PUBLIC ENGAGEMENT REPORT

Controversial cobalt – Supply chain management of the other conflict mineral

Q1 2018

HERMES
EOS

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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 Q1 2018.

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

Engagement by region

Over the last quarter we engaged with 190 companies on 495 environmental, social, governance and business strategy issues and objectives. Our holistic approach to engagement means that we typically engage with companies on more than one topic simultaneously.

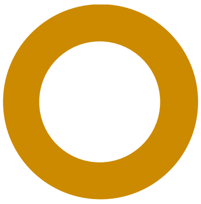
Global

We engaged with **190** companies over the last quarter.

- Environmental **21.4%**
- Social and ethical **24.0%**
- Governance **33.7%**
- Strategy, risk and communication **20.8%**

Australia and New Zealand

We engaged with **one** company over the last quarter.



- Strategy, risk and communication **100.0%**

Developed Asia

We engaged with **34** companies over the last quarter.

- Environmental **15.3%**
- Social and ethical **21.4%**
- Governance **35.7%**
- Strategy, risk and communication **27.6%**

Emerging and Frontier Markets

We engaged with **37** companies over the last quarter.

- Environmental **25.5%**
- Social and ethical **25.5%**
- Governance **29.1%**
- Strategy, risk and communication **20.0%**

Europe

We engaged with **43** companies over the last quarter.

- Environmental **16.7%**
- Social and ethical **23.5%**
- Governance **41.2%**
- Strategy, risk and communication **18.6%**

North America

We engaged with **49** companies over the last quarter.

- Environmental **25.6%**
- Social and ethical **26.4%**
- Governance **26.4%**
- Strategy, risk and communication **21.5%**

United Kingdom

We engaged with **26** companies over the last quarter.

- Environmental **23.8%**
- Social and ethical **22.2%**
- Governance **41.3%**
- Strategy, risk and communication **12.7%**

Engagement by theme

A summary of the 495 issues and objectives on which we engaged with companies over the last quarter is shown below.

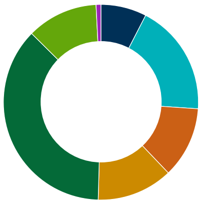
Environmental

Environmental topics featured in **21.4%** of our engagements over the last quarter.

- Climate change **68.9%**
- Forestry and land use **1.9%**
- Pollution and waste management **10.4%**
- Supply chain management **13.2%**
- Water **5.7%**

Social and ethical

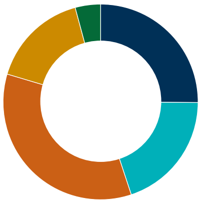
Social topics featured in **24.0%** of our engagements over the last quarter.



- Bribery and corruption **7.6%**
- Conduct and culture **18.5%**
- Diversity **11.8%**
- Human capital management **12.6%**
- Human rights **37.0%**
- Labour rights **11.8%**
- Tax **0.8%**

Governance

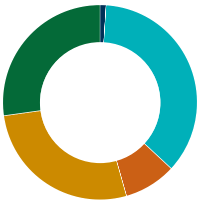
Governance topics featured in **33.7%** of our engagements over the last quarter.



- Board diversity, skills and experience **25.1%**
- Board independence **19.8%**
- Executive remuneration **34.7%**
- Shareholder protection and rights **16.2%**
- Succession planning **4.2%**

Strategy, risk and communication

Strategy and risk topics featured in **20.8%** of our engagements over the last quarter.



- Audit and accounting **1.0%**
- Business strategy **35.9%**
- Cyber security **8.7%**
- Integrated reporting and other disclosure **27.2%**
- Risk management **27.2%**

Environmental

Beyond extractives – Expanding the engagement on climate change

We are enhancing our dialogue on climate change and are moving the conversation beyond the extractive industries.

Setting the scene

Extreme weather events, from the 2017 hurricane season to droughts, one of which is threatening Cape Town with becoming the world's first modern city to run out of water, have guaranteed that climate change remains in the news. These physical climate-related risks threaten the well-being of societies, as well as the growth and stability of the global economy. In addition, investors worry about transition risks and potential litigation, as regulation and disruptive technologies drive the move to a low-carbon economy. The transition risk is more likely to affect poorly prepared companies in exposed sectors. Since the 2015 Paris Agreement on climate change, pressure on governments and companies by institutional investors alike has therefore been increasing to implement the deal and ensure a smooth transition. To ensure alignment with the 2°C target of the Agreement, efforts to cut carbon emissions have to date concentrated on the most polluting sectors.

Engagement with extractive companies

We have long been pressing companies in the oil and gas sector to undertake low-carbon scenario analyses and report in their annual reports, and more recently in their financial filings, on the resilience of their portfolios of assets to the effects of climate change and their preparation for this. The industry's products are the largest cause of greenhouse gas emissions and the required energy transition will have a fundamental effect on the sector, which is why it has been the focal point of the efforts to combat climate change.

Our engagement focuses on ensuring that companies effectively manage the risks and opportunities arising from climate change through appropriate board-level oversight, strategic risk appraisal and target-setting. Companies need to align their business models to the low-carbon economy in order to not only survive, but thrive, through the transition. This is likely to mean a managed decline of investment in fossil fuels, potentially accompanied by investment in low-carbon alternatives or other diversification strategies. In addition, we ask companies to manage the physical risks arising from climate change, including issues such as water stress. To support the implementation of low-carbon policies, long-term investors also want to see an alignment of the public positions and lobbying activities of companies with those of their owners.

As part of our engagement efforts on climate change, we led the co-filing process of a shareholder resolution at US oil major Chevron in 2016 and 2017, the latter which we withdrew tactically after the company published its first-ever climate change report following dialogue with us ahead of its AGM. We also had significant engagements with oil companies BP, ConocoPhillips, Eni, ExxonMobil, Petroleo Brasileiro, Petróleos Mexicanos, Repsol, Shell and Total. Under the auspices of the Aiming for A coalition of investors, we coordinated the filing of shareholder resolutions at mining companies Anglo American, Glencore and Rio Tinto in 2016, requesting further disclosure of their carbon risk reporting and management.

Changes

Due to our engagement and the pressure coming from other institutional investors, we have seen significant change in the extractive industries, above all more openness towards our dialogue on this matter and an increased awareness of the importance of addressing the risks and opportunities related to climate change. Several companies have now conducted portfolio resilience analyses against the 2°C scenario outlined by the 2015 Paris Agreement on climate change, have committed to renewables and are shifting away from oil towards gas. We continue to press them to follow industry best practice.

Furthermore, we have been encouraging companies in sectors to which climate change is a particularly material threat to follow the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) in their reporting on the risks and opportunities they face from climate change.

Positively, some companies have substantially changed their disclosure. The 2017 AGM season marked the first year of new climate change risk reporting requirements for Anglo American, Glencore and Rio Tinto, following the passing of our shareholder resolutions the year before. The resolution prompted Rio Tinto to publish its approach to managing climate change risks. Anglo American meanwhile published its energy efficiency targets and included greenhouse gas reduction targets in its executive remuneration scorecard. And a number of companies, such as Glencore, have set and published greenhouse gas emission reduction targets for the first time following our engagement.

Climate Action 100+

In 2017, we joined the Climate Action 100+ initiative, a globally coordinated engagement initiative focused on the top 100 most strategically important greenhouse gas emitters, based on a methodology by the CDP initiative that combines scope 1, 2 and 3 emissions. The initiative's coalition of investors will push for more standardised disclosures, based on the TCFD's recommendations. In addition to enhanced transparency, the objectives of this initiative are to encourage companies to implement a strong governance framework and take action to reduce greenhouse emissions.

We have already started to put Climate Action 100+ on the agenda of our engagements with companies, for example, at the AGM of Siemens in January 2018, where we demanded enhanced dialogue between the company's board and investors on climate change-related issues. We will continue to do so in the run-up to and at the AGMs of companies globally, including at Chevron and ExxonMobil in the US. As part of the initiative, we are leading engagements at various European and Asian companies and supporting others across all regions of the world.

