Excellence. Responsibility. Innovation.

Q3 2016

Hermes EOS

Public Engagement Report

How to get the buzz back – Seeking solutions to the decline in pollinators

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 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.

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 £236.8/€273.7 billion* in assets under advice.

Hermes has one of the largest stewardship resources of any fund manager in the world. Our 26-person team includes industry executives, senior strategists, corporate governance and climate change experts, accountants, ex-fund managers, former bankers and lawyers.

The depth and breadth of this resource reflects our philosophy that stewardship activities require an integrated and skilled approach. Intervention at senior management and board director level should be carried out by individuals with the right skills, experience and credibility. Making realistic and realisable demands of companies, informed by significant hands-on experience of business management and strategy-setting is critical to the success of our engagements.

We have extensive experience of implementing the Principles for Responsible Investment (PRI) and various stewardship codes. Our chair Colin Melvin 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[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, 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 360 companies are included in 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 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 30 September 2016

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

Hermes EOS team

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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 182 companies on 379 environmental, social, governance and business strategy 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 **182** companies over the last quarter.

- Environmental **18.7%**
- Social and ethical **26.1%**
- Governance **38.5%**
- Strategy, risk and communication **16.6%**

Developed Asia

We engaged with **27** companies over the last quarter.

- Environmental **10.5%**
- Social and ethical **32.9%**
- Governance **40.8%**
- Strategy, risk and communication **15.8%**

Emerging and Frontier Markets

We engaged with **39** companies over the last quarter.

- Environmental **33.7%**
- Social and ethical **26.5%**
- Governance **12.0%**
- Strategy, risk and communication **27.7%**

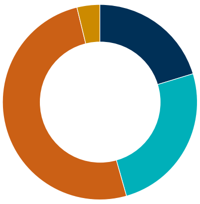
Europe

We engaged with **33** companies over the last quarter.

- Environmental **19.4%**
- Social and ethical **23.6%**
- Governance **37.5%**
- Strategy, risk and communication **19.4%**

North America

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



- Environmental **20.3%**
- Social and ethical **25.3%**
- Governance **50.6%**
- Strategy, risk and communication **3.8%**

United Kingdom

We engaged with **40** companies over the last quarter.

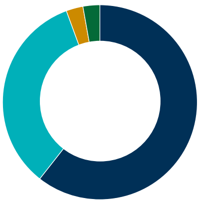
- Environmental **7.2%**
- Social and ethical **21.7%**
- Governance **55.1%**
- Strategy, risk and communication **15.9%**

Engagement by issue

A summary of the 379 issues on which we engaged with companies over the last quarter is shown below.

Environmental

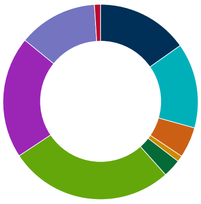
Environmental topics featured in **18.7%** of our engagements over the last quarter.



- Climate Change **60.6%**
- Environmental policy and strategy **33.8%**
- Pollution and waste management **2.8%**
- Water **2.8%**

Social and ethical

Social topics featured in **26.1%** of our engagements over the last quarter.



- Bribery and corruption **15.2%**
- Conduct and culture **14.1%**
- Cyber security **5.1%**
- Diversity **1.0%**
- Human capital management **3.0%**
- Human rights **27.3%**
- Labour rights **20.2%**
- Supply chain management **13.1%**
- Tax **1.0%**

Governance

Governance topics featured in **38.5%** of our engagements over the last quarter.

- Board diversity, skills and experience **31.5%**
- Board independence **20.5%**
- Executive remuneration **28.1%**
- Shareholder protection and rights **13.0%**
- Succession planning **6.8%**

Strategy, risk and communication

Strategy and risk topics featured in **16.6%** of our engagements over the last quarter.

- Audit and accounting **4.8%**
- Business strategy **33.3%**
- Integrated reporting and other disclosure **23.8%**
- Risk management **38.1%**

Environmental

How to get the buzz back – Seeking solutions to the decline in pollinators

With parts of the global bee population falling, we are engaging with the companies accused of playing a part in the decline of the pollinator.

