OUTCOMES BEYOND PERFORMANCE

PUBLIC ENGAGEMENT REPORT

Food for thought: the irresistible rise of sustainable proteins

Q3 2019

For professional investors only

www.hermes-investment.com

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 Q3 2019. 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.

Engagement statistics by region	4
Engagement statistics by theme	5
Recipe for success	6
Engagement vs divestment	10
A blueprint for a better future	15
A clearer picture	20
Engagement on strategy	24
Public policy and best practice	27
Voting	30
About Hermes EOS	33
Hermes EOS team	34

This report has been written and edited by Claire Milhench, Communications & Content Manager, Hermes EOS

ENGAGEMENT BY REGION

Over the last quarter we engaged with 232 companies on 576 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.

Source: Hermes EOS

ENGAGEMENT BY THEME

A summary of the 576 issues and objectives on which we engaged with companies over the last quarter is shown below.

Environmental topics featured in 25.3% of our engagements over the last quarter.

- Climate Change **74.0%**
- Forestry and Land Use **3.4%**
- Pollution and Waste Management **12.3%**
- Supply Chain Management **4.8%**
- Water **5.5%**

Social and Ethical topics featured in 25.3% of our engagements over the last quarter.

- Bribery and Corruption **3.4%**
- Conduct and Culture **14.4%**
- Diversity **14.4%**
- Human Capital Management **30.8%**
- Human Rights **28.8%**
- Labour Rights **6.2%**
- Tax **2.1%**

Governance topics featured in 31.8% of our engagements over the last quarter.

- Board Diversity, Skills and Experience **27.9%**
- Board Independence **14.2%**
- Executive Remuneration **38.8%**
- Shareholder Protection and Rights **13.1%**
- Succession Planning **6.0%**

Strategy, Risk and Communication topics featured in 17.5% of our engagements over the last quarter.

- Audit and Accounting **5.0%**
- Business Strategy **41.6%**
- Cyber Security **1.0%**
- Integrated Reporting and Other Disclosure **28.7%**
- Risk Management **23.8%**

Source: Hermes EOS

RECIPE FOR SUCCESS

The growth of plant-based nutrition

Livestock farming accounts for up to 18% of global carbon emissions, and with the human population expected to grow to 9.8 billion by 2050, the pressure is on to find alternatives to ensure we don't exceed safe planetary boundaries. Are plant-based ingredients the answer?

Setting the scene

Animal livestock systems already occupy 26% of the planet's surface area, and account for 15-18% of greenhouse gas emissions – more than the global transportation fleet. As well as contributing to the climate crisis, they can fuel deforestation and reduce biodiversity, as land is cleared and converted for livestock farming. Yet demand for animal proteins is expected to grow by nearly 70% by 2050, according to the World Resources Institute (WRI)[1], as incomes rise in developing nations. Under this scenario, the world would fail to meet the Paris Agreement goal to limit global warming to well below 2°C, according to a landmark EAT-Lancet report[2] on sustainable diets released early this year. Its findings were reinforced by a report on climate change and land use published in August 2019 by the Intergovernmental Panel on Climate Change (IPCC), which warned that temperatures can only be kept at safe levels if land is managed sustainably.

26%
of the earth's surface area is occupied by animal livestock systems

15-18%
of carbon emissions are produced by livestock farming

70%
potential rise in demand for animal proteins by 2050

9.8BN
expected global population by 2050

For further information, please contact:

Aaron Hay
aaron.hay@hermes-investment.com

Emma Berntman
emma.berntman@hermes-investment.com

[1] https://wrr-food.wri.org/
[2] https://eatforum.org/content/uploads/2019/07/EAT-Lancet_Commission_Summary_Report.pdf

Supermarkets scrambled to get vegan product lines into their stores this year as Western consumers looked to introduce more plant-based nutrition into their diets. A bellwether of the trend – Beyond Meat, which makes burgers from pea protein – had to delay its launch in UK grocery store Tesco due to unexpectedly high North American demand[3]. Non-dairy alternatives such as soya and coconut milk are also growing in popularity, as consumers become increasingly aware of the impact of dairy farming.[4]

But this encouraging trend masks the underlying reality – global greenhouse gas emissions and agricultural land use are forecast to grow rapidly over the next three decades as developing nations adopt higher-protein diets.

There has been little regulatory pressure to address this issue to date, with collaborative investor network FAIRR pointing out that no countries have national plans for tackling livestock emissions. However, given farming's contribution to global emissions, it would be reasonable to expect more action from policymakers in future. For example, the Netherlands has proposed a national target of 40% animal content in total protein intake, while the Swedish and Canadian governments advocate mostly plant-based diets.

"[Food production] is the single largest driver of environmental degradation and transgression of planetary boundaries … A radical transformation of the global food system is urgently needed."

The clearing of land for livestock farming has a serious impact on biodiversity and local communities who may lose access to critical ecosystem services, such as reliable water supplies. Deforestation and desertification also exacerbate climate change – a growing concern given the extent of the 2019 forest fires in Brazil's Amazon to clear land for cattle ranches and other farming.[5] "Global food production threatens climate stability and ecosystem resilience," the EAT-Lancet Commission report stated. "It constitutes the single largest driver of environmental degradation and transgression of planetary boundaries … A radical transformation of the global food system is urgently needed."

Inefficient converters

Why are the consequences so dire? One problem is that cattle and other mammals are inefficient converters of food energy, so livestock farming is much more resource intensive than arable crops.

Chicken, eggs and fish convert feed to protein at a rate of 17-25% of calorific value, whilst the cattle conversion rate is as little as 4%. This means 25 calories of feed are needed to produce one calorie of beef, with 96% of the food 'wasted'.

Beef farming greenhouse gas emissions per unit compared to non-animal products:

6x more than eggs

14x more than soya

17x more than lentils

As a result, beef produces at least six times more greenhouse gas emissions per unit of protein than eggs, about 14 times more than soya (tofu), and 17 times more than lentils. In addition, arable land is being used inefficiently to grow feed-based crops for livestock, rather than crops that people can eat.

As land is a finite resource, we are in danger of breaching safe planetary health boundaries, beyond which there could be "irreversible and potentially catastrophic shifts" in the earth's system, according to the EAT-Lancet report. The increase in land cultivation is also shrinking forests and grasslands, threatening extinctions and biodiversity failures. A recent UN report estimates that around one million animal and plant species are now threatened with extinction, many within decades, if urgent action is not taken[6].

The proliferation of antibiotics in livestock farming also poses a threat to their effectiveness in humans, while a recent UK study showed that eating even moderate amounts of red and processed meat increases the likelihood of developing bowel cancer.[7]

Given all this it is perhaps not surprising that consumer demand for alternatives to meat and dairy is growing, along with generational shifts in eating habits for millennials. More people are going vegan or vegetarian or switching to "flexitarian" diets – reducing their meat and dairy intake without giving them up entirely. This trend is partly driven by growing environmental awareness and concerns about provenance and industrial farming techniques, as well as health, cost and ethical reasons.

[3] https://www.theguardian.com/food/2018/nov/12/bleeding-vegan-burger-arrives-on-uk-supermarket-shelves
[4] https://www.foodnavigator-usa.com/Article/2018/07/30/US-retail-sales-of-plant-based-milk-up-9-plant-based-meat-up-24-YoY#
[5] https://www.theguardian.com/environment/2019/aug/23/amazon-fires-what-is-happening-anything-we-can-do
[6] https://www.un.org/sustainabledevelopment/blog/2019/05/nature-decline-unprecedented-report/
[7] https://academic.oup.com/ije/advance-article/doi/10.1093/ije/dyz064/5470096

We expect companies to meaningfully allocate resources to the investigation and development of products and services that align with gradual global shifts in how nutrition is sourced and sold.

Food producers have responded to this changing demand with innovative meat and dairy alternatives. As well as start-ups such as Impossible Foods and Beyond Meat, which develop plant-based substitutes for meat, incumbents such as Unilever and Danone have made strategic acquisitions to bring plant-based offerings in-house (see box). Retailers testing the market with vegan ranges have also been pleasantly surprised by their success, with UK baker Greggs now working on vegan versions of its traditional bestsellers after sales of its vegan sausage roll boomed.[8]

Our engagement approach

Looking to 2020, we will engage companies across food and agriculture value chains on their plant-based and animal-alternative food and ingredient strategies.

We expect companies to meaningfully allocate resources to the investigation and development of products and services that align with gradual global shifts in how nutrition is sourced and sold. We do not believe this is a flash-in-the-pan opportunity – indeed, for companies exposed to risks associated with animal-derived ingredients (from land use and associated carbon emissions, to deforestation and animal welfare), this is about long-term commercial resilience and responsible management of scarce natural resources. We plan to set objectives for change which, while based on where companies are at today, demand substantive investigation and action to ensure opportunities are captured.

Companies with strategies for plant-based growth in place face risks in product development, safety and quality, manufacturing, marketing and customer loyalty and satisfaction, as well as questions of cost and margin competitiveness relative to animal-based products. We seek to understand how companies are addressing their customers' needs and interests (including 'latent customers' that do not purchase from the company, but would consider the product if available), and how they are investing to scale up production safely and effectively.

Companies should also disclose how plant-based strategies will address sustainability and natural resource scarcity challenges material to their business. Ideally, this should be quantified – for example, by demonstrating the proportion of animal alternatives making up total revenues, and how carbon emissions intensity per unit of sales is changing thanks to the comparative benefits of these alternatives.

For companies that are not exploring this, we need to know why. We challenge the validity of existing strategies by asking what might happen if demand for plant-based alternatives accelerates, or if the profitability of animal protein production begins to be eroded by cost, environmental, ethical or regulatory risks, and price changes cannot be passed on to consumers. We also challenge companies on the extent to which they have considered the impact on reputation, brand value and growth prospects that might result from a lack of plant-based products or ingredients.

Key questions for companies

1. What role will plant-based and animal-alternative food and nutrition play in long-term strategy and how material is the opportunity?
2. How is the company allocating capital to research, development and sale of attractive plant-based foods or ingredients?
3. Has the company conducted scenario analyses to determine the impact on business-as-usual from rapid increases in plant-based demand and a coinciding decline in animal-based food demand, such as has already been seen in global dairy sales?
4. By investing in plant-based opportunities, how will the company's value proposition be differentiated and enhanced for its customers?
5. What are the key barriers to success in this category?

[8] https://www.theguardian.com/business/2019/aug/23/greggs-to-develop-vegan-versions-of-all-its-bestselling-foods

Sustainable food systems

In 2019, we focused on plant-based and alternative proteins and antimicrobial resistance, given their interest to investors and the need for action on both from the companies with which we engage.

