Votes for change

This year we saw a notable increase in shareholder resolutions seeking a vote on climate transition plans, and proposals for racial equity audits. Investors are calling for a swifter, more fundamental response to these deepening environmental and social crises.

Setting the scene

This voting season saw the emergence of formal shareholder votes on companies' responses to climate change. This followed attempts to improve investor scrutiny of companies' actions on climate and the rapid expansion in company commitments to achieving net-zero emissions.

Meanwhile, investor focus on racial equity continued. Our tightening vote policies led us to oppose FTSE 100 chairs in the UK at five meetings for failing to meet minimum expectations for racial diversity on boards, while shareholder proposals filed with several US companies urged each board to oversee a racial equity audit analysing the company's impacts on non-white stakeholders and communities of colour. Finally, as the impacts of the coronavirus pandemic continued to be felt around the world, scrutiny of company actions – including the treatment of employees and executive pay – remained high on the agenda.

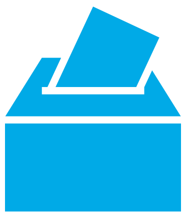
Amy Wilson
Theme co-lead: Business Purpose & Strategy
amy.wilson@hermes-investment.com

The 2021 voting season took place in the shadow of the coronavirus pandemic, with its impacts still being felt. Companies continued to hold shareholder meetings virtually or in hybrid formats, with 2021 being a key year to establish new practice norms.

We made at least one voting recommendation against management at

67% of meetings, up from

61% in the first half of 2020.



Some countries, such as Denmark and Japan, introduced legislation to allow virtual-only meetings, leading companies to propose changes to their Articles of Association to allow this. We selectively supported these, for example at Maersk and Novo Nordisk, where we were able to gain assurances that companies would conduct the meetings in ways that protect all shareholder rights and that they would return to in-person or hybrid meetings as soon as practicable. For Japanese companies, we said they should not conduct a virtual-only meeting unless absolutely necessary. We supported this type of proposal at Takeda Pharmaceutical, SoftBank Group and Sumitomo Mitsui Banking Corporation.

In the first half of 2021, we made voting recommendations at 9,630 meetings, versus 7,976 over the same period in 2020. We made at least one voting recommendation against management at 67% of meetings, up from 61% in the first half of 2020. We 'attended' and asked questions at 22 shareholder meetings, including Deutsche Bank, BP, Google owner Alphabet, Novartis, Amazon and Facebook, up from nine in 2020.

We made statements at nine meetings and asked live questions at six, submitting questions in advance for others. We recommended votes on 2,395 shareholder resolutions in the first half of 2021. Some 468 of these were in the US (versus 420 in 2020), where we recommended against management on 262 proposals or 56% (versus 64% in 2020).

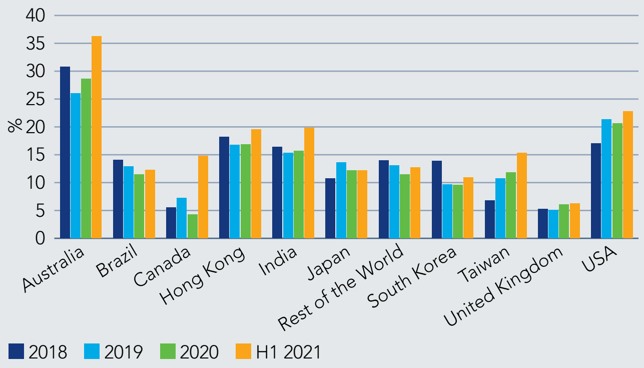
Climate change

2021 can be seen as a tipping point for investor engagement and voting on climate change, with the emergence of 18 'vote on transition' proposals at companies spanning oil and gas, construction, aviation, and consumer goods. Japan saw its second and third shareholder resolutions on climate change, after the first at Mizuho Financial Group in 2020.

This year, two similar proposals were filed at Mitsubishi UFJ Financial Group and Sumitomo Corp, asking the companies to align their business strategies to the Paris Agreement goals. These companies were targeted for their significant exposure to fossil fuels, including coal. We accelerated our engagements with them, while also seeking views from the NGOs who had filed the proposals, then recommended support for both.

EOS has had a formal climate change voting policy in place since 2019 targeting climate change laggards and we strengthened this again in 2021. We continued to use the Transition Pathway Initiative (TPI) assessment, setting a threshold of Level 4 for all European companies, coal mining companies or oil and gas companies, or Level 3 for all other companies. We also identified several other areas where we believed a company's actions were materially misaligned with the goals of the Paris Agreement, including companies contributing to coal expansion and deforestation.