New areas of engagement

In relation to our engagement on climate change, we focus on three angles, namely the supply of fossil fuels, the demand for them and on so-called facilitators or enablers. Due to the vast surplus of accessible fossil fuels, limiting supply as a means to reducing demand for fossil fuels is unlikely to work. The real challenge is how to limit demand for fossil fuels. But even in relation to the demand for fossil fuels there is only so much that can be achieved, such as greater energy efficiency of products. It is therefore important for investors to not unduly focus on fossil fuel companies as the sole cause of, or solution to, tackling climate change.

Although Climate Action 100+ is still tilted towards the most carbon-intensive companies, as part of the initiative, we are expanding our engagements with companies beyond the oil, gas and mining sectors to include businesses in the consumer goods and retail, financial services, technology and industrials sectors.

As the automotive industry has a crucial role to play in cutting emissions and other pollutants, in line with tighter environmental regulations, we have encouraged car manufacturers to develop a sound roadmap for sustainable vehicle models. We want them to set out a strategy designed to reduce fleet emissions and publicly back policies that support emissions reduction over time. We will, for example, ask Volkswagen to act more decisively on climate change and ask for enhanced climate change-related dialogue with investors at the company's AGM in May 2018.

Facilitators

The newest part of our engagement is dialogue with facilitators, such as financial services and technology companies. These could prove to be game-changers. We believe that technology companies such as Alphabet can have more leverage on the climate change debate than, for example, the US government. Investment in digitisation and artificial intelligence can improve operational efficiency and thus reduce greenhouse gas emissions. Technology companies could introduce smart energy management systems, for example, to manage domestic heating, while financial services companies could decide to provide funding only to low-carbon projects.

Companies such as utility National Grid have begun to explore the application of artificial intelligence in the UK's energy market. Algorithms could more accurately predict demand patterns and help balance the national energy system more efficiently.

We set similar objectives for technology companies in relation to climate change than we do for businesses in other sectors. These relate to good management, for example, a commitment to 100% renewable power, action and alignment with strategic goals and the reporting on their efforts.

We have also expanded our dialogue with financial services companies on the risks they face with regard to the funding of projects and lending to various sectors and regions. We strongly encourage them to report against the TCFD recommendations. Positively, we have seen financial commitments by several banks to green opportunities, such as JPMorgan, which has committed $200 billion worth of environmental finance by 2025.

Deforestation

Furthermore, we will increasingly focus on reducing carbon emissions in the supply chains of consumer goods and retail companies, paying particular attention to meat and palm oil, given their links to changes in land use and deforestation. To this extent, we are part of a collaborative engagement group of the Principles for Responsible Investment on cattle-linked deforestation, which focuses on companies that have direct and indirect exposure to deforestation driven by cattle, soy, timber/pulp and paper.

Methane

With regard to the oil and gas sector, our focus has shifted to methane emissions. Methane has far greater greenhouse gas effects than CO_2 over a 20-year time horizon and a leakage rate of 2.8% is sufficient to eliminate the greenhouse gas benefits achieved through the switch from coal to gas-fired power generation over a 20-year period, according to the Climate and Clean Air Coalition's Oil and Gas Methane Partnership. We have therefore urged companies in the oil and gas sector to measure, report and reduce methane leakage rates in accordance with industry best practice, as part of their wider greenhouse gas reduction strategies.

Some oil and gas companies have already pledged to near zero methane emissions and to eliminating the flaring of fugitive emissions by 2030, in line with the World Bank's target. However, we acknowledge that unless the right infrastructure is in place, the practice of flaring is better than methane escaping into the atmosphere.

Overall, we are pushing companies to diversify their product range and services to best protect themselves against the risks from climate change and make use of any arising opportunities.

Public policy engagements

At the same time as broadening our engagements with companies on climate change, we continue to advocate for strong policies on climate change at the national, regional and global level.

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Social

Controversial cobalt – Supply chain management of the other conflict mineral

We have been calling for transparency in the cobalt supply chain in our engagement with companies and other stakeholders.

Setting the scene

Cobalt, a by-product of copper, is an essential component of rechargeable lithium-ion batteries that are used in smart phones, laptops and electric vehicles. Demand for the mineral is therefore expected to continue to grow strongly for the next 10 years. However, the mining of cobalt has been controversial. More than half of the world's cobalt is mined in the Democratic Republic of Congo, and approximately 20% of it stems from artisanal mines where it is mined by hand by an estimated 110-150,000 people, including children, often without any protective clothing and only with basic tools in return for small wages. A 2016 report by Amnesty International accused major electronics companies of failing to undertake basic checks to ensure that the cobalt ending up in their products does not involve child labour.

While some companies have begun working on a substitute for the highly sought after cobalt, in reality developments are several years away. This means that for the foreseeable future, cobalt will remain a necessity in the production of lithium-ion batteries and demand stay robust. Improving the transparency and traceability of the cobalt supply chain is therefore crucial.

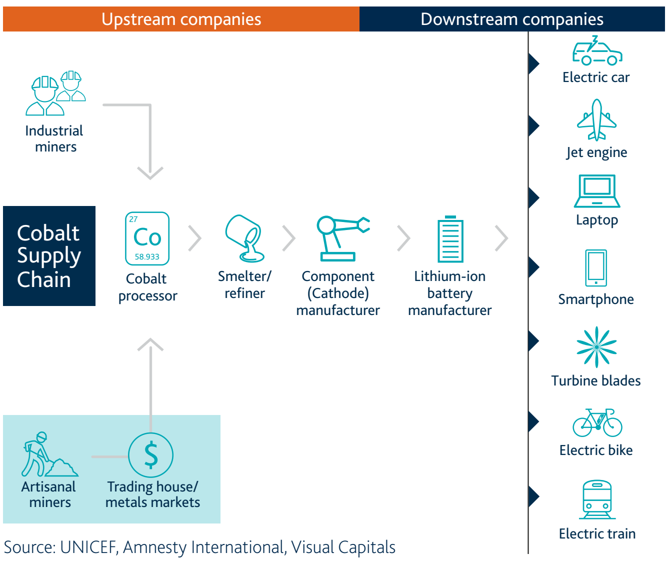
Regulation

At present regulations, such as the Dodd-Frank Act in the US, as well as the upcoming 2021 EU Conflict Minerals Regulation, only cover the conflict minerals of tin, tungsten, tantalum and gold.

However, the 2015 UK Modern Slavery Act, which applies to all companies conducting any part of their business in the UK and with a certain threshold of global gross revenue, requires firms to publish an annual slavery and human trafficking statement that verifies the different stages in their supply chain and to confirm that none of their suppliers are involved in slavery. This includes identifying where and how cobalt in their products was mined.

A significant proportion of cobalt from the Democratic Republic of Congo (DRC) is sold to Chinese traders and smelters. The region's largest cobalt buyer is Congo Dongfang International, an ancillary of Zhejiang Huayou Cobalt, a processing company that supplies the mineral to the majority of battery manufacturers globally. The batteries then enter the supply chains of consumer electronics companies but the origin of the cobalt and whether child labour was part of the mining process is often several layers removed from the buyer.

Cobalt supply chain



Source: UNICEF, Amnesty International, Visual Capitals

At this point it is important to note that a study by the Center for Effective Global Action on Artisanal Mining, Livelihoods and Child Labor in the Cobalt Supply Chain of the Democratic Republic of Congo found that while disengaging from artisanal mining could decrease the prevalence of child labour, it could also increase it due to lower household incomes. We acknowledge the possibility that avoiding the employment of children could be detrimental to the communities. In addition, not all mines can be automated and some form of human labour will continue to exist there. We believe that if companies start purchasing from mechanised mines only, they ought to, for example, contribute to the monitoring of the benefits provided to the communities where they have supply chain operations.

The new mining code introduced in the DRC requires all artisanal mines to be part of a cooperative. However, the code may also have its downsides, such as the payment of royalties to the government.

In 2016, NGO Amnesty International exposed how batteries used in the products of major electronics and electric vehicle companies could be linked to child labour in the DRC. In its follow-up Time to Recharge report from November 2017, the NGO accused the companies of still not doing enough to prevent human rights abuses in their cobalt supply chains. It found that while a handful of companies have made progress, others have yet to take even basic steps, such as investigating their supply links in the DRC. Continued failure to improve the transparency of their operations in the move towards an ethical supply chain for cobalt exposes companies to considerable reputational and potentially financial harm.

