

Dear Sir/Madam

EOS at Federated Hermes is a leading stewardship provider, advising on €1tn<sup>1</sup> of assets (as of 30 September 2020), on behalf of global international institutional investors. Federated Hermes is a global leader in active, responsible investing with €524.4bn<sup>2</sup> in assets under management (as of 30 September 2020). Our goals are to help people retire and invest better, to help clients achieve better risk-adjusted returns, and to contribute to positive outcomes that benefit the wider world.

### **EOS Sweden Corporate Governance Principles 2021**

Enclosed is a copy of our 2021 Sweden Corporate Governance Principles. This document expresses our expectations of companies across a number of important strategic, governance, environmental and social topics and guides our approach to our corporate engagement programme, as well as our approach to recommending votes at shareholder meetings. We seek to take an engagement-led approach on voting where practicable and to take account of company circumstances when making vote recommendations. Our voting policies reflect the importance of long-term issues such as board effectiveness, climate change and diversity. However, when making voting recommendations on the election of directors, particularly board and committee chairs, we will continue to consider the importance of consistent leadership for companies facing acute distress caused by the ongoing coronavirus pandemic.

We would like to emphasise the following points:

**Company purpose:** Companies should be guided by a purpose that serves not only shareholders, but also other stakeholders, society and the environment. This is particularly important in times of crisis, such as that caused by the coronavirus pandemic in 2020, when difficult trade-offs may be required.

- **Diversity and Inclusion:** We support the aspiration that all levels of management and the wider workforce should broadly reflect the diversity of society and believe boards should seek diversity in its broadest sense to support high-quality debate and decision-making. Many companies around the world still fall far short of gender equality, while the death of George Floyd in the US has re-energised the anti-racist movement in the US and around the world and renewed concerns about poor representation of ethnic minorities in business, particularly in senior positions. We are likely to extend our voting policies to include consideration of racial and ethnic diversity on boards and leadership teams in the coming years and to consider opposing the election of directors or other relevant proposals where we believe insufficient progress is being made.

On gender diversity, in 2021 we will continue to recommend voting against resolutions at companies that we judge to be making insufficient progress, including:

- We strongly support the recommendation set out in the Swedish corporate governance code that companies should strive for gender balance on the board. We expect Swedish companies to have achieved or have a credible plan in place to reach at a minimum 30% representation of the minority gender on their boards. We will

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<sup>1</sup> Source: Federated Hermes as at 30 September 2020.

<sup>2</sup> Please note the total AUM figure includes €6.9bn of assets managed or under an advisory agreement by Hermes GPE LLP ("HGPE"). €59.6m of total group AUM figure represents HFM mandates under advice. Source: Federated Hermes as at 30 September 2020.

generally recommend a vote against the board member representative on the nomination committee of any company which falls materially below this level.

- Gender diversity below board level is equally important. While many companies have been working hard to improve the gender balance of their leadership teams, too many continue to fall short. We would expect to see at least one woman in the leadership team and may recommend a vote against the chair of the board where this is not achieved.
- **Climate change:** The breakdown of the climate is a systemic risk to the value of our clients' portfolios, due to the economic and political consequences, as well as the physical impacts of climate change. We expect as standard annual reporting using the guidelines of the Taskforce on Climate-related Financial Disclosures. We will consider recommending voting against the chair of the board or other responsible directors of companies which we do not believe to have demonstrated sufficient management of climate-related risks, such as those below a Level 4 management rating from the Transition Pathway Initiative<sup>3</sup>, or where a company's strategy is materially misaligned with the goals of the Paris Agreement.
- **Remuneration:** The limitations of pay schemes reliant on performance-based incentives schemes have been highlighted by the coronavirus pandemic, as share price volatility and limited visibility meant boards in most industries have struggled to set meaningful targets. Meanwhile the ensuing rally in markets may lead to undeserved windfall gains for executives from shares-based incentive schemes. As the impacts of the pandemic continue, we expect boards to use their judgement to ensure executive pay can be justified in the context of the experience of other stakeholders, particularly for companies that have made redundancies, made use of government support, or those that are otherwise in distress.

We continue to make the case for switching to simpler pay schemes aligned to long-term success and the desired culture in the organisation, with an emphasis on long-term share ownership for executives.

- We are unlikely to support the use of share options apart from under very limited circumstances and would encourage a transition to using restricted share units.
- We expect companies to formally introduce minimum shareholding guidelines set at 100% of fixed pay for the CEO accompanied by a post-employment holding period of at least two years.
- We would expect total shareholder returns (TSR) to constitute only a small part of metrics and we will generally no longer support pay packages that are fully dependent of TSR.
- **Bundled director elections:** It is good corporate governance practice to vote on director candidates individually and not as a single slate and we encourage all companies to introduce individual director elections. This enables investors to express concerns about specific candidates without having to vote against the entire board.
- **Board and shareholder engagement:** Our experience has shown that dialogue between companies and committed, long-term investors on strategy, finance, risk management

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<sup>3</sup> <http://www.lse.ac.uk/GranthamInstitute/tpi/the-toolkit/>

and material environmental, social and governance issues can improve the governance, performance and value of companies. We encourage chairs and other non-executive directors, in particular board committee chairs, to make themselves available for engagement with shareholders, as an essential part of their responsibilities.

We welcome any comments and observations on our 2021 Corporate Governance Principles and would welcome the opportunity to answer any queries or concerns they may raise.