2020 We will expand our engagement focus to sustainable food systems

From 2020, we will expand our engagement focus to sustainable food systems, which encompasses these and interrelated issues. To devise effective strategies for action, these issues are best considered as a systemic whole from the perspective of food and agriculture businesses, their investors, policymakers and food value chain stakeholders. Additional issues include human health and nutrition, food waste, climate change, water and biodiversity impacts, and the issues of human rights and animal welfare in food supply chains.

The concept of sustainable food systems is well defined by UK-based organisations Food Foundation and the Food Climate Research Network. We participated in a panel with these organisations in September 2019. In 2020, we will use the concept of sustainable food systems as a platform for public policy engagement, and broader engagement with companies that work along the entire food value chain.

Market trailblazers in sustainable meat and dairy

Few investors will have missed Beyond Meat's dramatic stock market debut, with shares soaring from $65.75 in May to almost $235 in late July, before falling back to trade around $155-$160 in August and September.

As the first alternative meat producer to go public, it was the most successful IPO of the year to date, offering investors a chance to get in on the ground floor. In a sign that dietary habits might change rapidly, it partnered with US fast food chain KFC to pilot plant-based chicken, selling out within hours, while its unlisted rival Impossible Foods has launched plant-based burgers with Burger King.

$140BN estimated "alternative meats" market value in 10 years

$41BN estimated non-dairy market by 2025

It is estimated that this new sector will capture around 10% of the meat market within 15 years and is worth some US$19.5bn according to Euromonitor research quoted by the FAIRR investor network.[9] Based on the latest trends, this could underestimate the opportunity – for example, Barclays estimates that the entire plant-based and "alternative meats" market could be worth US$140bn in sales in the next decade.[10]

Meanwhile, the global dairy alternatives market is expected to reach US$41.06bn by 2025, according to a January 2019 report from Grand View Research, with lactose intolerance and cancer concerns helping drive demand for almond and soy milks.[11]

However, agribusinesses, food manufacturers and retailers searching for growth in their mature businesses are not standing still. Some notable examples include the following:

- **Unilever** acquired the 4,000-outlet Vegetarian Butcher in December 2018, after in-house launches including dairy-free Ben & Jerry's and egg-free Hellmann's mayonnaise.
- **Tesco and Marks & Spencer** launched bespoke plant-based products, with Tesco reporting a 25% increase in its chilled vegan food sales in 2018, reportedly breaking the company's internal record for a product launch success.[12]
- **Danone**, one of the world's largest buyers of dairy, is prioritising the plant-based brands it acquired through WhiteWave Foods to expand its nut and soy milk offerings, while **Conagra**, which owns Birds Eye, sees a US$30bn sales opportunity in the US alone over the next seven to 10 years from plant-based proteins.[13]
- **Nestle** is planning to launch a cook-from-raw plant-based burger in Europe and the US under its Garden Gourmet and Sweet Earth brands. It has said it expects its plant-based sales to reach US$1bn in 10 years.
- **Tyson Foods**, the largest producer of meat in the US, entered the market with a range of both plant-based and blended products in June 2019, including its 'Raised & Rooted' brand.

These companies recognise that innovative alternatives to meat and dairy are likely to find favour with wholesale buyers and end-consumers alike. Conversely, those who fail to introduce plant-based proteins into their ranges could come under pressure due to falling sales and regulatory changes. Late adopters may also find it harder to secure the raw materials for their products as supply chains facing unprecedented demand for key base ingredients such as peas are locked up by early movers.[14]

[9] https://www.fairr.org/article/appetite-for-disruption-how-leading-food-companies-are-responding-to-the-alternative-protein-boom/
[10] https://www.businessinsider.com/meat-substitutes-impossible-foods-beyond-meat-sales-skyrocket-2019-5?r=US&IR=T
[11] https://www.grandviewresearch.com/press-release/global-dairy-alternatives-market
[12] https://www.veganfoodandliving.com/tesco-doubles-wicked-kitchen-range-to-include-26-brand-new-vegan-products/
[13] https://www.foodnavigator-usa.com/Article/2019/08/13/Conagra-Brands-talks-plant-based-meat-In-7-10-years-we-re-talking-about-a-30bn-opportunity-in-the-US
[14] https://www.afr.com/companies/agriculture/vegan-products-face-a-pea-shortage-as-consumers-avoid-soy-based-foods-20190516-p51nyr

ENGAGEMENT VS DIVESTMENT

Which is more effective?

The divestment movement has gathered pace in recent years with increasing numbers of investors cutting their fossil fuel exposure as concerns about the climate crisis grow. But could engagement prove more effective over the long term? By Claire Milhench.

Setting the scene

Heightened awareness of climate change has prompted a wave of fossil fuel divestments, starting in 2010 and intensifying over the last year with announcements from pension funds, asset managers, sovereign wealth funds, charities, university endowments, arts organisations and local authorities. There was a similar co-ordinated push to divest from South Africa during the apartheid era, while faith-based investors commonly screen out tobacco and alcohol producers, casino operators and bookmakers or arms manufacturers. A key aim of a divestment campaign is to bring public pressure to bear on companies and regimes of which investors disapprove. But given the scale of the climate crisis, and the need for an enduring transition to a low carbon economy, could engagement ultimately prove more successful by steering companies on to a new path?

Pressure on institutional investors to divest from fossil fuels has steadily intensified, driven by rising concern over inaction on climate change. We have seen striking school students led by Swedish climate activist Greta Thunberg and acts of non-violent civil disobedience by campaign group Extinction Rebellion.

For further information, please contact:

Bruce Duguid
bruce.duguid@hermes-investment.com

Actors and artists have called on arts associations to end lucrative sponsorship deals with oil companies, keeping the debate in the public eye.[1, 2] Meanwhile, there is a greater awareness of the financial risk to assets exposed to climate change and the urgent need to act following dire warnings from the UN's Intergovernmental Panel on Climate Change on the perils of global warming exceeding 1.5°C.

The concept of divestment is not new – it is the key element of many socially responsible investment strategies that seek to screen out unethical sectors. But the scale of the fossil fuel divestment commitments made by investors is impressive, with over 1,110 institutions pledging to divest[3]. The question is whether divestment is the best means by which to influence society and the environment for the better.

[1] https://www.theguardian.com/stage/2019/jun/21/mark-rylance-resigns-from-royal-shakespeare-company-rsc-over-bp-sponsorship
[2] https://www.theguardian.com/artanddesign/2019/jun/09/artists-national-portrait-gallery-bp-oil
[3] https://financingthefuture.platform350.org/wp-content/uploads/sites/60/2019/09/FF_11Trillion-WEB.pdf

A short history of divestment

The divestment movement can trace its origins all the way back to the 1750s when a Philadelphia meeting of Quaker churches banned members from participating in the slave trade.

By the 20th century, with the rise of socially responsible investing (SRI), it was common for religious foundations or charities to avoid investing in "sin" stocks such as tobacco or alcohol, or sectors that were otherwise considered harmful, such as guns or gambling.

Consumer boycotts have also been used to send powerful signals to companies, sometimes allied with divestment at the pension fund level supported by trustees. For example, some large institutional investors such as US university endowments divested from interests in South Africa under apartheid in the 1980s and early 1990s as public opprobrium grew. Also, the Tobacco-Free Finance Pledge, launched at the UN in 2018, attracted over 90 founding signatories with some US$6.5tn in assets.

The fossil fuel divestment movement began on US university campuses in 2010, gathered pace with the work of global climate action groups such as 350.org, and by December 2018, some 1,000 institutions representing US$8tn in assets had committed to divest from fossil fuels.[4]

By September 2019:

Institutions with assets totalling

$11TN pledged to divest from fossil fuels

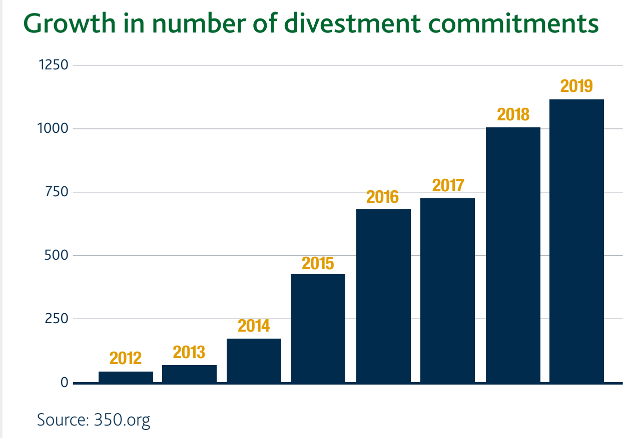
This has accelerated in 2019 following warnings from the Intergovernmental Panel on Climate Change (IPCC) about the limited time left to address global warming, allied with the effectiveness of campaign groups in raising awareness. By September 2019, institutions with assets totalling US$11trn had pledged to divest from fossil fuels, according to a report from 350.org. This is equivalent to about 16% of global equity markets in 2018, according to World Bank statistics.

The fossil fuel divestment movement has accelerated in 2019 following warnings from the IPCC about the limited time left to address global warming, allied with the effectiveness of campaign groups in raising awareness.

In the UK alone, the National Trust[5], Royal Society of Arts[6] and Royal College of Emergency Medicine[7] are divesting. For conservation charities such as the National Trust, investing in fossil fuels conflicts with the overall goal of preserving the natural landscape for future generations. Some investors also argue that even if divestment doesn't directly impact a company's capital, it helps remove the company's social licence to operate.

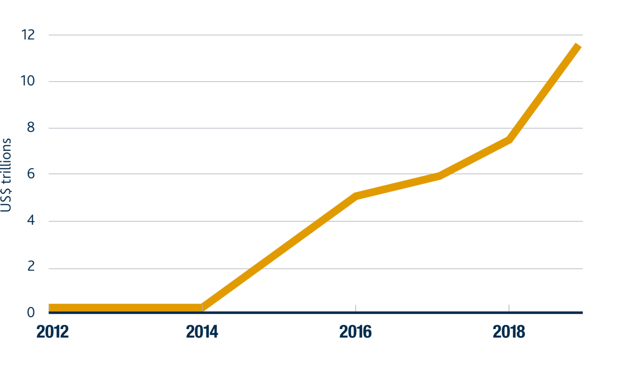
In mainland Europe, Nordea Liv & Pension has moved funds out of carbon-intensive sectors, while Chubb became the first US insurer to phase out its coal investments and insurance policies.[8] Banks have also given commitments to exit coal funding, with the Commonwealth Bank of Australia saying in August that it would phase out its exposure to thermal coal or power plants by 2030.[9]

Growth in number of divestment commitments



Source: 350.org

Growth in total assets of divesting institutions



[4] https://gofossilfree.org/major-milestone-1000-divestment-commitments/
[5] https://www.nationaltrust.org.uk/press-release/national-trust-announces-it-will-divest-from-all-fossil-fuel-companies
[6] https://www.thersa.org/discover/publications-and-articles/rsa-blogs/2019/07/rsa-divestment
[7] https://www.rcem.ac.uk/RCEM/News/News_2019/RCEM_sells_fossil_fuel_shares_and_urges_London_organisations_to_follow_suit.aspx
[8] https://financingthefuture.platform350.org/wp-content/uploads/sites/60/2019/09/FF_11Trillion-WEB.pdf
[9] https://www.reuters.com/article/us-climatechange-cba/cba-joins-global-push-to-limit-emissions-by-cutting-coal-exposure-by-2030-idUSKCN1UX0NW

Pros and cons

Investors assessing oil and gas companies face a dilemma – from a financial perspective the investment may appear attractive, paying good dividends or bond coupons and delivering solid growth.