Engagement

Investors increasingly realise the need for action to address human rights abuses. As there will always be other buyers in the market, simply refusing to buy unethical cobalt from the DRC is unlikely to solve this complex problem. We believe that all stakeholders in the cobalt supply chain management business need to work together to identify and address the challenges in the mining of the mineral and help the communities adversely impacted by the activities.

In our engagements, we have called for transparency in the audit process, a wider range of metrics that go beyond smelters and more granular information about the individual mines to be able to address human rights issues, such as forced and child labour. As companies often lack the experience and resources to conduct human rights due diligence at the mine level, we advocate closer collaboration with local governments and communities and the support of platforms that facilitate the sharing of costs and expertise.

We have spoken to the first tier suppliers of the companies concerned, including battery and product manufacturers, and approached the industry association responsible for setting up the Conflict-Free Smelter Initiative audit, the Electronic Industry Citizenship Coalition (EICC), now called the Responsible Business Alliance (RBA), in order to work collaboratively with companies on the responsible sourcing of cobalt.

Car manufacturers were relatively late to the discussion on cobalt although some have since mapped out their supply chains. We will continue our engagement with these, in particular as car batteries contain much more cobalt than smart phones, approximately 15 pounds versus the eight grammes of the latter.

Progress

Encouragingly, more companies now include cobalt in their definition of conflict minerals. We have also seen some progress on transparency, for example at Huayou Cobalt, Apple and Samsung SDI, which have demonstrated that it is possible to map supply chains in the DRC.

After receiving complaints about child labour in its supply chain, US technology company Apple, for example, updated its supplier responsibility standard in January 2017. It now references cobalt as a mineral that requires supplier due diligence. All of Apple's suppliers must therefore have a due diligence policy consistent with the OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas. Furthermore, all mineral processors in its supply chain, including smelters and refiners, are required to trace their supplies back to the mining companies or sites.

Multinational materials technology company Umicore meanwhile sets an example by sourcing only ethically mined cobalt from the DRC, with its entire supply chain fully traceable and certified.

Good due diligence processes are becoming increasingly important as companies try to secure long-term contracts for the supply of cobalt amid industry fears of a shortage driven by the increasing demand for electric vehicles.

Circular economy

We have also been encouraging companies to adopt the concept of a circular economy by re-using minerals, such as cobalt, that have already gone through the human rights due diligence cycle, to reduce waste and costs and lower the demand for limited natural resources.

Initiatives

To increase the impact of our engagement, we have also been involved in dialogue with other stakeholders.

We have long been engaging with the EICC on the ethical sourcing of raw materials. We therefore welcomed the announcement by the EICC at a stakeholder outreach meeting that it would go beyond the conflict minerals mandated by the Dodd-Frank Act to include cobalt from the DRC. We were also encouraged by its launch of the Responsible Raw Materials Initiative (RMI), which focuses on developing a more robust supplier audit for consumer electronics and auto companies, covering cobalt and other conflict minerals.

Equally positive was the establishment of the Responsible Cobalt Initiative (RCI), which focuses on upstream engagements with local communities in the DRC, to help the industry conduct due diligence in line with the OECD guidance, and eradicate child labour in the DRC.

At the EICC board meeting and outreach seminar in Brussels in 2017, we called for a project platform among the existing initiatives to direct funding to a range of coordinated due diligence and community building activities aimed at tackling child and forced labour issues. We believe that funding should focus less on projects and more on topics and needs – such as education, healthcare, access to information – in order for a holistic programme on the cobalt supply chain to work effectively and cost efficiently.

In March 2018, we attended the RMI webinar where representatives from the OECD, RCS Global's Better Sourcing Initiative and car manufacturer Ford, gave an update on supply chain audit transparency and related capacity building activities. The OECD has an ongoing programme with the governments of the DRC and China on improving audit standards and met the Chamber of Commerce of Metals, Minerals and Chemicals Importers and Exporters (CCCMC), a unit of China's Ministry of Commerce, for the first time in 2016 to discuss the application of its due diligence guidance in a Chinese context specifically for cobalt. The Better Sourcing Initiative deploys field agents who use smart phone applications to provide audit checks onsite to improve the supply chain transparency outside of scheduled audits. It is also working with a local NGO to improve community access to education and health, in line with our recommendations.

Blockchain

We believe that technologies may provide an effective solution in the move towards increased transparency in the cobalt supply chain. The use of a decentralised online database in the form of a distributed ledger such as blockchain, for example, enables supply chains to be monitored from the bottom up instead of the top down audit approach that is in place at the moment.

Blockchain is already used in the diamond industry. Gems are given a digital fingerprint that is tracked by blockchain technology as they are sold, giving a forgery-proof record of where the stones have come from. The cobalt supply chain is far more complex but the developers of a pilot programme hope blockchain can track at least some of the stages that are a major worry for end users and indicate whether the minerals are conflict- and child labour-free without exposing the supply chain information of individual companies, thereby enabling them to retain a suitable level of privacy and competitive advantages.

At the 2018 OECD Forum on Responsible Mineral Supply Chains in April 2018, we participated in multiple discussions on how to improve data and analytical tools in the management of supply chains, which includes bottom-up agent feedback and blockchain technology.

Although the success of blockchain in the cobalt supply chain depends on many factors, we are confident that the involvement of the technology will bear fruit at some point.

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Governance

Separating the wheat from the chaff – How to deal with dominant founders and families

As part of our engagement programme, we talk to various family- or founder-controlled companies.

Setting the scene

The crisis engulfing US social media giant Facebook, after investigations revealed that the company had passed on data of its users, is just the latest in a series of negative headlines involving founder- or family-controlled companies. The strong influence of their owners or founders has also caused controversies at Murdoch-owned media companies News Corp and Twenty-First Century Fox, e-commerce conglomerate Alibaba, India's Tata Group, Brazilian meat-processing company JBS and car manufacturer Volkswagen. Even at family-controlled companies with a large number of independent directors things can go downhill. At Swiss chemical company Sika, for example, the sale of the founder's shares to French manufacturing company Saint-Gobain resulted in a takeover battle and the departure of its CEO.

Pros and cons

While a dispersed ownership model, with institutional investors making up a large part of the shareholders, prevails in the UK, in other regions, such as continental Europe or Asia, companies with dominant founders or families are more common. In particular it tends to be technology companies that are still founder-led, such as Alibaba, Alphabet, Facebook, NetEase and Tencent and formerly Microsoft.

Founders and families can have a positive impact on company culture. Businesses that are controlled by or have dominant founders or families tend to possess a strong, long-term, as well as employee-orientated, culture with good benefits. For long-term investors, their stability and sustainability are particularly attractive. Concerns typically tend to be about their pyramid structure, concentrated decision-making, board composition and lack of refreshment thereof and, most crucially, their succession planning. Related party transactions and high-profile conflicts that can have consequences for minority shareholders can be equally worrying. While we accept that these companies are different and the arrangements they have in place may differ from best practice, we have some minimum expectations in terms of their board composition and succession planning.

Succession planning

Succession planning tends to be the biggest risk facing family-or founder-owned companies as founders do not live forever and their direct influence stops at some point, in particular as industries and sectors evolve. Companies therefore need to put in place the appropriate governance structures to ensure a smooth transition of power from the original founders of a business to independent professional managers and directors or the appropriate family members to allow the culture to adapt. But succession planning continues to be a taboo subject at many controlled companies.

US technology company Microsoft has been an unusual case where the founder agreed to step down as chair of the board, while remaining a director. We were one voice that made this suggestion to its board while it was considering the succession of the former CEO.

Brazilian bank Itaú Unibanco is one example of organised succession planning. Until 2017, its CEO always used to be a family member but the company then chose a different, independent CEO as he was deemed the best equipped for the role. The bank communicated to its shareholders every step of the two-year succession planning process, for example, the timing of when the CEO was going to step down. By producing this constant flow of information, the bank set a positive precedent in the market.

In Asia, we welcomed the steps taken by Taiwan Semiconductor Manufacturing. The company has a co-CEO structure until one becomes chair and the other CEO and has been open to dialogue during the transition process. Encouragingly, the CFO told us that the complete retirement of the founder from the company has been accepted by its staff and other shareholders. This is a rare, especially for a successful company, as it is still common practice in this market that upon retirement, the founder retains an advisory role. As part of our engagement, we discussed the final phase of succession planning, in particular the processes in place to assess the CEO and the chair.