Percentage of proposals voted against management per key market



Source: EOS data

This year the policy identified over 250 companies - versus around 130 in 2020 - including over 190 outside the EOS engagement programme. We wrote to companies setting out the reasons for our concern and requesting further engagement, and saw a high level of response. This enabled us to successfully engage with over 45 companies beyond the core engagement programme. The work is ongoing, as many of the companies identified are based in regions where shareholder meetings will be held later in the year.

To date, we have recommended opposing the election of the responsible director for climate change (usually the chair) at over 100 companies, including Canadian Natural Resources and China Resources Cement Holdings. We supported directors by exception to our policy at companies where we noted progress or gained assurance that positive changes would be made, including at Itochu.

Climate transition plan votes

This year also saw the emergence of 'say-on-climate' resolutions, with various companies facing a shareholder vote to approve their climate change transition plan. This came in response to various movements to improve investor scrutiny of such plans, following the rapid expansion in the number of companies aiming to achieve net-zero emissions.

EOS is generally supportive of the concept of a vote on transition plans, believing it will improve a company's focus on climate change and aid transparency. It will also improve investor scrutiny and engagement, and provide a clear pathway to engagement escalation in the event of material opposition from shareholders.

We sought to support proposals that demonstrated robust target-setting, were aligned to external frameworks and accreditations such as the Science-Based Targets initiative, and where we could see a clear and credible strategy in place to achieve the stated targets, including at Unilever, Aviva and Nestlé. However, we did not support the proposed climate plans at Royal Dutch Shell, Glencore and Total, as these did not appear to be aligned to the Paris Agreement goals, or at airport operator Aena, due to a lack of targets for the Scope 3 emissions that are critical to its transport infrastructure.

In our role as Climate Action 100+ (CA100+) co-lead for the French oil and gas major Total, we led a group of 35 institutional investors to move a collective statement[1] at the annual shareholder meeting. Although we and the other CA100+ co-leads all recommended voting against Total's climate policy, only 8% of shareholders did so, demonstrating that there is more work to do to educate investors on what it takes to be Paris aligned. Similarly, at Royal Dutch Shell, its policy attracted a vote of only 11% against, but a Dutch court differed in its view (see page 19) and a separate resolution requiring targets aligned to the Paris goals attracted 30% support.

We also led a delegation of eight institutional investors who spoke at the annual shareholder meeting of chemicals company LyondellBasell, in our role as CA100+ lead. While the other agenda items together took only 12 minutes to resolve, this was followed by over 45 minutes of debate on the company's climate change strategy. This elicited some useful, if still rather vague commitments on a forthcoming new climate strategy anticipated for Q3. Earlier this year, we had escalated this engagement by obtaining support from 27 institutional investors to use a legal mechanism under Dutch law to require a discussion on climate change at the shareholder meeting – the only legal route used by CA100+ in Europe this year.

Proxy battle at Exxon

In the US, oil major Exxon, another notable climate change laggard, partially lost a proxy battle with activist investor Engine No. 1. Three out of four directors proposed by Engine No. 1 were appointed against management advice, with a view to improving the company's stance on climate change. We recommended support for all four, believing that additional board refreshment would preserve and enhance long-term shareholder value through the energy transition.

Engine No. 1's concerns about Exxon's long-term financial underperformance, overly aggressive capex, and lack of sufficient plans for climate change echoed those expressed in our engagement with the company over the years. We also recommended support for various shareholder resolutions that we believed would enhance transparency and action on climate change and related material issues.

Meanwhile, a shareholder resolution requiring Scope 3 targets at another US oil major, Chevron, gained 61% support from investors. We had recommended support for the proposal, noting that Chevron's existing strategy in relation to the energy transition appeared to assume that it would not need to shrink in the short, medium and possibly long term. Accordingly, it had set emission intensity targets for its Scopes 1 and 2 emissions only. To us, this seemed a very high-risk strategy, made riskier by being widely shared by its sector peers.

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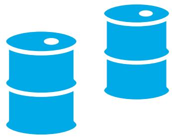


We also recommended support for another proposal requesting an audited report on how a significant reduction in fossil fuel demand, as envisaged by the International Energy Agency's net-zero 2050 scenario, would impact the company's financial position and underlying assumptions.