But from an environmental and social perspective there are a number of drawbacks – not least the fossil fuel contribution to climate change. There is also the risk of stranded assets further down the line as policymakers scramble to limit the damage.

Divestment

Divestment may appear the only option for the concerned investor at first glance – particularly if the company has blocked attempts to engage with it or failed to learn from its mistakes.

For example, in 2019 US oil major ExxonMobil asked the Securities and Exchange Commission (SEC) to block a shareholder proposal from the collaborative investor coalition Climate Action 100+ (CA100+) that would have urged the company to adopt and disclose greenhouse gas emissions targets. The SEC ruled in Exxon's favour, but some frustrated investors said they would divest or served notice of an intention to divest by a certain date if no progress was made.

The "voting with your feet" argument is a strong one for ethical investors – it signals to the company and the wider world that companies that appear unwilling to prepare for the transition to a low carbon economy have no place in investment portfolios. US university endowments are under intense pressure from students to divest, and the debate is becoming increasingly polarised.

Oil-backed sovereign wealth funds are doubly exposed to the risks of falling asset values if they invest in oil producers.

Investors can only send this signal once – and after they have sold all their shares or bonds in a company, they can no longer influence its strategy. However, for those who argue that fossil fuels are an existential threat to life on earth this may seem a necessary step. The aim is simply to remove the social licence to operate, and the more institutions that divest, the higher the pressure on others to do so.[10]

Divestment may also make sense for other reasons – oil-backed sovereign wealth funds (SWFs) for example, are doubly exposed to the risks of falling asset values if they invest in oil producers. In 2019 Norway's SWF, the roughly US$1tn Government Pension Fund Global, which derives its wealth from North Sea oil revenues, was mandated to phase out crude oil producers, as classified by the index provider FTSE Russell, although it can keep its investments in integrated oil and gas companies for the time being.[11 12]

Insurance companies are exposed both as investors and underwriters due to the higher incidence of hurricanes, floods, wildfires and droughts.

Financial risk management is increasingly cited as a key reason for divestment – investors argue that they aren't carrying out their fiduciary duties properly if they don't reduce their exposure to assets that are at risk of stranding. They may prefer to get out now at a good price before values are written down. It is vital to address concerns over financial risk exposure. However, divesting from a whole investment class regardless of individual asset prices, rather than merely reducing exposure levels, may imply that other factors are contributing to the decision, such as reputation concerns or the desire to signal a need for policy change.

Others express concerns about the physical impacts of climate change on real assets. Insurance companies are exposed both as investors and underwriters due to the higher incidence of hurricanes, floods, wildfire and droughts.

Divestment also frees up capital to invest elsewhere – in assets that help support the low-carbon transition such as renewable energy or electric vehicles, for example. This argument is particularly attractive to big city or state pension funds as local authorities wrestle with the challenges of providing new infrastructure to accelerate the transition, such as roadside charging points for electric vehicles, while also protecting their populations from flooding or freak storms.

But buying and selling shares in companies does not necessarily erode their capital base. Most large listed oil companies do not need to raise funds from equity investors, so divesting equity is not likely to change the amount of capital they have available to invest in new projects.

Another disadvantage is that the ethical investor may have sold their shares to an investor who cares very little about global warming. As a result, climate change isn't addressed as effectively because there is less pressure on the company to do so from investors.

[10] https://www.vox.com/2019/9/18/20872112/university-california-divestment-fossil-fuel-climate-change
[11] https://www.newscientist.com/article/2206472-norway-to-sell-off-fossil-fuel-stocks-worth-more-than-8-billion/
[12] https://www.regjeringen.no/en/aktuelt/decision-on-the-definition-of-upstream-oil-and-gas-companies-in-the-gpfg/id2670931/

Engagement

Engaging with companies offers an alternative – shareholders and bondholders who seek to influence the business strategies of fossil fuel companies can help steer them towards alignment with the goals of the Paris Agreement.

Engagement also enables the savvy investor to obtain more information about a company's resilience in the event of an accelerated transition to a low carbon world. This helps them determine whether or not it is a good financial investment for the long term.

But does engagement really work? First the engager must set realistic objectives. It's very hard to engage a fossil fuel company to radically change its strategy overnight - it takes time to turn around a super-tanker. It has taken years of determined, patient and collaborative engagement for oil and gas companies such as BP and Equinor to consider putting in place a strategy consistent with the Paris Agreement. In addition, certain objectives may be unrealistic and financially damaging, such as an attempt to persuade a pure coal miner to close its coal mines and switch to solar panel manufacturing within a short timeframe.

A successful engagement should help to add value for investors over the long-term by improving the sustainability characteristics of the company, leading to more secure profitability, dividends and coupon payments.

It's also important to consider the most appropriate engagement objectives at a company. For example, companies must have good governance in the sense that they are fully aware of the risks, including around lobbying. CA100+ participants are working to ensure that companies' lobbying, including through trade associations, is aligned to their stated policy positions. It is also important that companies consider climate-related risks and disclose these to investors, for example by using the guidelines of the Task Force on Climate-related Financial Disclosures (TCFD).

However, increasingly Hermes EOS is targeting action-focused engagement objectives at the core of a company's strategy, such as asking companies to reduce greenhouse gas emissions by setting science-based targets or calling for banks like HSBC to restrict lending to coal-fired power stations.[13]

A successful engagement should help to add value for investors over the long-term by improving the sustainability characteristics of the company, leading to more secure profitability, dividends and coupon payments.

Successful climate change engagements

Notable positive outcomes at companies following collaborative engagement, supported by Hermes EOS include:

- **Anglo American** announcing greenhouse gas targets to 2030, set using a science-based methodology.
- **Centrica** announcing the ambition to help its customers reduce emissions by 25% by 2030, and to develop a path to net zero by 2050.
- **Chevron** improving disclosure of its portfolio resilience to climate change.
- **Daimler and Volkswagen** announcing the ambition or goal for all new car sales to be carbon neutral by 2040.
- **Maersk** setting the goal to reach carbon neutrality by 2050.
- **PetroChina** improving disclosure of its climate change risks and opportunities, including its plans to contribute to the goal of limiting climate change to below 2C.

Escalated engagement approaches

Most engagement takes the form of confidential one-on-one discussions with a company.

This helps develop a relationship based on mutual trust while jointly exploring solutions. However, at times it does not yield results quickly enough, particularly if management has entrenched views against progress in a particular area. In such cases, investors can employ different engagement techniques.

Collaborative engagement

This is when investors join forces to represent a larger block of shares. Often engagers will hear the refrain from a company that their view is unique: "We have not heard that concern from anyone else." However, if investors are working in a group, this notion is dispelled. CA100+, a major global initiative that aims to help limit global warming to less than 2°C, is one of the most effective collaborative engagement initiatives. Over 370 investors with some US$35tn under management are using a 'divide and conquer' strategy to ensure limited engagement resources are employed most effectively to spur change at over 100 of the world's biggest greenhouse gas emitters.

[13] https://www.ft.com/content/35ca50c2-3f54-11e9-b896-fe36ec32aece

CA100+, which aims to help limit global warming to less than 2°C, is one of the most effective collaborative engagement initiatives.

2 Public statements

These include open letters to sectors such as the utilities letter drafted by Hermes and others in late 2018 and backed by investors collectively representing US$11.5tn, and to individual companies. For example, we participated in ShareAction's co-ordinated letter-writing campaign to banks, which called for more robust and relevant climate-related disclosure to be supplied to investors.[14]

3 Annual shareholder meeting statements

We raised climate change concerns at six shareholder meetings in the 2019 voting season, putting questions to companies on behalf of our clients and CA100+. This has the advantage of allowing us to engage the whole board, raise awareness, and potentially gain press attention.

4 Voting against the company

We are supporters of the Transition Pathway Initiative (TPI), a global, asset-owner led initiative that assesses companies' preparedness for the transition to the low-carbon economy. In 2019 we introduced a guideline that we would consider recommending a vote against the re-election of the board chair or other responsible director of a company with a management ranking of 0 or 1 by the TPI, unless the company had provided a credible plan to address the climate risks and opportunities of the low carbon transition.

5 Joint statements with a company

There have been a number of these as a result of intense efforts by CA100+. For example, Royal Dutch Shell issued a joint statement with CA100+ investors in December 2018, agreeing to set short-term targets as part of a long-term ambition to reduce the net carbon footprint of its energy products. Miner Glencore issued a statement in February 2019 agreeing to set a cap on coal production, while in April, energy company Equinor committed to formulating a strategy consistent with the goals of the Paris Agreement.

6 Shareholder resolutions

These are proposals put forward by shareholders in an effort to change a company's approach. Their effectiveness varies by jurisdiction as in the US they are advisory, and investors must avoid 'micromanaging' the company. However, with careful planning, investors can succeed. For example, at Exxon in 2017, 62% of shareholders supported a resolution we had helped to co-file asking the company to publish the results of a scenario stress test of its portfolio in low carbon scenarios.

In the UK, shareholder resolutions are legally binding. At BP's 2019 AGM, a resolution that we had played a leading role in co-filing, which asked the company to set out how its strategy and capex are consistent with the goals of the Paris Agreement, passed with overwhelming support.

Two sides of the same coin?

Engagement and divestment need not be viewed as mutually exclusive.

If an investor is concerned about potential over-exposure to companies at risk from climate change, an effective strategy may be to discriminate between companies in the same sector, reducing exposure to the riskier companies, rather than selling out of the whole sector.

Keeping a reduced holding allows investors to retain a foot in the door and hold out the carrot of rewarding good behaviour with reinvestment.

Retaining a shareholding, albeit reduced in value, enables the investor to continue to engage, with the aim of achieving a positive outcome. Some investors say companies become more willing to co-operate after they have sold down some of their stake, as the company attempts to win them back. Keeping a reduced holding, in equity or credit, allows investors to retain a foot in the door and hold out the carrot of rewarding good behaviour with reinvestment.

However, it's also important for engagers to set clear targets and be disciplined enough to recognise when engagement is failing. Further escalation may then be required, which could include recommending changes to the leadership of the company. Achieving lasting change at a company requires broad shareholder support and is a reason to remain invested, rather than to divest.