Yours sincerely

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# Corporate Governance Principles

**Sweden**

Our expectations of  
Swedish-listed companies

**EOS at Federated Hermes  
2021**

## Introduction

EOS at Federated Hermes represents a broad range of long-term investors, who seek to be active stewards and owners of their beneficiaries' assets, including the shares or debt of the companies in which they invest. EOS engages with these companies around the world in which our clients are invested to promote long-term, sustainable returns. These Principles express our expectations of companies across a number of important strategic, governance, environmental and social topics. More detail on our expectations, particularly on environmental and social topics, can be found in our public, annually updated Engagement Plan<sup>1</sup>.

## Stewardship and engagement

Investors must also act as responsible stewards and promote long-term value through constructive engagement with companies and their directors. All substantive correspondence from institutional investors should be shared promptly with all board members to help directors fulfil their role to safeguard the interests of all shareholders. Our experience has shown that dialogue between companies and committed, long-term investors on strategy, finance, risk management and material environmental, social and governance (ESG) issues can improve the governance, performance and value of companies. Developing relationships of trust with long-term shareholders can be invaluable for boards, and we expect chairs and independent directors to make themselves available for engagement, beyond opportunities at formal shareholder meetings.

We expect companies to engage with long-term investors across a range of asset classes, including different types of corporate debt, in addition to their shareholders. Companies should now recognise that debt investor expectations have similarly aligned expectations to long-term shareholders in relation to governance, long-term strategy, capital allocation and environmental and social matters. Debt investors now expect accountability and constructive dialogue on opportunities and risks which might enhance or impair earnings or cashflow.

At EOS, our model is to provide stewardship on behalf of a collective of investors – mainly pension funds and other long-term, institutional investors from around the world. We engage with investee companies on matters material to long-term value, encompassing ESG and strategic topics, and make voting recommendations on resolutions at shareholder meetings. This collective model aims to make the engagement process more efficient and effective, for companies and investors, by pooling resources and assets. We also aim to reduce potential conflicts of interest through a collective focus on long-term, sustainable value, shaped with input and agreement from our clients.

## Company purpose and leadership

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<sup>1</sup> The latest public version of the EOS Engagement Plan can be found at: [www.hermes-investment.com/stewardship/eos-library](http://www.hermes-investment.com/stewardship/eos-library)

It is our strong belief that companies can only create and preserve long-term value for investors if they provide goods and services that sustainably solve societal needs. To achieve this, we expect companies to be guided by a purpose that serves not only shareholders, but also other stakeholders, society and the environment. This helps protect the long-term interests of the savers and pensioners – current and future – invested in companies, who require sustainable financial returns and an economy, society and environment which can provide a secure future.

A clear and meaningful business purpose should enable business leaders to identify the right things to do in the short term, in order to fulfil their purpose over the long term. This is critical in a time of crisis – such as that caused by the coronavirus pandemic in 2020 – when difficult trade-offs may be required, particularly between shorter-term financial returns and maintaining strong relationships with key stakeholders, including government, the workforce, customers and supply chains<sup>2</sup>.

Companies need to be able to rationalise and explain their decisions affecting key stakeholders. This includes the most difficult decisions, such as redundancies, but also how they allocate capital, including dividend payments and share buybacks.

We expect boards to consider capital allocation in the context of a company's purpose and long-term strategy. We are concerned that buybacks may be chosen to improve the share price or other related metrics over the short-term but are not always the best use of capital to support the creation of long-term, sustainable value.

### **Endorsement of Swedish Corporate Governance Code**

We generally endorse the recommendations of the Swedish Corporate Governance Code and encourage companies to comply with these or to explain their reasons for non-compliance. However, the recommendations do not sufficiently cover all the issues we regard as important. As such, our Swedish Corporate Governance Principles are intended to assist Swedish companies and their directors in understanding our views on a range of important social, environmental and governance topics.

### **Board effectiveness and composition**

Boards should ensure they comprise members with strong and diverse skills, experience, perspectives and psychological attributes, as well as sufficient independence and strength of character to challenge, as well as advise and support executive management teams. They should ensure membership of the board is frequently reviewed and refreshed, and that shareholder representative directors are elected and re-elected by shareholders on a regular basis to ensure accountability. Biographies for all directors should be provided to shareholders, indicating which are considered independent and the value that they bring to the board. This should be accompanied by an analysis of how the board as a whole displays the necessary skills, independence, diversity and other attributes to meet the company's evolving needs.

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<sup>2</sup> We expand on our expectations of companies in responding to coronavirus in more detail in our open letter to CEOs: <https://www.hermes-investment.com/ukw/eos-insight/eos/stewardship-during-and-after-the-pandemic/>

## Independence and tenure

On all boards, we expect a strong core of independent directors to ensure that all stakeholder interests are protected, to exercise objective judgement and, if necessary, to act as agents for change. This group should play an import role in guiding the boards' decision making and in the recruitment of directors. It should be empowered to meet independently, including before and after board meetings, and should do so in practice. It should be granted unfettered access to members of management, information and resources as required.

Independent directors should constitute at least half of the shareholder elected directors on the board. For companies where employee representatives serve on the board, we expect the level of independence of the entire board to be at least one third.

Ensuring sufficient levels of independence is particularly important for founder-led companies, those with executive chairs, significant shareholder representatives on the board (which we believe can be useful and justified, provided minority shareholder interests are protected) or strong management representation on the board. We expect at least half of the board directors to be independent in companies with a dispersed ownership structure, and at least one third to be independent in controlled companies. In their disclosures, companies should clearly state which directors they consider to be independent and the criteria for determining this.

We consider the overall composition of boards and recognise the value that long-serving directors can contribute. However, too many directors serving concurrently can increase the risk of groupthink and complacency. We expect a healthy mixture of tenures on boards, including regular board refreshments.

