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Q3 2015

Hermes EOS

Public Engagement Report

Lessons learned from the past – Mitigating ESG risks in Brazil's resources sector

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 2015.

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.

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 our clients' investments 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 42 clients and £146.6 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, ex-fund managers 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 chief executive Colin Melvin chaired the committee that drew up the original principles and we are actively engaged in a variety of workstreams through the PRI clearinghouse. This insight enables us to help signatories in meeting the challenges of effective PRI implementation.

How does Hermes EOS work?

Our corporate, public policy and best practice engagement programmes aim to enhance and protect the value of our clients' investments and safeguard their reputations. We measure and monitor progress on all engagements, setting clear objectives and specific milestones. 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 social, ethical and environmental 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 and 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 within our core engagement programmes. 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 press.

For these reasons, this public report contains few specific details of our interactions with companies. Rather 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:
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* as of 30 September 2015

[1] https://www.hermes-investment.com/wp-content/uploads/2015/09/the-hermes-ownership-principles.pdf

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Lucy Saville
Client Relations

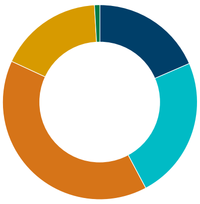
Michael Wills
Client Relations

Engagement by region

Over the last quarter we engaged with 113 companies on 232 social, environmental, business strategy and governance issues. Our holistic approach to engagement means that we typically engage with companies on more than one issue simultaneously. The engagements included in these figures are in addition to our discussions with companies around voting matters.

Global

We engaged with **113** companies over the last quarter.



- Environmental **18.5%**
- Social and ethical **23.7%**
- Governance **39.7%**
- Strategy and risk **17.2%**
- Stewardship **0.9%**

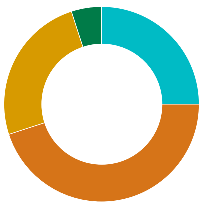
Australia and New Zealand

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

- Environmental **75.0%**
- Governance **25.0%**

Developed Asia

We engaged with **17** companies over the last quarter.



- Social and ethical **25.0%**
- Governance **45.0%**
- Strategy and risk **25.0%**
- Stewardship **5.0%**

Emerging and Frontier Markets

We engaged with **21** companies over the last quarter.

- Environmental **26.9%**
- Social and ethical **32.7%**
- Governance **26.9%**
- Strategy and risk **13.5%**

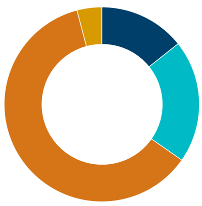
Europe

We engaged with **25** companies over the last quarter.

- Environmental **29.3%**
- Social and ethical **19.5%**
- Governance **22.0%**
- Strategy and risk **29.3%**

North America

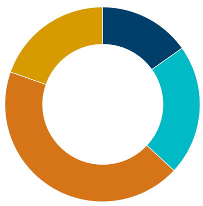
We engaged with **25** companies over the last quarter.



- Environmental **14.3%**
- Social and ethical **20.4%**
- Governance **61.2%**
- Strategy and risk **4.1%**

United Kingdom

We engaged with **23** companies over the last quarter.



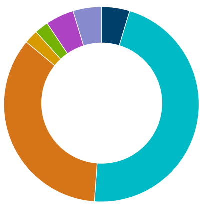
- Environmental **15.2%**
- Social and ethical **21.7%**
- Governance **43.5%**
- Strategy and risk **19.6%**

Engagement by issue

A summary of the 232 issues on which we engaged with companies over the last quarter is shown below.

Environmental

Environmental issues featured in **18.5%** of our engagements over the last quarter.



- Biodiversity **4.7%**
- Climate change/carbon intensity **46.5%**
- Environmental management **34.9%**
- Forestry **2.3%**
- Oil sands **2.3%**
- Waste **4.7%**
- Water stress **4.7%**

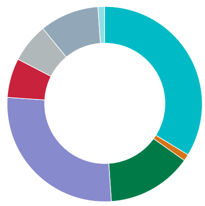
Social and ethical

Social issues featured in **23.7%** of our engagements over the last quarter.

- Access to medicine **3.6%**
- Bribery and corruption **10.9%**
- Community relations **14.5%**
- Corporate culture **12.7%**
- Employee relations **12.7%**
- Health and safety **16.4%**
- Licence to operate **9.1%**
- Operations in troubled regions **5.5%**
- Supply chain management **14.5%**

Governance

Governance issues featured in **39.7%** of our engagements over the last quarter.



- Board structure **33.7%**
- Committee structure **1.1%**
- Other governance **14.1%**
- Remuneration **27.2%**
- Separation of chair/CEO **6.5%**
- Shareholder communications **6.5%**
- Succession planning **9.8%**
- Voting rights – not 1 share 1 vote **1.1%**

Strategy and risk

Strategy and risk issues featured in **17.2%** of our engagements over the last quarter.

- Business strategy **45.0%**
- Reputational risk **5.0%**
- Returns to shareholders **7.5%**
- Risk management **42.5%**

Stewardship

Stewardship issues featured in **0.9%** of our engagements over the last quarter.

- Reporting/disclosure **50.0%**
- Stewardship code **50.0%**

Carbon pledges – Milestones in the battle against climate change or just hot air?

We have been engaging with companies and policy-makers on a range of climate change-related issues ahead of the UN climate change summit in December 2015, including on emissions reduction pledges, carbon pricing and methane emissions.

Setting the scene

With the UN Climate Change Conference in Paris fast approaching, countries have been busy preparing and submitting their voluntary emissions reduction commitments, so-called Intended Nationally Determined Contributions (INDCs). Although guidelines exist, the nature and scope of the INDCs is intentionally flexible and emissions targets agreed as part of a climate deal in December 2015 are unlikely to be binding. The same applies to the carbon reduction pledges made by companies – they are voluntary and non-binding but shareholders may hold companies to account for the promises they have made. As the success of the climate summit depends significantly on the ability of the private sector to deliver, actions by companies have been increasingly in the spotlight.

Pledges

International negotiations in the run-up to the UN Conference on Climate Change – the 21st Conference of the Parties (COP21) – in Paris in December 2015 have been built on four pillars. These are: national pledges to reduce emissions, non-state contributions by regions, cities and businesses, climate finance and the overarching legal agreement of the climate deal.

High-profile figures – such as Christiana Figueres, executive secretary of the UN Framework Convention on Climate Change (UNFCCC) and US president Obama – have called on companies to make a commitment in the battle against climate change by publicly pledging emissions reductions across their businesses.

To date, 81 companies – with a combined market capitalisation of over $5 trillion, just under two thirds of the S&P 500's total market capitalisation – have made commitments under the American Business Act on Climate Pledge. These included companies such as Apple, Coca-Cola, Microsoft and Wal-Mart.

By signing the American Business Act on Climate Pledge, the companies are voicing support for a strong outcome at COP 21, demonstrating an ongoing commitment to climate action and setting an example to their peers. Pledges can include efforts to reduce emissions, increase low-carbon investments, deploy more clean energy and take other actions to build more sustainable businesses and tackle climate change.

We welcome the announcements by US and – as part of the UNFCCC[2] and the We Mean Business Coalition[3] initiatives – European companies on their plans to cut carbon emissions and encourage others to follow suit, as the potential for a positive impact on the climate change summit and its aftermath is substantial.