[14] https://shareaction.org/investor-letter-bank-low-carbon/

A BLUEPRINT FOR A BETTER FUTURE

Engagement on the UN SDGs

The UN's Sustainable Development Goals address global challenges such as poverty, inequality, climate change, environmental degradation, prosperity and peace. What can companies do to advance these policy goals, to help build a sustainable future?

Setting the scene

The UN's 2030 Agenda for Sustainable Development sets out 17 goals and 169 underlying targets, providing a blueprint for shared prosperity in a sustainable world — one where everyone can live productive and peaceful lives. The goals call for action by all countries to promote prosperity while protecting the natural environment, and have been adopted by all UN member states.

In late September, heads of state and government gathered at the UN's headquarters in New York to review the progress towards implementing the 2030 Agenda for Sustainable Development. The event was the first UN summit on the Sustainable Development Goals (SDGs) since the adoption of the 2030 Agenda in September 2015. In some countries SDGs are widely recognised and adopted with Japan among those setting the pace, but in others progress has been slow.

The summit acknowledged that the goals were off track, and efforts should be stepped up to achieve them. Accordingly, it was a good time to take stock of our own approach to engagement on the SDGs, to reflect on our achievements to date, and set out a roadmap for 2030.

Why it matters

Why do we engage on the SDGs, when these are policy goals and not always directly applicable to companies?

Our view is that the long-term success of business is inextricably linked to that of the goals. This is because the SDGs can create an economy and society in which businesses can best thrive. According to the Business Commission[1], achieving the SDGs could create 380 million jobs and help unlock at least US$12tn in business opportunities by 2030. On the flip side, businesses need to seize market opportunities to help progress the goals rather than find themselves left behind.

Achieving the SDGs could deliver:

380M jobs

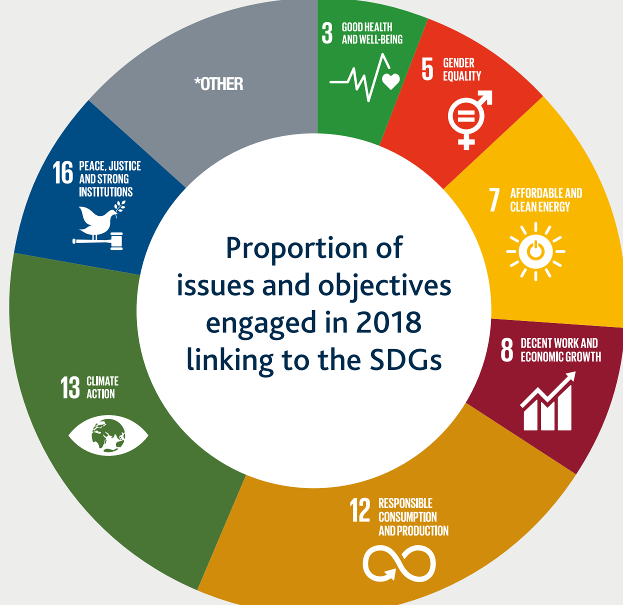
$12TN in business opportunities

For further information, please contact:

Kimberley Lewis
kimberley.lewis@hermes-investment.com

Katie Frame
katie.frame@hermes-investment.com

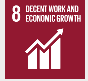
[1] http://report.businesscommission.org/report



Good health and well-being

Gender equality

Affordable and clean energy

 Decent work and economic growth

Responsible consumption and production

Climate action

Peace, justice and strong institutions

914 of the issues and objectives engaged in 2018 were linked to one or more of the SDGs

914 of the issues and objectives engaged in 2018 were linked to one or more of the sustainable development goals, this graph represents the breakdown of these links across the SDGs.

*This represents the proportion of the issues and objectives assigned to the remaining SDGs.

How we engage on the SDGs

Our stewardship work has always focused on improving the sustainability of companies in order to boost long-term wealth creation and achieve positive outcomes for society.

So in a sense, all of our engagement work is aligned to delivery of the SDGs. In particular, SDG target 12.6, which is to "encourage companies, especially large and transnational companies, to adopt sustainable practices and to integrate sustainability information into their reporting cycle", underpins much of our engagement work with companies.

When we engage on an SDG we are often seeking positive outcomes through which companies can contribute to solving problems such as inequality, poor health and climate change. There is no universally accepted standard or benchmark for reporting on the SDGs, therefore, we have developed our own approach in alignment with our engagement strategy.

Of our engagements linking to an SDG:

21% link to SDG 13, climate action

19% link to SDG 12, responsible consumption and production

We attribute a direct link between one of our engagement themes and an SDG if our engagement objectives directly support at least one of the UN's targets underpinning the relevant goal. For example, the UN states that the most urgent issue to address is climate change[2]. We have already begun to see the compounding effects of global warming, which disproportionately impact the poor. Correspondingly, we have found that SDG 13 – climate action – accounted for 21% of our engagements linking to an SDG, with SDG 12 – responsible consumption and production – a close second on 19%.

We undertake the most engagement on SDG 13 as most companies rely directly or indirectly on energy and its associated emissions in their operations and supply chains. Climate change is also a high priority engagement topic for our clients, and there is a very clear and direct link to the SDG. For similar reasons, we also see a high number of engagements linked to SDG 7 – affordable and clean energy.

To encourage companies, especially large and transnational companies, to adopt sustainable practices and to integrate sustainability information into their reporting cycle.

– SDG target 12.6

[2] https://unstats.un.org/sdgs/report/2019/The-Sustainable-Development-Goals-Report-2019.pdf

Often an engagement on climate change will link to more than one SDG. For example, engaging with an oil and gas company to encourage it to set and pursue a strategy that is consistent with the goals of the Paris Agreement directly impacts SDGs 7, 12 and 13. However, engaging with an electronics manufacturer in order that it set an absolute CO_2 reduction target is likely to only directly impact SDG 13, although we may see indirect impacts on SDGs 7 and 12. Many more SDGs will also be indirectly impacted through climate action given the strong links to poverty and inequality.

We recognise that good corporate governance is essential to the achievement of the SDGs, as a well-governed company will be better placed to address the key environmental and social issues identified by the goals. However, we do not often attribute a direct link between corporate governance and any single SDG preferring to map our environmental and social themes to the goals instead.

Engagements with companies on social topics tend to impact a broader range of SDGs. As every company is an employer, this provides an engine for advancing development agendas in areas such as equality, education, training, lifting people out of poverty and improving health and wellbeing. In this way companies can contribute to solving these challenges as part of their business models, rather than merely mitigating the impact of peripheral risks.

We recognise that good corporate governance is essential to the achievement of the SDGs, as a well-governed company will be better placed to address the key environmental and social issues identified by the goals.

For example, an engagement with a technology company encouraging it to disclose its gender pay gap and develop a plan to rectify any inequalities would directly impact SDG 5 (gender equality) and 10 (reduced inequalities). Similarly, SDGs 1, 2 and 3 would be impacted by an engagement on access to finance, nutrition and healthcare respectively. Our engagement on bribery and corruption and ethical culture is strongly linked to SDG 16 – peace, justice and strong institutions.

In addition to our corporate engagement on the SDGs, we undertake public policy work in support of individual SDGs. For example, we have engaged with the Access to Medicine and Access to Nutrition Foundations, supporting SDGs 3 and 2 respectively. Our engagement with the Living Wage Foundation supports SDG 1 (no poverty) and SDGs 8 and 10.

Whilst we would not attribute every SDG engagement to SDG 17 (partnerships for the goals), we hope that through our engagement with companies and organisations we can help to play a meaningful role in working towards the achievement of the goals.

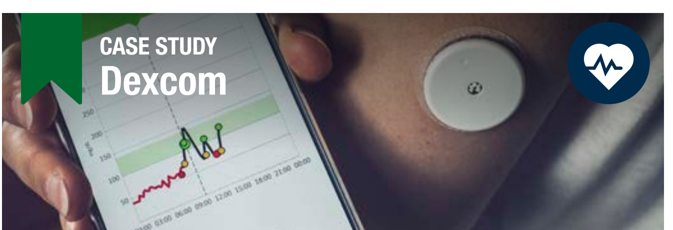
What are the benefits of doing this?

The SDGs provide a common purpose and language for investors and companies to work together on externally agreed objectives to some of the world's biggest challenges.

They also provide a clear time frame in which change needs to take place, helping to set targets and create a greater sense of urgency.

This allows us to have more robust engagement discussions, with an opportunity to engage along the value chain from supply to distribution. It opens the door to conversations in different parts of the business and different stages of the product lifecycle, as well as potentially with suppliers or customers.

More specifically, it presents us with an opportunity to expand our discussions with companies by making linkages to social and environmental issues in a business framework. For example, when engaging with an energy company we could engage on a number of issues related to achieving the SDGs, such as expansion of renewables, energy access, resource recovery or carbon capture and storage.



SDG 3 – Good health and well-being

3 GOOD HEALTH AND WELL-BEING

Dexcom Inc is a medical device company which designs and develops continuous glucose monitoring systems for people with diabetes.

It has developed a transcutaneous product that continuously measures glucose levels in subcutaneous tissue just under the skin, avoiding the need for skin pricks. Currently its latest technology is available in a limited number of markets. However, diabetes is one of the leading causes of death worldwide with about 422 million diabetics in total[3].

Given the global epidemic that diabetes has become, we urged the company to start thinking about how it could address the diabetes burden in developing markets. It indicated that it had limited capacity to expand the roll out of its G6 system to certain markets because of the high demand. However, we responded that its licence to operate mandates that it addresses lesser-served countries in its long-term business strategy.

We also suggested that in the short-term it could trial pilot programmes to begin to understand those markets, or sponsor diabetes awareness programmes to develop relationships with local country organisations. We have asked the company to think about developing an access to healthcare strategy, providing input into the substance and form of this. It is currently in the process of scaling manufacturing capacity.

[3] https://www.who.int/news-room/fact-sheets/detail/diabetes

SDGs 7, 12, 13 Clean/renewable energy opportunities

As an oil and gas major, BP is a significant greenhouse gas emitter. It is therefore important to the company's long-term future and our ability to tackle climate change that BP's strategy is consistent with the goals of the 2015 Paris Agreement.

The company demonstrated leadership on climate change in a number of important areas, with the evolution of the BP Energy Outlook... and a range of climate-related targets.

As part of the Climate Action 100+ initiative, we have been co-leading the collaborative investor engagement with BP. The company had demonstrated leadership on climate change in a number of important areas, with the evolution of the BP Energy Outlook to include a scenario consistent with the Paris goals, and a range of climate-related targets, including best-in-class management of fugitive methane emissions. However, we remained concerned that the company had not yet demonstrated that its strategy, which includes growth in oil and gas as well as pursuing low carbon businesses, is consistent with the Paris goals.

