

Public Engagement Report



Between a rock and a hard place – Human rights
in Western Sahara

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 Q4 2016.

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.

2 Preface

What is Hermes EOS?
How does Hermes EOS work?

3 Hermes EOS team

Our team

4 Engagement by region

Engagement statistics by region

5 Engagement by theme

Engagement statistics by theme

6 Environmental

Emissions, water and trees –
Why CDP disclosure matters

8 Social

Between a rock and a hard
place – Human rights in
Western Sahara

10 Governance

An essential mix – Ensuring
optimal board composition

12 Strategy

From chaebols to good corporate
governance – The stewardship
landscape in South Korea

14 Business strategy

Engagement on strategy and
governance issues

16 Public policy

Public policy and best practice

19 Overview

Regional voting statistics

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 42 clients and £261.3/€306.1/\$322.9 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 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 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 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, 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:

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* as of 31 December 2016

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

Hermes EOS team

Leadership



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Co-Head



Emma Hunt
Co-Head



Bruce Duguid
Director
Sector lead: Mining, Utilities
Sectors: Oil and Gas,
Pharmaceuticals



Tim Goodman
Director
Sector lead: Oil and Gas
Sectors: Financial Services,
Mining



James O'Halloran
Director
Head of Voting and
Engagement Support



Carl Short
Director of Engagement

Engagement professionals



Dr Emma Berntman
Sectors: Financial Services,
Mining, Oil and Gas,
Pharmaceuticals, Utilities



Roland Bosch
Sector lead: Financial
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Sectors: Consumer Goods
and Retail



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Sectors: Oil and Gas,
Pharmaceuticals



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Natacha Dimitrijevic
Sector lead: Pharmaceuticals
Sectors: Consumer Goods
and Retail, Financial Services,
Industrials, Oil and Gas



Claire Gavini
Sectors: Consumer Goods
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Technology, Utilities



Sachi Suzuki
Sector lead: Industrials
Sectors: Technology



Dr Michael Viehs
Sectors: Industrials,
Mining, Oil and Gas,
Pharmaceuticals, Utilities



Maxine Wille
Sectors: Financial Services,
Industrials, Technology

Business Development and Client Service



George Clark
Voting and Engagement
Support



Amy D'Eugenio
Head of Business
Development and Client
Service



Alan Fitzpatrick
Client Relations



Rochelle Giugni
Client Relations



Bram Houtenbos
Voting and Engagement
Support



Nina Röhrbein
Reporting and
Communications



Lucy Saville
Client Relations

Engagement by region

Over the last quarter we engaged with 240 companies on 506 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 **240** companies over the last quarter.



■ Environmental **23.9%**
 ■ Social and ethical **25.1%**
 ■ Governance **34.0%**
 ■ Strategy, risk and communication **17.0%**

Australia and New Zealand

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



■ Environmental **40.0%**
 ■ Social and ethical **20.0%**
 ■ Governance **40.0%**

Developed Asia

We engaged with **41** companies over the last quarter.



■ Environmental **17.1%**
 ■ Social and ethical **25.2%**
 ■ Governance **38.7%**
 ■ Strategy, risk and communication **18.9%**

Emerging and Frontier Markets

We engaged with **47** companies over the last quarter.



■ Environmental **37.0%**
 ■ Social and ethical **22.2%**
 ■ Governance **19.8%**
 ■ Strategy, risk and communication **21.0%**

Europe

We engaged with **42** companies over the last quarter.



■ Environmental **12.8%**
 ■ Social and ethical **30.8%**
 ■ Governance **33.3%**
 ■ Strategy, risk and communication **23.1%**

North America

We engaged with **70** companies over the last quarter.



■ Environmental **33.0%**
 ■ Social and ethical **22.0%**
 ■ Governance **39.4%**
 ■ Strategy, risk and communication **5.5%**

United Kingdom

We engaged with **35** companies over the last quarter.



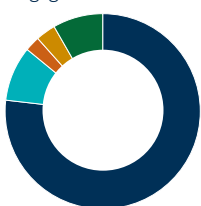
■ Environmental **22.9%**
 ■ Social and ethical **24.1%**
 ■ Governance **34.9%**
 ■ Strategy, risk and communication **18.1%**

Engagement by theme

A summary of the 506 issues and objectives on which we engaged with companies over the last quarter is shown below.

Environmental

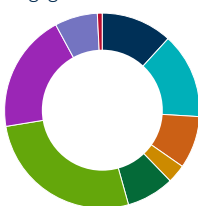
Environmental topics featured in **23.9%** of our engagements over the last quarter.



■ Climate Change	76.9%
■ Environmental policy and strategy	9.1%
■ Forestry and land use	2.5%
■ Pollution and waste management	3.3%
■ Water	8.3%

Social and ethical

Social topics featured in **25.1%** of our engagements over the last quarter.



■ Bribery and corruption	11.8%
■ Conduct and culture	14.2%
■ Cyber security	8.7%
■ Diversity	3.1%
■ Human capital management	7.9%
■ Human rights	26.8%
■ Labour rights	19.7%
■ Supply chain management	7.1%
■ Tax	0.8%

Governance

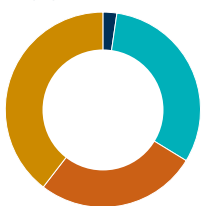
Governance topics featured in **34.0%** of our engagements over the last quarter.



■ Board diversity, skills and experience	19.2%
■ Board independence	22.7%
■ Executive remuneration	27.9%
■ Shareholder protection and rights	17.4%
■ Succession planning	12.8%

Strategy, risk and communication

Strategy and risk topics featured in **17.0%** of our engagements over the last quarter.



■ Audit and accounting	2.3%
■ Business strategy	31.4%
■ Integrated reporting and other disclosure	26.7%
■ Risk management	39.5%

Emissions, water and trees – Why CDP disclosure matters

As part of our engagement, we press companies to disclose their environmental data to the CDP initiative.

Setting the scene

Founded in 2000 as a not-for-profit organisation, CDP – formerly known as the Carbon Disclosure Project – enables companies to disclose their environmental impacts to a wide range of stakeholders, including investors. It is supported by more than 820 investors with over \$100 trillion in assets under management, which underpins its economic significance.

The investor-led CDP seeks to obtain self-reported information about the environmental impacts of companies and their management thereof through an annual survey. Questions refer to the CO₂ emissions of companies and ask, among others, whether they incorporate climate change risks as part of their business strategy, whether board-level responsibility for climate change exists and whether the companies are undertaking any meaningful actions to reduce their impact on the environment. The answers to these questions improve their transparency on environmental, social and governance issues and provide long-term institutional investors with a picture of their approach to climate change. Ultimately, information from the CDP helps investors in the assessment of a company's environmental risk profile, which they increasingly factor into their financial decision-making.

Starting off in 2004 by surveying UK-based companies only, the CDP has expanded to request climate change information from more than 5,600 companies globally in 2016. Recently, the initiative also extended its disclosure system to include water and deforestation.

Benefits

Companies tend to perceive requests for information on environmental, social and corporate governance issues as an additional reporting burden. However, while the questionnaires from the CDP initiative require companies to spend time to appropriately answer the questions, pursuing this type of reporting can be beneficial to companies and investors alike.

Reporting in a systematic and structured way, such as through the CDP survey, allows investors to assess a company's approach to climate change and to directly compare and contrast it with the actions undertaken by its peers. This, in turn, allows investors to identify the leaders in environmental information disclosure and management of climate change risks, as well as those that do not reveal meaningful information through the CDP and/or lag behind others in terms of managing climate change risks. We firmly believe that what is not measured is not managed, and that good reporting through the CDP improves a company's transparency on environmental issues, thus potentially increasing its attractiveness in capital markets.