Making commitments to the reduction of greenhouse gas emissions is partly about reducing the risk companies are exposed to as a result of climate change, for example in the event of an applicable cost of carbon on emissions. But companies also benefit from making climate change pledges by improving their reputations, particularly in consumer-facing industries.

While we are supportive of greenhouse gas emissions reduction targets and aware of their significance in helping to build political momentum, we realise that the quality of pledges can vary significantly. However, even so-called greenwash pledges acknowledge the challenges climate change presents to businesses and can be seen at least as the start of the process of taking climate change into account in a company's strategy and operations.

Furthermore, corporate greenhouse gas emission reduction targets can be just as difficult to set as those commitments made by countries. Both are struggling with the same issues when setting targets, such as different timeframes, objectives and whether to set relative or absolute reduction targets. Our view is that carbon pledges by companies should be SMART – in other words specific, measurable, attainable, realistic and timely. They need to be value-enhancing as well as sufficiently stretching over a five to 10-year period.

A poor example we have seen was a company pledge to a 20% reduction in carbon emissions per GBP of sales. Inflation and increasing revenue have created favourable tailwinds that will help it meet a large part of this target without any change to its business model. After allowing for these factors, the company's own contribution to reduce its absolute emissions is a much more modest figure of approximately 5%.

As part of our corporate engagement programme, we scrutinise the pledges made by companies. We also encourage companies to update existing pledges, incorporate these into their wider environmental and business strategies and publish them where this has not been the case to date. We expect companies to be clear on their strategic plans to move to a carbon-constrained world in their disclosures and in their discussions with us.

Pricing

As much as we need companies to support government action, we also want to see them taking and sharing leadership on climate issues. This is particularly important in view of the new Clean Air Act in the US, which may lead more US states to introduce carbon pricing. Some oil and gas majors have stated the importance of widespread and effective pricing of carbon emissions to replace coal with gas in power generation[4], while Canada's oil industry has called for an enhanced carbon price that already exists in the province of Alberta. More importantly, renewable energy will also receive a boost. A coalition of 120 investors, representing over CAD4.6 trillion (€3.1 trillion) in assets under management, including Hermes EOS, has written to the prime minister of Alberta to voice support for the planned increase of its carbon price from CAD15 to CAD20 in 2016 and to CAD30 in 2017, as this would make the province a favourable investment jurisdiction.

We welcome the efforts of companies to improve long-term business resilience by factoring a cost of carbon into their investment decisions. We also urge companies, if they have not done so already, to advocate publicly for the implementation of a cost of carbon across large parts of the economy. Although it is not the only policy measure required, we believe that without this mechanism, businesses will fail to understand the true costs of alternative actions.

In our longstanding engagement with Exxon Mobil, we have welcomed its greater willingness to engage deeply in the debate on climate change, which presents a significant step forward for the company and the industry. In line with the International Association of Oil & Gas Producers (IOGP), Exxon believes that a revenue-neutral, market-based carbon pricing system is the best mechanism to reduce carbon emissions but like the IOGP it falls very slightly short of publicly advocating a carbon price. We have encouraged the company to support carbon pricing publicly and to use its influence on the IOGP to follow suit. Some of the other oil and gas majors have made such a public commitment and we believe that Exxon should be at the edge of evolving best practice in the industry in order to minimise the risks it is exposed to from changing climate regulation.

The introduction of a carbon price will help the industry reduce the risk of more disruptive public policy action and pave the way for investment in carbon capture and storage and other technology that will reduce the industry's own direct emissions and those of its customers, reducing the long-term risk to asset owners. The Oil and Gas Climate Initiative has been prominent in seeking change on this.

We look forward to continuing our dialogue with Exxon Mobil and other important players in the climate change debate.

Methane

We also engage with companies on the issue of methane in an effort to curb the effects of climate change. Over a 20-year time horizon, methane has far greater greenhouse gas effects than CO_2 – it is at least 84 times more potent, according to the Climate and Clean Air Coalition's (CCAC) Oil and Gas Methane Partnership. Cuts in methane emissions can therefore lead to important and quick reductions in global warming.

Methane is lost in upstream oil and gas production, as well as further downstream in pipelines and distribution, transmission, storage and processing. While it is relatively easy to incorporate best practice into new well designs, it is more challenging for old facilities. Due to the low gas price, there is less economic incentive to invest in retro-fitting and without a local market and infrastructure that allows the capturing of methane, the cost of capturing may be too high, meaning that it is easier and cheaper to flare it.

About 140 billion cubic metres of gas – mainly methane – per year are burnt off by the oil industry in flares, according to the World Bank, causing more than 300 million tonnes of CO_2 to be emitted to the atmosphere. According to the World Bank, the gas estimated to be flared annually is equivalent to nearly 20% of US and over 30% of the EU's gas consumption.

We engage with various initiatives on methane, such as the CCAC Oil and Gas Methane Partnership, which is attempting to build a best practice coalition to reduce methane emissions in upstream oil and gas operations, and the Zero Routine Flaring by 2030 initiative by the World Bank.

By endorsing the World Bank initiative, governments, oil companies and development institutions recognise that routine gas flaring is unsustainable from a resource management and environmental perspective. They have agreed to cooperate to eliminate ongoing routine flaring as soon as possible, and no later than 2030, and completely forgo the practice in new oil field developments. In addition, they promise to publicly report their flaring and progress towards the target on an annual basis.

US energy company Southwestern Energy is leading on this issue. It is the only US member of the CCAC Oil & Gas Methane Partnership and targets less than 1% well-to-wheel methane emissions. The company acknowledges that the benefits of buying gas over coal disappear if methane emissions make up over 1% of that limit and has set ambitious environmental targets.

In our engagements with oil and gas companies, we encourage them to endorse the Zero Routine Flaring by 2030 initiative and join the CCAC Oil & Gas Methane Partnership, publish their policies on flaring and seek to stop this practice.

For further information, please contact:

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[2] http://climateaction.unfccc.int/companies.aspx?industrygroupid=5

[3] http://www.wemeanbusinesscoalition.org/

[4] http://www.ft.com/cms/s/0/682898fe-07e4-11e5-9579-00144feabdc0.html#axzz3p0DP5yrV

Social

The next frontier – Developing diversity

We have been engaging to increase diversity at companies at the board level and beyond and we are developing a diversity framework.

Setting the scene

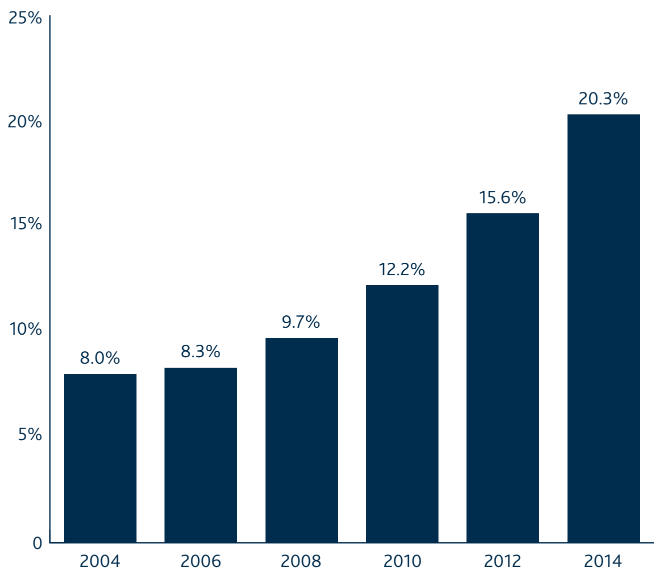
The need for greater diversity in the management and leadership of companies and society has been a matter of increasing public concern. Much of the focus has been on gender diversity. In the UK in 2011, Lord Davies launched a campaign to increase the proportion of women on the boards of FTSE 100-listed companies to 25% by the end of 2015 – a target exceeded earlier this year. The 30% Club – of which we are a member – aims for 30% to be reached by the end of 2015, as 30% is deemed to be the point at which critical mass is reached. Progress has also been made at companies outside the FTSE 100. Countries such as France, Italy, Spain and the Netherlands meanwhile have followed in the footsteps of early adopter Norway by introducing quotas for women on boards, ranging from 30–40%. Germany even requires 50% of the members of supervisory boards at large listed companies to be female by 2018.

