
Head of Business Development and Client Service

Alan Fitzpatrick
Client Relations

Rochelle Giugni
Client Relations

Charlotte Judge
Marketing, Events and Communications

Alice Musto
Client Relations

Hermes EOS enables institutional shareholders around the world to meet their fiduciary responsibilities and become active owners of public companies. Hermes EOS is based on the premise that companies with informed and involved shareholders are more likely to achieve superior long-term performance than those without.

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