Board composition

Where companies have a charismatic or powerful CEO, who is seen as the rainmaker, the future success of the business depends on the strength of the board. It is up to the board to ensure a smooth succession and careful management of the transition period.

We therefore want to see governance structures in place that provide a system of checks and balances to ensure that companies are run in the interests of all shareholders, in other words a well-balanced board. Chairs should be genuinely independent, chosen by an expert committee with a diversified set of skills and background. Independent board directors ought to provide executives with the policies and frameworks in which they operate, including strategic guidance, material environmental, social and governance matters, risk management, legal and audit functions.

In large, family-owned conglomerates, directors often serve on multiple boards at different business entities within the group. This practice becomes controversial where the ability of directors to handle the rights of minority shareholders fairly is doubtful, for example in cross-directorships in complex group structures, thus leading to increased related party transaction risks. In general, directors need to ensure that decisions are made in the interest of all shareholders. While we acknowledge that family members sitting on the board of companies can be a force for good in terms of the long-term sustainability of the business, in our engagement we push for a strong core of independent directors and an influential lead independent director.

We usually oppose the non-independent directors proposed for election to the board if the independence at the company falls below one third. As the controlling shareholder can nominate the majority of the board members and present them for election, this level can be difficult to achieve. In our dialogue with companies, we therefore point out that, as long-term shareholder representatives, our interests are aligned and try to persuade the controlling shareholders to have a different perspective to improve the effectiveness of the board.

In India, we engaged with technology company Infosys to increase the transparency on how it selects its director candidates and how it measures the effectiveness of the board. Infosys addressed conflicts between a founder and the former CEO by refreshing its board and appointing a new CEO. As outlined in our Corporate Governance Principles for India,[1] we are pushing for diversity on company boards in the country. India's 2013 Companies Act mandates that listed companies have at least one female director. However, this has led to some companies putting female family members on their boards. We support the election of independent female directors in line with our wider voting policy. This is reinforced by a change in regulations, which requires the top 500-listed companies in India to introduce at least one independent female director by April 2019. Where boards lack independent female directors, we recommend voting against all members of the nomination committee standing for election.

Regional peculiarities

In Italy, which is home to many family-owned companies, the voices of minority shareholders are heard through the voto di lista mechanism. The mechanism calls for shareholders to vote on slates of nominees, submitted by the controlling, as well as minority, shareholders. As at least one director has to be elected from the slate submitted by minority shareholders, this ensures representation of minority shareholders on company boards.

In the Nordic region, the concept of independent directors is well-established and transparent at family-controlled businesses, which gives structure to the nomination process. In Denmark, families typically control the businesses by setting up foundations with formal governance structures, which tend to be the biggest shareholders in the companies and thus have large input into the nomination process. In Sweden, an external nomination committee – usually made up of the five largest shareholders – is responsible for proposing candidates. Minority shareholders can also put forward candidates through the nomination committee.

Unfortunately however, shares with different voting rights are common for companies in the region. For example, one share in a foundation could equal 10 votes of other shares, and many directors have shares in foundations.

Dual-class share structures

Dual- or multiple-class share structures are a major concern about founder- or family-controlled businesses. Many of them, in particular start-up technology businesses, have insisted as part of their negotiations with stock exchanges on listing with these structures. They allow founders to reduce their economic interests while remaining in power. However, they also mean that shareholders that have provided the company with capital have no or only a limited voice.

Following the listings of technology services companies Alphabet and Facebook with their multiple-class share structures, the listing of their peer Snap in 2017 – which offered only shares without any voting rights to the public – took the trend among US companies to share structures with differential voting rights to a new extreme. However, lately there has been pushback from institutional investors, which, for example, prevented Facebook from issuing a third class of shares.

We have been engaging with companies with dual-class share structures, such as Alibaba, which has a partnership structure that grant the founder and early investors more rights to appoint directors to the board, in an attempt to enhance the rights of minority shareholders, increase transparency and push for effective boards and investor dialogue. We have also taken a stance through our voting recommendations at the AGMs of companies, for example, by opposing the election of the chair of the governance committee at US media companies Twenty-First Century Fox or co-filing shareholder proposals requesting the elimination of dual-class share structures at News Corp.

We believe that alignment between the economic interests of an investor and control rights through the principle of one-share one-vote is the best structure to ensure management accountability. Adherence to the principle is also a prerequisite for stewardship. If stock exchanges allow companies to list with differential voting rights, these should be time-bound through sunset provisions and provide adequate safeguards for investors. In addition, having superior voting rights should be seen as a privilege, not a right, and thus be put to an annual shareholder vote at the AGM.

Engagement

We believe that institutional investors in particular can play a role where conflict arises between the parties involved in the governance of an organisation. They can engage with the concerned parties to limit unilateral leaks of information to the media and focus on structural governance changes to improve transparency, strengthen accountability and reduce the risks of conflicts of interest in future.

Of course, some companies may still treat shareholders merely as a source of capital. In difficult cases, where our influence is limited due to the company's ownership structure, we collaborate with other independent, long-term shareholders to increase leverage and use a wide range of private and public engagement techniques.

Our engagement with German car manufacturer Volkswagen shows that persistence can pay off. Despite the company's highly concentrated ownership structure, its supervisory board has opened up to enhanced dialogue with investors, including ourselves, on governance and executive remuneration following the emissions scandal and our numerous interventions at AGMs and votes against the discharge, a vote of confidence, of some members of the supervisory board. In our view, the access to the chair indicates that the supervisory board is taking investor concerns more seriously than in the past, also in relation to its own composition. But while we welcomed the appointment of its new CEO, we still need to see more improvements from the company in terms of culture and governance.

We therefore continue our engagement with founder- and family-controlled companies wherever possible.

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[1] https://www.hermes-investment.com/ukw/wp-content/uploads/sites/80/2017/10/India-CG-Principles-Sep-2017.pdf

Strategy

The crucial tone from the top – Mitigating the risks of the online world

We have been engaging with companies on cybersecurity and data privacy issues.

Setting the scene

Cybercrime continues to spread. In 2017, companies such as AP Moller-Maersk, Deloitte, Equifax, Reckitt Benckiser and Uber became victims of cyberattacks, while the WannaCry ransomware attack affected hundreds of thousands of computer systems, including that of the UK National Health Service, within days. Telecoms company TalkTalk meanwhile was fined for the second time in 2017 for failing to protect the data of its customers and US retailer Home Depot reached a $25 million settlement with several banks to pay for damages they incurred as a result of its breach. The extent of losses incurred by companies is also broadening, encompassing financial, physical and reputational damages. According to information technology consulting firm CGI, share prices fall by an average of 1.8% on a permanent basis following a severe breach. However, in some extreme cases, breaches have wiped as much as 15% off the valuations of affected companies. The breach at US retailer Target in 2013 and financial services company JPMorgan Chase in 2014 was estimated to have cost them over $200 million each.

Digital technology is increasingly core to a company's operations and its interface with customers and other stakeholders, giving rise to cybersecurity risks in various forms. Cyberattacks can be highly damaging. The theft of sensitive data from consumer-facing companies can harm an organisation's reputation and/or revenues. Corporate espionage meanwhile can damage the competitive advantage of one company over another, and theft of intellectual property could potentially lead to the closure of businesses, while the spread of viruses by hackers can disrupt operations, resulting in lost revenues.

The rapid spread of internet-enabled devices – the so-called Internet of Things – cloud computing and the changing profiles of hackers increase the vulnerabilities of companies. Hackers are becoming more sophisticated and can include simple enthusiasts, insiders who have easy access to the systems of an organisation, hacktivists with a political or publicity agenda, lone hackers, organised cybercriminals operating as part of syndicates, nation state hackers or terrorist groups.

The World Economic Forum therefore cites cyber risks as one of the top risks globally. However, cyber is still under-resourced in comparison to the potential scale of the threat.