In addition, we wanted the company to explain the consequences of this strategy for its future business model and long-term investment proposition, including its ambitions, goals and targets for the energy transition. Following a lengthy period of collaborative engagement, we helped facilitate the development of a shareholder resolution calling for the company to set out a business strategy that is consistent with the goals of the Paris Agreement on climate change. It was co-filed by 9.6% of shareholders, supported by the board and subsequently passed with the support of over 99% of shareholders. We will continue our engagement with the company, seeking to ensure that BP's strategy and reporting set a good precedent for demonstrating alignment of business models to the Paris goals.

Challenges to overcome

There are, however, some challenges to overcome, not least the fact that SDG reporting is still inconsistent and limited.

Some companies retrospectively map their existing programmes and operations to the SDGs, perhaps claiming many different ways in which they deliver all the SDGs while continuing to contribute to a number of harms – sometimes known as "rainbow washing". Others take a more targeted approach, identifying future steps to take, and perhaps focusing on the achievement of only one or a few SDGs.

Through our engagement we are encouraging companies to view the SDGs as a framework to identify areas where they can make a positive impact towards the goals through their supply chain, operations, products or services, rather than simply mapping work that is already being done.

Additionally, many companies have yet to fully embrace the business case for adopting an SDG-aligned action plan. Often there is a tension around how to reconcile government responsibility and corporate action. Investors can play a role by encouraging business leaders to embrace more sustainable and inclusive models, and we will continue to use the SDG goals as a basis for these conversations.

The implementation of the SDGs is evolving, and our stewardship activity will evolve with it. As we believe in the business and social benefits of adopting this framework, we will continue to:

Engage with companies and other stakeholders to further integrate the SDGs into corporate strategies and business planning

Improve reporting against the SDGs

Focus on positive engagement, and the market opportunities that arise as a result

We are encouraging companies to view the SDGs as a framework to identify areas where they can make a positive impact towards the goals through their supply chain, operations, products or services.

Public policy

As part of the wider 2019 United Nations General Assembly held in New York in September, Hermes hosted a seminar to discuss Sustainable Development Goal 3.7. The goal is that by 2030, there will be universal access to sexual and reproductive healthcare services. During the roundtable, speakers discussed ways to address this.

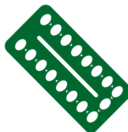
The ability to decide when or whether to have children is not only a basic human right, it is also the key to economic empowerment, especially for poorer women. But in many developing countries women still lack access to safe, modern contraception. This puts them at risk of dying due to complications related to pregnancy and childbirth, or from vaccine-preventable cervical cancer. And over a year, more than 2.5 million children will die in the first few hours and days after birth. This is in large part due to the chronic and systemic underinvestment in the health of women and girls.

In developing countries:

2.5M+ children will die each year in the first few hours and days after birth

225M women would like to delay or stop childbearing

For every dollar invested in reproductive health services:



$2.20 is saved in pregnancy-related healthcare costs

Providing women with modern forms of contraception would reduce maternal and child mortality by cutting unintended pregnancy and unsafe abortion. There is also evidence it would empower families and lead to higher household wealth due to the ability to limit the number of children. An estimated 225 million women in developing countries would like to delay or stop childbearing but are not using any form of contraception.

Investments in family planning have been shown to be highly cost effective. It is inexpensive and the return on investment is high. For every dollar invested in reproductive health services, US$2.20 is saved in pregnancy-related healthcare costs. Moreover, the longer a woman waits to have children, the longer she can participate in the paid labour force, thereby boosting the prosperity of poor communities.

Our event participants included representatives of private sector companies such as Pfizer and RB, non-profit organisations such as the RFK Human Rights Foundation, think tanks and investors, all of whom were looking for ways to collaborate to accelerate progress towards the UN goals. These included UNAIDS, Merck for Mothers, the Reproductive Health Investors Alliance, the Access to Medicines Index and Nursing Now.

The event achieved its aim of bringing together the various stakeholders needed to build public-private partnerships to help advance SDG 3.7.

The ability to decide when or whether to have children is not only a basic human right, it is also the key to economic empowerment, especially for poorer women.

A CLEARER PICTURE

Steps towards greater tax transparency

The avoidance of tax by some large multinationals has attracted a great deal of criticism, and small businesses shouldering a heavier tax burden have struggled to compete. How can investors ensure companies pay an appropriate amount of tax, in line with the spirit of local tax policy and the location of the economic value generated? By Andy Jones.

Setting the scene

While small high-street businesses have little choice but to pay corporate taxes in their home jurisdiction, there have been several high-profile cases of big international businesses engineering tax accounting to avoid paying their fair share. Starbucks[1], Apple and Vodafone are among those to have been criticised in recent years for tax avoidance[2], while banks named in the "cum-ex" scandal allegedly booked unearned reimbursements from European governments in a complex derivatives trading scheme[3]. Tax avoidance has a serious knock-on effect on society as governments are less able to fund schools, hospitals and other vital services. Pensioners also lose out from lower investment in services over their lifetimes.

Benjamin Franklin famously wrote that in this world nothing can be said to be certain except death and taxes. But in the last decade, tax avoidance by large international retailers and internet-based companies has grown. News reports of companies employing such practices have led to widespread public condemnation – and increased scrutiny from regulators.

For further information, please contact:

Andy Jones
andy.jones @hermes-investment.com

[1] https://uk.reuters.com/article/us-britain-starbucks-tax/special-report-how-starbucks-avoids-uk-taxes-idUKBRE89E0EX20121015
[2] https://www.dailymail.co.uk/news/article-4303030/The-major-firms-avoiding-corporation-tax.html
[3] https://www.theguardian.com/business/2019/sep/20/the-men-who-plundered-europe-city-of-london-practices-on-trial-in-bonn
[4] https://www.ft.com/content/43812efa-d7f4-11e9-8f9b-77216ebe1f17

In 2018 Apple paid Ireland over €14bn in back taxes as a result of a decision by the European Competition Commission. Both Apple and Ireland, which attracts companies via low tax rates to generate jobs, are appealing against the decision.[4] However, the ruling is indicative of a growing trend among regulators to ensure businesses pay their fair share of tax, and level up the playing field.

The Apple/Ireland case is an example of one method of corporation tax avoidance – national or local authorities awarding 'sweetheart deals' to individual companies to incentivise them to locate in the country. Although some citizens benefit from job creation in their region, members of society outside the labour force, such as the long-term sick or elderly, may lose out as public services are cut due to lower gross tax revenues to the treasury.

And although jobs generate employment tax revenues from individuals and higher sales tax receipts as the employed spend more, tax incentives can drive a 'race to the bottom' on national corporation tax rates.

A second method of tax avoidance is the exploitation of tax loopholes and compliance with only the letter, rather than the spirit, of the law. Identifying and exploiting loopholes and an alternative interpretation of tax law has been seen as a desirable attribute by some tax professionals and business leaders. Although the legacy of this mentality still exists, many companies have now emerged from a culture of seeing tax law as a cost that could be engineered away.

A reliance on incentives or tax havens is unsustainable in the long-term and creates additional risks for investors as well as the company.

The third key method of avoidance is known as base erosion and profit shifting: internal accounting within a business that spans different tax jurisdictions, leading to higher profits recognised in locations with lower tax rates.

In July 2019 UK retailer Sports Direct announced it had received a demand from the Belgian government for €674m in unpaid taxes.[5] The claim related to a dispute over the point-of-sale of the products, and therefore the relevant VAT to be applied. Identifying point-of-sale is a key challenge for tax authorities trying to tax internet sales, a growing issue due to the dominance of internet retailers. Should they look at the location of the purchaser, the intermediary's website, the product, the selling company or the intellectual property? Tax authorities, particularly those in Europe and the US, have called for harmonisation of international tax law relating to digital businesses to achieve global consistency and limit tax leakage.

3 key methods of corporation tax avoidance:

'Sweetheart deals' to incentivise companies to locate in the country

Exploitation of tax loopholes

Base erosion and profit shifting

€674M of unpaid taxes by Sports Direct requested by Belgian government in 2019

The Apple/Ireland and Sports Direct cases highlight a tax risk to corporations and their shareholders: is the business model resilient to increases in tax rates or changes in political sentiment on taxes paid in the past? Risks can materialise through investigations, litigation or fines. Allegations of low tax payments can also affect a company's social licence to operate, hitting its sales and profitability[6] as customers shift purchases away from businesses seen as unethical.

In accordance with directors' fiduciary duties, companies should be financially efficient and avoid paying undue tax. However, in our view opaque and aggressive tax structuring, or a high reliance on incentives or tax havens, is unsustainable in the long-term and creates additional risks for investors as well as the company.

[5] https://www.thetimes.co.uk/article/sports-direct-delays-results-over-674m-tax-demand-srmlrxdj9#
[6] https://www.independent.co.uk/news/business/news/starbucks-suffers-first-uk-sales-fall-after-tax-row-9284988.html

CASE STUDY
The banking sector

Many banks know that they need to do more on tax, and some are strengthening their policies and reporting.

Poor tax-related conduct has occurred in the banking industry in relation to client servicing. In one example banks offered investors tax benefits from investment in films, but tax authorities later ruled these were illegitimate tax avoidance schemes. Another recent example is the 'cum-ex' financial engineering scheme. In this case, staff in one bank allegedly traded shares to another just before dividends were paid, enabling both to claim withholding tax rebates on the same shares. The treasuries of several European nations, in particular Germany, Austria and Denmark are thought to have lost high sums in overpaid tax rebates.[7] A legal process against a set of primarily European banks to reclaim the funds is ongoing.[8,9]

We sent our expectations on tax policy, governance and transparency to an initial focus list of 10 banks and requested a meeting with a senior tax professional. For each bank we assessed its tax policy and annual reporting against our expectations to identify current practice and areas for improvement.

In our subsequent engagement we investigated the unreported areas of tax practice, in particular oversight, practice and controls, and made requests for improvement. Given that the conduct issues identified with the banks were related to the behaviour of customer-facing staff rather than any central tax function, we pressed the banks on their controls for tax-related conduct across the company.

We sent our expectations on tax policy, governance and transparency to an initial focus list of 10 banks.

In our discussions we found that in general the banks know they can do more, and need to do more on good tax practice, in particular around policy and reporting, and most were willing to do so. Since the start of this engagement we have seen banks publish strengthened policies.

Following our engagements with the banks, we compared the findings from the meetings with the initial assessment of their public reporting to identify the most material areas for improvement. Once these were pinpointed, we sent letters to the banks setting out specific requests for enhanced tax practice and created formal engagement objectives to track and engage on in future. We will monitor progress in the next reporting cycle and engage again where needed.

Recent progress

Austerity policies in some countries since the credit crunch have served to increase the scrutiny of government tax revenues and corporate taxes.