Diversity and inclusion

We have tightened our voting policies for diversity and inclusion, demanding greater representation of women and ethnic minorities on boards and amongst leadership teams. Globally, we opposed the re-election of directors deemed most responsible due to concerns about insufficient diversity. In the US, where we expect women and ethnic minorities to make up at least 40% of the board at the largest companies, we opposed 39% of nominating committee chairs, including at Kinder Morgan, Thermo Fisher Scientific and Discovery.

In the UK, we continued to push for greater gender diversity on boards and among executives/leadership teams. We expect FTSE 350 boards in the UK to have reached 33% female representation, for FTSE 100 companies to have at least one woman on the executive committee, and for women to comprise at least 20% of the executive committee and its direct reports. We opposed the directors responsible (typically the board chair) at companies that fell below our expectations, such as at Ocado, Imperial Brands and Glencore.

[1] https://www.iigcc.org/media/2021/05/Total-2021-AGM-Statement-.pdf

CASE STUDY

Berkshire Hathaway and climate change

In November 2020, the international business of Federated Hermes together with California Public Employees' Retirement System (CalPERS) and Caisse de Dépôt Et Placement Du Québec (CDPQ), filed a shareholder proposal asking Berkshire Hathaway's board to publish an annual assessment addressing how the company manages physical and transitional climate-related risks and opportunities. Tim Youmans, the EOS lead for North America, spoke at the 2021 shareholder meeting on behalf of the proposal.

We had concerns that the board of Berkshire Hathaway believes climate-related disclosures to be immaterial and unnecessary for investor interests, and that climate change is not a major threat to aspects of the company's business, including its insurance operations. The company only provides qualitative statements that its subsidiaries are managing climate risks effectively. For over a year Berkshire Hathaway was unresponsive to our repeated requests to engage at the parent company level on climate-related reporting and targets.

In conjunction with CalPERS and CDPQ, we filed a shareholder proposal, hoping to trigger a dialogue with Berkshire Hathaway on climate change. Following confirmation in February that the company would include the shareholder proposal in its definitive proxy statement, we wrote to the company chair and CEO Warren Buffett in March 2021 requesting a meeting to discuss the proposal with him or an appropriate board representative. The chair declined, but said he hoped that a representative of the proposal would be able to present it at the meeting.

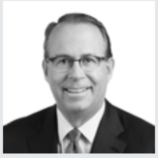
Tim Youmans, the EOS lead for North America, attended the company's annual meeting at the broadcast location, with the meeting held virtually and broadcast live by Yahoo Finance. The company chair, three vice chairs and a media representative also attended in person.

During the question-and-answer session in the lead up to the formal annual meeting, the company's chair and vice chairs addressed questions about the company's actions on climate. Buffett stated that the company's material emissions resided within two of its largest businesses – railroad and energy – both of which report on climate, with the railway business committed to a science-based target. On the topic of providing climate reporting across the group, he added: "It's asinine, frankly, in my view. We do some other asinine things because we're required to do it, so we'll do whatever's required. But to have the people at Business Wire, Dairy Queen ... making some common report ... we don't do that stuff at Berkshire."[2,3]

In our supporting statement for the climate reporting shareholder resolution, we urged the company to provide annual disclosure at the subsidiary level on climate risks, as these risks and impacts are not transparent, and shareholders can only purchase shares in the combined parent company entity. While the company has historically performed well, simply asking shareholders to "trust" the company on its capital deployment decisions without climate risk being adequately disclosed is concerning. For example, Berkshire Hathaway Energy is now the largest US power company without a net-zero goal.

The shareholder proposal went to a vote immediately after the EOS introduction without further comment from the chair/CEO beyond saying the proposal was interesting and that the views set forth were well written. Berkshire Hathaway insiders, including Warren Buffett, control 35% of the company's voting power. With Berkshire Hathaway opposing the shareholder proposal, it was defeated, but when adjusted for non-insiders, the vote results were close to 60% in favour of the proposal.

Vice chair Greg Abel – who has been named by Buffett as his likely successor – has stated that all the company's coal-fired power plants will be shut down by 2049 and that there is a transition plan for renewable energy. However, the timing for these shutdowns is not aligned with the Paris Agreement making it all the more urgent that Berkshire Hathaway begins to disclose its climate risks.