Furthermore Japan, which has traditionally been the laggard in relation to female recruitment and promotion, now targets 30% of women in management by 2020 and has passed a bill requiring companies with over 300 employees to set targets for benchmarks such as the percentage of female hires and managers and publish them starting in April 2016. We strongly support these developments. However, for the full benefits of diversity to be achieved, it needs to go beyond gender and the board.

Open, strategic questions to ask companies on diversity

- How do you define diversity?
- Do you see the benefits of diversity, in terms of performance, innovation, staff management and commercial impact?
- Are you satisfied with your current level of diversity?
- How do you integrate diversity as a driver of performance in your organisation?

Representation of women on European boards



Source: Egon Zehnder European Board Diversity Analysis 2014

What is diversity?

As well as gender, diversity encompasses nationality, ethnicity, religion, cultural background, education, personality differences, experience and skill-sets. In our engagement with companies, we have called in particular for greater diversity on boards in order for their members to provide a different perspective necessary to challenge senior executives and non-executives as well as to counter groupthink and unconscious biases that might dominate decision-making.

Benefits

It is in companies' interests to have greater diversity at the board but also at the executive and non-executive levels below. An increasing body of research[5] shows that greater diversity leads to better performance of companies. McKinsey's 2015 Diversity Matters study says that gender-diverse companies in the top quartile for diversity are 15% and ethnically diverse companies 35% more likely to financially outperform those in the bottom quartile. In the UK, for every 10% increase in gender diversity, earnings before interest and tax rose by 3.5%, according to the study.

Other research shows that different forms of diversity bring values, change corporate risk-taking behaviour and may even have an impact on likelihood of fraud. Groups that perform at a high level have a wealth of external perspectives, characteristics and approaches to problem-solving and manage the differences and potential conflicts of diversity well to reap its benefits. However, selection and promotion processes at most companies currently do not promote diversity – instead they continue to build homogenous teams.

Besides strategy and governance, diversity data at all levels helps a company understand its customer and product footprints. For example, a luxury goods company should have the necessary staff and executives' composition to explore its high-growth markets. Furthermore, embracing diversity sends a signal to staff, investors and the public that the company takes a positive attitude towards differences in views and is committed to challenging the status quo. These issues are highly related to our engagement work on strategy, risk and governance at the board and senior executive levels.

Engagement

Often, diversity is too narrowly defined and some companies may pay lip service to it as a compliance issue without understanding how diversity initiatives could bring benefits to them. We therefore seek to engage with companies and discuss their strategy on how different dimensions of diversity are taken into account, so that diversity truly becomes a strategic response rather than a knee-jerk reaction to developing trends, expectations and opportunities.

Most of our work on diversity has focused on board composition with objectives relating to independence, countries of origin/international experience reflective of the footprint of the company and professional or industry experience. Moving beyond these initial criteria, we are also looking at how board membership factors in gender as this tends to force companies to look outside their traditional talent pool. Other background features, including education, are much more difficult to assess although prior existing ties such as university, past mutual jobs and other institutional ties often influence selection processes.[6]

Encouragingly, more companies are making an effort to increase diversity – including beyond the board. In a meeting with its head of diversity in the second quarter of this year, for example, we learned about some of the best practice and practical initiatives undertaken at Lloyds Banking Group to increase diversity among its 8,000 most senior managers. The dialogue was a follow-up to the CEO's assertion in a previous meeting with us that Lloyds is targeting 40% of its senior staff being women on merit by 2020 – up from currently 29% – as the bank has recognised the waste of talent and the diversity of its customer base. In the meeting, we uncovered some groundbreaking work carried out by Lloyds in its approach to recruitment, consideration of working practice structures, mentoring and childcare as well as covering gender, ethnicity, age and sexual orientation. The initiative is carried out by a small dedicated team to ensure that diversity is the responsibility of everyone at Lloyds. It is overseen and promoted by the CEO and his executive team, each who have key performance indicator targets relating to diversity. Diversity also regularly features on the meeting agenda of the executive committee. We continue to monitor progress at Lloyds and plan to take its best practice on diversity below the board level to other companies.

Equal pay

With good progress being made on the representation of women on FTSE 100 boards, focus has turned to the low number of women chairs and the loss of talented, senior women from the executive pipeline. One contributing factor to this may be the pay gap between the genders whereby men get paid significantly more for the same role. The UK's Chartered Management Institute found in a 2014 study that women only take home 77% of men's earnings in full-time comparable jobs.

Large employers in Austria, Finland, Germany and Sweden are already legally required to report on their gender pay gap.

In 2015, the UK government proposed that UK companies should provide an overall gender pay gap figure that captures the difference between the average earnings of men and women as a percentage of men's earnings.

We recently responded to this consultation, supporting the implementation of section 78 in the Equality Act 2010 – gender pay gap information – which the government has committed to introducing within the Small Business, Enterprise and Employment Act 2015.

We welcome this proposal, as we believe the publication of an overall gender pay gap figure is an important step forward. The published figure may not provide meaningful comparisons across sectors but will reflect different and specific circumstances for each organisation beyond a simple pay gap issue. Moreover, we believe that increased transparency on the matter is likely to propel companies into action. Companies could then provide additional information on a voluntary basis to explain their own specific circumstances. Overall, we feel this legislation has the potential to encourage companies to ask themselves the right questions regarding their general approach to diversity and human capital management.

In our engagement with companies, we address the quality of management and organisational issues, such as staff retention, to ensure equal opportunities. We find that companies that are implementing measures to improve equality to be more transparent and willing to share data on their progress, including survey results. We encourage the gender pay gap indicator to be made available to all stakeholders, including employees. For a public company, the indicator should be published in its annual report, to ensure regular monitoring as well as its visibility to management and accessibility to shareholders. A specific target for reducing the pay gap is helpful to ensure that action is taken before the divide widens further.

Closing the gender pay gap would undoubtedly benefit society as a whole. A wide set of research indicates that rising levels of productivity and employment, which drive a healthy economy, are natural by-products of a narrower gender pay gap. Companies that manage to narrow their gap benefit from lower turnover and a higher employee attraction and retention rate.

Diversity framework

We are developing a methodology that can be tailored to our engagement with companies in which our clients invest. We are taking a pragmatic approach to its design, which encompasses culture and regulation, sector, geographic footprint and the capital structure of a company, all of which can contribute to the unlocking of value and avoidance of risk.

We will continue to challenge companies that fail to tackle diversity issues and push them to meet the voluntary targets or quotas. We will also increase our focus on achieving greater diversity at the executive level.