Expectations of corporate transparency have evolved significantly, and coupled with a rising corporate responsibility agenda and company concern over reputation, this has mitigated poor practices.

Instead, more companies are now taking a long-term view that investment in the community and the society in which they operate by paying taxes will ultimately lead to greater prosperity for the business too. For example, UK energy supplier SSE has obtained the Fair Tax Mark independent accreditation for 'paying the right amount of tax, in the right place at the right time'. Businesses benefit from the societal infrastructure paid for by taxes – education, healthcare, law and order – and therefore shareholders also benefit from companies paying an appropriate level of tax.

Given the role of tax revenues in underpinning vital social services they are potentially the single largest source of funding for the UN Sustainable Development Goals (SDGs). This is particularly the case for low-income, resource-rich economies, which historically may have seen profits expatriated to the high-income country headquarters of the licensed extractor. On average, corporate income tax alone contributes 9% of government tax revenue in OECD countries and sometimes over 15% in emerging markets[10].

However, the Extractive Industries Transparency Initiative has improved transparency in the sector around payments to governments, such as taxes and royalties, at the project level. Making a full 'economic contribution' is now a source of pride for some companies, as well as being a key factor in winning future licences.

For example, metals and mining company Rio Tinto states: "The taxes and royalties we pay to national, regional and local governments are an important part of [our integrated sustainability strategy linked to the UN SDGs], and of our contribution, enabling governments to provide essential services to communities and to invest for the future"[11].

[7] https://www.dw.com/en/cum-ex-tax-scandal-cost-european-treasuries-55-billion/a-45935370
[8] https://www.bloomberg.com/news/articles/2019-09-02/the-german-tax-case-putting-the-entire-finance-industry-on-trial
[9] https://www.ft.com/content/d1871958-d3c6-11e9-8367-807ebd53ab77
[10] http://www.oecd.org/tax/beps/corporate-tax-statistics-database.htm and https://taxfoundation.org/sources-of-government-revenue-oecd-2018/
[11] https://www.riotinto.com/documents/RT_taxes_paid_2018.pdf
[12] https://sse.com/media/540154/Talking-Tax-2018_WEB.pdf

Outside the extractives sector, telecoms provider Vodafone, which was heavily criticised for its approach to tax in the past, now has some of the most considered and transparent reporting, with a report on 'Taxation and our total economic contribution to public finances'. Meanwhile, SSE states it "has long made the case that tax is the fundamental way in which businesses contribute to the societies that enabled their business success".[12]

Given the role of tax revenues in underpinning vital social services they are potentially the single largest source of funding for the UN Sustainable Development Goals.

Our expectations

Although tax transparency has made significant gains in some sectors and geographies, in others it remains limited.

In our engagements our requests for greater transparency are often met by companies citing concerns about commercial sensitivity, the potential implications for competitiveness, or the prospect of misinterpretation by media or the public – for example in relation to legacy corporate structures in tax havens.

In our view, tax should not be an area on which companies compete and any risk of misinterpretation can be mitigated by clear and considered reporting and engagement with stakeholders. There are an increasing number of tax reports that show commendable honesty and openness. For example, Vodafone explains why parts of its corporate structure are still located in tax havens. This aids investors in making their own appraisal of tax practice and risk.

Transparency can only be achieved if it includes country-by-country reporting. This disaggregation has been mandated for banks and the extractives sectors under EU rules. Where it is not mandated, there tends to be a small minority providing this information voluntarily. In our engagements we hear companies admitting that this reporting is straightforward to do, as they already provide it to tax authorities. They add that it is something they expect to do in the near future due to stakeholder pressure, but for now they are watching peers, not wanting to be the first.

As a result of increased stakeholder expectations and reputational risk, there is now greater oversight of tax at the board level. We expect boards to understand the level of tax risk within the business and the associated risk appetite, including reputational, plus the controls in place to ensure that the defined risk appetite is adhered to. Where exposure to tax risk may be material, companies can 'stress-test' current tax arrangements against varying external factors outside management's control.

What investors can do

Tax can be a complicated area as the information asymmetry between investor and company is high and front office investor teams generally don't include tax expertise.

However, there is much investors can achieve through engagement to understand and reduce the 'tax risk' that they are exposed to, while promoting the payment of a sustainable rate of tax. To test and improve controls and accountability we engage on the three areas of policy, governance and transparency.

On policy and governance, we ask for examples of decision-making around tax and effective implementation of the tax policy, such as a transaction that was rejected for having too great a tax risk or being incompatible with the company's tax policy. There is no one-size-fits-all solution for responsible tax practice and we do not determine 'the right level' of taxes to be paid.

On transparency, investors can encourage country-by-country reporting as well as broader transparency, and praise those companies already communicating their approach clearly and comprehensively. Engagement can help understand company approaches and concerns, plus potential confidentiality issues that may limit reporting.

By driving enhancements in policy, governance and transparency in line with good practice we are working to increase internal and external accountability of taxes paid.

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 range across many key areas, including business strategy and risk management, which covers environmental, social and ethical risks. Structural governance issues are a priority too. We challenge and support management on the running of the company and management's approach to ensuring the company's long-term future. In many cases, there is minimal external pressure on the business to change. Much of our work, therefore, is focused on encouraging management to make necessary improvements.

The majority of our successes stem from our ability to see things from the perspective of the business with which we are engaging. Presenting environmental, social and governance issues as risks to the company's strategic positioning puts things solidly into context for management. The issues may 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

Circular economy and TCFD reporting

Lead engager: Sonya Likhtman

This UK alcoholic drinks producer asked us to provide an investor perspective on what its 2030 ambitions should address. The company was seeking input on what we consider to be the most material issues, where there are gaps in its current strategy, and how we expect the world to change by 2030. We emphasised the transition to a circular economy and that the company could play a role in developing innovative packaging solutions that enable re-use and reduction of waste, rather than recycling.

We reiterated that water stress and climate change were material issues that the company should address by improving its TCFD reporting, expanding its supply chain partnerships and setting emission reduction targets that are aligned to 1.5-degrees Celsius of global warming. Other issues that we raised included linking executive remuneration to the sustainability metrics that will be captured within the 2030 ambitions and expanding the responsible consumption programme to focus on measuring behaviour change. Within the latter area, we challenged the company to consider its role in contributing to solutions for addiction, mental health and homelessness.

Transformation of corporate culture

Lead engager: Michael Viehs

We discussed this European car manufacturer's upcoming sustainability day and potential ways to improve its reporting on the various supply chain initiatives in which it is participating. According to the investor relations representative, the company has launched various initiatives to improve its culture. While we welcomed this news, we reiterated that we need to see tangible evidence of a changing culture and would like to see improved reporting on these various initiatives.

Financing fossil fuels

Lead engager: Tim Goodman

We encouraged this US investment bank to seek out opportunities to reduce the demand for greenhouse gases as well as considering the risks associated with financing fossil fuels, when we spoke to a new member of the bank's sustainable finance team. Significantly, he explained that the stress test regime was an impediment to climate financing as it is insufficiently forward-looking to capture climate risks. This made it difficult for his team to identify risks in its comprehensive capital analysis and review.

We encouraged the bank not just to look at its fossil fuel risk exposures but to look for opportunities for financing to reduce the demand for fossil fuels. We also encouraged him to argue within the bank that reputational and other risks associated with fossil fuel financing would accelerate dramatically if the world's trajectory did not move towards what is needed for the Paris Agreement to succeed. Conversely, the bank would be exposed by its fossil fuel financing if it did not become better at identifying high risk companies and projects.

We reiterated that water stress and climate change were material issues that the company should address by improving its TCFD reporting, expanding its supply chain partnerships and setting emission reduction targets.

Corporate governance principles

Lead engager: Katie Frame

During a call with this US entertainment provider, it acknowledged our view that it should publish formal corporate governance principles, and understood the reasons for doing so. We understand the company perspective that it has a strong culture and does the right thing, but we said it is important that when there are problems, there are formal governance procedures in place. We believe that formal governance principles should give the board the power to fire and hire a CEO and the internal information it needs to do so. The company noted that its CEO had publicly stated that he also views this as the role of the board. Discussing its disappointing second quarter results, the company noted that it aims to be stretching in its internal forecasts, which it shares with the market, unlike most companies that publish more conservative ones. Therefore it was not as concerned as the market about missing its forecast.

Board composition and executive pay

Lead engager: Claire Gavini

In a call with the board secretary of this European building systems supplier, we discussed board composition and executive remuneration. We welcomed the internationalisation of the director profiles. The board secretary described the board as very dynamic and young, which can create attendance issues as several non-executives are executives at other quoted companies. We noted that the attendance rate remained high, however.

On remuneration, we welcomed the improvements made to the policy but encouraged the implementation of a two-year holding period for the long-term incentive plan. Our comment will be fed back to the remuneration committee chair. The relative total shareholder return criterion allows vesting for performance below median, which is partly mitigated by the demanding nature of the peer group, but we encouraged a tighter vesting schedule. Finally, we pressed for a review of the termination packages, which may be excessive. We agreed to participate in the governance roadshow in the autumn and to organise a call on human rights.

Responsible business reporting

Lead engager: Roland Bosch

We participated in a materiality assessment survey to inform the responsible business reporting of this UK bank, which will be published in 2020. Apart from promoting good governance and a strong business performance in relation to sustainability, we highlighted the importance of promoting financial inclusion, responsible and ethical lending, human capital management, and supporting the transition to a low-carbon economy.

Blog Spotlight

How to move corporate purpose forward

Hermes EOS has continued its input to the US debate on business purpose and developed a Guidance Document for directors. This sets out the value of publishing a statement of purpose, and makes practical suggestions on its content.

In August there was a welcome breakthrough when 181 CEO members of the US Business Roundtable (BRT) signed a Statement of Purpose, endorsing a stakeholder-inclusive purpose for corporations. We believe this replaces the shareholder-centric view that has dominated corporate boardrooms for four decades.

This commitment will only begin to have an impact when the boards of BRT member companies publish a statement and describe how they are going to deliver on their social purpose. A board of directors has ultimate responsibility for the long-term interests of a company and purpose should transcend CEO tenures and business cycles. By defining purpose and issuing a statement, the board asserts its role in setting the long-term priorities for the company. It should then oversee the fulfilment of the stated purpose.

Since 2016 we have requested that companies articulate a societal corporate purpose in our Corporate Governance Principles, which we send to several hundred of the largest public companies around the world as part of our efforts to improve best practice standards.

Hermes EOS serves on the advisory board of the Chief Executives for Corporate Purpose's Strategic Investor Initiative, which is focused on helping companies to articulate their corporate purpose and the long-term strategic plan to fulfil it. We are now helping to lead the statement of purpose campaign with others, including the Said Business School of Oxford University, Berkeley Law School's Business in Society Institute, and law firms in New York and London.