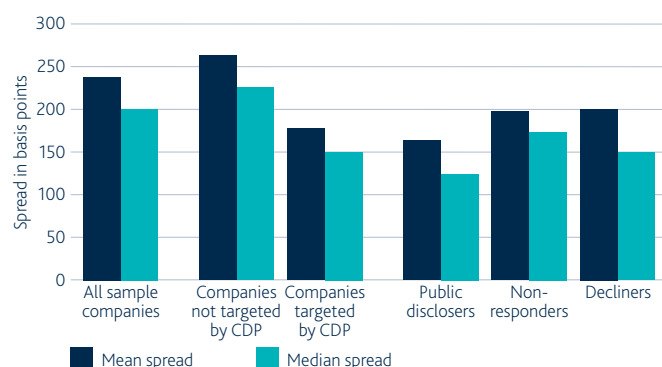
There are also financial implications for companies. A study² on carbon disclosure, emission levels and the cost of debt found that companies that respond to the CDP questionnaire pay lower interest rates on their outstanding bank debt compared to their non-responding counterparts.

Economically speaking, so-called informational opaque companies – those that do not have a credit rating or publish financial statements – can save up to \$1.5 million per annum in interest payments if they decide to respond to the CDP survey and publish their carbon emissions. The econometric analyses of this study also adjust for various company and industry characteristics which might influence

the interest rate that companies have to pay. Graph 1 illustrates that, on average, companies which take part in the CDP survey pay 164 basis points on their outstanding bank loans, while those that do not respond have to pay 198 basis points.

In addition to providing a disclosure system, CDP also offers useful assessments of the reporting qualities of companies in the form of ratings which feed into our assessments of their environmental performance and our engagements with them. Over 81% of the companies we engage with and close to 90% of our tier 1 engagement companies currently report to the CDP. Non-reporting companies tend to be situated in Asia, emerging markets and North America.

Graph 1: Cost of debt for different companies

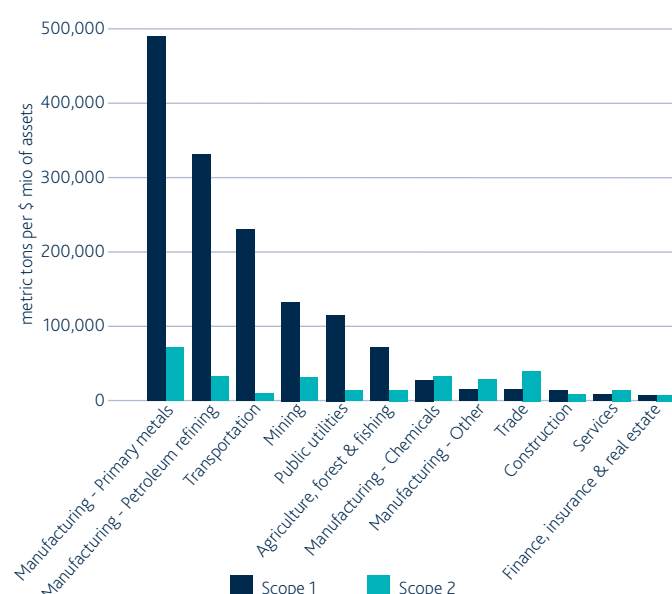


Source: Kleimeier and Viehs (2016)

Use in our engagement

As part of our engagements on climate change, we have been encouraging companies to respond to the CDP survey in order to improve their transparency on environmental issues, such as climate change. We observe that once companies start responding to the questionnaire, they tend to maintain the reporting. Therefore, we have been pressing those companies that never responded to CDP to begin disclosing the relevant information. However, climate change reporting is not equally important across sectors because environmental issues are less material to some types of businesses. As can be seen in Graph 2, relative to their size, manufacturing, transportation and mining companies are particularly responsible for producing high CO₂ emission levels and thus warrant engagement on improving the quality of their disclosure.

Graph 2: Median CO₂ emissions by industry group



Source: Kleimeier and Viehs (2016)

Admittedly, CDP is only one way to disclose environmental- and climate change-related information. Nowadays, most companies publish sustainability or corporate social responsibility reports in which they outline their approach to climate change and other environmental, social and governance topics. However, the quality and content of these vary immensely, thus not allowing for the direct compare- and contrast approach which CDP offers. This is important because more and more investors use the self-reported sustainability information of companies they invest in for their own decision-making.

While the number of initiatives and organisations that encourage environmental reporting has increased substantially over the last years, CDP in our view remains a good benchmark and its information informs our engagements on climate change and the environment.

For smaller companies, which are often outside the CDP's universe of coverage, we encourage disclosure on greenhouse gas emissions and other climate change related information in their sustainability reports.

Water and forestry

Compared to climate change information, which CDP started to collect in 2004, its questionnaires on water and forestry are newer. The Global Canopy Programme started the forest programme under the name of the Forest Footprint Disclosure Project in 2009, which transitioned to the CDP in 2013, while the water programme was launched in 2010.

Fewer companies also respond to the surveys on water and forestry than on climate change, largely because these are environmental issues that are not universally material to all companies but apply only to a specific subset.

At Hermes EOS, we use this information from the CDP for our water, forestry and land use-related engagements.

Collaboration

We also directly collaborate with the CDP by giving feedback on its survey, reporting and assessment of companies. Where appropriate, and mostly as part of our engagement, we also put companies in touch with the CDP directly to discuss specific ratings and concerns they might have.

We will support a CDP event in China in 2017 aimed at Chinese companies where we will provide the asset owner perspective on disclosure and reporting. Furthermore, we have a representative sitting on the steering committee of the CDP's Reimagining Disclosure project.

Above all, we will continue to push companies to set ambitious but realistic emissions reduction targets and to improve their reporting on environmental issues overall.

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² https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2719665



Between a rock and a hard place – Human rights in Western Sahara

We have been engaging with buyers of Western Sahara phosphate on the management of human rights in the disputed territory.

Human rights engagements

Our human rights related engagements are based on the International Bill of Human Rights, which includes the Universal Declaration of Human Rights, the International Covenant on Civil and Political Rights, the International Covenant on Economic, Social and Cultural Rights and the International Labour Organization Declaration on Fundamental Principles and Rights at Work. Companies should be able to articulate what their salient human rights issues are and the likelihood of those occurring. Salient human rights issues are defined as those at risk of having the most severe negative impact on human rights holders through a company's activities and business relationships. We expect companies to influence business partners and the state where possible to minimise any negative impact on human rights.

We ask companies to conduct a thorough and independent human rights due diligence assessment in line with the UN Guiding Principles on Business and Human Rights Reporting Framework. We also urge them to set goals in line with their human rights policies and develop processes to ensure that their operations respect internationally recognised human rights.

In our engagements to address allegations of human rights violations, we take account of all factors, including analysis of the political situation. We focus on how adverse human rights impacts can be mitigated, using the leverage that we may have and that a company can exert to improve human rights outcomes as a result of its operations, supply chain or products and services.

Legal opinion

UN Legal Counsel Ambassador Hans Correll expressed in 2002 the widely referenced opinion that the natural resources management in Western Sahara only is in line with international law if it takes into account the interests of its people, the Sahrawi, thus upholding a responsibility for companies to respect human rights in the territory.

In recent years, pressure on Morocco over Western Sahara has been mounting. In 2015, the legal opinion of the African Union stated that Morocco has no legal right under the UN charter and international law to occupy and govern the territory of Western Sahara and that only the

Setting the scene

After Spain withdrew from Western Sahara, its colony in the northwest of Africa, Morocco reclaimed the area in 1975.

The sovereignty of Western Sahara, however, remains the subject of a dispute between Morocco and the native population's political organisation, the Polisario Front, founded in 1973 with the aim to gain independence. Soon after, the Polisario Front created the Sahrawi Arab Democratic Republic whose government is headquartered in exile in Tindouf, Algeria. The dispute has been accompanied by a lack of international recognition of Morocco's right over Western Sahara.