## Nomination committee

In Sweden, the nomination committee is appointed by and reports to the shareholders' meeting. Generally, representatives from three to five of the largest shareholders form the committee, together with a member of the board of directors. We recommend that the representative of the board of directors should be a member who is independent from the company, its management and major shareholders. If the board representative on the nomination committee represents a major shareholder, that individual's role should solely be to provide information about the board's work to the committee. In this event, the committee should also meet from time to time without this individual being present. The committee should implement procedures which ensure that the interests of all shareholders are taken into consideration during the nominations process.

We note that the nomination committee normally considers the overall composition of the board, as well as the merits of the individuals when proposing nominees. Nevertheless, we believe that candidates should be voted on individually and not as a single slate. This would enable investors to express concerns about specific candidates without having to vote against all board candidates.

## Director attendance and commitment

We expect board directors to be able to devote sufficient time to fulfil their duties, including to build and maintain a good understanding of the company and to fully absorb and be able to challenge the information presented to them by management. As a broad guideline, we do not support directors holding more than five directorships at public companies and in this context, we consider a non-executive chair role to be roughly equivalent to two directorships.

Whether a director may be over-committed depends on a range of factors beyond the number of other roles they hold, including the size and complexity of the company and additional responsibilities, such as being a committee chair. We consider that certain industries such as banking (due to its business model and regulatory complexity) and multi-site operating companies such as international mining (due to the need for site visits) require more time commitment.

We expect companies to encourage their executives to take on non-executive roles outside their own group companies to assist in their development, bring current experience to boards and to build a pipeline of future board directors. However, we do not expect executives to hold more than one non-executive role.

## Effectiveness

Measurable aspects of boards, such as those outlined above, are important but insufficient indicators of a board's functionality. While we welcome improvements to disclosure of these around the world, ticking all the good governance boxes does not necessarily translate into good governance, as demonstrated by continuing large-scale corporate failures.

Engagement between investors and board directors provides a valuable opportunity to more deeply assess how well a board is functioning. Our white paper, Guiding Principles for an Effective Board<sup>3</sup> highlights the factors that we consider to be most important in determining board effectiveness, focusing on the human, relational, and behavioural elements that are more difficult to assess.

## Evaluation

We expect boards to regularly assess their own effectiveness to ensure they are operating optimally, with the best governance practices and supporting structures. We endorse the Swedish Corporate Governance Code's recommendation that the board should undertake an annual process of evaluation, and we recommend an independent evaluation at least every three years. The independent reviewer should be carefully chosen for their relevant skills and experience and should be enabled to interact fully with the board and individual directors. Each director should play his full role in ensuring effective evaluations. The board should then report to shareholders, balancing confidentiality with transparency, on the main issues arising from the

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<sup>3</sup> <https://www.hermes-investment.com/wp-content/uploads/2020/04/guiding-principles-for-an-effective-board-april-2020.pdf>

evaluation, as well as the steps that have been taken, and will need to be taken, to address them.

### Succession planning

Effective succession planning at board and senior management level is essential for safeguarding the ability of companies to deliver long-term returns. It should involve contingency planning for the sudden loss of key personnel, as well as planning for foreseeable change such as impending retirement. It should include consideration of the diversity of skills, experience and other attributes required at board and senior management level.

Overseen by the board, senior management should create a pipeline of suitable candidates from within the organisation to become senior managers and executive directors.

### Granting discharge

The annual formal discharge of the board and president are a standard voting item and represents shareholder approval of actions taken during the fiscal year in review. It does not necessarily eliminate the possibility of future shareholder action, although it may make such action more difficult to pursue. Discharge from liability is granted unless the majority at the AGM, or a minority representing at least 10% of all shares in the company, votes against discharge. We view voting against discharge as a warning gesture and will recommend a vote against the discharge to express our dissatisfaction with one or more decisions made and/or with a disappointing performance of the management and/or supervisory board, before using other escalation mechanisms. Any board director, whose discharge was not unequivocally supported during his or her tenure, should generally not be proposed to shareholders for re-election.

### Diversity and inclusion

As well as the intuitive, social case that companies should embrace diversity and realise its benefits through inclusive cultures, there is a growing body of evidence supporting the link between more diverse company leadership and financial performance<sup>4</sup>, including a 2020 study from McKinsey which found that companies with executive teams ranking in the top quartile for ethnic diversity were 36% more likely to have above-market profitability than their less-diverse peers. McKinsey also noted that companies that already saw diversity and inclusion as a strength were likely to leverage this to bounce back from the pandemic more quickly<sup>5</sup>.

Boards should seek diversity in its broadest sense to support high quality debate and decision making. Considering diversity of skills, experience, networks, psychological attributes and demographics (including gender, ethnicity, nationality, sexual

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<sup>4</sup> For example, The 30% Club has compiled a list of studies examining the benefits of gender diversity <https://30percentclub.org/initiatives/investor-group>

<sup>5</sup> <https://www.mckinsey.com/featured-insights/diversity-and-inclusion/diversity-wins-how-inclusion-matters>

orientation and age) will equip the board to effectively serve the company and its stakeholders.

Diverse perspectives throughout an organisation are also likely to more accurately reflect employees, customers, and suppliers across the company's geographic footprint. As such, we support the aspiration all levels of management and the wider workforce, should broadly reflect the diversity of society, including in the company's core functions, such as operations and sales.

We expect boards and management teams to monitor key indicators to assess the composition of the workforce and how the company's culture supports inclusivity. Where diversity is found to be lacking – for example, the under-representation of women or ethnic minorities in the workforce or leadership positions – we expect companies to develop timebound targets and initiatives to address it. We expect them to carefully consider how these targets and initiatives can take into account the convergence of different dimensions of diversity and support those facing combined challenges, for example, the promotion of women of colour to leadership roles.