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[5] Diversity Matters, McKinsey 2015
The Business Case for Equality and Diversity, UK Government 2015
Is Board Diversity Important for Firm Performance and Board Independence, Monetary Authority of Singapore 2012
Gender Diversity and Fraud, Cumming, Leung and Rui 2015
Diversity of Corporate Board Committees and Financial Performance, Carter et al 2004
The Difference: How the Power of Diversity Creates Better Groups, Firms, Schools and Societies, Scott E Paige 2007
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Corporate Governance, Board Diversity and Firm Value, Carter, Simkins and Simpson 2003

[6] http://www.sonean.com/uploads/media/20744_SONEAN_Whitepaper_Feb_2015_en_final_Web_01.pdf

Double trouble – There is nothing equal about dual-class share structures

We promote the principle of one-share one-vote and push for equal shareholder rights at companies where dual – or multiple share structures are the norm. We also press for strong safeguards to be in place wherever there are such structures.

Setting the scene

Dual- or multiple-class share structures are based on the idea that not all shareholders are equal. This means that some shareholders hold disproportionate voting power in relation to the shares that they own. The complexities and costs involved in share registration where multiple-class share systems are in place, the limitations on eligibility for some shareholders given the different fund and holding structures and a potential lack of understanding of the system create a disadvantage for international investors. This is often the case where companies still have their founder in an influential position and it has recently occurred at the initial public offerings of Alibaba and Facebook. In France and Italy, the regulator has promoted dual-share structures in an attempt to reward long-term investors. As a result, many of our clients are invested in companies with multiple class share structures.

Hermes EOS view

Our view is that equal voting rights should be attached to shares regardless of the total holding or other characteristics of an investor. We therefore promote the principle of one-share one-vote, which ensures proportionality between equity ownership and voting powers, and thus economic risk-bearing. Any divergence from one-share one-vote can have a disenfranchising effect on minority shareholders, which is why we do not support multiple-class share structures when engaging with companies. While we are in favour of encouraging long-term investment, we oppose the measures recently taken in France and Italy.

Europe

In France, the Florange Act – which was adopted in March 2014 – seeks to reward long-term investment by granting double-voting rights to shareholders registered for a continuous 24-month period. Unless companies opt out by amending their articles of association, this provision will apply from April 2016.

Due to the strengthening of large block shareholders over the interests of minority shareholders, the process effectively disadvantages international institutional investors. In our view, the mechanisms of the Florange Act will therefore not achieve the objective of long-term investment in a fair and equal manner.

We have systematically engaged CAC40 companies regarding the dilution of shareholder rights as a result of the Florange Act, urging them to maintain their current application of one-share one-vote or reconsider the implementation of double voting rights and reinstate the principle of one-share one-vote. So far, only 12 of the CAC40 companies have chosen to include one-share one-vote in their articles. Some companies are reluctant to opt out of the Act, particularly where double voting rights existed prior to the Florange Act, as they claim they are working well.

Italy introduced legislation on loyalty shares in 2014, whereby companies may opt into double voting rights rather than opt out like in France. Italian listed companies can grant double voting rights to shareholders who have held their shares continuously for at least two years. The Italian government passed a resolution in July 2014 lowering the majority requirement from two thirds to half the votes cast for companies wanting to change their by-laws to implement loyalty shares. This caused significant concern given that, according to the Italian regulator CONSOB, approximately 70% of Italian listed companies are majority-controlled.

Hermes EOS voted against loyalty share proposals at AGMs in 2014, and in 2015 we co-signed a letter sent to a selection of listed Italian companies, urging them to maintain the principle of one-share one-vote.

Pressure from institutional investors and non-executive directors at major Italian companies helped stop the extension of the simple majority rule, which expired at the end of January 2015.

The initial draft of the revision of the EU Shareholder Rights Directive contained suggestions for loyalty shares. Following our intensive lobbying and that of other investors expressing concerns, these suggestions were dropped in the final draft text, as EU member states would have been required to implement similar rewards for shareholders to those envisaged by the Florange Act, reducing the attractiveness of European companies as investments and disadvantaging shareholders.

Hong Kong

But multiple-class share structures rights are not just limited to European companies. They have become a contentious issue in Hong Kong of late[7] although the listing of companies with multiple class share structures has not been practice at the Hong Kong Exchanges and Clearing (HKEx).

In August 2014, in light of increasing[8] listings by Mainland Chinese companies with multiple-class share structures in the US, particularly against the backdrop of the initial public offering of Chinese e-commerce giant Alibaba with a partnership structure on the New York Stock Exchange, the HKEx published a concept paper to explore the idea of multiple-class share structures.

In June 2015, it published a summary of the responses it received to the paper, recommending to allow primary listings with multiple-class share structures that may potentially adhere to some of the following features:

1) In terms of **size**: Companies eligible for multiple-class share structures should have a large market capitalisation, such as a high minimum valuation

2) In terms of **structure**, companies should have:
   - Sunset clause – the loss of superior voting rights at a pre-set future date
   - Continued active involvement of the founder
   - Restriction on transfers
   - Cap on votes per share
   - Shareholder vote – the loss of superior voting rights after a vote by independent shareholders
   - Minimum equity threshold held by founders or others
   - Board structure with a greater proportion of independent non-executive directors
   - Be allowed for secondary listed company if the company is already listed in a market with credible regulatory standards.

We believe that specifying the size of the company poses significant risk to institutional investors because companies with large market capitalisation are highly likely to be included in market indices. Investments that use market indices as benchmarks and passive funds instruments are therefore most exposed to multiple-class share structures. Passive investments are obliged to buy, and most likely hold, the stock.

We acknowledge that investors may benefit from founders' value that is significant for a growing company, including value that is realised by granting companies the ability to manage short-term investors who seek to reap gain at the expense of long-term growth of the company.[9]

But Hong Kong's Securities and Futures Commission (SFC) unanimously rejected the HKEx' proposal to allow companies with multiple-class share structures to list in certain circumstances a week after the HKEx published its proposal. The SFC had concerns about regulators having to assess compliance with the criteria for companies to be eligible for multiple-class share structures, such as the contribution of the founder/s. It argued that these criteria can only be applied subjectively and are therefore inherently vague. The SFC also argued that Hong Kong's securities markets and reputation would be harmed if these structures became commonplace.

The HKEx has since suspended the second consultation on the issue.

We propose that ordinary shareholders should be entitled to vote for or against the multiple-class share structure on a regular basis, irrespective of retirement or disassociation of the founders from the company, with equal participation from shareholders with different share classes. The key difference of our proposition here versus that of the HKEx is that multiple-class share structures are not a structure that shall be maintained, but a transition arrangement that needs to be voted for periodically to justify a misaligned structure due to the interim benefits it brings. Ongoing stewardship is therefore necessary to maintain sound corporate governance and the protection of minority shareholders when companies – albeit temporarily – deviate from best practice in order to benefit from the upside potential of multiple-class share structures.

US

Dual class shares structures also exist in the US. We have been engaging with media company Twenty-First Century Fox on this issue. Its dual-class share structure gives founder Rupert Murdoch and his family control of more than 40% of the voting power, despite his relatively modest 12% economic stake in the company. When the publishing and book businesses were spun off from the TV and film segments in June 2013 under the name 'News Corp', the same dual-class share structure was incorporated into the new entity, preserving the significant governance risk associated with the brand prior to the spilt.