Board oversight questions

- Has the company appointed a chief information security officer? If not, who has responsibility for information management and cybersecurity at the senior management level?
- Has the board approved the company's cybersecurity strategy and framework?
- Does the board have the requisite tools and knowledge to effectively oversee the company's management of cyber risk?
- How are the company's cyber risks communicated to the board, by whom and with what frequency?
- How often does the board evaluate its existing security controls and protocols and the extent to which they are sufficient to meet its cybersecurity objectives and developments in this space?

Source: PRI

Risk management

While cyber breaches can never be ruled out completely, the risk of attacks must be identified, managed and mitigated. This means that a comprehensive risk management framework and a cyber incident response plan must be in place, describing who is in charge of the incident, who else is involved in the response, for example external organisations, the processes and procedures to follow, the contact details of key individuals and other essential materials. These must be kept up-to-date.

Detection and response time are among the most important metrics that companies should track to ensure progression and effectiveness of the techniques being deployed, something consumer goods company Reckitt Benckiser recognised in its annual report after its cyberattack. Internal audit also plays a central role in helping audit committees oversee cybersecurity.

Governance

Many organisations focus on the technical parts in relation to cyber security without understanding the absolute need for leadership, governance, planning and culture change. But cyber and data security breaches often highlight weaknesses in corporate governance, which is why it is one of the important areas of our engagement on the issue.

We want to know whether cyber security is treated as a company-wide business risk and assessed just like any other risk. Cybersecurity should be on every board agenda and, as a minimum, discussions should be about the risk to the business, the nature of sensitive data and the mitigation progress. Companies need to understand what information systems are most critical to their operations to avoid overprotecting certain information systems and under-protecting others. For pharmaceutical companies, for example, the most critical information can be chemical formulas or other intellectual property.

In terms of accountability, we want to see overall oversight by the board. However, expertise in technology is still limited on the boards of companies. We would also like to see companies have access to specialist expertise to advise and inform the board, whether from internal teams or external advisers. We welcome the appointment of chief information security officers (CISOs), however, there is only a limited pool of them available and their retention is difficult due to a lack of career prospects and advances. Equifax, for example, poached the CISO from US retailer Home Depot, while HSBC recently appointed the CISO of technology conglomerate Cisco.

In addition to looking at their own operations, companies have to engage with their suppliers and ask them critical questions about their cybersecurity practices.

Engagement

In our engagement, we are looking for evidence that company boards understand and can articulate the cybersecurity risks specific to their business. In addition, we push for disclosure of a robust cybersecurity and data protection strategy, including employee training and senior accountability, and for evidence that measures are in place to manage cybersecurity risks arising from third party relationships, including suppliers or merger targets. Companies, however, are reluctant to broadcast what kind of cyberattack prevention measures they have in place to avoid becoming a target for hackers. We recognise that public disclosure of the defences put in place is therefore not realistic. Nevertheless, companies need to give investors confidence about the processes they have implemented and how they monitor the effectiveness of these. We commend, for example, the detailed disclosure and global privacy policy provided by Spanish telecommunications company Telefónica.

We also acknowledge that companies cannot completely protect themselves against cyberattacks. We therefore challenge how they would respond to, manage and communicate a cyber risk event. Companies should increase their communications to shareholders when they have suffered a security breach to restore trust and confidence in their management teams. Good communication between the board and management is also critical for the former to fulfil its oversight responsibilities.

We have engaged with global financial institutions such as Equifax, Hana Financial, HSBC and Shinhan Financial Group on their cybersecurity capabilities and preparedness for new regulation on data protection and payments services, as well as with companies in other sectors such as Johnson & Johnson, Reckitt Benckiser and Smith & Nephew. We welcome that the major UK banks participate in intelligence sharing with law enforcement and industry schemes – such as the country's National Cyber Security Centre – to help improve their understanding of the evolving threats.

Furthermore, we encourage exercises involving simulated attacks and ethical hackers testing the defences companies have in place.

The complexities and risks arising from cyber-related issues mean that we cannot engage on this topic without also engaging on civil liberties. These include the right to data privacy, balancing legitimate law enforcement and anti-terrorism activity against the human right to privacy. Companies have increasingly been seeking to ensure the legality of requests from governments to disclose data in order to protect the privacy of their customers, using legal experts to evaluate the requests.

In the technology sector, we encourage the adoption of a dynamic and evolving strategy to identify and adapt to cybersecurity threats, as well as the implementation of a comprehensive data privacy policy and a transparent framework to ensure compliance. In addition, we press for the implementation of a policy to handle requests from authorities to access data, where possible. Best practice companies publish transparency reports on data requests as part of their education and policy efforts in this area.

While a dedicated cyber insurance market is developing rapidly, the scope of cover is modest relative to potential exposure. Ultimately, some cyber risks, especially those related to extreme catastrophic loss events, may be uninsurable.

Policy engagements

As members of the investor steering group of the Principles for Responsible Investment (PRI) on the issue, the cyber security advisory committee, we have contributed to the development of a collaborative engagement strategy on cybersecurity.

We continue to promote and enhance investor dialogue and corporate transparency on cybersecurity and data access alongside the PRI. We also aim to engage with the National Cyber Security Centre to reflect the investor perspective and engage on regulation in relation to cyber.

Regulation

Apart from increasing investor pressure on the issue, companies are also beginning to feel the impact of tighter laws on cybersecurity and data privacy.

The introduction of the EU's General Data Protection Regulation (GDPR) in 2018 obliges companies to report a cyber breach, have a data protection officer in place, meet a 72-hour breach notification period, deliver increased data accuracy, seek consent from users and provide the right to data erasure. Any company whose operations affect EU citizens will have to comply and will face major fines if sensitive personal data is mishandled. The Network and Information Security (NIS) Directive meanwhile, which came into force in 2016, was designed to raise the levels of overall security and resilience of network and information systems across the EU. In the US, in February 2018, the Securities and Exchange Commission voted unanimously to approve a statement and interpretive guidance to assist public companies in preparing disclosures about cybersecurity risks and incidents.

It is difficult to claim success in the area of cybersecurity and companies are often judged on how they have responded to an attack. But, in our view, to combat the threat of cyberattacks, first and foremost leadership and a strong tone from the top are key.

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Strategy

Engagement on strategy

Many of our most successful engagements include discussions on business strategy and structural governance issues.

Overview

We adopt a holistic approach to engagement, combining discussions on business strategy and risk management, including environmental, social and ethical risks, with structural governance issues. We challenge and support the management of companies in their approach to the long-term future of the businesses they run, often when there is minimal outside pressure for change. We are generally most successful when we engage from a business perspective and present environmental, social and governance issues as risks to a company's strategic positioning. Businesses may benefit from new perspectives on the board and from promoting fresh thinking at the head of the company. An independent chair or change of CEO is frequently the key to improving performance and creating long-term value for shareholders.

Examples of recent engagements

Carbon and water disclosure

Lead engager: Christine Chow

Following our engagement and letter to its founder, chair and CEO, an Asian company promised to enhance its emissions disclosure to the CDP initiative to cover all of its manufacturing sites that employ over 5,000 people. In our letter, we had criticised the quality of disclosure to the CDP's climate change and water surveys and expressed that, in our opinion, the company does not appear to have an adequate grasp of the short- and long-term risks related to these issues. We supported our statement by referring to the CEO's commitment to green and sustainable procurement management practices. The company also decided to publicly disclose emissions information through the CDP initiative from 2017 onwards. We were pleased with the significant progress on environmental disclosure and its first attempt to set some form of target. During the quarter, we conducted further analysis of the physical asset risks of the company due to climate change, as well as the water stress risks, after the company provided the location coordinates of some of its facilities for the first time. We encouraged it to pass this information on to the CDP water surveys and to include information of facilities in other locations if possible. Our analysis showed that many of the facilities are located in high water stress areas, and we pushed for improved water management plans.