Politically, the situation has reached deadlock, with Morocco proposing a plan for autonomy under its sovereignty while the Polisario Front demands a referendum on self-determination, with the UN Security Council split on this. The mandate of the UN Mission for the Referendum in Western Sahara has been renewed every year since 1991 but a referendum has yet to take place. In 2015, for the first time a human rights organisation was recognised in Western Sahara, the Sahrawi Association of Victims of Grave Human Rights Violations Committed by the Moroccan State.

people of Western Sahara have the right to permanent sovereignty over their natural resources. This was followed by the annulment of the EU trade agreement with Morocco with respect to Western Sahara by the European Court of Justice and a ruling that Western Sahara is not part of the territory of Morocco, meaning that the EU and its member states do not recognise Morocco as having sovereignty over Western Sahara. The UN Committee on Economic, Social and Cultural Rights, in its review published in October 2015, also made clear the significance of the Sahrawi's right to self-determination. This right has emerged as the cornerstone principle governing the Western Sahara peace talks.

Legally, it is difficult to justify Morocco's presence in Western Sahara, however, the situation has been made more complex by the long time this situation has been allowed to go on, especially as many Moroccans have now been long-term residents, who will have to be accommodated if the region were to become independent.

Human rights in Western Sahara

Human rights that are impacted as a result of Morocco's claim to sovereignty are the right to self-determination, discrimination in employment and elsewhere, freedom of association and freedom of expression. This is because of the alleged forceful dispersion of gatherings supporting self-determination, the prosecution of critics of the regime by Moroccan-run courts, harassment of human rights groups and the expulsion and intrusive surveillance of foreign visitors. Furthermore, the living conditions of Sahrawi that have fled to refugee camps near Tindouf in Algeria have been reported to be severe.

We believe that we should be part of the push for better human rights in Western Sahara and that companies operating or sourcing products from the territory have a duty to respect human rights there under the UN's Protect, Respect and Remedy Framework and Guiding Principles.

Phosphate

For the territory, phosphate is a key export resource, with Morocco holding three quarters of global phosphate reserves.³ After extraction from the mines, the phosphate is exported by 100% Moroccan state-owned company Office Chérifien des Phosphates (OCP).

Our engagement has involved the two largest buyers of phosphate from Western Sahara – Canadian companies Agrium and Potash Corporation of Saskatchewan (Potash), which together in 2015 bought 64.5%⁴ of the region's phosphate from OCP subsidiary Phosphates de Boucraa (Phosboucraa), which operates the Boucraa mine site in Western Sahara. An agreement to merge Potash and Agrium has been approved by directors and shareholders of both companies. The merger requires Canadian court approval, which is expected to be granted but still pending.

Our engagements

The UN provides for indigenous peoples to be entitled to free, prior and informed consent with regard to activities on their traditional lands and resources. This is clearly not possible any longer in Western Sahara. Even the aspirational goal of the Sahwari negotiating the future of the territory and a solution to the problem of the exiled population is probably not a currently feasible goal.

However, we have been engaging with Agrium and Potash to ensure that they use their leverage as the key purchasers of Western Sahara phosphate to confirm that their supplier's operations do not breach human rights. As a representative of investors, we seek to find leverage with other like-minded investors to increase the pressure on the companies.

We have challenged Agrium to demonstrate that its dealings with OCP do not contravene international law. The company, a signatory to the UN Global Compact sustainability initiative, described its strong supply chain policy and monitoring on the ground in Western Sahara, as well as its partial reliance on a confidential legal opinion provided by the Moroccan supplier. Its management explained that its rigorous supplier standards are based on the UN Guiding Principles on Business and Human Rights, noting that under these Principles, the responsibilities of the company and its suppliers are limited to their sphere of influence, which does not include brokering a political solution. Through disclosure and engagement with the company, we are satisfied that Agrium has been a good actor, influencing OCP in an ongoing engagement which has led to positive change accompanied by fuller disclosure from the supplier. Pressed by us, management said it has been looking at other phosphate sources but stood by its belief that it should continue to purchase Western Sahara phosphate, closely monitor and positively influence OCP and the community within it operates.

We also introduced the idea of providing direct benefits to the Sahwari, including those in refugee camps in Algeria, to the company, as part of its arrangement with OCP.

Human rights assessment

Agrium undertook, and subsequent to our engagement, published an independently-produced human rights assessment report⁵ called Agrium Phosphate Rock Supply from Western Sahara. The report was commissioned by Agrium in response to increased stakeholder engagement and a repeat filing of a shareholder resolution requesting such a report, which in 2015 gained 12% support of shareholders. Compiled by a reputable law firm with relevant expertise, it provides an analysis of the human rights impacts of the phosphate operations and trade with Agrium. The review concluded that the company is not compelled by the UN Guiding Principles to end its supplier relationship with OCP and could continue sourcing phosphate from Phosboucraa on the basis that it does not cause or contribute to potential or actual negative human rights impacts in Western Sahara through its supplier relationship and that it has the leverage to mitigate potential or actual negative human rights impacts linked to this relationship.

The report says Agrium is, based on its due diligence and ongoing evaluation efforts, satisfied that OCP operates in compliance with its own supplier code of conduct, which is based on the UN Guiding Principles on Business and Human Rights. With its influence as a supplier, the company has also encouraged OCP to publish information on key performance indicators, including environmental performance, community investments and labour profiles, and update this regularly. If and when negative human rights impacts are identified that cannot be addressed adequately by Agrium's leverage over OCP, the continued relationship with OCP/Phosboucraa should be re-evaluated.

We recognise Agrium's goodwill in commissioning the report. We also expect the new company formed from the proposed merger of Agrium and Potash to follow the recommendations of the report. However, we are concerned that Agrium's legal opinion narrowly defines its responsibilities. While acknowledging the limited scope for influence over the Moroccan state, in our opinion its purchase of phosphate helps to perpetuate the Moroccan occupation and related human rights abuses that exist in Western Sahara. Under the UN's Protect, Respect, Remedy framework, we believe that it has some obligations to respect the human rights of the Sahwari population as a whole.

In 2016, Potash put a shareholder proposal for a human rights assessment relating to Western Sahara on the agenda of its annual general meeting, which gained the support of 31.6% of its shareholders. After recommending a vote in favour of the shareholder proposal calling for more disclosure at Potash, we provided our reasons for our decision to the company. We explained that we supported the shareholder proposal and expect ongoing disclosure of the company's or preferably an independent expert's assessment of the operations of OCP regarding community and human rights. In response to our questions, the company reiterated that its sourcing of phosphate contributes to the economic well-being of the region and the population of local communities. Consequently, Potash maintains that its activities are consistent with its code of conduct and do not violate international humanitarian laws. The company continues to engage with and monitor OCP to ensure it is operating in a manner that is beneficial to the region. But the position papers published by Potash do not discuss the Sahrawi's right to self-determination.

What next?

We believe that if the merger between Agrium and Potash is completed, the new entity should have greater leverage over OCP in Western Sahara. This may mean that it can use its leverage to achieve better human rights outcomes than the two companies can currently achieve. We believe that the new company should argue for a better outcome for the Sahrawi as a whole, not just those directly affected by OCP's operations. We will try to convince the new company to use its influence to achieve this outcome.

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³ <http://www.resourcegovernance.org/our-work/country/morocco>

⁴ <http://wsrw.org/files/dated/2016-04-07/p-for-plunder-2015-web.pdf>

⁵ https://www.agrium.com/system/files/agrium_hrdd_summary_report_0.pdf

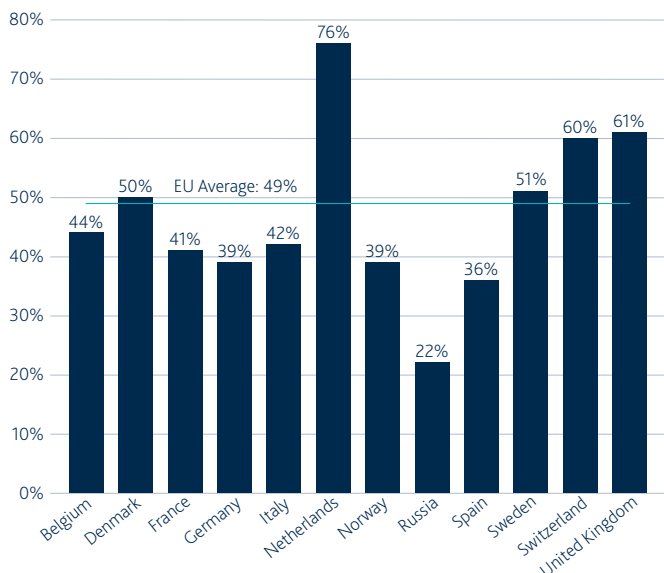
An essential mix – Ensuring optimal board composition

Board composition is one of the cornerstones in our engagement with companies on corporate governance.