### Racial inequity

The death of George Floyd while in police custody in the US ignited an anti-racism<sup>6</sup> movement that spread quickly around the world, renewing concerns about poor representation of ethnic minorities in business, particularly in senior positions, and the role that companies may play in perpetuating racial inequity<sup>7</sup> in their workforces and in society, through their products, services and customer practices and their public policy and other societal actions<sup>8</sup>.

We welcome the steps taken by companies around the world to acknowledge and commit to addressing racial inequity, in the workforce and beyond, but we expect this to be followed up with concrete action.

We believe many companies, including our own, have much more to do to address this urgent problem. We seek to learn from those companies that are taking a lead. But even those leading companies are only beginning to address the problem. Those which, like us, are only beginning or accelerating the journey must do so without further delay.

Many companies will have a global footprint with a workforce spread over different geographies. In markets where data collection is restricted by law, companies should find alternative ways of monitoring their diversity and inclusion efforts. This could for example include anonymous staff satisfaction and engagement surveys. Where

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<sup>6</sup> In contrast to racism ('The belief that race is the primary determinant of human traits and capacities and that racial differences produce an inherent superiority of a particular race' [<https://www.merriam-webster.com/dictionary/racism>]), anti-racism is defined as 'The idea that racial groups are equals and none needs developing' and 'Supporting policy that reduces racial inequalities' [Ibram X. Kendi, 2019]

<sup>7</sup> Racial inequity or inequality is defined as 'When two or more racial groups are not standing on approximately equal footing' For example, the percentage living in owner-occupied homes [Ibram X. Kendi, 2019]

<sup>8</sup> For example: products, services or practices that intentionally or unintentionally create or sustain racial inequity (e.g. banks' lending practices to people of colour), perpetuate racist stereotypes or group supremacy (e.g. the representation of different groups in marketing); lobbying and political donations, support for community organisations, etc.

companies operate in countries where such data collection and reporting is not restricted we expect it to be used responsibly and in line with the expectations stated below.

As a start, we expect companies to:

1. Publish a statement internally and to external stakeholders that acknowledges and condemns racism and racial inequity in society, and which acknowledges any inequity within the company, such as under-representation of minorities in leadership.
2. Commit to a thorough review of the company's actions to date to identify where it may be perpetuating racial inequity and where there are opportunities to make a positive contribution to racial equity. This should include the company's culture and workforce; products, services and customer practices; actions with suppliers; and contributions to public policy and other societal actions. To inform this assessment, seek and act on feedback from employees, customers, suppliers and other stakeholders, including independent external experts.
3. Make public commitments to address urgently racial inequities within the workforce and other challenges and opportunities identified, including setting time-bound targets, where possible. This should be set in the context of actions taken on other underrepresented groups, acknowledging the important combined challenges faced, for example, by women of colour.
4. Where possible, start collecting, as a minimum, data on the ethnic composition of the workforce by seniority. At least annually, publish these and other relevant data, including pay gaps/ratios, with a narrative explanation of what the figures mean and a brief, timebound, action plan to address shortfalls. Data should be used internally to prompt further investigations so that underlying drivers can be understood and acted on.

### Gender equality

Advancing gender equality in company leadership and throughout organisations also remains critically important, with many companies around the world still falling far short of equal representation. We continue our global support for initiatives like The 30% Club, which advocate for companies to achieve a minimum of 30% female representation on boards and in leadership populations.

We strongly support the recommendation set out in the Swedish Corporate Governance Code that companies should strive for gender balance on the board. Gender diversity has been a focus for companies and investors for a number of years and we will be taking a firm approach in our voting recommendations for 2021 AGMs. We expect Swedish companies to have achieved or have a credible plan in place to reach at a minimum 30% female representation on their boards and we will vote against the board member representative on the nomination committee of any company which falls materially below this level. Gender diversity below the board is equally important. We would expect see at a minimum of one female among the

executive committee and are likely to recommend a vote against the chair of the board where this is not achieved.

Improving the representation of women should not be considered in isolation from other dimensions of diversity and, particularly, ethnic diversity. We welcome the integration of targets for representation of people of colour and for women, for example, that boards should include at least one person of colour and that half of these board seats should go to women of colour.

### **Executive remuneration**

We are increasingly concerned that executive remuneration structures and practices around the world are not fit for purpose, neither serving long-term investors nor aligning properly with the core long-term objectives of companies.

We are concerned that the models common in markets like the US and the UK, which gear the majority of pay towards performance-based pay, may have been well-intentioned but have produced damaging, unintended consequences such as escalating quantum and encouraging short-termism or financial engineering. Other markets around the world where pay is more restrained are at risk of importing these poor practices.

We consider a key risk to be focusing the majority of pay on achieving performance targets which can be difficult to define and set with the right degree of rigour. This risks strongly incentivising executives to hit targets over relatively short time frames, regardless of whether these actions are best aligned to long-term, sustainable returns to shareholders and other stakeholders. This is particularly the case with schemes that disproportionately focus on increasing the share price through heavy weighting to total shareholder returns (TSR) metrics. We would expect TSR to constitute only a small part of the metrics used and be balanced with other metrics better aligned with long-term performance. Starting from 2021 we will not support pay packages where TSR is the dominant metric. We are also hesitant to support the use of share options, apart from under very limited circumstances, as we believe share options can introduce similar risks of short-termism, too much focus on the share price, and which do not encourage long-term ownership of stock.