CEO pay

Lead engager: Tim Goodman

We told the lead independent director of a US company that we would recommend voting against the say-on-pay resolution and in favour of a shareholder proposal calling for an independent chair. The lead independent director explained that, while the CEO is unlikely to seek a new role elsewhere, in fairness to him the compensation committee believed that it was right to pay him a similar amount to the CEOs at its peers. We argued that CEO pay in the US is too high and that we need to make a stand on behalf of our clients while seeking systemic change. More positively, the lead independent director explained how the board is working to support one of the biggest ever corporate recoveries, highlighting the early contribution of a newly appointed female director, who is already deepening board discussions. The company is also improving its disclosure on any potential gender pay gap and tackling systemic inequality in its organisation, for example by substantially improving its diversity in recruitment. While it did not commit to increasing its low-carbon energy financing targets, it appeared increasingly committed to the opportunities that the energy transition represents. Encouragingly, the company's CEO is involved in ongoing discussions with the Task Force on Climate-related Financial Disclosures (TCFD). We argued that the company should explain why it cannot fully disclose against any of the recommendations, should this be the case. We look forward to its TCFD disclosure at the end of the year.

Climate change ambitions

Lead engager: Bruce Duguid

A mining company set long-range energy efficiency and greenhouse gas reduction targets for 2030. It claims that the targets are stretching and in line with a science-based methodology, which aims to support its long-term goal of achieving carbon neutral mining. The company also committed to publishing the results of a detailed portfolio resilience analysis to low-carbon scenarios in 2019. It expanded further on its newly implemented sustainability strategy, including on its goal to achieve waterless mining. The company's overall mission is to reimagine mining to improve people's lives, and this is supported by a range of ambitious long-term goals, together with 2030 targets and interim milestones. However, it acknowledged that it still has a number of more basic concerns to tackle, including the unacceptable number of fatalities, which stood at nine lost lives in 2017. We also received some assurances about the environmental impact of one of its mines on local communities. The company confirmed that the mine's use of non-potable water does not displace any other water that might be used by local communities and so does not impair or affect their access to water. The mine is also taking pre-emptive action to prepare for enhanced national dust control standards that will bring its performance in line with international levels.

Remuneration

Lead engager: Natacha Dimitrijevic

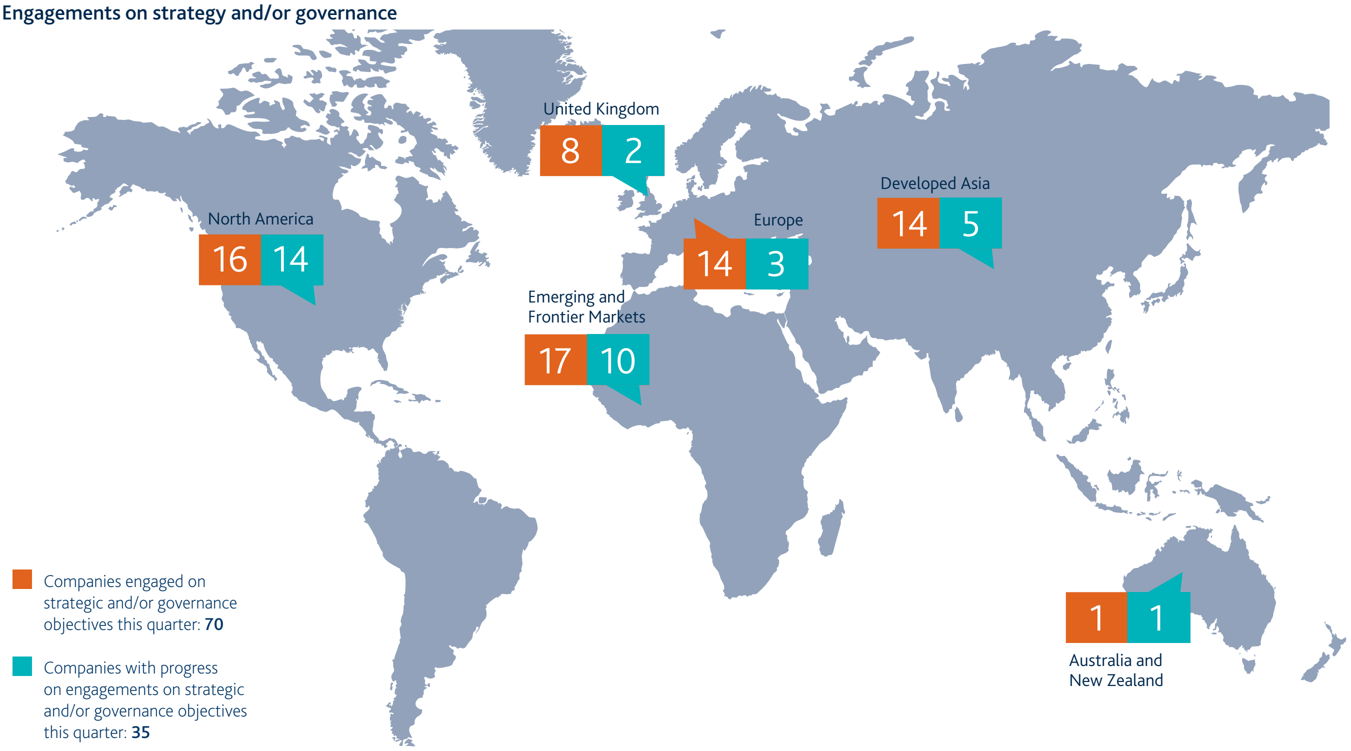
We commended the enhanced disclosure of the nature and weightings of the remuneration performance metrics of a European company, which we have been requesting for a number of years. Nonetheless, in a meeting with its lead independent director, we suggested additional narrative, especially in relation to the strategic indicators. We again pressed for a simplification of the remuneration policy and the greater differentiation of indicators between the bonus and the long-term incentive scheme and challenged the increase in the base salary of the CEO. Moreover, we suggested a return on investment metric, especially as the company is expanding through acquisitions. On a different note, we also welcomed the clear succession planning for the combined chair and CEO and gained reassurance that this is also underway for the lead independent director. We obtained positive insights into the board refreshment process and the depth of discussions in relation to key issues such as asset allocation and cybersecurity. Furthermore, we encouraged the company to showcase the good work it has done on diversity and culture through best-in-class disclosure.

Withdrawal of proposed mandate

Lead engager: Jaime Gornsztejn

An emerging markets company sought approval for a five-year mandate to the board to approve the issuance of shares without pre-emptive rights, amounting up to 25% of the outstanding share capital. We expressed concerns about the potential dilution to existing shareholders and challenged the company on the use of the funds. It told us that the board sought the mandate to have flexibility to raise capital should an opportunity arise. We recommended that the company ask for the permission of shareholders when there is a specific use for the funds and made clear that we would oppose the broad mandate requested. We were therefore pleased that just one day later the company announced the withdrawal of the proposal due to the feedback it had received from investors. We also welcomed the gradual increase in diversity on the company's board following our engagement on the issue. The board secretary assured us that our concerns on board diversity had been taken into account and that the chair is committed to improvements in this area. A new independent candidate with the relevant experience was presented to the 2018 AGM to replace a longstanding member of the founding family. We commended the company for the board refreshment and for nominating a candidate with experience in important markets. We remain concerned, however, about its lack of gender diversity. The board secretary, explained that a female candidate had been selected but withdrew her candidacy at short notice. However, the company's chair remains committed to selecting a female candidate for its 2019 AGM.

Engagements on strategy and/or governance



Public Policy

Public policy and best practice

Hermes EOS contributes to the development of policy and best practice on corporate governance, sustainability and shareholder rights to protect and enhance the value of the shareholdings of its clients over the long term.

Overview

We participate in debates on public policy matters to protect and enhance value for our clients by improving shareholder rights and boosting protection for minority shareholders. This work extends across company law, which in many markets sets a basic foundation for shareholder rights, securities laws, which frame the operation of the markets and ensure that value creation is reflected for shareholders, and developing codes of best practice for governance, the management of key risks, as well as disclosure. In addition to this work on a country-specific basis, we address regulations with a global remit. Investment institutions are typically absent from public policy debates even though they can have a profound impact on shareholder value. Hermes EOS seeks to fill this gap. By playing a full role in shaping these standards, we can ensure that they work in the interests of shareholders instead of being moulded to the narrow interests of other market participants whose interests may be markedly different – particularly companies, lawyers and accounting firms, which tend to be more active than investors in these debates.