Setting the scene

Engagements on corporate governance make up about half of our engagements and board composition features frequently in those. We believe that appropriate board composition can strengthen oversight and accountability and help to ensure that a company is well run. This is fundamental to board effectiveness, because having the appropriate skills, characters and balance on the board is essential to asking the right questions and making good decisions. In turn, this can pre-empt any strategic, financial, environmental and social issues or make it easier to address them. While the effectiveness of boards is partly a result of their composition, good succession planning, as well as board and director evaluations, are additional tools to improve board performance.

Proportion of independent board members at European companies



Source: ISS

The duty of the board is to promote the interests of a company and its stakeholders, including its shareholders.

We want to see a well-performing board at every listed company, made up of directors with complementary skills, experience and other attributes that are relevant to the business and its purpose. We do not want to see a club culture that is prone to groupthink and seek to improve the board composition at companies where we do not view it as good enough. However, we are aware that governance and expectations of boards are at different stages of development globally.

Succession planning

Good succession planning at the board and senior management level is an important measure that should help to safeguard long-term value at any organisation. It ought to involve contingency planning for the sudden loss of key personnel, as well as planning for foreseeable change, for example future retirement or likely change following long tenure. Succession planning should work to build a solid pipeline of suitable candidates from within the organisation to become senior managers or executive board members. In addition, boards should always have a portfolio of potential non-executive directors who could be considered for board appointments.

We also prefer to see a staggered refreshment at companies for executive and non-executive directors to avoid losing all the knowledge and insight at once. Even in a crisis, we would like to see a relative smooth transition and handover, for example through directors acknowledging their mistakes, resolving the problem, conducting a handover and stepping down at next appropriate juncture, such as an AGM.

A staggered succession plan could for example see the chair being replaced first, then the senior independent or lead independent director and then the CEO.

Experience and skills

Experience of the board of directors should be wide-ranging, encompassing industry, geographic, functional and stakeholder experience, but be specific to the needs and future direction of the company in terms of sector, country and public or private company background. The latter, for example, can be particularly important for government-controlled enterprises, while a director with a background in retail could be beneficial to a consumer goods company.

In view of the hacking incidents at numerous companies over the last few years, a lot of companies have added to their technology experience, for example on cyber security, which we have welcomed. However, the aim is for the entire board to engage in more robust discussions about technology trends and the risks and opportunities they present to the company.

Diversity

We advocate diversity on the board in its broadest sense. Depending on where the company is generating its revenues or has its operations, its board should comprise a mix of nationalities. This is an issue we have particularly engaged on with Asian and US companies.

The board should also tap into all available talent with regard to gender, ethnicity, age and background, which we believe will contribute to the effectiveness of discussions in the boardroom. We also prefer a broad spectrum of directors, representing all age ranges, experience of multiple business cycles, as well as new and fresh perspectives.

Independence

We want to see an independent board, ideally led by an independent chair and consisting of a majority of independent directors. Most countries with corporate governance codes in place have criteria for independence, which we use in our initial assessment of the

board. We also assess independence from our own best practice standpoint and interactions with companies, including with the directors themselves where we are able to. Where we have doubts about the independence of a director, we will challenge the company on this and may recommend voting against that particular director, the lead independent director, the chair or members of the governance committee.

We have a strong preference for the roles of chair and CEO to be split at listed companies, as we believe this ensures the most effective separation of supervision and management. Combining the roles can confuse responsibilities and overly concentrate power in one person, creating problems in relation to oversight, objectivity about the performance of management and accountability.

Boards should be organised in such a way that a sufficient number of independent non-executive or supervisory board directors play an effective role in key areas where the potential for conflicts of interest is particularly high. To this end, nomination, remuneration and audit committees should be created with a majority of independent directors.

We do not take a stringent approach to tenure as experience can be beneficial. Similarly, the age at which a director may be asked to retire should be flexible and dependent on individual circumstances, unless there is a legally required retirement age. Tenure is one of the biggest challenges to independence because the longer directors work together the cosier their relationship tends to be. A study⁶ by proxy advisory firm ISS revealed that among the top 1,500 US companies, just over 13% of all directorships were filled by directors with less than two years' tenure. Past connections could also make independence more difficult. For audit committee chairs, especially as they are likely to have gained accounting experience at one of the big four auditors, connections with the audit firm can also compromise their independence.

Boards should have an appropriate balance of executive and non-executive directors so that no individual or small group of individuals can dominate the decision-making. Boards must ensure that powerful individuals or groups, such as management, founders or their families or other large shareholders neither dominate decision-making nor restrict the free flow of necessary information.

Each director should be able to allocate sufficient time to the company to discharge his or her duties, alongside other commitments, with attendance at board and committee meetings and carrying out the necessary preparation for them a requirement. The number of board, committee and other meetings attended by each director should be disclosed routinely in the annual report and accounts as a matter of best practice. Instances of less than full attendance should be explained.

Wells Fargo

US bank Wells Fargo is one example of where going against best practice in terms of corporate governance may have created problems. In our opinion, its leadership issues seem to have partly contributed to the circumstances that allowed the fake customer accounts scandal to occur, which has caused significant harm to the bank.

Together with three institutional investors, we therefore co-filed a shareholder proposal in late 2016 calling for a change in the company's by-laws to require an independent non-executive board chair. While the board elevated the serving lead independent director to chair following the resignation of the chair/CEO, which was a welcome first step, we

believe this must be followed by definitive action locking in a credible change to the board leadership structure that would help to ensure effective oversight for guiding management on a permanent basis.

At least partly as a result of the pressure applied on Wells Fargo stemming from our shareholder proposal, the board subsequently agreed to adopt the by-law amendments proposed in our resolution. The changes were made with immediate effect to ensure that the bank's chair will always be an independent member of the board from this point onwards. We commended the board for making this important change, thus locking in a material improvement to its leadership structure. We will continue to engage with the bank on its culture transformation plans and the board's oversight of ethics and values.

Board evaluation

We expect companies to continually assess the effectiveness of their boards to ensure they are operating optimally, in line with appropriate governance structures. We want to see a board evaluation conducted internally on an annual basis and an externally facilitated one by an independent firm at least every three years. However, in many countries this is still not common.

Boards should demonstrate their commitment to effectiveness by publishing the identity of the independent reviewer and report transparently and honestly on the main issues arising from the evaluation, its findings and/or the steps that have been taken and will need to be taken to address them.

We will continue our engagement on all the above issues to ensure the optimal composition and effectiveness of boards, which is the base for good governance at companies.

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⁶ <https://corpgov.law.harvard.edu/2016/06/01/iss-2016-board-practices-study/>



From chaebols to good corporate governance – The stewardship landscape in South Korea

We are engaging with companies in South Korea, as well as at the public policy level, on governance and stewardship.

Governance

South Korea's economy is dominated by chaebols – large, family-controlled business conglomerates that were established after the Korean War. They were instrumental to the country's rapid industrialisation and economic growth in the post-war era. Chaebols typically have a complicated ownership structure, meaning chaebol companies own stock in other affiliated companies through a complex, multi-layer and interlocking relationship. Because of this ownership structure and the influence of family members in formal and informal capacities on boards, governance has been the biggest concern in relation to our engagement with companies in South Korea, and it has been the most difficult issue to engage with apart from health and safety, where we have already seen improvements.