Read our EOS Insights posts in full at
www.hermes-investment.com/ukw/stewardship/eos-insights

Companies engaged on strategic and/or governance objectives and issues this quarter:

Global
165

United Kingdom
46

North America
39

Developed Asia
28

Emerging Markets
27

Europe
25

CASE STUDY

Hyundai Motor: Improving board composition and skill sets

Lead engager: Sachi Suzuki

Our recent case study looks at how South Korea's Hyundai Motor has improved in a number of areas, including board composition and the sustainability of its vehicles.

Meeting with the newly-appointed lead independent director in 2015, we raised concerns as to whether the independent directors displayed the requisite balance of skills and experience for a major international company. We followed this up with a series of meetings where we pressed the company to embark on an externally-facilitated board evaluation and suggested that it allow shareholders to propose candidates to the nomination committee.

Initially Hyundai Motor was reluctant to adopt the recommendations, although it did acknowledge that the board would benefit from greater diversity. We continued to press for an external board evaluation and proposed a self-assessed board director skills matrix as a first step.

We also raised our concerns about the apparent weakness in the company's sustainability performance, as revealed in a report published by CDP. With little initial improvement, we continued to question vehicle sustainability performance over the next three years, including meeting with the independent chair in 2018.

Encouragingly, in 2018 the company announced it would seek shareholder nominations for an independent director and conduct an internal board evaluation. In early 2019 a team of five external governance specialists reviewed a range of candidates suggested by shareholders for the role. The subsequent election of one of these candidates at the shareholder meeting has materially improved the relevant skills and experience. In a recent meeting with the new shareholder-nominated independent director, we were comforted by his clear understanding of shareholder concerns.

Sustainable vehicle model sales

3.8% of total sales currently

20% of total sales by 2025

Hyundai Motor has also made good progress on improving the sustainability of its vehicles, launching a number of lower emissions models. It is planning to increase its sustainable vehicle model sales from approximately 3.8% of the total to 20% by 2025. Moreover, the company has established an ESG taskforce and is considering setting a science-based target on carbon emissions.

We will continue to assess the effectiveness of the board, especially in protecting the interests of minority shareholders. Given the lack of gender diversity, we will press for the appointment of the first female board director and continue to argue for an external board evaluation. We will also monitor improvements in overall fleet emissions to ensure that the company makes progress against its peers.

Read our engagement case studies in full at
www.hermes-investment.com/ukw/stewardship/eos-insights

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 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, which may differ markedly – particularly those of companies, lawyers and accounting firms, which tend to be more active than investors in these debates.

Equator Principles consultation response

Lead engager: Andy Jones

We attended the London in-person consultation on the revised Equator Principles (EP) draft text to push for a strong and ambitious final wording. We were the only investment industry representative present and provided our perspective on effective environmental and social risk management. In our written response we again called for a strengthened set of principles. We urged the EP association and the signatory financial institutions to learn from the issues in project financing that have arisen since the last iteration, in particular the issues relating to consent by indigenous peoples regarding the Dakota Access Pipeline. We also asked that the principles incorporate latest international initiatives and good practice such as the Paris Agreement and the UN Guiding Principles on Business and Human Rights and be fit for purpose as a risk management framework for the next five-plus years.

Our key messages also included encouraging a risk-based approach to the application of the principles, regardless of project location or transaction size. As such we supported removal of the distinction between designated and non-designated countries, to remove the risk of any legalistic 'compliance with the law' approach. We also encouraged acknowledgement of the UN Declaration on the Rights of Indigenous Peoples.

We raised our concern about the lack of powers granted to boards of state-controlled companies to appoint and dismiss the chief executive.

Hong Kong Stock Exchange consultation response

Lead engager: Marcus Wilert

We submitted our response to the Hong Kong Stock Exchange's (HKEX's) public consultation on ESG reporting in July. In our response, we expressed support for the proposals to enhance issuers' disclosure of ESG activities and metrics, including outlining the responsibilities of the board. Our feedback included suggestions for how the HKEX might strengthen the proposals, such as by aligning with the TCFD and by encouraging companies to refer to the UN's Guiding Principles on Business and Human Rights. We also requested more information about how the HKEX will encourage companies to demonstrate progress over time and if it plans any enforcement of the new requirements.

Call with the Oil and Gas Climate Initiative on methane intensity targets

Lead engager: Bruce Duguid

This oil and gas industry association promotes best practice among its members on climate change-related initiatives. It confirmed that each of its members will have their own methane intensity measurement and targets, which will then be used to compile the Oil and Gas Climate Initiative (OGCI) target of 0.25% methane intensity by 2025, against a current baseline of 0.32% for upstream operations. The focus of the OGCI is on upstream oil and gas emissions, which account for the majority of the industry's emissions. There can be significant downstream gas emissions (perhaps 20% of total industry emissions) but these are not covered by OGCI members consistently.

0.25% **methane intensity target by 2025 vs baseline of 0.32%**

We established that unfortunately not every OGCI member will publish their own methane intensity target and some will report using their own methodologies, despite the OGCI's attempts to standardise. Therefore, we will engage with companies to encourage them to report annually on methane intensity emissions and publish their targets. This will enable us to benchmark individual companies' performance and drive higher standards over time.

Brazilian stewardship working group meeting

Lead engager: Jaime Gornsztejn

In the regular AMEC (Associação de Investidores no Mercado de Capitais) stewardship working group meeting in Brazil, we discussed the capital markets initiative recently launched by the government. AMEC was invited to provide input on the governance of state-controlled companies. As Brazil is applying for membership of the OECD, the group agreed that there is an opportunity to press for the adoption of the OECD Guidelines on Corporate Governance of State-Owned Enterprises. In particular, we raised our concern about the lack of powers granted to boards of state-controlled companies to appoint and dismiss the chief executive, who is usually appointed by the Brazilian president. The OECD Guidelines recommend that boards of state-controlled companies are assigned a clear mandate with ultimate responsibility for the enterprise's performance, and that they treat all shareholders equitably.

Workforce Disclosure Initiative workshop

Lead engager: Katie Frame

We attended a workshop organised by the Workforce Disclosure Initiative (WDI) to help investors and companies understand the need for workforce disclosure and how it can be improved. We communicated our position to the companies that investors need more detailed and consistent reporting on this topic as we view it as highly material to all businesses. We noted that whilst data gives us an important snapshot of company performance, the supporting narrative around this is of most value, to understand how a company is approaching specific human capital management issues.

The discussion also focused on the living wage and how investors and companies can more clearly communicate the business case for paying a living wage. We found that the key factor determining this within a company is the culture and how management views the workforce - as an asset or a cost - which is often determined by the sector or business model. We pushed the WDI to help encourage businesses to more clearly communicate how they assess the impact of human capital management practices and programmes on business performance.

Sustainable Stock Exchanges report review

Lead engager: Christine Chow

We reviewed the Sustainable Stock Exchanges (SSE) report launched in September to celebrate the 10-year anniversary of the SSE Initiative. We were pleased to see that our comments about emphasising data privacy and information security as a material issue, and the references to the Sustainability Accounting Standards Board and the Task Force on Climate-related Financial Disclosures have been included in the report. We encouraged the introduction of milestones and performance indicators when exchanges decide to implement a sustainability plan.

To operationalise implementation, we recommended further references using the UN Guiding Principles on Business and Human Rights and OECD Due Diligence Guidance for Responsible Business Conduct for supply chain management. However, we were disappointed that there was only a light touch on disclosure regarding conflicts of interests, such as how to manage the challenges of multi-class shares, which is a trend amongst exchanges to attract technology companies. We encourage more content guiding exchanges to manage the delicate balance of attracting companies and maintaining investor confidence on this topic.

UK Investment Association's remuneration principles

Lead engager: Amy Wilson

We gave input into the UK Investment Association's annually-revised remuneration principles, including making a stronger case for alternative models such as restricted shares. We were pleased to hear that investors are increasingly open to such models, for which we have advocated strongly over a number of years. We also reiterated our call for other investors to do more on gender diversity in the UK, particularly below the board level.

International Corporate Governance Network board election

Lead engager: Christine Chow

At the ICGN's 2019 AGM, Christine Chow, a representative of Hermes EOS, was elected as a member of the board. She has made initial contributions at the finance and audit meeting on directors and officers liability insurance. She was invited to help put together training materials for the ICGN education programme given her experience as a university adjunct professor, specialising in social innovation and impact investment. She was also invited to support the website redevelopment and social media strategy and to become the shareholder rights committee board liaison.

In addition to promoting members' interests in the fields of climate emergency, executive remuneration, diversity and inclusion, and human rights, she has shared the thought leadership research on AI governance produced by EOS in April 2019. The importance of AI applications was highlighted at the board committee meeting in July, and at the closing plenary session run by key leaders in the corporate governance industry. Hermes is to leverage its intellectual capital to advance the work of AI ethics started by the founding ICGN chair in June 2019.

Global Witness meeting on deforestation

Lead engager: Sachi Suzuki

The NGO Global Witness sought our insights on deforestation, based on our engagement experience on related themes. We shared information on our ongoing engagements with cattle and soy supply chains and our learnings from engagements on palm oil, both with growers and financiers. We discussed the challenges in making progress against agricultural deforestation due to the dispersed nature of the supply chain. We suggested that if deforestation was being driven by smaller, local companies, a campaign might gain more traction with investors if a clear link to financiers could be established, as well as the buyers further up the chain.

Human rights speech at Thun group conference

Lead engager: Christine Chow

At the annual meeting on financial services and human rights hosted by the Thun group of banks, we spoke on the emerging human rights risks caused by digitalisation, big data and artificial intelligence (AI). We outlined our expectations on responsible AI based on the paper we published in April 2019, and provided comments on positive applications in compliance, access to finance, and monitoring human trafficking and money laundering activities. We highlighted the risk of discrimination through the use of AI in conversational banking, targeted marketing and hiring. We shared insights into methods to address these risks. The chair of the OECD responsible business conduct working group would like to include AI and human rights as a topic at the next UN Forum of Business and Human Rights and asked us to contribute. We promised to consider this.

Ministry of Economy, Trade & Industry, Japan

Lead engager: Sachi Suzuki

In a group meeting organised by a regional corporate governance association, we were pleased with the revision of Japan's merger and acquisition guidelines, which now cover cases where the parent company acquires a subsidiary.

Although they are not legally binding, they are expected to have a substantial impact as the guidelines have been referenced by the court. Given that Japanese company boards, particularly those with statutory auditors, have traditionally played executive roles with little monitoring function, we welcomed the Corporate Governance Guidelines published by Japan's Ministry of Economy, Trade and Industry (METI), setting out the view that any style of board needs to play a monitoring role.