Highlights

Conflict minerals legislation

Lead engager: Tim Goodman

We co-signed an investor letter to a number of key US senators protesting against the possible repeal of section 1502 of the Dodd-Frank Act. The section requires listed companies to report on how they prevent the inclusion of conflict minerals in their supply chains. While the wording of the section is narrowly drawn, it has helped US companies to reduce the human rights risks associated with some minerals in the conflict region in and close to the Democratic Republic of Congo. In turn, this has contributed to improving the human rights outcomes in the area and helped companies to enhance their human rights activities more widely. Repeal of the legislation would therefore be a setback for human rights activities by US companies.

Data privacy

Lead engager: Christine Chow

We exchanged views with the UK Prime Minister's special representative on internet safety and the shadow minister for the digital economy on the roles and responsibilities of internet and social media companies in managing the risk of disinformation and potentially resulting conflicts in relation to legislation on data privacy. We discussed the risk of amplifying disinformation when replacing the majority of human editors with algorithms and what companies, such as Facebook, have learned from their experience with regard to the US presidential election. The representative encouraged investors to engage with internet and social media companies and to urge them to work with stakeholders to address the issues.

French Corporate Governance Code

Lead engager: Natacha Dimitrijevic

We welcomed the public consultation on the revision of the French Corporate Governance Code, the AFEP-Medef Code. The Association of Large Companies AFEP, which drafted the consultation, gave us insights into the context of the consultation, especially in light of the law on the purpose of companies and their duties towards stakeholders. We discussed the rationale behind some specific proposals, including in relation to employee representation. We suggested that some provisions for the revised code could be more forceful, especially those relating to the independence of lead directors and board access. We also conveyed our concerns about the opacity of the governance of the authority in charge of the regulation of the code, which is sponsored by companies. In addition, we provided feedback to the French Association for Corporate Governance and the French Asset Management Association, ahead of submitting our response to the consultation.

Implementation of the Brazilian Stewardship Code

Lead engager: Jaime Gornsztejn

We participated in several calls of the working group on stewardship of the Association of Capital Market Investors (AMEC) to discuss the implementation of the Brazilian Stewardship Code. All signatories were expected to publish their first reports on stewardship by the end of the first quarter of 2018 but some asked for an extension of the deadline because they have been struggling to gather the required information. AMEC intends to assess and provide feedback on each report but will take no enforcement action at this point. We raised concerns that only a few pension funds have signed up to the code to date because in other markets the development of a stewardship culture has been driven by pension funds. AMEC described its efforts to attract pension funds, which it expects to result in additional affiliations in 2018.

UK Corporate Governance Code

Lead engager: Roland Bosch

We responded to the consultation on proposed revisions to the UK Corporate Governance Code and the initial consultation on the future of the UK Stewardship Code. We welcomed the proposed revisions to the former, as they address the elements of governance most important to board effectiveness and corporate purpose. The focus on stakeholders, integrity, culture and diversity is positive, as is the emphasis on how the overall governance of a company contributes to its long-term success. We are particularly sympathetic to strengthening the role of employees within governance arrangements and specifically giving the workforce a greater voice in boardrooms. Furthermore, we believe that many lessons can be learned from the success and continued evolution of the Corporate Governance Code with regard to the direction of the Stewardship Code. The recent recognition of the importance of a company defining and articulating its purpose has particular resonance for the actors in the investment chain. Institutional investors have a duty to deliver holistic returns to their clients and, ultimately, to their underlying beneficiaries. However, they can only fulfil this duty by acting as stewards of the companies and assets in which they are invested.

Other work in this quarter included

Promoting best practice

- We re-committed to the new **Bangladesh Accord on Fire and Building Safety**. It is a three-year legally-binding extension of the Accord for Fire and Building Safety and will come into effect when the original programme expires in May 2018. The new agreement between global trade unions and companies grants additional time to remediate safety issues found in garment factories and to build effective worker safety committees.
- We had an encouraging exploratory conversation with the independent chair of the review of the **Best Practice Principles for Shareholder Voting Research** (BPP). The BPP serves as a code for the proxy advisory industry. We reaffirmed our intention to sign up to the principles once the review is finalised and agreed to explore ways to work together over the course of 2018, feeding into the revision of the principles where appropriate.
- We chaired a meeting of the corporate governance expert group of the Quoted Companies Alliance at which the practical implications of the UK's exit from the EU on company law and accounting policy were discussed with a senior official from the country's Department for Business. One of the key issues talked about was the endorsement of International Financial Reporting Standards post-**Brexit**.
- At a meeting of the resolutions sub-group of the Institutional Investors Group on Climate Change, we agreed that institutional investors should seek to take control of the **climate change resolutions agenda** at companies that are targeted by the Climate Action 100+ initiative. The rationale for this approach is that institutional support for resolutions can be better coordinated with engagement efforts and is thus more likely to achieve long-term impact at companies.
- We met the chair of the Institutional Investors Collective Engagement Forum (IICEF), which was set up in October 2017 by five Japanese institutions, in Tokyo. The IICEF's objective is to facilitate **collective shareholder engagements in Japan**. The IICEF will talk to the companies held in the passive funds of its members, as these generally have broad engagement agendas. It intends to address the issues most commonly found with Japanese companies.
- We supported the initiative of the Association of Institutional Investors (API) in Russia to introduce a **dividend policy** to the listing rules of the Moscow Stock Exchange that applies to all companies. API Russia successfully pressed the country's government to adopt a dividend policy for state-controlled companies, establishing a minimum 50% dividend payout on a comply-or-explain basis. It now proposes that the rules extend the obligation to all listed companies to adopt a dividend policy similar to that of their state-controlled peers.
- We contributed to a discussion by the All-Party Parliamentary Corporate Responsibility Group at the UK's House of Lords on **fair working conditions**. We pressed for enhanced disclosure of key human capital metrics, such as zero-hour contracts and living wages.
- We met the CEO of the Interfaith Center on Corporate Responsibility (ICCR) to discuss our engagement on human rights and potential collaboration. The ICCR is establishing a collective investor platform for human rights designed to create strategic opportunities for action. We agreed to join this investor alliance and subsequently signed its statement on **firearms**, which provides best practice guidelines for gun manufacturers, retailers and other companies with a presence in the US.
- We contributed to the Environmental Defense Fund's white paper on **methane reduction targets in the oil and gas industry**. In particular, we recommended that the paper refine its arguments with regard to absolute methane reduction targets to make them more convincing for an oil and gas industry audience. We also made suggestions to improve the paper and its compelling case that methane reduction is a vital measure to quickly make dramatic changes in the fight against climate change.
- We were the only institutional investor invited to talk about our experience with stewardship with policy-makers from Singapore, Malaysia, Thailand, Vietnam, Laos, Cambodia and Myanmar at the **OECD-Southeast Asia Corporate Governance Initiative** event. At the launch of the OECD Myanmar corporate governance programme, we explained why institutional investors believe corporate governance is important to long-term value creation, financial stability, sustainability and inclusive growth.
- We co-signed a letter to the British Retail Consortium in support of including plastic pellets in the revision of its Global Standard for Packaging and Packaging Materials. We believe that the promotion of best practice in plastic pellet management will help reduce marine **plastics pollution**.
- We made a number of suggested changes to the guidelines by the UK's Investment Association on **restricted share schemes** to help improve the attractiveness of this solution to companies. Consistent with our Remuneration Principles, we believe that a move towards more fixed pay in the form of company shares and lower variable pay would help to simplify executive pay and reduce inappropriate risk-taking.
- We contributed to the working group of the **30% Club** and discussed future joint engagement initiatives. In addition to voting recommendations, we agreed to act on the recommendations of the Hampton-Alexander Review, with a focus on companies that have no or a low level of gender diversity on their boards or in their leadership teams.
- We signed up to the **UN Standards of Conduct for Tackling Discrimination against LGBTI People**. We had been approached on this by the UN's human rights officer and a former human rights executive at a large US technology company with whom we remain in contact over human rights issues.

Public policy

- We chaired a meeting of the Quoted Company Alliance's corporate governance expert group with representatives from the UK's Financial Reporting Council at which their proposed revisions to the country's **Corporate Governance Code** were discussed. We talked in particular about the merits of removing exemptions from some provisions of the code, such as in relation to independent board evaluations and the composition of audit committees for smaller companies.
- We responded to the European Commission's consultation on the **sustainability duties of institutional investors and asset managers**. The consultation was intended to inform the commission's impact assessment process ahead of consulting more substantively on detailed policy proposals. It aims to take forward the policy recommendations proposed by the High-Level Expert Group on Sustainable Finance that fiduciary duties be clarified and explicitly require the integration of material environmental, social and governance factors. In our response, we made the case that investment entities should consider the interests of the beneficiaries on behalf of whom they invest, in particular the time horizon over which their interests lie.