Pressure has been increasing to break up the chaebols, as the system not only allows poorly performing companies to have a negative impact on others through concessional business relationships, but also means that they trade at a discount, commonly referred to as the Korea governance discount. Restructuring it would create more transparency and introduce accountability to the individual boards of companies. A hedge fund manager recently published a proposal aimed at the board of Samsung Electronics to split the company into holding and operating companies, in addition to other recommendations. While we are supportive of a restructuring of the company and the appointment of more independent directors with international and C-suite experience to its board, we do not support the proposal in its entirety because we do not believe that a listing on the Nasdaq stock exchange in the US is necessary, given that the company is already listed in South Korea, London and Luxembourg. The suggestions on capital efficiency and board independence, however, are in line with our engagement objectives for the company.

Some chaebols have already committed to increasing the independence of their boards and strengthening the role of their non-executive directors. Over the past year, we managed to meet three independent directors from different Korean companies, which, on a country level, indicates progress in accessing the board. Although we commend these changes, much more needs to be done to improve corporate governance standards in Korea.

To find out the true skills and capabilities of boards, we have begun to ask them to undertake board evaluations and requested to meet a number of independent directors together with executives to improve our understanding of board dynamics, interactions and board culture.

Setting the scene

South Korea – officially known as the Republic of Korea – faced a year of change in 2016. Previously known for being at the leading edge of the digital revolution, the country made headlines for the wrong reasons. A corruption scandal has overshadowed the president of the country, leading to large protests in the country and members of parliament voting for her impeachment by a large margin. Adding to this were the problems engulfing the country's flagship company Samsung Electronics and the recall of its Galaxy Note7 product. It is against this backdrop of political uncertainty that we visited the country with some of our clients in the fourth quarter of 2016 in order to further our engagements with its companies and push for the launch of a stewardship code, to whose development we have contributed. We met several companies we have in our engagement programme, as well as labour union representatives, academics, government ministers and a major shareholder in the country's companies.

We also engage on the diversity of boards, as we believe increased diversity leads to greater effectiveness and performance when board dynamics allow strategic matters to be viewed from different perspectives. At present, most boards consist entirely of Korean nationals and a large number of academics.

Executive pay tends to be disclosed at a comprehensive board, not at an individual level, which we have been trying to address. Furthermore, we have been encouraging companies to improve their capital efficiency and to ensure that repurchased shares are cancelled because, unlike in the UK and in other Asian markets, such as Hong Kong and Singapore, this is not always the case. The lack of cancellation of repurchased shares provides the company with additional resources when negotiating strategic acquisitions but to the detriment of transparency and the protection of minority shareholders.

Since 2015, we have noticed the elections of boards of directors becoming increasingly bundled, an issue we have raised in our dialogue with the Korea Exchange. The power to elect directors is the most important shareholder right and shareholders should be able to vote on each director individually, depending on his or her skills, experience and performance, and not be forced to vote for or against a group of directors, in particular if they only have doubts about one of the proposed candidates.

Although we welcome the decision by the Korea Exchange to encourage some listed companies to disclose key business and financial information in Korean as well as in English to provide a level playing field to domestic and international investors, obtaining audited financial statements in a timely manner for us to be able to vote on them is still problematic. We want to see as many companies as possible provide a timely disclosure of audited financial statements and other reference documents for their annual general meetings (AGMs), in other words a publication of accounts at least two weeks before the AGM. This is often difficult as AGMs in South Korea tend to be held before the end of March at which shareholders must approve the audited financial statements. Listed companies are required to submit their annual reports to the Financial Services Commission (FSC) and the Korea Exchange within 90 days of the end of the fiscal year, which, in most cases, falls on 31 March.

We have also encouraged companies to develop strong anti-bribery and corruption policies, processes and measures to ensure the effective functioning of whistleblowing and penalty systems. We believe the recent political scandal involving bribery and corruption

issues at the highest level of government will provide momentum for positive change in South Korea, in time leading to a cleaner and more transparent society. Overall, we are pleased to see that corporate governance is improving, and that our recommendations have been taken into consideration.

Hana Financial Group

South Korea also has a tradition of strong participation by labour unions, which set strict targets for increases in wages and working hours. This became clear in our engagement with the dynamic player in the financial sector Hana Financial Group (Hana) in relation to its merger with the established and prestigious Korea Exchange Bank (KEB).

When Hana agreed to acquire KEB in 2012, significant tension and conflict arose between Hana and KEB's labour union, which demanded job security and independent management of the bank. The union filed a lawsuit to block Hana's acquisition of KEB and sued its president. Hana threatened to sue the union in return. We challenged Hana's relationships with the union and offered to communicate with union leaders to understand their viewpoints and frustrations regarding the cultural and pay differences between Hana and KEB.

The merged bank subsequently made significant improvements in the management of its labour relations. To help the establishment of a single unified work culture following the merger, work processes were standardised to mitigate cultural differences. The company set up integrated departments and held training sessions for Hana and KEB employees, while the new CEO of KEB Hana Bank appointed the former union leader of KEB as chief secretary who was tasked with the integration of the two unions associated with the banks. Senior staff from KEB meanwhile were appointed to the leadership team of the merged bank, including the CFO, strengthening its message of treating the employees of both banks fairly in the new entity.

Our objective was to encourage the unification of the different pay bands of the merged bank and the introduction of a firm-wide remuneration policy that is performance- instead of seniority-based, which the company has begun to work on. Its corporate governance report now contains greater detail on the metrics used in the remuneration policy, such as return on equity, risk-adjusted return on capital and total shareholder return. We also welcomed a board evaluation undertaken by a third party.

In addition, a year after we raised concerns that its board needed to improve, especially with regard to the independence and skill sets of its non-executive directors, the company appointed an independent outside director with banking and financial services experience. The number of directors with an apparent link to the government has also been reduced.

Recent developments

One of the most high-profile companies we engaged with in 2016 was Samsung Electronics. Based on our engagement experience, we in part attributed its product recall scandal to its governance and corporate structure. Having initially met resistance to have a dialogue with board members, we were eventually able to participate in a meaningful shareholder engagement meeting at the board level. We were pleased that in the fourth quarter of 2016, at a strategy call led by its CEO and CFO, the company committed to appointing new board members, the establishment of a governance committee composed entirely of independent directors and to undertaking a review of its corporate structure, which is already underway.

The current board of five independent directors and four executive directors plans to add at least one new board member with

international experience and/or C-Suite experience, in line with our expectations. Encouragingly, the company hopes to already propose one or several new directors for its 2017 AGM. We also welcomed the replacement of the corporate social responsibility (CSR) committee with the governance committee, which feeds into the board. This follows our recommendation that CSR should be integrated within the company's business model. The governance committee will address board decisions and proposals that are linked to shareholder value protection and enhancement and facilitate strong board level communication with shareholders.

In addition, the company shared with the investor community five major actions designed to enhance long-term shareholder value through better capital allocation. The company also committed to cancelling repurchased shares from share buybacks, a practice that we encourage in this market as current local regulations do not mandate the cancellation of shares bought by company. Overall, we were pleased with the announced reforms to strategy and governance and look forward to supporting further positive changes at the company.

Stewardship code

Following in the footsteps of its regional neighbours Japan, Singapore and Taiwan, South Korea launched its own stewardship code in December 2016. We welcomed this as we had already called for the introduction of stewardship guidance for investors in our keynote speech at a conference hosted by South Korean regulators in 2014⁷.

Positively, the code follows the comply-or-explain approach of other codes, instead of pushing for compliance only. The voluntary approach enables investors to make the decision to sign up to the code in their own time, depending on their experience and resource availability, and a number of local fund managers have reportedly already expressed interest in signing up. We offered our support and guidance in the development, launch and implementation of the code, and, as part of our public policy engagements, spoke to representatives from the Korea Exchange, Korea Corporate Governance Service, the FSC, the National Assembly and the National Pension Service of Korea. In our dialogue, we highlighted in particular the importance of securing the commitment of local pension funds and asset owners prior to the launch.

The code does not provide any guidance or encourage any collaboration among investors, which is in line with the Japan code where much emphasis is put on the challenges of investors perceived to be acting in concert. In addition, unlike the UK code, it highlights that institutional investors should have in-depth knowledge and expertise to appropriately fulfil their stewardship activities.