At News Corp's first annual meeting in 2014, we introduced a shareholder proposal calling for an end to this arrangement which received 90% support from independent investors. We were disappointed that the board chose to ignore this resounding message sent by investors by refusing to engage in meaningful dialogue to explore possible alternatives. Building on the overwhelming support from independent investors, we again filed a shareholder proposal at News Corp calling for the elimination of the dual-class share structure in 2015. We believe that the implementation of our 2015 proposal would reduce business risks at News Corp and Twenty-First Century Fox and help make the boards more responsive to the interests of all shareholders and permit greater scrutiny of management. After the presentation of our shareholder proposal in the fourth quarter of 2015, we will keep pursuing the board to enter into meaningful discussions.

Overall, we will continue our engagement with policy-makers and companies to ensure an optimum outcome for our clients and investors.

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[7] In Hong Kong, multiple-class share structures are referred to as weighted voting rights

[8] For example, nine of the 12 Mainland Chinese companies to primary list on a US exchange in 2014 adopted a multiple-class share structure.

[9] Tech Firms Seek Ways to Fend Off Activist Investors, Ovide and Clark Wall Street Journal 26 May 2015, Why Activist Investors are Targeting the Tech Industry, Griffith Fortune 21 July 2015.

Lessons learned from the past – Mitigating environmental and social risks in Brazil's resources sector

We have longstanding engagements with several Brazilian companies and have recently been on the ground to continue our dialogue.

Setting the scene

Brazil is the largest country in South America in terms of territory and population. Due to its natural resources and large labour pool, Brazil became Latin America's economic powerhouse in the 1970s before negative growth rates and financial crises impacted the country in subsequent decades. Its economy picked up again following the consolidation of the three pillars of fiscal responsibility, inflation targeting and floating exchange rate in the 1990s. Brazil was one of the first emerging markets to recover from the global financial crisis but has since experienced the end of the commodities super-cycle and a downturn in the economy. Natural resources – from farmland, water and forests to onshore and offshore oil and gas exploration – have continued to be the focus of many of the country's largest companies, which, although some of them remain controlled by the state, attract international investors.

Itaipu Dam – Source: Eletrobras

Corruption scandal

A large corruption scandal involving government officials and one of the world's largest companies – state-controlled energy company Petroleo Brasileiro (Petrobras) – engulfed Brazil in 2014 and 2015.

Senior Petrobras officials that were appointed by political parties in the ruling coalition government are alleged to have been bribed by large construction firms in return for over-inflated contracts, which in turn are said to have helped fund political campaigns. The investigation into so-called Operation Car Wash (Lava Jato) has accused over 100 people of corruption, money laundering and other financial crimes, including many politicians.

Governance

Since the corruption allegations surfaced, Petrobras has been under pressure from the public, media and shareholders to get its house in order and has taken significant steps to improve its governance and compliance in an attempt to restore investor confidence.

The company has appointed independent directors to its board to replace the previous government ministers, something we had long been pressing for in our engagement because we felt that the board had neither been fulfilling its oversight function nor challenging management. The appointees included an independent chair, the first non-government official to lead the board in 12 years, marking a sharp contrast in the board to that of the past.

Together with other shareholders, we were heavily involved in the selection of two minority shareholder representatives and were pleased that Petrobras published their names ahead of its AGM. We subsequently supported their successful election. Given their rich expertise, we believe these new shareholder-appointed directors will help raise the level of discussion and improve the decision-making on the board, thus increasing the chances of the company acting in the best interests of all its shareholders. The company also added independent members to its fiscal council, which is charged with overseeing audit issues. The new composition of the board and the relative ease with which we were able to nominate and ratify the minority shareholder representative director candidates indicate a meaningful shift in board composition and quality at Petrobras and a significant step towards its depoliticisation.

Furthermore, to create a strong compliance function in the company, a chief compliance officer was appointed who has been tasked with putting in place a compliance programme. In our meeting with him, we examined the progress made since the creation of the compliance division in early 2015. Having pressed Petrobras to implement a robust compliance culture since the outset of the corruption scandal in 2014, we are pleased that a credible compliance programme has been devised and were assured that senior management and the board are committed to its speedy implementation although a change in culture – particularly in a company with 20,000 accredited suppliers and 86,000 employees – takes time to take effect. We will monitor the implementation closely to ensure that the reforms are effective and sustainable in the long term. We also offered examples and contacts of companies that underwent significant change of culture after being affected by corruption, to facilitate an exchange of best practice.

Public policy efforts

At the same time – albeit unrelated to the corruption scandal – pressure for good governance is increasing in the public policy sphere. The fifth version of Brazil's Corporate Governance Code is under review and expected to be published in the fourth quarter of 2015, which we addressed when meeting the organisation responsible for the code, the independent Brazilian Institute for Corporate Governance. While the code is voluntary, a discussion is underway to see whether the principle of one-share one-vote embedded in it could be made more flexible, given that it is common in Brazil to have two classes of shares – voting and non-voting shares – although only companies abiding by the one-share one-vote principle have recently been listed on Brazili's stock exchanges. In our consultation response we reinforced our view in favour of one-share one-vote.

Meanwhile, Brazil's market regulator CVM has been debating enforcement of the country's Corporate Governance Code via a complyor-explain clause, suggesting that companies failing to adhere to the code will have to sufficiently explain their reasons for non-compliance. In addition, the BM&F Bovespa stock exchange has launched a public consultation for a voluntary code for state-controlled companies. If the draft is implemented, companies will be scored against a points system for good governance structures to obtain a seal of approval.

The Brazilian parliament is also discussing a draft bill aimed at state-controlled companies, although many, such as the Association of Capital Market Investors AMEC, have come out against enforcement by law. The overwhelming opinion seems to be that Brazilian legislation is sufficient but that the problem lies with enforcement.

Dam constructions

The construction of the Belo Monte dam on the Xingu river in northern Brazil has been controversial and attracted strong criticism from NGOs, the media and the public. The consortium building the Belo Monte dam – Norte Energia – for example, had been accused of failing to obtain free, prior and informed consent from the indigenous tribes affected by that construction. Although Norte Energia significantly invested in the mitigation of environmental and social risks, communication with the stakeholders was not effective.

With new dams proposed to be built on the Tapajós river in the North of Brazil – again to provide Brazil's growing population with clean energy – we visited Eletrobras, the company involved, to see whether any lessons had been learned from Belo Monte.

Although any construction projects undertaken – especially as they typically take place in remote areas – will always have some impact on the environment or communities on the ground, in our engagement with companies we urge them to minimise that impact and the associated risks by putting in place appropriate mitigation measures.

In the past, projects had a severe impact on their locations, for example by requiring big reservoirs, flooding of a significant area and a large number of workers. More recent projects have managed this more carefully. Equipment was typically transported to the construction site on purpose-built roads. Now, to minimise environmental and social impacts, the materials are moved to the site by river barges whenever possible. Furthermore, although the construction schedule for the dams in the Tapajós river depends on many factors – such as a period of consultation by the government – Eletrobras has already been engaging intensively with local communities on the developments and informing them about the dams and hydroelectric power plants, which included the preparation of communication materials to indigenous communities in their own language. A preliminary environmental impact assessment has been submitted to the authorities and was met with criticism from some NGOs.

Unlike in the past, a new town will not be purpose-built in the area to accommodate employees and their families. Workers will instead be required to live at buildings on the construction site by themselves, preferably in the area to be flooded post-construction when the reservoir is formed, thereby affecting a much smaller amount of land. In addition, this time a population of only 800 is expected having to be relocated, a significantly lower number than at the Belo Monte project.