Setting the scene

Three quarters of the world's food crops depend at least in part on pollination, undertaken by pollinators[2] such as bees, birds, bats, butterflies, beetles and other animals. The UN's Food and Agriculture Organisation estimates that out of the 100 crop species that provide 90% of the food worldwide, 71 are bee-pollinated[3]. Bee pollination – whether by domestic honeybees, wild bees or bumblebees – is also known to improve the yields and quality of the fruit, vegetables and nuts pollinated, according to the Intergovernmental Science-Policy Platform on Biodiversity and Ecosystem Services. Thus bee-pollinated commodities account for an estimated $217 billion in worldwide agricultural production.[4] The role of pollinators in the food production chain also makes their protection an important part of achieving the UN Sustainable Development Goals.

But for the last decade, beekeepers in the US and Europe, have been reporting annual losses of hives, the structures occupied by honeybee colonies, of 30% or higher[5], more than is considered normal or sustainable, although we do not have firm evidence that the population is in crisis globally.

Parasitic, bacterial and viral diseases such as the varroa mite have contributed to the decline in bees. Other factors include the decline in the number of professional beekeepers, changing weather patterns, increasing levels of pollution, habitat loss and monocultures and a resulting lack in forage areas, as well as chemical-intense agricultural practices and the application of pesticides, including the use of neonicotinoids.

With bee populations under threat, environmental and consumer activist groups, beekeeper associations, farmers, scientists and policy-makers have begun to take action to protect the natural habitat of pollinators. Although multiple causes have been found to be contributing to the decline in bees, a lot of attention has been paid to the role of pesticides.

Ban

After the European Food Safety Authority identified for certain crops high acute risks[6] for bees from some plant protection products containing the three neonicotinoids clothianidin, thiamethoxam or imidacloprid, as well as the insecticide Fipronil, the European Commission introduced an EU-wide ban on their use in 2013. The restriction has remained in place while a risk evaluation is underway, which is expected to be completed[7] by January 2017. Depending on the outcome, this could lead to modifying the conditions of approval of the pesticides or a lifting of the ban.

But the ban was not popular with everyone. Pesticide producers Bayer and Syngenta sought to overturn the ban and, as neonicotinoids are favoured by many farmers for their ease of application and relative low maintenance, the UK's National Farmers' Union even achieved a 120-day lift of the restriction in the country in 2015.

More weight has been given to the EU-wide ban by an assessment undertaken by the US Environmental Protection Agency (EPA), which confirmed a correlation between the use of neonicotinoids in certain crops and bee decline. However, other research has not been able to prove this link. While it remains difficult to establish the most dominant factor in the decline of bees, overall studies seem to point to neonicotinoids as a contributory one, depending on the type of crop.

Engagement

At Hermes EOS, we view bee welfare as fundamental to a sustainable economy. Food retailers and manufacturers, for example, are exposed to the risks stemming from a decline in bee populations across their supply chains from fresh fruit and vegetables to processed meals, fruit juices and confectionery. Consumer goods companies selling flower-dependent perfumes or cotton fibres, pharmaceutical industries reliant on natural flora and fauna and biofuel industries are equally at risk.

As part of our initial engagement with the implicated chemical companies, we asked them to acknowledge the – albeit involuntary – role of their products in the contribution to the decline in bee populations.

Our engagement on bee welfare forms part of the wider group of engagements around the management of risky products manufactured by companies. Ultimately, we want to ensure that companies have systems in place which identify the risks associated with their products and that they are able to substantiate their effectiveness through quantitative performance metrics and qualitative case studies. However, progress on this has been relatively limited to date.

As increased transparency of how companies manage the material risks arising from bee decline is important to investors, we urge them to disclose these, ideally in the form of integrated reporting. An integrated report gives a holistic view of an organisation by putting its performance, business model and strategy in the context of its material social and environmental risks and opportunities.

Bayer

We began our engagement on product risk management with German multinational company Bayer in 2012.

Despite only accepting a link to a decline in pollinators in individual cases where neonicotinoid products were applied against label recommendations and not in line with best practice, the company has begun to collaborate with the EPA in order to find solutions to protect bees, as it views the health of bees as a shared responsibility of multiple stakeholders.

As part of our engagement, we visited the company's headquarters and Bee Care Center in 2015 to discuss product risk management. Most of the research produced by the centre to date has been supportive of the company but we were pleased to see that its approach to pollinator decline has been gone beyond that of its sponsor.

Positively, Bayer began publishing integrated reports from 2014, into which we provided feedback, and we have been encouraged by the continuous improvements in this disclosure.

Bee roundtable

However, the decline in bee populations is a multi-causal and thus complex matter.