We expressed our concerns about METI's view that strategic shareholdings with an economic value do not need to be dissolved. Some companies have told us that they are made to hold customers' shares in order to do business with them, so we said these holdings may be justified by companies as having an economic benefit. Lastly, we discussed the issue of disclosure of financial statements around AGMs. Companies are required by the Companies Act to publish a business report before the AGM, but the audited annual securities report, which contains more detailed information, is typically published after the AGM. While METI understands the investor view that the two reports should be integrated and published before an AGM, it appeared reluctant to change the practice immediately.

VOTING

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

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

VOTING OVERVIEW

Over the last quarter we made voting recommendations at 1,297 meetings (11,181 resolutions). At 640 meetings we recommended opposing one or more resolutions. We recommended voting with management by exception at 8 meetings and abstaining at 4 meetings. We supported management on all resolutions at the remaining 645 meetings.

Global

We made voting recommendations at **1,297** meetings (**11,181** resolutions) over the last quarter.

- Total meetings in favour **49.7%**
- Meetings against (or against AND abstain) **49.3%**
- Meetings abstained **0.3%**
- Meetings with management by exception **0.6%**

Europe

We made voting recommendations at **114** meetings (**981** resolutions) over the last quarter.

- Total meetings in favour **51.8%**
- Meetings against (or against AND abstain) **48.2%**

United Kingdom

We made voting recommendations at **156** meetings (**2,243** resolutions) over the last quarter.

- Total meetings in favour **60.9%**
- Meetings against (or against AND abstain) **35.9%**
- Meetings abstained **0.6%**
- Meetings with management by exception **2.6%**

Emerging & Frontier Markets

We made voting recommendations at **780** meetings (**6,086** resolutions) over the last quarter.

- Total meetings in favour **50.8%**
- Meetings against (or against AND abstain) **48.8%**
- Meetings abstained **0.1%**
- Meetings with management by exception **0.3%**

Developed Asia

We made voting recommendations at **86** meetings (**629** resolutions) over the last quarter.

- Total meetings in favour **51.2%**
- Meetings against (or against AND abstain) **48.8%**

North America

We made voting recommendations at **133** meetings (**1,094** resolutions) over the last quarter.

- Total meetings in favour **24.8%**
- Meetings against (or against AND abstain) **72.2%**
- Meetings abstained **1.5%**
- Meetings with management by exception **1.5%**

Australia & New Zealand

We made voting recommendations at **28** meetings (**148** resolutions) over the last quarter.

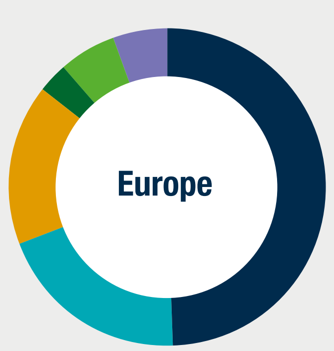
- Total meetings in favour **64.3%**
- Meetings against (or against AND abstain) **35.7%**

Source: Hermes EOS

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

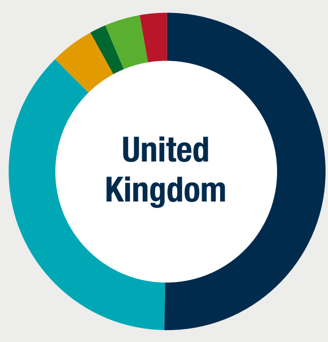
We recommended voting against or abstaining on **1,659** resolutions over the last quarter.

- Board structure **48.3%**
- Remuneration **21.2%**
- Shareholder resolution **2.1%**
- Capital structure and dividends **13.2%**
- Amend Articles **5.4%**
- Audit and Accounts **4.0%**
- Investment/MandA **0.4%**
- Poison Pill/Anti-Takeover Device **0.2%**
- Other **5.2%**



We recommended voting against or abstaining on **167** resolutions over the last quarter.

- Board structure **49.7%**
- Remuneration **19.8%**
- Capital structure and dividends **16.2%**
- Amend Articles **3.0%**
- Audit and Accounts **6.0%**
- Other **5.4%**

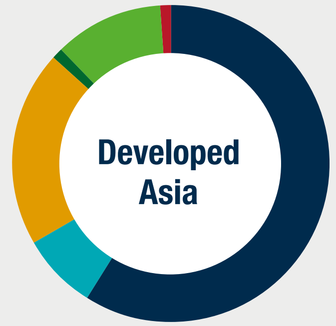


We recommended voting against or abstaining on **113** resolution over the last quarter.

- Board structure **50.4%**
- Remuneration **37.2%**
- Capital structure and dividends **4.4%**
- Amend Articles **1.8%**
- Audit and Accounts **3.5%**
- Poison Pill/Anti-Takeover Device **2.7%**

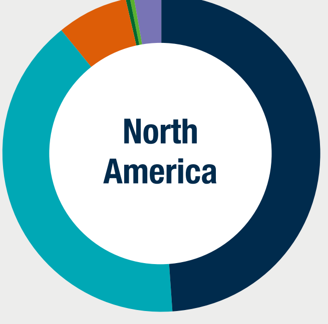
We recommended voting against or abstaining on **1,039** resolutions over the last quarter.

- Board structure **47.1%**
- Remuneration **16.0%**
- Shareholder resolution **1.6%**
- Capital structure and dividends **16.2%**
- Amend Articles **7.7%**
- Audit and Accounts **3.9%**
- Investment/MandA **0.6%**
- Other **6.9%**



We recommended voting against or abstaining on **90** resolutions over the last quarter.

- Board structure **58.9%**
- Remuneration **7.8%**
- Capital structure and dividends **20.0%**
- Amend Articles **1.1%**
- Audit and Accounts **11.1%**
- Poison Pill/Anti-Takeover Device **1.1%**



We recommended voting against or abstaining on **232** resolutions over the last quarter.

- Board structure **49.1%**
- Remuneration **40.1%**
- Shareholder resolution **7.3%**
- Amend Articles **0.4%**
- Audit and Accounts **0.4%**
- Other **2.6%**

We recommended voting against or abstaining on **18** resolutions over the last quarter.

- Board structure **27.8%**
- Remuneration **55.6%**
- Shareholder resolution **5.6%**
- Capital structure and dividends **5.6%**
- Amend Articles **5.6%**

Source: Hermes EOS

About 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 like-minded investors creates a strong and representative shareholder voice and makes our company engagements more effective. We currently have £634.1/€716.8/US$781.4 billion* in assets under advice.

Hermes has one of the largest stewardship resources of any fund manager in the world. Our 32-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[1] 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:
Dr Hans-Christoph Hirt, Head of Hermes EOS
Hans-Chistoph.Hirt@hermes-investment.com

*As of 30 September 2019
[1] https://www.hermes-investment.com/ukw/wp-content/uploads/sites/80/2018/03/final-responsible-ownership-principles-2018.pdf

HERMES EOS TEAM

Engagement

Dr Hans-Christoph Hirt
Executive Director, Head of Hermes EOS

Dr Emma Berntman
Sectors: Consumer & Retail, Pharmaceuticals & Healthcare

Roland Bosch
Sector lead: Financial Services

Dr Christine Chow
Team lead:
Asia & Emerging Markets
Sector lead: Technology

George Clark
Voting and Engagement Support

Michael Dieschbourg
Head of Stewardship and Responsibility North America

Bruce Duguid
Director, Head of Stewardship, Hermes EOS

Katie Frame
Sectors: Consumer & Retail, Pharmaceuticals & Healthcare, Technology

Claire Gavini
Sectors: Consumer & Retail

Tim Goodman
Sector lead:
Oil & Gas

Jaime Gornsztejn
Sector lead: Industrials & Capital Goods

Bram Houtenbos
Voting and Engagement Support

Andy Jones
Team lead: Europe
Sector lead: Mining

Lisa Lange
Sectors: Automotive, Financial Services, Technology

Pauline Lecoursonnois
Sectors: Consumer & Retail, Industrials & Capital Goods

Kimberley Lewis
Sector lead: Pharmaceuticals & Healthcare

Sonya Likhtman
Sectors: Consumer & Retail, Mining, Pharmaceuticals & Healthcare

Claire Milhench
Communications & Content

James O'Halloran
Director of Business Management, Hermes EOS

Marija Rompani
Sectors: Consumer & Retail, Pharmaceuticals & Healthcare

Hannah Shoesmith
Sectors: Consumer & Retail, Financial Services, Technology

Nick Spooner
Sector lead:
Utilities

Sachi Suzuki
Sector lead: Automotive

Marcus Wilert
Sectors: Consumer & Retail, Financial Services, Technology

Amy Wilson
Sector lead:
Consumer & Retail

Janet Wong
Sectors: Technology and Financial Services

Tim Youmans
Team lead: North America
Sectors: Financial Services, Industrials & Capital Goods, Technology

Client Service and Business Development

Amy D'Eugenio
Director, Head of Client Service and Business Development, Hermes EOS

Alexandra Danielsson
Client Service

Rochelle Giugni
Client Service and Business Development

Charlotte Judge
Communications & Marketing

Marwa Maan
Client Service

Alice Musto
Client Service

HERMES INVESTMENT MANAGEMENT

We are an asset manager with a difference. We believe that, while our primary purpose is to help savers and beneficiaries by providing world class active investment management and stewardship services, our role goes further. We believe we have a duty to deliver holistic returns – outcomes for our clients that go far beyond the financial – and consider the impact our decisions have on society, the environment and the wider world.

Our goal is to help people invest better, retire better and create a better society for all.

Our investment solutions include:

Private markets
Infrastructure, private debt, private equity, commercial and residential real estate

High active share equities
Asia, global emerging markets, Europe, US, global, small and mid-cap and impact

Credit
Absolute return, global high yield, multi strategy, unconstrained, real estate debt and direct lending

Stewardship
Active engagement, advocacy, intelligent voting and sustainable development

Offices

London | Denmark | Dublin | Frankfurt | New York | Singapore

Why Hermes EOS?

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.

Contact information

Hermes EOS

Dr Hans-Christoph Hirt Hans-Christoph.Hirt@hermes-investment.com

For more information, visit **www.hermes-investment.com** or connect with us on social media:

For professional investors only. The activities referred to in this document are not regulated activities. This document is for information purposes only. It pays no regard to any specific investment objectives, financial situation or particular needs of any specific recipient. Hermes Equity Ownership Services Limited ("HEOS") and Hermes Stewardship North America Inc. ("HSNA") do not provide investment advice and no action should be taken or omitted to be taken in reliance upon information in this document. Any opinions expressed may change. This document may include a list of clients. Please note that inclusion on this list should not be construed as an endorsement of HEOS' or HSNA's services. HEOS has its registered office at Sixth Floor, 150 Cheapside, London EC2V 6ET. HSNA's principal office is at 1001 Liberty Avenue, Pittsburgh, PA 15222-3779. Telephone calls will be recorded for training and monitoring purposes.

EOS000484 0007305 10/19