The pandemic in 2020 has served as a reminder of the limitations of pay schemes reliant on stock options or performance-based incentives schemes as share price volatility and limited visibility of the future meant boards in most industries have struggled to set meaningful targets. Meanwhile the ensuing rally in markets may lead to undeserved windfall gains for executives from shares-based incentive schemes.

We continue to make the case for switching to simpler pay schemes aligned to long-term success and the desired culture in the organisation, based on fixed pay and long-term time-restricted stock, with an emphasis on long-term share ownership for executives. We would expect executives to build up shareholdings over a number of years to support alignment with long-term value creation. To encourage this, companies should formally introduce shareholding guidelines for the CEO set at a

minimum of 100% of fixed pay accompanied by a post-employment holding period of a minimum of two years.

We expand on our views on executive pay in our paper, *Remuneration Principles: Clarifying Expectations*<sup>9</sup>.

They can be summarised as follows:

1. **Simplicity:** Pay should be simple; for example, fixed pay (mix of cash and long-term shares) plus a single incentive scheme (an annual bonus).
2. **Alignment:** Pay should be aligned to long-term strategy and the desired corporate culture, incentivising long-term value creation, including wider social and environmental outcomes. Where metrics and targets are used in incentive pay, they should reflect strategic goals, rather than focus attention on total shareholder return, stock price appreciation or earnings per share.
3. **Shareholding:** Management should become long-term stakeholders in the company's success through substantial shareholdings. Significant shareholding requirements should remain in place for at least two years following departure from the company.
4. **Accountability:** Pay outcomes should reflect outcomes for long-term investors and take account of falls in company value or reputation. The board should intervene and apply discretion whenever formulaic outcomes do not achieve this. The potential pay outcomes under a policy should be rigorously scenario tested in advance, with a cap on the total possible pay published, to help reduce the risk of unintended consequences.
5. **Stewardship:** Pay outcomes should be communicable to all stakeholders, including employees and the public. Boards should take into account wider workforce pay practices and ratios when judging the appropriateness of pay opportunities and outcomes. Boards should then write to employees each year explaining the outcomes of executive pay and the alignment to long-term value, and the company's strategy and purpose. Companies and investors should regularly discuss strategy, long-term performance and the link to executive pay.

We are not yet taking the position of automatically opposing all pay models that do not align to our principles. However, we set various guidelines and thresholds in our voting policies which seek to improve market practice and encourage closer alignment with our principles. These are tailored to the context of each market.

### Say on pay

In May 2019, the Swedish Companies Act was revised to transpose the amended EU Shareholder Rights Directive (SRDII) into law. We welcome the change that from

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<sup>9</sup> <https://www.hermes-investment.com/wp-content/uploads/2018/10/remuneration-principles-clarifying-expectations.pdf>. The principles contained in this paper are global in nature, but some of the specific references to structures are more applicable to certain markets such as the UK.

2021 the remuneration policy must be submitted to a binding shareholder vote at least every four years. Obtaining binding approval of the remuneration from shareholders should encourage a dialogue between investors and the company on the design and implementation of the remuneration policy.

### Remuneration reporting

We also welcome the annual advisory shareholder vote on the remuneration report for the prior year starting from 2021. In addition, the 2020 Swedish Corporate Governance Code includes expectation of disclosure standards for executive remuneration in line with SRDII on a comply or explain basis. We encourage companies to prepare and publish comprehensive remuneration reports, including a maximum achievable remuneration level and increased disclosure around underlying metrics including weighting and targets. Long-term incentive schemes should be linked to sustained performance indicators and not vest before three years, preferably five years.

One-time payments, if exceptionally granted, should be capped, adequately justified and only awarded to new joiners. The remuneration report should also state the factors that led the supervisory board to exercise any discretion.

### Protection of shareholder rights

We rigorously defend shareholder rights on behalf of institutional investors, including the right to receive good quality corporate reporting and material information on a timely basis, to propose shareholder resolutions and to vote at shareholder meetings.

### Multiple class share structures

We support a single share class structure, with one share one vote, and oppose introduction of measures that deviate from this. Multiple class share structures disenfranchise minority shareholders and often increase the power of one shareholder for a disproportionate economic stake. We encourage issuers with multiple-class share structures to adopt the concept of one-share one-vote for all shares. We are very unlikely to support the issuance of shares with reduced or no voting rights, capital raising exercises or share buyback schemes that discriminate against minority shareholders.

### Hybrid or virtual shareholder meetings

Annual general meetings and other shareholder meetings are an important part of the governance process for companies. They provide a forum for shareholders to hear directly from the company about its performance and to challenge directors on important topics, bringing transparency and accountability to shareholders.

We believe dialogue between shareholders and the board is enhanced by the in-person meeting format: it presents the opportunity to make points to the whole board, not just to one or two directors; the ability to ask questions spontaneously and to build on the questions asked by others is valuable; it is more difficult for directors

to avoid difficult questions or topics; directors must provide answers in a public forum and, accordingly, be accountable for them.

We also support meetings being convened in a hybrid format – where shareholders have the option to join the meeting via an online platform or to join in person, provided all shareholder rights are protected or enhanced. Online participation can increase opportunities for participation, while retaining the accountability of in-person meetings. Companies must ensure that this format is not used to suppress dialogue or otherwise reduce opportunities for shareholder participation that would have been available at an in-person only meeting.

We do not generally support virtual-only meetings unless these are a temporary solution in response to restrictions on in-person gatherings prompted by the pandemic. In those cases, we expect all shareholder rights to be protected and the meeting to be run as it would be in-person: giving ample opportunity for any shareholder to ask a question, and for these to be answered live by the board. We also expect a clear commitment to return to in-person or hybrid meetings as soon as restrictions allow.