In October 2016, we therefore hosted the Hermes EOS roundtable on bee welfare, which was attended by academics, representatives from NGOs, including the European Professional Beekeepers Association, and industry players such as Bayer, BASF and Syngenta. It was intended to move beyond the already widely discussed causes to find solutions to the decline in bees, reinforce the economic importance of bees and call for better disclosure of the exposure to pollinator-related risks in company reporting.

The willingness to participate in the debate showed an increased awareness of the issue by all stakeholders and indicated their preparedness to find answers.

The roundtable concluded that as the decline in bees cannot be attributed to a single cause, efforts must be multi-fold too and involve all key stakeholders. This means adapting the countryside through the introduction of meadows and bee-enticing wild flowers, which at the same time will bridge some of the fragmentation of bee populations occurring as a result of climate change and habitat loss. It also involves raising awareness about the importance of neonicotinoids and the disadvantages of alternatives and for producers of pesticides to make pollinators part of their business model. In addition, a focus on biosecurity, in other words the protection of the pollinators from disease, as well as the training of landowners and leaseholders in land management and the smart use of pesticides is important.

There was hope that evolving technologies would lead to less of a reliance on pesticides because of more efficient application as a result of innovation in pesticide application equipment manufacturers, particularly as allegedly careless application by farmers has frequently been blamed for the decline in pollinators by pesticide producers.

Significantly, the consensus was that a collaborative multi-stakeholder programme, including companies, NGOs, scientists and farmers, would most effectively tackle the problem at many levels.

We will therefore continue to push for closer collaboration of companies with other stakeholders, as demonstrated by Bayer and the EPA, as well as better reporting on the issue.

The role of investors

Insect pollination is not just a free service but one that requires investment and stewardship to sustain it. Through their influence and exposure to many of the actors involved, global investors are well positioned to help find a solution by increasing awareness and having discussions with companies on the issue and encouraging better reporting about related risk management. Holding companies to account for the direct and indirect impact of their products is an important part of many of our engagements.

We will continue to engage with companies producing neonicotinoids and other pesticides to ensure they play their part in the protection of bees. With respect to Bayer, we also want to ensure that its looming takeover of US multinational agrochemical and agricultural biotechnology company Monsanto will not impact negatively on the efforts it has made with regard to bee welfare so far.

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[2] http://www.ipbes.net/article/press-release-pollinators-vital-our-food-supply-under-threat http://www.ipbes.net/sites/default/files/downloads/pdf/SPM_Deliverable_3a_Pollination.pdf

[3] http://www.unep.org/dewa/Portals/67/pdf/Global_Bee_Colony_Disorder_and_Threats_insect_pollinators.pdf

[4] http://www.fsa.usda.gov/Internet/FSA_File/pollinator_fact_sht.pdf

[5] http://e360.yale.edu/feature/declining_bee_populations_pose_a_threat_to_global_agriculture/2645/

[6] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:139:0012:0026:EN:PDF

[7] https://www.efsa.europa.eu/en/press/news/160111

Social

The price of health – Challenges of value creation in the pharma industry

The cost of public health on economies and social inequality have put the spotlight on pharmaceutical companies and their responsibilities towards society. As a result, the sector has begun to understand that in particular its behaviour in terms of ethics and access to medicine underpins its license to operate. We have therefore broadened our engagement with pharmaceutical companies to ensure the scope of their access to medicine programmes goes beyond infectious diseases and developing countries.

Setting the scene

Globally, two billion people cannot obtain the medicine they need, according to the Access to Medicine (ATM) Foundation. The Foundation's ATM Index ranks research-based pharmaceutical companies on their efforts to improve ATM globally, providing investors with a framework for benchmarking in the sector and spurring companies to improve their performance on the issue. The ranking is based on a combination of seven technical areas – general access to medicine management, market influence and compliance, research and development, pricing manufacturing and distribution, patents and licensing, capacity building and product donations, each of which is evaluated against a company's actions in relation to commitments, transparency, performance and innovation. We have been supportive of the index since its inception and contributed with our insights during its development, as well as a member of its expert review committee. We signed the ATM Foundation's Investor Statement in 2010, a pledge by over 50 institutional investors to encourage greater transparency on the efforts by companies to improve global ATM.