Eletrobras acknowledged that it could improve its communications with stakeholders. It has enhanced disclosure in its 2014 sustainability report, particularly in terms of environmental and social indicators by following the 3.1 guidelines set by the Global Reporting Initiative (GRI). It told us that the 2015 sustainability report, to be published in early 2016, will follow GRI 4 and include targets for greenhouse gas emissions and water consumption for the following five years.

After expressing concern about disclosure and reporting in previous engagements, we were pleased to see the progress made.

We pressed Eletrobras' environmental and social risk team to adopt best practices in its relationship with the communities affected by the project and in the reporting of performance. The company has established an environmental and social risk committee aimed at sharing best practice. Furthermore, Eletrobras has attempted to be transparent by disclosing any action it takes to stakeholders, something we continue to strongly encourage.

Disaster preparedness

Overall, a lot of work has been undertaken by Brazilian companies on environmental issues and disaster preparedness.

We were assured that Petrobras has taken extra measures to make its disaster response more effective, as a result of the lessons learned from two big accidents it incurred in 2000, BP's 2010 Macondo spill in the Gulf of Mexico and the increased complexity of its new deep water fields. In addition to its large in-house capabilities, upgrading and investing in safety measures to mitigate the risk of oil spills, Petrobras joined the Oil Spill Response and Subsea Well Response projects, together with eight other international oil companies, which have invested in intervention equipment that can be deployed around the world. This includes four capping stacks – the equipment that ultimately stopped the Macondo spill and one of which is located in Brazil – three containment toolkits – again one of which is based in Brazil – and a stock of dispersants. Petrobras' own structure is equally robust, with a 500-strong response team based in 25 cities, equipped with barriers and dispersants ready to be dispatched during any accidents. In addition, it has 40 oil spill response vessels to cover its offshore platforms. Given the scale of its oil and gas production and deep water construction vessels in the country, these measures are crucial. The company has not had any major spills since 2000 and incurred 32 small spills, amounting to 437 barrels only, in 2014.

In a meeting with Petrobras' environmental and climate change team, we challenged the company's strategy towards the possible impact of climate change in its operations and pressed for greater transparency and better reporting. We were pleased with the various initiatives aimed at reducing flaring, greenhouse gas and other atmospheric emissions, and at increasing energy efficiency. Petrobras has also improved the quality of its reporting of environmental indicators, which has been an important item on our engagement agenda with the company. It has started a detailed mapping of climate change scenarios across the various regions of Brazil. As the work is in its early stages, we agreed to monitor progress, particularly the adaptation and mitigation actions that may result from it, and to convey to the board the need to ensure there are enough resources allocated to the project, given its budget constraints.

As companies have to make cuts in the wake of falling commodity prices, we continue to seek to ensure that their environmental and social risk management is not compromised. Despite the pressure they are under, we have gained a sense of commitment to good risk management practices from Brazilian companies.

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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 social, environmental and ethical risks, with structural governance issues. We challenge and support corporate management 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 the company's strategic positioning. Companies 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

Climate change portfolio analysis

Lead engager: Bruce Duguid

We welcomed the publication of a climate change portfolio analysis by a dual-listed extractives company. This sets a welcome new precedent in transparency by a major company regarding its preparedness for the challenges of climate change. The company confirmed that the publication was based on the analysis conducted in 2014 which had been the subject of a successful engagement objective by Hermes EOS. We were comforted to hear that the climate change portfolio analysis has been discussed at board level and informed the wider group strategy. Furthermore, the full publication gave reassurance about the level of granularity of analysis. It also demonstrated that, even in a more extreme 2°C scenario, with a cost of carbon of $80/tonne, climate change is estimated to reduce the operating margins of the company over a 20-year period by only 5% because, while demand for some commodities is anticipated to fall in a lower carbon economy, the company expects it to rise for others. We will use this precedent to encourage the company's peers to carry out a similar exercise.

Data privacy and security

Lead engager: Hans-Christoph Hirt

Having learned the lessons from the data leakages of 2008 – the theft of personal information of 17 million customers – a European company is now at the forefront of data privacy and security measures, something we have strongly encouraged. The company has been vocal about the need to bolster data security measures, not least through its lobbying efforts at the EU level, demanding the implementation of uniform data protection regulations. Considering data security is its unique selling proposition, the company claims to have been able to monetise this strength and considers the demand for data security to be an upward trend. Reporting of data security measures is detailed. For example, the company does not only publish a separate annual data privacy and data security report, but also informs customers about its most recent data security improvements and incidents with its online status report on data privacy. We also challenged the company's perception of the reputational damage caused by allegations of its involvement in espionage. The head of group security policy and public safety asserted that it had acted in accordance with the domestic law at the time. While aware of the reputational risk, the company believes that the public has now understood that it had been required by law to transfer the data. We thus feel comfortable with the data protection measures. Furthermore, we are satisfied with the carbon footprint reduction measures in place at the company and its overall human capital approach, particularly with the approach and priorities that the new executive board member responsible for human resources has set. While applauding the company's reporting on key sustainability issues, we pushed for a switch to integrated reporting to show how it delivers value for shareholders in all areas.

Presentation at Hermes EOS' Client Advisory Council

Lead engager: Hans-Christoph Hirt

In a highly unusual group investor call, the special adviser to the chair/CEO of an emerging markets company presented to us at our Client Advisory Council via teleconferencing. This allowed us to gain valuable insights into the company's human capital management, its strategy involving diversification and overseas expansion as well as its corporate governance. During the call we discussed the various measures the company has taken to look after its workers, such as increasing wages, moving production sites inland and closer to the families of workers, providing more off-campus housing and counselling, introducing automation and robotics in its factories, as well as job rotation for the most monotonous work. The company's progress on human capital management was verified independently by the Fair Labor Association. We questioned whether the company should invite the FLA back for another review. The adviser does not see a case for undertaking another full review and suggested we speak to its clients about their regular audits of the company's operations.

We also discussed the company's strategic focus. The company is growing organically, as well as through partnerships, joint ventures and acquisitions. It is also seeking new growth opportunities in other related businesses and is planning a major move into a different market. The move would create production sites that would serve some of its key customers. However, the country under consideration is known for its bureaucracy and difficult labour laws and the company does not have the same advantages as in its home market, the move would come with some new challenges and risks. We encouraged the company to improve transparency on its capital allocation decisions and disclosures relating to the performance of investments and new businesses. Key man risk and succession planning will be a focus in our engagement on governance over the next 12 months.