We believe that the code will encourage institutional shareholders to establish and disclose their internal voting guidelines, as well as help them fulfil their fiduciary duties by exercising their voting rights and disclosing their voting decisions.

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⁷ <https://www.hermes-investment.com/uki/blog/eos-articles/conquering-the-world-the-success-of-stewardship-codes/>



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

Actions on climate change

Lead engager: Bruce Duguid

A European company updated us on the progress it has made in responding to the climate change-related resolution passed at its AGM in April 2016, which we co-filed on behalf of our clients. We were pleased to hear that its first priority has been to achieve radical energy efficiency, including identifying its contribution to limiting global warming as a result of climate change to 2°C degrees. The resolution prompted the company to organise a workshop with global climate change and low-carbon technology experts to help it define low-carbon scenarios and a potential pathway to low-carbon operations. In the short term, the company acknowledged the need to update its energy efficiency targets for 2020, and we encouraged it to do so prior to its next AGM, even if this requires further updating with stretch targets following the conclusion of its more radical thinking process. On long-term portfolio resilience to climate change scenarios, the company admitted that its thinking is less advanced and that it may not be ready to provide details to investors. We explained that investors expect the company to be able to articulate the strategic risks and opportunities arising from climate change, including an indication of materiality by different commodities. The company is also looking at the physical risks arising from climate change. Although it claims to have various climate-related metrics on its corporate scorecard, it was unable to explain its approach to the link to remuneration. We will follow up with the company's head of sustainability and the chair of its remuneration committee to discuss the priority given to a detailed response to the resolution.

Changes to remuneration

Lead engager: Darren Brady

We welcomed the actions taken by a US company when we continued our dialogue about its compensation structures, political lobbying disclosures and issues which arose out of its latest AGM and are in line with our engagement. Following substantial opposition to its advisory vote on pay in 2015, which saw nearly 40% of shareholders vote against its pay structures, including us, we commended the company for the notable outreach and adjustments it made, which resulted in 95% support at its 2016 AGM. We were also pleased about the substantial change introduced by its compensation committee in 2016. Previously, cash incentive awards were based on a quantitative rating of performance instead of a fixed formula, relying too heavily on board discretion, while equity grants were largely time-based factors versus performance, and the company targeted executive pay at the

75th percentile of its peer group. We found that these concerns were largely addressed in 2016, with cash incentive awards now based on the disclosed performance of six metrics, while 60% of equity grants will also be tied to company performance indicators. Perhaps most positively, the company dropped its plans to target total direct compensation at the 75th percentile of its peers group, a problematic practice which can ratchet pay levels market-wide, opting instead to not target a specific percentile. We will monitor its implementation. We will also revisit other issues, such as the possible over-boarding of one of its directors and the continued desire from investors for greater transparency regarding the company's political disclosures, after the next board meeting to allow internal views to coalesce.

Climate change and water disclosure

Lead engager: Jaime Gornsztejn

In a meeting with the climate change team of an emerging markets company, we were encouraged by the progress made on disclosure and risk management. We were pleased that, following our engagement in the first quarter of 2016 and a letter to the company about the importance of disclosing water data to the CDP, it submitted its response to the water questionnaire for the first time. As it was its first submission, the company decided not to publish it, but we were reassured that from this year onwards the company's response to the water questionnaire would be made public, like its climate change response. With regard to the climate change questionnaire, the quality of the company's response has improved significantly, reaching a score of A- in 2016. We explored the reasons for this improvement and were given a detailed explanation about various initiatives aimed at reducing and avoiding emissions. We also discussed other climate change programmes underway at the company, in particular a public statement on its position about climate change, how it will contribute to meeting the 2°C scenario, the incorporation of carbon pricing into investment decisions and a full assessment of physical and non-physical – regulatory or economic – risks of climate change to its business. We were satisfied with the priority given to climate change by the company's new management and agreed to follow up on the progress of the initiatives discussed and provide feedback.

In another meeting with its health and safety team, we gained comfort from the company's public commitment to safety and the detailed plan presented to us on implementation. In its business plan for 2017-2021 presented by the CEO, the company set a target to reduce the total recordable injury frequency rate from 2.2 in 2015 to 1.4 in 2018. We challenged the feasibility of the target, which is ambitious for the company but still behind the consolidated performance of

the industry. The company sought to reassure us that it is possible to achieve this reduction in the accident rate and detailed the plan being implemented. We discussed the focus of the team on assessing the safety of processes where low probability failures may cause high impact in terms of injuries and fatalities. We also investigated how the company is embedding a culture of safety in its operations through intensive training and sharing of best practice. Additionally, the company penalises contractors that do not comply with its safety procedures. We will follow up with the health and safety team on progress towards the target.

Performance measures and cyber security

Lead engager: Darren Brady

Encouragingly, following our last discussion with a UK company where we encouraged it to justify the awards it pays under its annual bonus schemes by disclosing the performance goals tied to payouts, its remuneration committee agreed to begin disclosing performance measures retrospectively as a result of our urging. The company previously refused to do so, citing competitive sensitivity. We commended the company for announcing this important enhancement to its pay disclosures, which will feature in its next annual report, and acknowledged the other improvements it has made to its remuneration reporting in the interim, based on our recommendations. The company is particularly exposed to cyber security risks and suffered a high-profile breach of customer data two years ago. We therefore also continued our examination of its cyber security strategy and oversight structures to ensure the robustness of its approach. The company was unequivocal that cyber security is one of the top risk factors it faces and described the substantial enhancements it has made to an already strong approach following the wake-up call provided by the

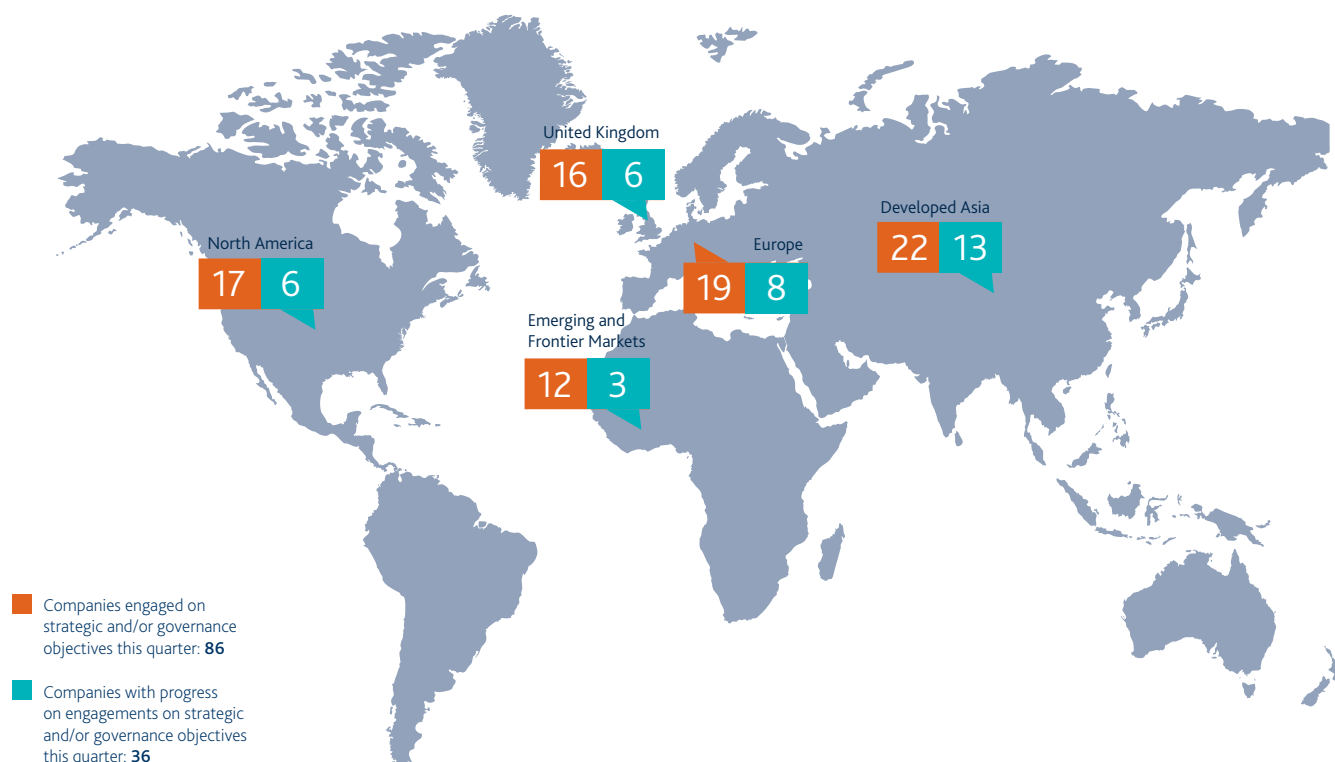
breach. It painted a compelling picture, demonstrating the board's oversight and understanding of cyber security risks, the continuing training received by all directors on the topic, as well as the full extent to which cyber security considerations are integrated into the broader strategy, risk and budgeting planning process. We sought to understand the enhancements made by the company following the breach and were impressed by a lengthy list of profound changes, which included a doubling of its existing investment in cyber security efforts, the strengthening of senior executive oversight of cyber security, regular mandatory cyber security training for all employees and an organisation-wide initiative to embed a security first-oriented culture throughout the company. We welcomed the company's efforts to mitigate what we acknowledged as an ever-present and unavoidable risk and agreed to aid it in developing enhanced shareholder communications regarding its efforts.