The geographic and disease scope of the index focuses on areas with the highest impact. In developing countries where they seek growth, pharma companies have focused their ATM programmes on specific needs, which traditionally been have infectious and neglected diseases. Preventable and treatable illnesses, such as HIV/AIDS, pneumonia, malaria and tuberculosis, in particular come at a high cost to poor countries. However, chronic conditions now also present a significant public health risk in low-income countries and have become the next frontier for ATM. We are therefore pleased that, as of 2017, the ATM Foundation will broaden its scope to include chronic diseases. In more established markets with tighter state budgets meanwhile, social inequalities have led to increasing pressure on price, as illustrated by the public outcry at the steep price hikes of pharma products.

Strategy

Long-term institutional investors have a vested interest in public health as improving access to medicine (ATM) in developed and emerging markets improves the resilience of society to the benefit of the global economy, while support for ATM is also consistent with the objectives of the UN Sustainable Development Goals.

In the pharmaceutical industry's traditional markets, the strains on healthcare systems have led to pricing pressures, while product pipelines are suffering from a decline in research and development, as well as tighter regulation. Developing countries, on the other hand, provide significant opportunities of growth for the industry due to their emerging middle classes and expansion of healthcare insurances and infrastructure. With greater emphasis put on accessing new markets as a source of future industry growth, pharma companies have come into close contact with ATM issues in developing countries. They have begun to realise that mismanagement of these issues can impact negatively on being granted a licence to operate in a market, while commercial opportunities can be unlocked by acting responsibly and with foresight. It has forced companies to re-think their existing business models and to roll out a different approach to these new markets.

Shifts

Pharma companies initially approached ATM through product donations and discount pricing, especially in geographies with high social inequalities and low incomes.

Today, research-based pharma companies have understood the relevance of ATM and have programmes in place to facilitate it. Mature pharma companies have long gone beyond corporate social responsibility and moved into differentiated pricing, patents and licensing strategies, capacity building and public-private partnerships to enable access to new markets.

As an investor representative, we believe that embedding ATM in corporate strategy across the value chain, from research and development to manufacturing and distribution, is key to the sustainability of business models. Through their ATM policy, pharma companies seek to be seen as a responsible partner by the regulator and stakeholders, making it easier for them to thrive in often complex markets.

These efforts will need to remain strong during the expansion of the ATM index from 2017. We welcome the planned enhancement of the scope of the ATM index to include non-infectious and non-transmissible diseases, such as cancers, diabetes, cardiovascular and respiratory diseases. These conditions are on the rise in low- and middle-income countries, resulting in the death of 28 million people annually there, nearly three quarters of the deaths associated with the diseases globally, according to the World Health Organization. The challenges associated with these diseases, such as prevention, diagnosis, long-term costs, as well as patient-centred and appropriate treatment over lengthy periods of time, require even closer collaboration between stakeholders and should bring ATM even further into business strategy.

Stewardship

As part of our engagement, we seek assurances that the companies in which our clients invest have fully considered the risks and opportunities of ATM and have effective policies and processes in place to deal with the challenges it brings.

With the industry increasingly recognising the importance of ATM, achieving a good ranking in the ATM Index has become more difficult, as even good programmes can face stiff competition, especially when the natural business of a company does not fully overlap with the ATM framework in terms of products and geographies. Our engagement objectives are based on the ATM's technical identified areas, which we tailor to a company's strategy and social footprint. We believe that, beyond its ranking, the index encourages greater transparency, thus leading to better business practices. We are therefore strongly supportive of the work of the index and engage with the companies, as well as the ATM Foundation, to improve their alignment.

The insights provided by the index, the latest version of which will be published in November 2016, also shed a light on the quality of company management beyond ATM. They indicate an awareness and understanding of the social issues by a company but also demonstrate its ability to operate ethically, innovate and adapt to its environment. On the contrary, a lack of disclosure, unwillingness to adjust and missing performance measures create doubt about the sustainability of a company's strategy.

In our engagement with pharma companies, we go beyond the existing perimeters of the ATM index in terms of diseases and drugs and the location of low and middle-income populations, encouraging them to address other widespread conditions and social inequalities globally.

We want to ensure an active and intelligent approach to ATM, which is appropriate to the nature of their business and see ATM fully integrated into individual strategy. ATM is a complex issue, as pharma companies have to balance company profitability and the ability to fund research with the interests of society. A focus on both these sides is generally a good indicator of success.