Recombination of chair and CEO

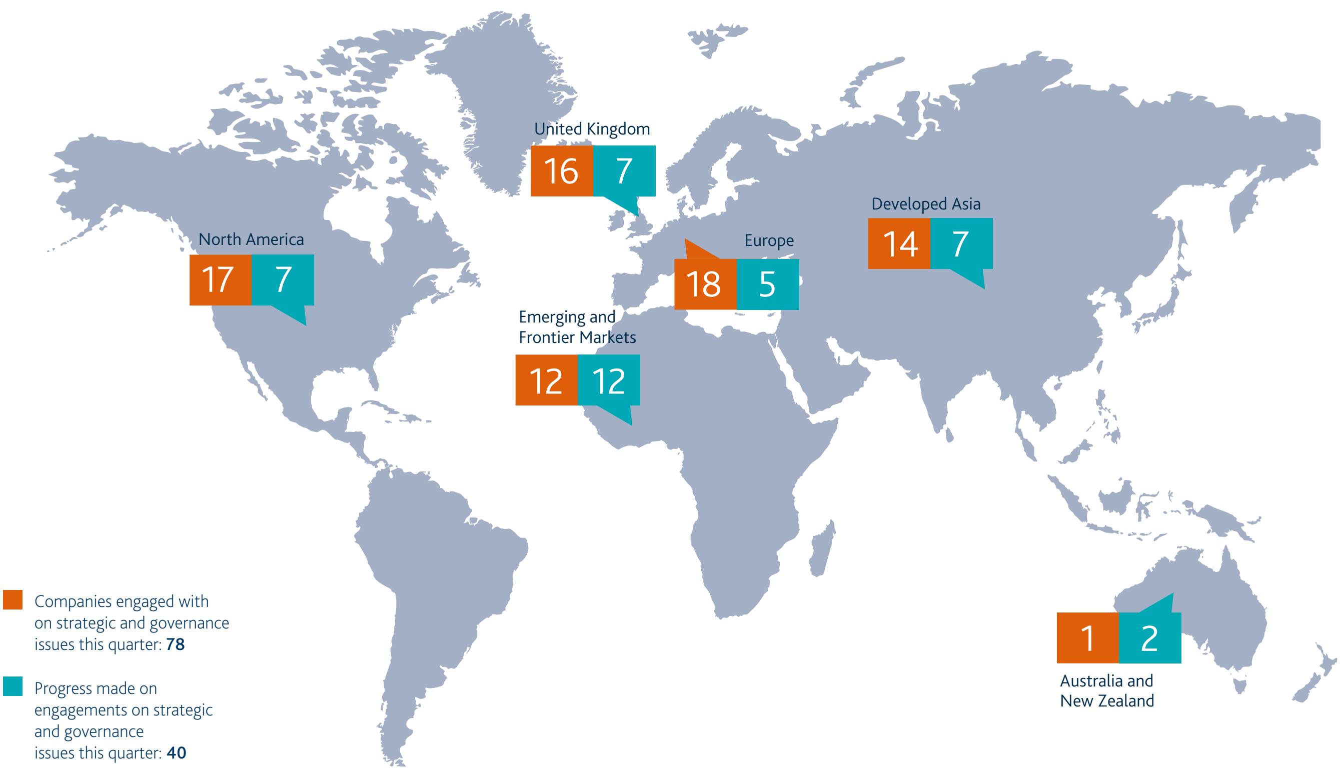
Lead engager: Tim Goodman

Ahead of a vote to approve the decision of the board of a US company to recombine the roles of chair and CEO, despite a binding shareholder vote to split the roles in 2009, we had a positive meeting with its lead independent director. He acknowledged that the board had made a mistake by changing the company by-laws to facilitate the recombination of the roles. We commended him on his willingness to meet shareholders and on the board's strong specification for his role, which is now close to our expectations. However, we pressed for a clear explanation of the board's desire to recombine the roles. We argued that retaining an independent chair would reflect well on the CEO and the board in the eyes of its investors and customers and provide reassurance about its governance progress. The lead independent director understood our position and highlighted that the CEO and board would respect the decision of the shareholders' vote. We also touched on the challenge of overseeing appropriate conduct and culture and heard that this topic is high on the board's agenda.

Subsequent to the meeting, we had a follow-up call with the general counsel during which he attempted to persuade us to recommend that our clients abstain on the vote. But while appreciating the suggestion and efforts made by the board to demonstrate its commitment to improve the company's governance standards, it was important to send a message to boards in the US that they should not reverse shareholder decisions, which is why we recommended a vote against.

We received a warm reply to our letter explaining the voting decision, confirming that every board member is keen to continue the dialogue with us notwithstanding our differences over the vote.

Engagements on strategy and governance issues



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 its clients' shareholdings over the longer term.

Overview

We actively 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 in value for shareholders and developing codes of best practice for governance, management of key risks and 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 rather than being moulded to the narrow interests of other market participants – particularly companies, lawyers and accounting firms, which tend to be more active than investors in these debates – whose interests may be markedly different.

Highlights

Business Supply Chain Transparency on Trafficking and Slavery Act

Lead engager: Darren Brady

Together with over 50 large institutional shareholders, we conveyed our support to the US House of Representatives and Senate for the introduction of the Business Supply Chain Transparency on Trafficking and Slavery Act of 2015. If enacted, the legislation will require companies with over $100 million in worldwide gross revenues reporting to the US Securities and Exchange Commission to disclose measures they have taken to identify and address the risks of forced labour, human trafficking and the most severe forms of child labour throughout their supply chains. This is likely to have broad international impact. The bill will apply to all publicly traded and private entities and comes against the backdrop of the California Transparency in Supply Chains Act of 2010 and the 2015 Modern Slavery Act passed in the UK, which calls for corporate disclosure on human trafficking mitigation efforts, including action to ensure end-to-end supply chains are slavery free. We are confident that the proposed legislation will not be burdensome for business but will build on existing commitments to responsible corporate practice. Some companies have been disclosing human rights supply chain information for many years, which increasingly includes information about human trafficking risks across their global operations.

Enhancing dialogue between investors and non-executive directors

Lead engager: Hans-Christoph Hirt

Together with a large auditing firm, we launched a project aimed at developing guidelines and best practice in the dialogue between investors and non-executive directors in Germany. While – with our help – engagement has developed significantly over the last decade in the market, the legal implications of this dialogue are controversial and the quality and quantity of dialogue varies significantly. By developing guidelines that are supported by companies and investors, we seek to remove legal uncertainty and encourage more constructive dialogue between investors and non-executive directors to ensure accountability and more access to information. We also believe that bringing investors and non-executive directors closer will enhance the confidence of foreign investors in the German two-tier system and facilitate company-specific approaches to governance issues such as board composition and remuneration. This topic is particularly relevant in light of the stewardship requirements in the revised Shareholder Rights Directive.

We met influential German companies institute DAI to discuss the project and were delighted that it is supportive of the initiative and willing to get involved. This is even more significant as DAI is home to the German Corporate Governance Commission which has historically been sceptical about this topic.

Institutional Investor Council Malaysia

Lead engager: Hans-Christoph Hirt

We participated in the inaugural meeting of Malaysia's Institutional Investor Council which was set up to oversee and support the development of corporate governance and stewardship policies and practice in the market. We were involved in the development and launch of the local stewardship code – the Malaysian Code for Institutional Investors – in 2014 and were therefore delighted to accept the invitation to join the Council as the only non-resident representative of international institutional investors. Malaysia's major pension funds are all represented on the Council by senior management and we were pleased to hear that at least one of them will formally sign up to the local code. This indicates a change after limited success in obtaining formal signatories among the local funds in 2014. At the meeting we elected a council chair, agreed on the Council's objectives and terms of reference and discussed topics to be addressed in future. Given that Malaysia is the first market of the Association of Southeast Asian Nations to launch a stewardship code and the likely proliferation of such guidance in other Asian markets, we suggested the Council play a role in promoting stewardship in the region and liaise with other bodies overseeing codes and guidance in Asia. This should help to ensure some consistency in principles and implementation between different markets which will become increasingly important for institutional investors facing global stewardship guidance. Our suggestion was well received and will be discussed at the next meeting. Overall, while the market faces some corporate governance challenges and grapples with stewardship as a new concept, the establishment of the Council seems to have recreated some momentum. We also took part in the first meeting of the Institutional Investor Council's working committee, which will support the Council's work and effectively drive its agenda.