Revised remuneration

Lead engager: Roland Bosch

Following our meeting with the remuneration chair and company secretary of a bank, a further call with the latter and the receipt of additional payout analysis of its future pay structure, we sent our initial feedback on the proposed remuneration policy to be voted at the company's AGM. Beyond the implementation of regulatory requirements, the new policy intends to further increase alignment with the desired culture within the bank, a focus on long-term, sustainable performance. Significantly lower quantum of variable pay is combined with increased certainty of outcomes for participants in the new remuneration scheme. We were encouraged by the changes to the policy, which go a long way towards our new remuneration guidelines and are acceptable to a majority of the bank's shareholders.

Engagements on strategy and/or governance





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 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

Climate change and the automotive industry

Lead engager: Michael Viehs

We presented the Investor Expectations of Automotive Companies report to the board of the Institutional Investors Group on Climate Change, institutional investors and automotive companies. As the lead author of this investor guide, we called on automotive companies to have long-term strategies in place that rest on resilient business models and take into account likely upcoming climate change regulation, significant shifts in demand and competition from high tech companies working on developing autonomous and sustainable vehicles. We also highlighted that we expect automotive companies to accept and publicly advocate the move towards a low-carbon economy. At a subsequent roundtable discussion of the GEAR 2030 High Level Group on Automotive Industry of the European Commission in Brussels, we presented the new guide along with our expectations of companies in the industry.

Brazilian Stewardship Code

Lead engager: Jaime Gornsztejn

At the launch of the Brazilian Stewardship Code, we spoke about our experience in stewardship and formally signed up to the code. The code was drafted by a working group of members of the Association of Capital Market Investors AMEC, of which we were the only non-resident member. The process comprised a benchmarking of stewardship codes, interviews with the International Corporate Governance Network (ICGN), the Financial Reporting Council, local and international asset managers and asset owners and a public consultation. The code is aligned with the ICGN's global stewardship code. We believe that it will be instrumental in developing a stewardship culture in the Brazilian market and were pleased by the attendance of some major local asset managers at the launch. We will continue our public policy engagement on the Brazilian Stewardship Code as AMEC develops the guidelines for implementation during 2017.

Corporate Governance Scorecard

Lead engager: Christine Chow

We participated in a panel session at the launch of the Corporate Governance Scorecard, a multi-stage project led by the International Finance Corporation and the Bombay Stock Exchange. The scorecard is based on the OECD's corporate governance principles, namely shareholder rights, stakeholder engagement, disclosure and transparency and board responsibilities. The disclosure-based approach enables companies to score themselves against best practices, with a tilt that addresses governance characteristics specific to the Indian market, such as related party royalties, the influence of family or founder-controlled shareholders and CSR efficacy. The scoring tool is available on the stock exchange's website for benchmarking and gap analysis. During the panel discussion, we stated that we believe that good governance is a growth- and performance-driver because companies that are willing to undertake self-assessments tend to embrace change with a progressive mindset, which is vital to a positive corporate culture and the generation of long-term shareholder value.

UK corporate governance reform

Lead engager: Hans-Christoph Hirt

We provided evidence to the select committee of the UK's House of Commons that leads its work on corporate governance reform. In our evidence, which was based on the written response we had provided, we outlined our proposals on executive remuneration and showed our support for a rethinking of the composition of boards. We explained how simpler and less leveraged pay packages could increase transparency and lower the average payout. While we welcomed the proposals made in the green paper by the government on corporate governance reform, we also highlighted the important role of stewardship for remuneration committees, as well as investors. We specifically welcomed the government's exploration of different ways to give stakeholders and employees a stronger voice in the decision-making of the board. While we are not in favour of mandatory representation of employees on boards, we believe that this is a good way of enhancing diversity and bringing different perspectives to the boardroom.

Other work in this quarter included

Promoting best practice

- We attended a launch event for the new **Access to Medicine (ATM)** index. We were pleased that the ATM Foundation has strengthened its business rationale, following input from us and others. We also commended the future inclusion announced by the ATM Foundation of cancer as a disease in its scope, which we have encouraged.
- We participated in the launch of the **Climate Investments** partnership by the Oil and Gas Climate Initiative (OGCI). The OGCI announced a joint commitment to invest \$1 billion over the next 10 years collectively, in addition to each member company's own expenditure, into climate related technology. The initiative will focus on minimising methane emissions in the gas value chain and on carbon capture, use and storage.
- We spoke at the 19th EU Corporate Governance Conference. We explained that **corporate governance codes** must apply the principle of comply-or-explain to avoid prescriptive governance. As institutional shareholders represent the ultimate beneficiaries, workers and their pensions, we highlighted that no financial performance will compensate for the exploitation of valuable, increasingly diminishing resources and that a resilient and prosperous economy is needed to meet pension liabilities.
- Members of the Asian Corporate Governance Association from 40 countries, including us, visited the Financial Services Agency of Japan and raised concerns about the lack of transparency with regard to **cross-shareholdings**.
- We participated in the launch of the guide to **engagement on methane in the oil and gas industry** by the Principles for Responsible Investment and the Environmental Defense Fund, to which we had contributed.
- Japan's Ministry of Environment invited us to trial its new **environmental reporting tool**. The platform will give investors access to the environmental reporting of listed companies registered on the system. We welcomed this project, which we hope will promote dialogue between companies and investors and add to the growing momentum of responsible investment in Japan.
- We published a new paper calling on large publicly listed companies to overhaul **executive remuneration** structures so that they better align management with the interests of their long-term shareholders and better factor in issues of fairness. We suggested that the chair of the board should write annually to employees to explain the basis for the CEO's awarded pay for the current year – while the company should publish and comment on the ratio of CEO to median worker pay – using internal and external comparisons.
- At the invitation of a multinational law firm, we participated in a panel at a Business and Human Rights Knowledge Group event aimed mostly at lawyers. In the panel discussion, we explored due diligence in relation to the **Modern Slavery Act**, investor expectations and what the Act means for lawyers advising in that space.
- We spoke on a panel with the head of the UK's Serious Fraud Office (SFO), as well as representatives from Transparency International and a mining company at the UK's chapter of the UN Global Compact's **roundtable on anti-corruption**. We encouraged the move by the SFO to start more serious investigations into alleged corruption.
- We discussed with an executive from the Principles for Responsible Investment how to encourage Chinese stock exchanges to support the **Sustainable Stock Exchanges** initiative. This included engagement on climate change, green finance and green bonds.