Progress

We have seen companies in our engagement programme increasingly integrate ATM into their strategy where appropriate. Overall, we have engaged with more than a dozen companies on ATM-related issues and objectives since 2010.

As an example of best practice, Swiss healthcare company Novartis unveiled a new access-to-healthcare programme in 2015. After years of engagement on the issue with the company, we welcomed the establishment of its dedicated ATM committee and new cross-divisional access strategy framework, which tailors pricing and access approaches to income segments. The framework offers a set of tools to expand access, including through differential pricing, generics, patient assistance programmes, strategic philanthropy and zero-profit models.

We were pleased to be one of the few investors invited to reflect on the roadmap for its ambitious ATM activities. The new programme aims to make 15 medicines targeting the main chronic diseases, such as cardiovascular and respiratory diseases, as well as diabetes and breast cancer, available and affordable in low- and lower-middle-income countries. The portfolio is sold to governments and NGOs in these countries at a price of $1 per treatment per month. The disease scope, expected scale and collaborative learning-by-doing approach set a precedent for the industry. In our engagement with the company, we have challenged the perceived risks and encouraged a better linkage to the wider company strategy but were pleased with its systematic and integrated approach.

Outlook

While the story of ATM has been a success so far, not least because of the efforts of the ATM Foundation and investors shining a spotlight on the issue, maintaining this momentum is crucial, as many people still do not have access to medicine. ATM therefore continues to be a core part of our engagement programme.

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Governance

Chair vs CEO – Two peas in the pod they are not

Engagement on the roles of chair and CEO is part of our dialogue on board effectiveness and wider governance with companies globally.

Setting the scene

Companies across the globe have different governance and board structures in place, ranging from the one-tier board structures typically found in Anglo Saxon countries to two-tier structures which prevail in Germany, the Netherlands and China. Depending on the structure of the company and regional preferences, board compositions vary, and with this the scope of the roles of chair and CEO.

Roles

While sitting on the same board in most countries, the roles of chair and CEO are essentially different. Thus, they ideally require two individuals with two distinct personalities and capabilities to fill the roles. Although they are meant to complement each other, a certain amount of constructive tension between the two individuals is part of the necessary checks and balances for the company.

In the one-tier system, the chair is responsible for leadership of the board and ensuring its effectiveness. He or she should promote a culture of openness and debate by facilitating the effective contributions of all directors, in particular non-executives. The chair also tends to liaise with shareholders and can be the public face of the company, while the board is tasked with establishing the vision, mission and values for the business and determining its strategy and organisational structure. Day-to-day management of the company on the other hand is the primary function of the CEO or managing director. He or she is responsible for implementing strategic operating plans and delivering the operational performance of the company, as well as ensuring adequate planning and control systems are in place.

According to the UK Corporate Governance Code, the division of responsibilities between the chair and CEO should be clearly established, set out in writing and agreed by the board. In two-tier systems, the two roles are structurally separate, which is one of the main advantages of such frameworks.

Combination

The UK Code also states that the roles of chair and CEO should not be exercised by the same individual. However, in countries such as France, Spain and the US a combination of the chair and CEO roles is common, typically for historical reasons. This combination also occurs in smaller and/or fast-growing companies or where the founder remains in these roles. In the US, the trend to a separation of the roles has been slow although a growing number of companies now have an independent chair and a separate CEO in place, with combinations in S&P 500 companies falling from 71% in 2005 to 52% in 2015, according to the Spencer Stuart Board Index[8], and companies with an independent chair increasing from 9% to 29% over the same time period.

We have a strong preference for the roles of chair and CEO to be split at listed companies, as we believe it 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. Succession is harder to manage, and therefore riskier, when the roles of chair and CEO are combined, as the individual is unlikely to be interested in replacing him- or herself. Furthermore, conflicts of interest can arise for example on executive compensation, as the combined chair/CEO can influence the decision-making of the board, particularly where it lacks a sufficient number of independent non-executive directors. A combination of the roles also limits the effectiveness of committees supposed to be outside the remits of management but which report to the board.

We urge companies that continue to have a combined chair/CEO to consider appointing an independent chair to improve the effectiveness of their board by holding the executives to account. While we recognise that it may appear difficult to make changes in this respect, our expectation is that no later than upon the next CEO succession, the roles be split and an independent chair be appointed to the board, for approval by shareholders at the subsequent AGM.