Report written and produced by Nina Röhrbein

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

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

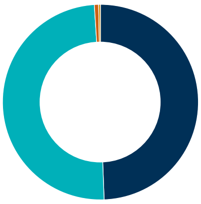
Hermes EOS makes voting recommendations at companies all over the world, wherever its clients own shares.

Voting overview

Over the last quarter we made voting recommendations at 1,424 meetings (12,144 resolutions). At 707 of those meetings, we recommended opposing one or more resolutions. We recommended voting with management by exception at four meetings and abstaining at 10. We supported management on all resolutions at the remaining 703 meetings.

Global

We made voting recommendations at **1,424** meetings (**12,144** resolutions) over the last quarter.



- Total meetings in favour **49.4%**
- Meetings against (or against AND abstain) **49.6%**
- Meetings abstained **0.7%**
- Meetings with management by exception **0.3%**

Australia and New Zealand

We made voting recommendations at **11** meetings (**33** resolutions) over the last quarter.

- Total meetings in favour **45.5%**
- Meetings against (or against AND abstain) **54.5%**

Developed Asia

We made voting recommendations at **564** meetings (**3,829** resolutions) over the last quarter.

- Total meetings in favour **49.5%**
- Meetings against (or against AND abstain) **50.4%**
- Meetings with management by exception **0.2%**

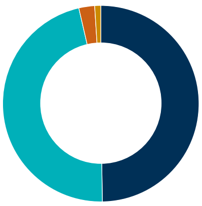
Emerging and Frontier Markets

We made voting recommendations at **400** meetings (**2,925** resolutions) over the last quarter.

- Total meetings in favour **48.8%**
- Meetings against (or against AND abstain) **51.0%**
- Meetings abstained **0.3%**

Europe

We made voting recommendations at **193** meetings (**2,841** resolutions) over the last quarter.



- Total meetings in favour **49.7%**
- Meetings against (or against AND abstain) **46.6%**
- Meetings abstained **2.6%**
- Meetings with management by exception **1.0%**

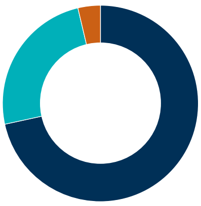
North America

We made voting recommendations at **175** meetings (**1,564** resolutions) over the last quarter.

- Total meetings in favour **40.0%**
- Meetings against (or against AND abstain) **58.9%**
- Meetings abstained **0.6%**
- Meetings with management by exception **0.6%**

United Kingdom

We made voting recommendations at **81** meetings (**952** resolutions) over the last quarter.

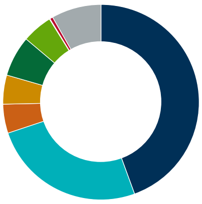


- Total meetings in favour **71.6%**
- Meetings against (or against AND abstain) **24.7%**
- Meetings abstained **3.7%**

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

Global

We recommended voting against or abstaining on **1,548** resolutions over the last quarter.



- Board structure **44.4%**
- Remuneration **25.4%**
- Shareholder resolution **4.8%**
- Capital structure and dividends **4.8%**
- Amendment of articles **6.7%**
- Audit and accounts **5.0%**
- Investment/M&A **0.1%**
- Poison pill/Anti-takeover device **0.5%**
- Other **8.2%**

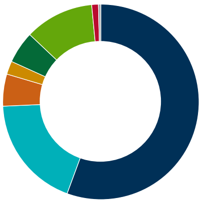
Australia and New Zealand

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

- Board structure **14.3%**
- Remuneration **28.6%**
- Capital structure and dividends **57.1%**

Developed Asia

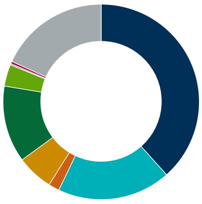
We recommended voting against or abstaining on **455** resolutions over the last quarter.



- Board structure **55.6%**
- Remuneration **18.7%**
- Shareholder resolution **5.3%**
- Capital structure and dividends **2.2%**
- Amendment of articles **5.3%**
- Audit and accounts **11.4%**
- Poison pill/Anti-takeover device **1.1%**
- Other **0.4%**

Emerging and Frontier Markets

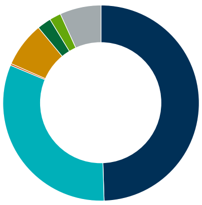
We recommended voting against or abstaining on **550** resolutions over the last quarter.



- Board structure **38.4%**
- Remuneration **18.7%**
- Shareholder resolution **1.8%**
- Capital structure and dividends **6.0%**
- Amendment of articles **12.7%**
- Audit and accounts **3.6%**
- Investment/M&A **0.2%**
- Poison pill/Anti-takeover device **0.4%**
- Other **18.2%**

Europe

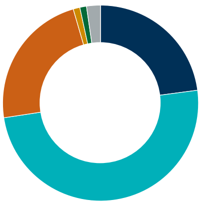
We recommended voting against or abstaining on **311** resolutions over the last quarter.



- Board structure **49.5%**
- Remuneration **31.8%**
- Shareholder resolution **0.3%**
- Capital structure and dividends **7.4%**
- Amendment of articles **2.3%**
- Audit and accounts **1.9%**
- Other **6.8%**

North America

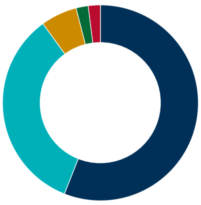
We recommended voting against or abstaining on **175** resolutions over the last quarter.



- Board structure **22.9%**
- Remuneration **49.7%**
- Shareholder resolution **22.9%**
- Capital structure and dividends **1.1%**
- Amendment of articles **1.1%**
- Other **2.3%**

United Kingdom

We recommended voting against or abstaining on **50** resolutions over the last quarter.



- Board structure **56.0%**
- Remuneration **34.0%**
- Capital structure and dividends **6.0%**
- Amendment of articles **2.0%**
- Poison pill/Anti-takeover device **2.0%**

What is Hermes EOS?

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

Pooling the resources of other like-minded funds creates a strong and representative shareholder voice and makes our company engagements more effective. We currently act on behalf of over 40 clients and £330.5/€377/$463.7 billion* in assets under advice.

Hermes has one of the largest stewardship resources of any fund manager in the world. Our 26-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[2] set out our fundamental expectations of companies in which our clients invest. These cover business strategy, communications, financial structure, governance and management of environmental and social risks. The engagement programme we have agreed with our clients, as well as the Principles and their regional iterations, guide our intervention with companies throughout the world. Our approach is pragmatic, as well as company- and market-specific, taking into account the circumstances of each company.

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

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

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

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

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

For further information, please contact:

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

* as of 31 March 2018

[2] 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
Head of EOS

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

Dr Emma Berntman
Sectors: Chemicals, Industrials, Pharmaceuticals

Roland Bosch
Sector lead: Financial Services

Dr Christine Chow
Sector lead: Technology

George Clark
Voting and Engagement Support

Natacha Dimitrijevic
Sector lead: Pharmaceuticals

Bruce Duguid
Head of Stewardship, Sector lead: Utilities

Claire Gavini
Sectors: Consumer Goods and Retail, Pharmaceuticals

Tim Goodman
Sector lead: Oil and Gas

Jaime Gornsztejn
Sector lead: Industrials

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Pauline Lecoursonnois
Sector co-lead: Consumer Goods and Retail

James O'Halloran
Head of Voting and Engagement Support

Nina Röhrbein
Reporting and Communications

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

Sachi Suzuki
Sector lead: Automotive

Amy Wilson
Sector co-lead: Consumer Goods and Retail

Tim Youmans
Sectors: Financial Services, Industrials, Technology

Business Development and Client Service

Amy D'Eugenio
Head of Business Development and Client Service

Alan Fitzpatrick
Client Relations

Rochelle Giugni
Client Relations

Alice Musto
Client Relations

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