Public policy

- We provided feedback on the emerging draft guidelines for company **reporting on climate-related financial disclosures**. We highlighted the need for scenario-planning to include a qualitative description of the potential impacts of low-carbon scenarios, as well as a quantitative assessment of the value at risk. In this context, we set out the key elements of a potential stress-test for the energy and resources sectors.
- We responded to the consultation by the Swiss government on its **climate policy post-2020**. We suggested that the Swiss government support the 2015 Paris Agreement on climate change and encourage all other stakeholders in the country, such as investors and companies, to contribute to the achievement of the objectives specified in the agreement. Ultimately, we asked the Swiss government to ratify the Paris agreement.
- We replied to a consultation by IPIECA, the global oil and gas industry's trade association for environmental and social issues, on **climate change reporting**. We highlighted that the Financial Stability Board's Task Force on Climate-related Financial Disclosures is likely to become the expected benchmark for disclosure and that IPIECA should view any of its standards as a baseline.
- We responded jointly with two large pension funds to the consultation on the amendments to the **German Corporate Governance Code**. In our consultation response, we focused on four major issues, namely the investor dialogue with German supervisory boards, supervisory board composition, audit committee independence and stewardship activities of institutional investors. We welcomed the proposed new recommendation that chairs of supervisory boards should have regular dialogue with investors and suggested the commission reference our Guiding Principles for the Dialogue Between Investors and German Supervisory Boards to specify the contents, format and participants of such dialogue.
- We made a submission to the UK Parliament's Business, Innovation, and Skills Committee's **inquiry on corporate governance**. The inquiry focused on executive pay, directors' duties and the composition of boardrooms, including worker representation and gender balance. In our response, we explained that we believe that the duties of directors are well defined in law and understood to be directed at the long-term success of the company, however, the day-to-day operations of capital markets too often shortens their time-horizons. We therefore suggested that companies should be required to disclose more about their interactions with key stakeholders and outline a number of proposals for improving remuneration structures.
- We co-signed a letter, co-ordinated by an investor group from the Principles for Responsible Investment, to policy-makers with jurisdiction over much of the region to encourage greater **regulation of exploration and production in the Arctic**. In particular, the letter called for a moratorium to all exploration in the Arctic High Sea area and stricter licencing requirements and uniform standards with regard to drilling across the rest of the region.
- We supported the concept of a **universal proxy** at shareholder meetings in the US when we responded to a consultation by the US Securities and Exchange Commission on the issue. We argued that this is a fundamental shareholder right, enabling shareholders to vote in favour of or against director candidates regardless of whether they are on the board's or a dissident shareholder's slate. This would result in less confrontational proxy contests and a more accurate expression of the wishes of shareholders.

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.

Overview

Over the last quarter we made voting recommendations at 1,104 meetings (7,639 resolutions). At 446 of those meetings we recommended opposing one or more resolutions. We recommended abstaining at four meetings and supported management on all resolutions at the remaining 654 meetings.

Global

We made voting recommendations at **1,104** meetings (**7,639** resolutions) over the last quarter.



■ Total meetings in favour **59.2%**
 ■ Meetings against (or against AND abstain) **40.4%**
 ■ Meetings abstained **0.4%**

Australia and New Zealand

We made voting recommendations at **204** meetings (**1,049** resolutions) over the last quarter.



■ Total meetings in favour **52.5%**
 ■ Meetings against (or against AND abstain) **47.5%**

Developed Asia

We made voting recommendations at **75** meetings (**433** resolutions) over the last quarter.



■ Total meetings in favour **57.3%**
 ■ Meetings against (or against AND abstain) **42.7%**

Emerging and Frontier Markets

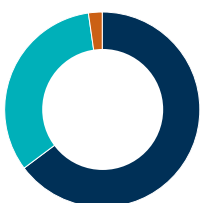
We made voting recommendations at **398** meetings (**2,647** resolutions) over the last quarter.



■ Total meetings in favour **57.3%**
 ■ Meetings against (or against AND abstain) **42.7%**

Europe

We made voting recommendations at **88** meetings (**640** resolutions) over the last quarter.



■ Total meetings in favour **64.8%**
 ■ Meetings against (or against AND abstain) **33.0%**
 ■ Meetings abstained **2.3%**

North America

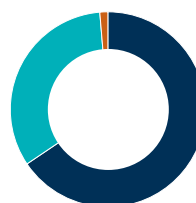
We made voting recommendations at **188** meetings (**1,320** resolutions) over the last quarter.



■ Total meetings in favour **63.8%**
 ■ Meetings against (or against AND abstain) **36.2%**

United Kingdom

We made voting recommendations at **151** meetings (**1,550** resolutions) over the last quarter.

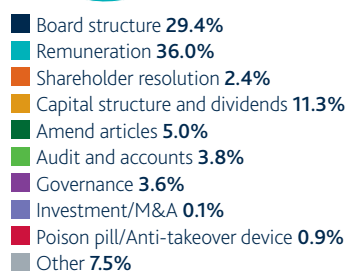
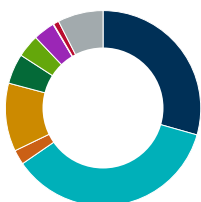


■ Total meetings in favour **65.6%**
 ■ Meetings against (or against AND abstain) **33.1%**
 ■ Meetings abstained **1.3%**

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

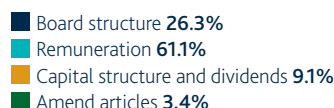
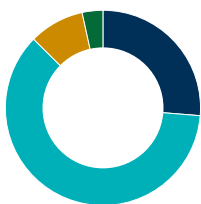
Global

We recommended voting against or abstaining on **983** resolutions over the last quarter.



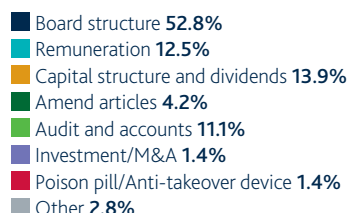
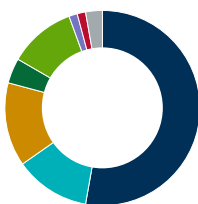
Australia and New Zealand

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



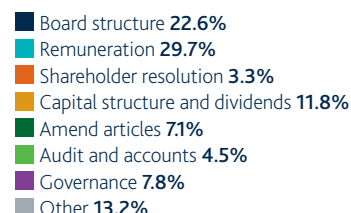
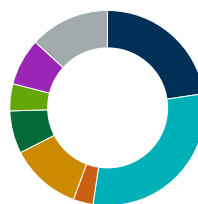
Developed Asia

We recommended voting against or abstaining on **72** resolutions over the last quarter.



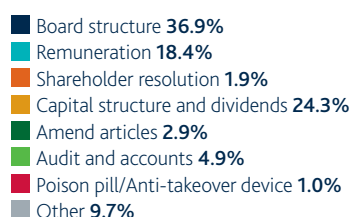
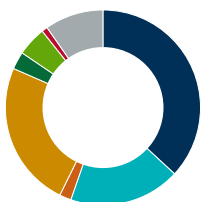
Emerging and Frontier Markets

We recommended voting against or abstaining on **424** resolutions over the last quarter.



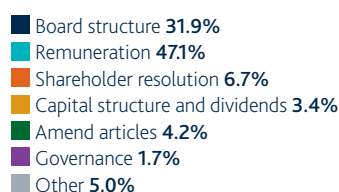
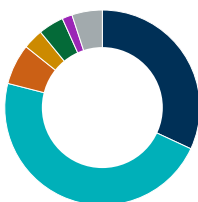
Europe

We recommended voting against or abstaining on **103** resolutions over the last quarter.



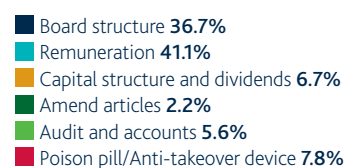
North America

We recommended voting against or abstaining on **119** resolutions over the last quarter.



United Kingdom

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



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