Other work in this quarter included

Promoting best practice

- We met the head of research at CDP, formerly known as the Carbon Disclosure Project, and the chair of the Institutional Investors Group on Climate Change corporate action programme to discuss the best way to coordinate engagement with companies on reducing **carbon emissions**. We agreed that a tiered approach focusing on the large companies receiving the main CDP Carbon Disclosure letter requesting disclosures is appropriate.
- As a member of the advisory panel of the **Chartered Banker Professional Standards Board (CB:PSB)**, we challenged whether the board is doing enough to ensure that UK banks are effectively implementing the standards. This followed a survey showing that only 37% of bank employees are aware of the CB:PSB code.
- We spoke to other investors and the secretariat of the Institutional Investors Group on Climate Change to discuss key engagement issues concerning **climate change for companies in the mining sector**. We are co-leading an initiative to develop a document outlining investor expectations on climate change for mining sector companies. This will focus on the key issues which companies should address and communicate to their investors.
- We met **French asset management association AFG** to discuss remuneration. Pay has been heavily debated in France following the public outrage caused by the departing package of the Alcatel-Lucent CEO in the wake of the company's announced merger with Nokia. The disproportionate package drew criticism from all stakeholders for not abiding by the terms of the remuneration policy voted at the AGM.
- We welcomed the attempt by the US Securities and Exchange Commission (SEC) to require listed companies to demonstrate a **link between realised pay and corporate performance**. However, we pointed out the unintended consequences of using total shareholder return as the sole underlying metric for this. We fear that this would encourage an increased use of TSR by compensation committees as a metric in their remuneration schemes and encouraged the SEC to attempt to mitigate this risk.
- The Securities Commission Malaysia was grateful for our input into its work on a **new corporate governance action plan**, which builds on its Corporate Governance Blueprint from 2011. We shared our experience and knowledge of other markets in relation to the role of regulators as well as the specific requirements the Commission is considering introducing.
- We met an anti-capital punishment NGO to discuss its campaign relating to some **pharmaceutical companies whose products seem to be used by a handful of US states to administer capital punishment**. Hearing the NGO's latest views, we were satisfied that the companies are making continued progress to minimise this problem, thereby reducing any legal and reputational risk.
- In a meeting with the Aiming for A investor coalition, which Hermes Investment Management has joined, we discussed the drafts for the proposed **shareholder proposals on portfolio resilience to climate change scenarios** with sustainability organisation Ceres, which had drawn up the initial proposal. We worked on a less confrontational proposal than those often filed on environmental issues in the US. This should provide the basis for broad investor support and constructive engagement with the companies.
- We provided feedback on the draft **Stewardship Disclosure Framework** for members, which was finalised by the UK's National Association of Pension Funds. Overall, we welcomed the disclosure framework as an important mechanism to monitor adherence to the UK Stewardship Code principles.

Public policy

- We submitted our response to the US Securities and Exchange Commission (SEC) to its consultation on **audit disclosure**. We explained how it might enhance the level and quality of disclosures provided by company audit committees.
- We are pleased that the European Parliament voted to require all EU importers of four specific minerals – tin, tungsten, tantalum and gold – to be certified to ensure they do not fuel conflicts and human rights abuses. We previously called on the European Commission to consider introducing such legislation and go beyond the much weaker and more limited voluntary rules it had proposed earlier. We were part of a group of global investors that urged the European Parliament to strengthen its proposal by expanding the scope of the legislation to ensure that all companies placing minerals on the market, be they raw, semi-finished or finished goods, are legally required to source responsibly. We also petitioned the European Commission to respect the outcome of the European Parliament's vote by taking steps to enact a mandatory **conflict mineral due diligence reporting framework** for all companies placing conflict minerals on the European market.
- The **French government is considering the implementation a stewardship code** along similar lines to that introduced in the UK and other markets. Following a request from officials at the French Treasury, we submitted information on the UK's Stewardship Code and market best practice as well as a comparison of the components of international stewardship codes.
- We responded to the UK government **gender pay gap consultation** proposing the publication by companies of an overall gender pay gap figure. We believe a published figure is an important step forward. It may not be meaningful per se, but it will reflect different and specific circumstances for each organisation beyond a simple pay gap issue. In our view increased transparency on the matter is likely to propel companies into action.
- We welcomed the amendments to the **listing requirements of Bursa Malaysia**, which we believe will promote improved reporting on sustainability by listed companies, thus better addressing the interests of their long-term owners. In our response to the consultation, we firmly endorsed the notion that issuers should disclose their management of material economic, environmental and social risks and opportunities, moving away from reporting merely on their corporate social responsibility activities.
- We participated in a meeting of the **stewardship code working group in Singapore** at which the final draft for the code was approved. We used the meeting to make a number of proposals relating to the consultation on this draft which is likely to be launched in the first quarter of 2016.
- We called on a group of UK parliamentarians to push for greater enforcement of **UK anti-corruption legislation**. We also encouraged it to stand firm against attempts to weaken the UK Bribery Act in relation to facilitation payments.
- We participated in a seminar on proposed **UK tax legislation** hosted by one of the big accounting firms. The proposed legislation seeks to develop and embed best practice rather than make substantive changes and will require large companies to publish a tax strategy. They will have the choice to sign up to a code of best practice on taxation.

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 a 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 our clients' concerns. 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 company meetings all over the world, wherever its clients own shares.

Overview

Over the last quarter we made voting recommendations at 1,180 meetings (9,825 resolutions). At 474 of those meetings we recommended opposing one or more resolutions. We recommended voting with management by exception at one meeting and abstaining at two meetings. We supported management on all resolutions at the remaining 703 meetings.

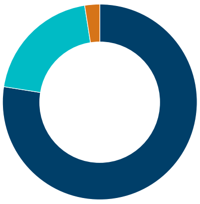
Global

We made voting recommendations at **1,180** meetings (**9,825** resolutions) over the last quarter.

- Total meetings in favour **59.6%**
- Meetings against (or against AND abstain) **40.2%**
- Meetings abstain **0.2%**
- Meetings with management by exception **0.1%**

Australia and New Zealand

We made voting recommendations at **40** meetings (**173** resolutions) over the last quarter.



- Total meetings in favour **77.5%**
- Meetings against (or against AND abstain) **20.0%**
- Meetings abstain **2.5%**

Developed Asia

We made voting recommendations at **101** meetings (**657** resolutions) over the last quarter.

- Total meetings in favour **48.5%**
- Meetings against (or against AND abstain) **51.5%**

Emerging and Frontier Markets

We made voting recommendations at **381** meetings (**2,693** resolutions) over the last quarter.

- Total meetings in favour **54.6%**
- Meetings against (or against AND abstain) **45.4%**

Europe

We made voting recommendations at **132** meetings (**1,185** resolutions) over the last quarter.

- Total meetings in favour **48.5%**
- Meetings against (or against AND abstain) **50.8%**
- Meetings abstain **0.8%**

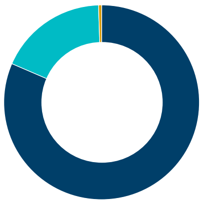
North America

We made voting recommendations at **304** meetings (**2,318** resolutions) over the last quarter.

- Total meetings in favour **55.9%**
- Meetings against (or against AND abstain) **44.1%**

United Kingdom

We made voting recommendations at **222** meetings (**2,799** resolutions) over the last quarter.



- Total meetings in favour **81.5%**
- Meetings against (or against AND abstain) **18.0%**
- Meetings with management by exception **0.5%**

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

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