Lead independent director

On a case-by-case or temporary basis, we may support boards where one individual holds both roles, provided a permanent lead independent director is appointed. The lead independent director needs to have not only the right character and skills for the role but clearly defined countervailing powers, including a significant role in creating board meeting schedules and agendas, in board and CEO evaluation and succession planning and the right to meet shareholders. This helps to ensure that the independent non-executive directors can act effectively as a body to advise and oversee management. We also expect the board to provide rationale for the leadership structure of the company and its timing, how its governance arrangements will satisfy the need for independent oversight of the executives, as well as the factors it will take into account at its next review. If the roles of chair and CEO are combined and a lead independent director exists, the company should state that the powers and the role of the lead independent director are equivalent to that of an independent chair and explain why the person holding the position is the best candidate for the role. In our view, the lead independent director should act as an intermediary for other directors and serve as a sounding board for the chair.

From time to time, we request meetings with company chairs or lead independent directors. Meeting institutional and other shareholders is a key part of the roles of these individuals. Where this access is unreasonably denied, we find it difficult to support the re-election of those board members. Overall however, access to these, in jurisdictions such as the US and Spain, has improved significantly.

Bank of America

We engaged closely with Bank of America on its leadership structure when it appointed its CEO as chair in 2014, in the wake of the departure of the independent chair from its board. This was in sharp contrast to the binding shareholder vote from 2009 to split the roles of chair and CEO. Following the recombination of the chair and CEO roles, our engagement regarding the bank's leadership gained in intensity. In the run-up to the shareholder vote to ratify amendment of the company's by-laws to provide the board with the flexibility in determining its leadership structure, we had a number of meetings and calls with various members of senior management and the lead independent director. We discussed the reasons behind the decision, the formal responsibilities of the lead independent director and his role in practice, as well as the functioning of the board. We recommended voting against the ratification because we were concerned that the board had decided to overturn the binding shareholder vote from 2009 without seeking shareholder approval first.

However, we explained in a letter to the lead independent director that we acknowledged that the written specification for his role is the strongest we have seen in the US to date and importantly effectively equivalent to that of an independent chair. Through our meetings with the company, we have gained the sense that the lead independent director appears to fulfil the role in line with our expectations. We have also seen other progress, in particular the willingness of the directors to step up their engagement with us and other investors. As a result of our engagement, we now have a deeper relationship with the board and the governance management.

Moving up

The UK Corporate Governance Code also states that a CEO should not become chair of the same company. A CEO who moves to become chair may struggle to relinquish power and can unduly influence his or her successor and restrict reflection on past decisions. This move is usually only considered acceptable when a company is in a period of significant distress, for example sudden loss of the chair due to illness or unexpected resignation. In certain situations, however, we acknowledge that bad succession planning could jeopardise the business, as, because of his or her extensive knowledge, the CEO would be too valuable to leave. Thus, clients and other shareholders may want to keep the experience of the CEO by allowing him to move to the chair role.

If exceptionally a board decides that a CEO should temporarily become chair, it should consult major shareholders in advance of the shareholder meeting at which approval is sought and set out its reasons to shareholders at the time of the appointment and in the next annual report.

In Germany, a cooling-off period of two years exists during which members of the management board cannot join the company's supervisory board. We opposed the introduction of this law in 2009 because, as mentioned above, we believe a blanket ban could lead to valuable experience and relevant knowledge being lost, which at times can be crucial. We decide on whether to support a move from the CEO to the supervisory board and possibly the chair role on a case-by-case basis and, where appropriate, will support it, as was the case at BMW in 2015[9]. The assessment should take into account the company's situation, the composition of the supervisory board, the CEO's track record as an executive and his or her personality.

Schroders

As an example of moving up, in 2016 asset manager Schroders announced that its CEO, who had been at the helm of the company for 15 years, was to become its new chair. Our engagement with the company entailed an insightful meeting with its senior independent director (SID), who led the process of appointing a new chair at the company. As the person ultimately responsible for board composition, the chair should be seen to be initiating the succession process, although it should be executed by the SID on behalf of the board.

While we were supportive of the timing of the CEO succession process, the appointment of the new CEO and the commitment given to have a majority independent board, we could not justify the decision to appoint the incumbent CEO as chair and believe that a stronger succession planning process should have been in place. While we recognise some of the key customer, regulator and partner relationships he holds, these do not warrant a significant breach of best practice of UK corporate governance, as the chair, on appointment should meet independence criteria.