Tim Youmans
EOS Lead, North America

Joanne Beatty
Theme lead: Corporate Reporting

[2] https://www.reuters.com/business/sustainable-business/berkshire-shareholders-reject-climate-change-diversity-proposals-that-buffett-2021-05-01/
[3] https://buffett.cnbc.com/video/2021/05/03/buffett-asinine-for-berkshire-to-compile-a-climate-change-report.html

We also began voting on racial diversity in the UK, opposing any FTSE 100 board chairs where the board had failed to meet the minimum expectations of at least one ethnic minority director. This meant we opposed at five companies – Carnival, Croda International, Evraz, Next and Informa.

Where we received assurances that this issue would be urgently addressed, we supported on an exceptional basis, including at housebuilder Persimmon and defence company BAE Systems.

In Continental Europe, we recommended against the discharge of the supervisory board chair at Heidelberg Cement as there were no women on the managing board. The company had a target of adding one woman by 2025 but it has now said that one will join later this year in a new role on the managing board. We also recommended a vote against a director at ArcelorMittal due to concerns about poor gender diversity, and at Bouygues. Here we raised concerns about the absence of women on the executive committee and recommended a vote against the re-election of the chair.

We have been disappointed by the lack of progress on gender diversity in China, Hong Kong and Taiwan. Many companies in China and Hong Kong have not met our expectation for women to comprise at least 20% of a board by 2021 and we recommended voting against the re-election of directors at Tencent and Tingyi Cayman Islands Holding Corp. In Japan, where progress has also been slow, we look for 10% women on boards of TOPIX 100 companies, and one female director at other companies.

> **In Continental Europe, we recommended against the discharge of the supervisory board chair at Heidelberg Cement as there were no women on the managing board.**

Japanese companies express support for the concept of board gender diversity and do not rule out appointing women in the future, but this has not translated into more women on boards, and we have not seen credible plans to introduce women. Companies often state that directors are appointed on merit, and that their recruitment pool is limited. However, we expect companies to look at talent outside the traditional pools and to address the serious lack of diversity, and the risks of group think and complacency.

We have applied our policy of recommending a vote against nomination committee chairs, or members or chairs of a board where this not possible, and have extended this to new male board members where independence is not a concern. For example, at Japanese retailer Seven & I we recommended a vote against an independent non-executive director who chairs both the remuneration and nominations committees for insufficient diversity, and pay concerns.

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Racial equity audits

This year we also saw a significant number of racial equity audit shareholder proposals, including at US banks Goldman Sachs and JPMorgan Chase. Resolutions requesting enhanced disclosure on the effectiveness of diversity and inclusion programmes were also filed at American Express, Berkshire Hathaway, Johnson & Johnson and others.

Although we did not always agree with every aspect of the supporting statements, we broadly agreed with their substance, believing that racial equity audits would add substantial value beyond the actions the companies were already taking. During engagement we explained that audits can provide additional insight into the root causes of complex problems that companies must address in order to develop enduring solutions. They also enable more rigorous performance evaluation against underlying challenges and increase a board's capacity to provide effective oversight.

We subsequently recommended support for the racial equity audit shareholder proposals at Bank of America, Citigroup, Goldman Sachs, JPMorgan Chase and Wells Fargo, among others, in order to accelerate momentum for closing racial equity gaps in society.

A few of these proposals were withdrawn, such as at BlackRock and Morgan Stanley, or were put to the vote with the support of management. BlackRock plans to implement the resolution "as is" and will publish the findings of the racial equity audit by 2022, while Morgan Stanley will undertake a review with a narrower scope. At IBM the board recommended that shareholders support a resolution for a diversity, equity and inclusion report as it "aligns with IBM's goals of a diverse and inclusive workforce". We encouraged other companies to consider supporting proposals in this manner.

In the US, where we expect women and ethnic minorities to make up at least

40% of the board at the largest companies, we opposed

39% of nominating committee chairs.

Executive remuneration

In 2021, shareholders in many countries were asked to vote on the decisions taken on executive pay for 2020, which heightened concern given the backdrop of Covid-19. We set a clear expectation that boards should continue to use their judgement to ensure that executive pay could be justified in the context of the experience of other stakeholders, particularly for companies that had made redundancies, benefited from government support, or were otherwise in distress.