### Shareholder resolutions

We support the selective use of shareholder resolutions as a useful tool for communicating investor concerns and priorities or the assertion of shareholder rights, and as a supplement to or escalation of direct engagement with companies. When considering whether or not to support resolutions, we consider factors including whether the proposal promotes long-term shareholders' interests; what the company is already doing or has committed to do; the nature and motivations of the filers, if known; and what potential impacts – positive and negative – the proposal could have on the company if implemented.

### Social, ethical and environmental responsibility

Taking a responsible and long-term approach to social, environmental and ethical issues is critical to the creation and preservation of long-term value, and should be reflected in the company's purpose, strategy and culture. Companies must identify and disclose the most material social and environmental issues for the company and its significant stakeholders. They must seek to address the associated risks and opportunities through their core business strategy and value proposition, rather than through adjacent initiatives which can feature in traditional corporate social responsibility programmes.

We expect boards and management to have oversight of material sustainability issues and to be accountable to shareholders for effectively managing the associated risks and opportunities. Boards should consider the issues in this section, although the list is not exhaustive.

### UN Sustainable Development Goals

We support the UN Sustainable Development Goals (SDGs) and believe that the private sector has an important role to play in achieving them by 2030. Companies

should assess the relevance of each SDG, identifying those that they can make a direct contribution to, and incorporate the most material SDGs into their strategies. We encourage companies to go beyond highlighting any SDG that the company could be connected to and to be purposeful in selecting those to which it intends to make an active, direct contribution, including through the allocation of resources and setting targets. We urge companies to report on their approach to the SDGs and to engage with its shareholders and civil society on how best to contribute to the SDGs.

### Climate change

The breakdown of the climate is a systemic risk to the value of our clients' portfolios, due to the economic and political consequences, as well as the physical impacts of climate change.

We strongly support the goal of the 2015 Paris Agreement – to limit global warming to well below 2°C and pursue efforts to reach 1.5°C of warming – and expect companies to publicly do the same, as well as ensuring any third-party organisations they support or are members of, such as trade bodies or lobbying organisations, are aligned to achieving this.

We urge companies not already doing so to:

- Establish strong governance of the risks and opportunities presented by climate change. Boards should ensure that climate change is included on the board agenda at least annually. We recommend that the board and senior management engage with outside experts who can advise on strategic risks and opportunities that climate change presents, including challenging the company's approach if necessary. For those companies materially exposed to climate-related risks and opportunities, we expect the energy transition to be clearly articulated in governance documents, including board committee charters and the articles of association.
- Set science-based targets to reduce greenhouse gas emissions in-line with the goals of the Paris Agreement. This should include consideration of material Scope 3 emissions associated with a company's supply chain or use of products or an explanation where this is not the case.
- Integrate climate change into the forward-looking strategy for the company. This includes conducting scenario analysis to establish the potential financial and other impacts of climate change on the business at different levels of warming. Companies should ensure that the financial risks associated with climate change and the energy transition are appropriately reflected in reports and accounts. The audit committee should be responsible for ensuring these risks are accounted for.
- Adopt the framework set out by the Task Force on Climate-related Financial Disclosures for the management and reporting of climate-related risks and opportunities.

We support the work of The Transition Pathway Initiative (TPI), which assesses companies' management of greenhouse gas emissions and risks and opportunities related to the transition to a low-carbon economy. It also assesses how companies' current and future carbon performance might compare to the international targets and national pledges made as part of the Paris Agreement. Company ratings can be accessed via the publicly available TPI tool<sup>10</sup>. We will consider recommending voting against the chair of the board or other responsible directors of companies which we do not believe to have demonstrated sufficient management of climate-related risks, for example, those scoring below a Level 4 management rating from TPI. For those companies which are not covered by the TPI assessment, we will consider recommending voting against directors in cases where a company's strategy is materially misaligned with the goals of the Paris Agreement.

We understand that companies may have different views on the climate crisis to organisations of which they are members or those which they may be able to influence. Boards should ensure robust governance processes are in place to identify misalignments. Where these are identified, all available avenues to influence these third parties should be used, to encourage effective action on climate policy in line with the Paris Agreement. The company should be transparent on this governance procedure, actions taken to reduce or eliminate any misalignment and any progress seen, in line with the Institutional Investors Group on Climate Change Investor Expectations on Corporate Lobbying on Climate Policy<sup>11</sup>. Ultimately the board should be prepared to cease membership where misalignment persists without progress. Companies should also proactively support and advocate for positive action to mitigate climate change risks in their spheres of influence.

Companies should ensure that climate-related risks are integrated into financial reports and accounts. The auditors should consider company relevant climate and energy related financial risks and assumptions, future plans (e.g. capital allocation, M&A, capital projects), compliance with laws and regulations and determine whether those risks are adequately disclosed in the financial statements.

### Biodiversity

Companies in many sectors are dependent on biodiversity and ecosystem services, including the supply of clean water, the availability of raw materials, and the existence of healthy soils. Company operations and supply chains also have extensive impacts on terrestrial, marine and freshwater biodiversity. There is also an important connection between biodiversity and human health, with the coronavirus pandemic highlighting the increased risk of transmission of viruses from animals to humans resulting from exploitation of wildlife and habitat destruction<sup>12</sup>.

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<sup>10</sup> <http://www.lse.ac.uk/GranthamInstitute/tpi/the-toolkit/>

<sup>11</sup> <https://www.iigcc.org/resource/investor-expectations-on-corporate-lobbying/>

<sup>12</sup> <https://www.hermes-investment.com/eos-insight/coronavirus/the-coronavirus->

Companies must acknowledge the centrality of nature to their continued success and take responsibility for ensuring that their activities do not directly or indirectly negatively impact biodiversity. To protect valuable ecosystems and habitats, companies should prioritise eliminating deforestation from their supply chains and helping farmers transition to more regenerative forms of agriculture. Where feasible, we will expect companies to demonstrate a net positive impact on biodiversity.

### Resource efficiency – circular economy

As the global population and consumption levels continue to rise, it is vital to find ways to use resources more efficiently, to tackle environmental challenges such as climate change; pollution to air, water and land; and soil erosion and loss of biodiversity. We expect companies to strive for the most efficient use of resources possible, and to consider how they can introduce circular economy approaches to their business model and operations.

One highly visible example is the urgent need to reduce plastics consumption and waste. We expect companies in exposed sectors to develop strategies and set targets for the reduction of, and optimal and balanced use of plastics in products and packaging; to end reliance on single-use plastics wherever practicable; and to invest in developing more circular supply chains which consider the most sustainable use of plastics or alternative materials throughout their lifecycles.

In the face of looming resource scarcity, another example is the need to shift to more sustainable sources of food, including reliance on inefficient animal and livestock-based proteins. Boards in relevant sectors should consider the potential for healthy, sustainable foods, ingredients and agricultural practices, such as plant-rich dietary options, plant-based proteins, and animal proteins which do not exacerbate further deforestation or fisheries depletion, and which avoid excessive use of antibiotics in rearing.

### Human rights

We endorse the UN Guiding Principles on Business and Human Rights and the UN Global Compact and expect companies to do the same. We expect companies to use the reporting framework of the Guiding Principles to disclose how they assess and manage human rights impacts related to their operations and supply chain. Companies should conduct regular human rights risk assessments and demonstrate effective human rights due diligence designed to identify, prevent, mitigate and account for how they address their impacts on human rights. They should prioritise their efforts on the salient human rights issues associated with their activities.

Companies' licences to operate are increasingly affected by reputational factors, including their approach to human rights. As a minimum, we expect companies to comply with all legal requirements, including, for example, the obligations of the UK Modern Slavery Act; and to respect all internationally recognised human rights.

### Human capital management

For many companies, employees are one of their most valuable assets, yet it is often unclear from disclosure or engagement with boards how companies invest in or manage their people effectively. The pandemic has brought into focus the important role that motivated, engaged workforces with sufficient levels of investment can play in an organisation's successful response to crisis, as well as the responsibility companies have to act as responsible employers.

Companies should set strategies and supporting objectives for the management of their human capital which reflect the importance of employees to long-term value creation and which are overseen by the board. We encourage companies to provide qualitative contextual information describing their approach, as well as annual disclosure of key performance indicators used to manage human capital.

A vital component of effectively managing human capital is for the board to set the expected culture of the company and require management to use various methods to identify the extent to which these expectations are being met in every business unit and department, with a goal to ensure that the culture is one in which employees are engaged and motivated.

We expect all companies to disclose the following as a minimum for human capital management:

- a) The number of people employed by the issuer, broken down by full-time and part-time employees along with contingent workers who produce its products or provide its services
- b) Turnover or similar workforce stability metric
- c) Workforce diversity data, concentrating on gender and ethnic/racial diversity across different employment bands/employee levels where possible

### Culture and ethical conduct

We expect companies to set and adhere to standards of ethical conduct through relevant policies and processes, including enforcing best practice anti-corruption and anti-bribery policies and processes. These should be overseen by the board with robust action taken where issues are identified. This, combined with clear cultural expectations and organisational measures provide the best possible defence against corruption and other unethical behaviour.

Policies and processes cannot be fully effective without the right leadership. We expect the board not only to oversee the company's culture and conduct but also to set the tone from the top, to encourage the highest ethical standards, and to drive company values.

### Tax

Companies should recognise the importance of taxation to the funding of public services on which they and their stakeholders rely and pay their fair contribution. This has been particularly emphasised during the pandemic, in which all businesses have directly or indirectly benefitted from government action to support the economy.

Fair payment of tax, based on the intention of tax law and in proportion to the location of economic value generated, is an important pillar of a company's social licence to operate. We believe that companies that seek to aggressively minimise their tax payments will face increasing reputational and financial risks.

We expect companies to:

- Comply with the intention of tax laws and regulations in all countries of operation.
- Pay taxes in line with where economic value is generated.
- Publish a global tax policy describing their approach to tax risk, controls and oversight, including any material variations across the entity. This should include policy on corporate structuring in low tax jurisdictions, intra-group transactions and the use of tax incentives from public authorities. Companies should ensure that their tax policies and practices do not damage their social license to operate in all jurisdictions in which they have a presence.
- Disclose publicly the full extent of taxes paid or collected by them in each country. Reporting on each country should include the purpose of the local corporate entity along with comparable corporate data such as revenue, profit before tax and number of employees. Companies can use the Global Reporting Initiative Tax Standard as a framework for this disclosure.
- Boards to ensure they have sufficient oversight of tax policy, risk and controls in their and their committee work.

## Transparency and reporting

We believe that the quality of narrative reporting reflects the board's strategic thinking, its line of sight into operations and how well it oversees the company. Boards must report openly and transparently on the performance of the company and their stewardship of it over the year, acknowledging the challenges, as well as the achievements, the state of the market and the competitive landscape. It is also fundamental that each company reports in a way that allows investors to understand the main risks that the board has identified for the business, along with how the company manages and mitigates them. This includes ESG, as well as financial and strategic, risks.

## Audit

Shareholders in listed companies rely on the quality and robustness of the audited information those companies report to the market when making investment decisions, and when holding company management and boards to account. High quality and effective audits are vital to ensure the markets trust and have confidence in the information companies report.