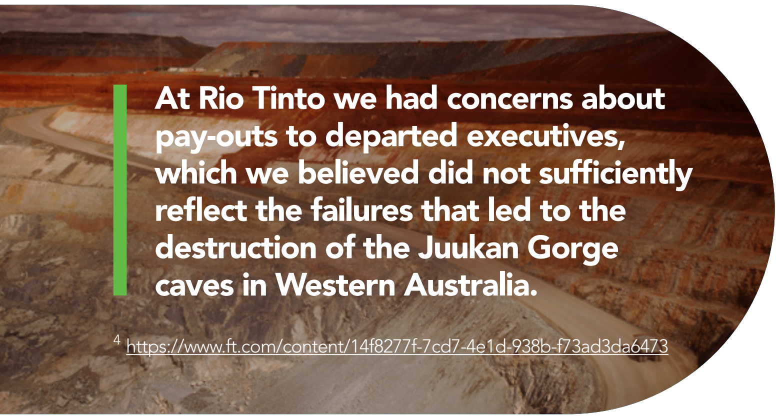
We saw some good practices. In the UK many companies repaid the money received from the government to furlough their employees or in business rates relief, and it was generally accepted amongst those not able to do so that they should not pay bonuses to executives.

However, we opposed pay proposals at Vinci and Whitbread, where non-financial elements of the CEOs' bonuses were judged to have been fully achieved and were paid or rolled over to next year respectively. This was despite the fact that both companies used government support to furlough employees and made redundancies.

Likewise, we opposed the remuneration report and the re-election of the remuneration committee chair at publisher Informa, where the decision was taken to adjust pay-outs to executives from a long-term incentive scheme that would have lapsed, in the face of a significant negative impact from the pandemic. This follows several years of poor pay practices and an inadequate response to shareholder concerns. The company saw one of the biggest defeats on record, with 62% of votes cast against the remuneration report.

We believe there are substantial issues with executive pay practices in the US and opposed 80% of "say-on-pay" proposals in the first half of 2021. These concerns were exacerbated by decisions to insulate executives from the impacts of Covid-19, relative to other stakeholders. For example, at hotel chain Hilton, we recommended voting against the say-on-pay proposal and the chair of the compensation committee.

The compensation committee had altered the performance metrics in the long-term incentive plan due to Covid-19 after the company realised that the performance stock units would not pay out. This meant that the long-term plan paid out much higher, appearing out of step with the company's decision to lay off 25% of its staff in mid-2020.



At Rio Tinto we had concerns about pay-outs to departed executives, which we believed did not sufficiently reflect the failures that led to the destruction of the Juukan Gorge caves in Western Australia.

As well as scrutinising decisions taken against the backdrop of the pandemic, we continued to oppose pay where we judged it to be excessive or misaligned with the interests of long-term shareholders and other stakeholders.

Elsewhere, we recommended a vote against the board chair at fast food chain McDonald's due to the board's failure to oversee a sufficient investigation into allegations of misconduct against the former CEO. We also recommended a vote against the executive compensation and compensation committee chair due to a failure in the company's clawback policies to recoup the severance awards made to the former CEO.

Similarly, at Disney we recommended a vote against the say-on-pay item and the compensation committee chair due to the high quantum of pay awarded to the CEO and executive chair, with pay remaining in the top quartile. The company had not adequately adjusted the executive chair's pay when he stepped down from his CEO role in 2020 and did not provide justification for continuing to pay the executive chair above the market rate.

As well as scrutinising decisions taken against the backdrop of the pandemic, we continued to oppose pay where we judged it to be excessive or misaligned with the interests of long-term shareholders and other stakeholders. At miner Rio Tinto, we opposed the remuneration report due to the heavy focus on shareholder returns in its pay schemes, with limited consideration of other, important strategic and stakeholder factors. We also had concerns about pay-outs to departed executives, which we believed did not sufficiently reflect the failures that led to the destruction of the Juukan Gorge caves in Western Australia. The company suffered a significant defeat with over 60% of shareholders opposing the remuneration report.

We believe there are substantial issues with executive pay practices in the US and opposed **80%** of "say-on-pay" proposals in the first half of 2021.

We also recommended a vote against at AstraZeneca, which proposed further increases to the already substantial incentive awards offered to its CEO, and where we opposed the previous schemes on the basis of excessive quantum. Investors voted about 40% against, a sign of the growing discontent.[4] Finally, we recommended opposing at BAE Systems due to a retention package for the CEO that we believe raises serious questions about the effectiveness of the board in managing the succession plan for this role.

[4] https://www.ft.com/content/14f8277f-7cd7-4e1d-938b-f73ad3da6473

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