Audits should provide assurance to shareholders that the financial statements present a prudent, true and fair view of the results, cash flow and financial strength of a company. In recent years, we have seen a spate of business failures following poor

quality audits. These high profile cases have raised questions about the quality, relevance and independence of audits, and strengthened calls for reform.

In addition, shareholders, regulators and other stakeholders have increasingly focused on the role and performance of audit committees and how they discharge their duties. Beyond the oversight of the financial reporting process and the appointment and oversight of the external auditor, audit committees have important risk and compliance oversight responsibilities, as delegated by boards or as specified by laws or regulations. To ensure the proper functioning of the audit committee, we expect the committee to be chaired by an independent director and be majority independent.

#### Auditor rotation

Maintaining independent external assurance is a fundamental pillar of good stewardship and the fiduciary duty of a board of directors. Independence, and potentially audit quality, is at risk when the same assurance provider is maintained for too long. Our experience is that simply rotating the audit partner is insufficient. Only by tendering the audit firm at regular intervals can auditor independence and quality be protected, in the interests of shareholders and other stakeholders. Our view is that auditor rotation can also add value with a fresh pair of eyes, fresh challenge and opinions. It will bring a new firm with a different approach and set of subject specialists.

In line with the EU Audit Regulation and related Audit Directive, we support the re-tendering of audit firms at 10 years, and mandatory rotation after 20 years as a minimum standard.

#### Non-audit services and fees

As part of overseeing the external auditor, the audit committee must establish and enforce a policy on what non-audit services the company can procure from the external auditor. We pay close attention to these services and related fees to ensure that they do not compromise auditor independence, which could compromise the integrity of the audit. The non-audit fees should normally be substantially lower than the audit fee.

As a guideline, we do not expect non-audit fees to exceed 50% of audit fees in any given year and consistent with EU regulation, we expect non-audit fees not to exceed 70% of the average of the audit fees over the previous three years. If this is exceeded, there should be a clear explanation as to why it was necessary for the auditor to provide these services (for example, for certain services such as reviewing interim reporting or performing due diligence on transactions) and how the independence and objectivity of the audit was assured. In these cases, we also expect the committee to take action to ensure this does not reoccur, either by tendering for a new audit firm or reallocating non-audit work to a different firm.

We recognise that audit quality cannot be ensured solely through regular rotation of external auditors or reducing conflicts caused by the payment of fees for non-audit work. We expect audit committee chairs and committee members to understand the

organisation, challenge management and external and internal audit teams, and to follow best practice guidance when appointing audit firms, such as those we contributed to with the UK Investment Association.<sup>12</sup> Committee chairs and members should ensure they have sufficient time to fulfil their duties, which we expect to be significant, particularly for large, complex organisations.

### Accounting practices

We are concerned that accounting standards, as applied, do not always reflect underlying company performance. We encourage companies to apply accounting standards in a manner which is prudent and provides a true and fair view. Where application of the standards does not provide such a view, we expect companies and their auditors to make this clear to investors.

As such, we expect companies to avoid aggressive accounting practices that represent the company's financial position in a flattering light. This creates a reliance on the most optimistic of outcomes transpiring in subsequent years, which can easily compound up to the point that a preventable collapse finally occurs. We expect companies to recognise liabilities in a timely fashion, and to only realise profits where there is a very high degree of confidence in their quality. We also expect a clear indication of the quality of any unrealised profits found in the company's income statement.

### Corporate actions

Most merger and acquisition transactions are not as successful as the acquiring party expects. When considering our voting recommendation on a commercial transaction, we will consider a range of factors, in the context of seeking to protect and promote long-term, sustainable value. The underlying expectation is that due process is followed, with information made available to shareholders. Considerations include:

- Consistency with strategy – whether the transaction is consistent with the prior stated strategic aims of the company or whether any change in strategy appears coherent and sensible.
- Risks and opportunities – the key risks and opportunities to the business from the transaction and the extent to which these appear to have been considered and managed. This includes factors such as cultural fit, human capital management implications and the post-transaction integration plan.
- Conflicts of interest – any conflicts of interest which may affect the alignment of the interests of directors or particular shareholders with those of long-term outside or minority shareholders. This includes considering whether the proposal is a related party transaction and, if so, whether appropriate disclosures and safeguards are in place; whether the transaction erodes any shareholder rights; and any potential conflict of interest concerning the directors' duty to act in the interests of shareholders, in particular, as these may arise from either existing or newly revised remuneration arrangements.

- Price – including whether any premium or discount to prevailing market share price is appropriate

The board should form an independent committee to oversee any mergers or acquisitions, particularly when there are potential conflicts of interest for executives who stand to benefit financially from the transaction.

## Federated Hermes

Federated Hermes is a global leader in active, responsible investing.

Guided by our conviction that responsible investing is the best way to create long-term wealth, we provide specialised capabilities across equity, fixed income and private markets, multi-asset and liquidity management strategies, and world-leading stewardship.

Our goals are to help people invest and retire better, to help clients achieve better risk-adjusted returns, and to contribute to positive outcomes that benefit the wider world.

All activities previously carried out by Hermes now form the international business of Federated Hermes. Our brand has evolved, but we still offer the same distinct investment propositions and pioneering responsible investment and stewardship services for which we are renowned – in addition to important new strategies from the entire group.

## Our investment and stewardship capabilities:

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

## Why EOS?

EOS enables institutional shareholders around the world to meet their fiduciary responsibilities and become active owners of public companies. 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.

For more information, visit [www.hermes-investment.com](http://www.hermes-investment.com) or connect with us on social media:



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