We therefore decided to recommend voting against the chair and SID, together with nearly a third of the asset manager's external shareholders, including three shareholder advisory groups. However, due to the company's big family investor base, which controls 47% of the company's shares and was supportive of the CEO's appointment as chair, overall only 15% of the company's shareholders rejected the move. The votes against Schroders sent a particular strong message, as research[10] has revealed that fund managers are almost 50% more likely to oppose management of companies in other sectors compared to the financial services sector. The study also found that because the finance sector is its own largest investor the industry's governance is undermined, potentially lowering director efficacy and company value.

We at Hermes EOS believe that if we as representatives of institutional investors and their ultimate beneficiaries advocate good corporate governance to companies outside the financial sector, it is important to uphold these principles inside the industry too. We will continue our engagement with Schroders on its governance structure to ensure it allows for effective oversight and that the new CEO is able to act independently from the chair.

Succession planning

Overall, any issues relating to controversial chair and CEO appointments or recombinations of the role tend to originate in bad succession planning. We therefore urge companies to have a strong formal programme on succession – including contingency – planning in place, with a wide pool of talent available for the short, medium and long term.

Good succession planning at the board and senior management level is an important safeguard of long-term value for any organisation. We encourage companies to make their senior management and executive directors available, where appropriate, to serve as non-executive directors at other companies as part of their development. This helps to develop a pipeline of suitable candidates for companies to draw from when selecting candidates for board positions. As part of good stewardship, institutional investors have a significant role to play in holding companies to account on succession planning.

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[8] As depicted in Chairman and CEO: The controversy over board leadership structure, Stanford Closer Look Series, June 2016 https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/cgri-closer-look-58-independent-chair.pdf

[9] https://www.hermes-investment.com/ukw/blog/eos/moving-on-up/

[10] Frenemies: How do financial firms vote on their own kind?, Cass and Toulouse Business School research 2015

Deutschland dialogue – Engaging with supervisory boards in Germany

The new communication guidelines for dialogue between investors and non-executive directors intend to break down barriers and foster mutual trust.

Guiding principles for the dialogue between investors and German supervisory boards

Guiding principle 1: Initiative and topics
A dialogue between investors and the supervisory board can* take place. On behalf of the company, the decision whether such a dialogue should take place rests with the supervisory board. The chair of the supervisory board decides whether to enter a specific dialogue. The dialogue exclusively pertains to topics that are part of the remit of the supervisory board.

Guiding principle 2: Composition and remuneration of the supervisory board
The composition of the supervisory board, its nomination process, as well as its remuneration system can be discussed in the dialogue. Specific proposals for the election to the supervisory board or those concerning individual candidates should not be discussed.

Guiding principle 3: Internal organisation and oversight
A dialogue between investors and the supervisory board can involve the discussion of the supervisory board's report and the supervisory board-related matters of the corporate governance report, the internal organisation of the supervisory board, the design of the control and participation processes, the committee formation, as well as the supervisory board's efficiency review and the measures derived from the review. A discussion of the results of the efficiency review regarding individual members of the supervisory board should not take place.

Guiding principle 4: Management appointment and removal, management remuneration
The requirement profile for management board members and the division of duties therein can be discussed in the dialogue. Specific proposals or those concerning individual candidates should not be the subject of the dialogue. In addition, the remuneration system of the management board, contemplated changes, possible suggestions for improvement, as well as the interpretation and, if applicable, the exercise of discretionary powers of the supervisory board pertaining to remuneration-related matters may be discussed with investors.

Guiding principle 5: Strategy development and implementation
The development and implementation of the corporate strategy is the responsibility of the management board. In the context of a dialogue with investors, the supervisory board can explain its participating role within the strategy process and its assessment of the implementation.

Guiding principle 6: Auditor
The criteria and the opinion-forming for the selection process of the auditor, as well as the extent and quality of the cooperation between the auditor and the supervisory board, can be discussed in the dialogue.

Guiding principle 7: Dialogue participants
The supervisory board's chair represents the supervisory board in communication with investors. He/she may call on other supervisory board members (for instance a chair of a committee), the chair of the management board or other management board members to participate in the dialogue. The supervisory board's chair informs the entire supervisory board about the dialogue.

Guiding principle 8: Form of the dialogue
The supervisory board discusses with the management board the basic principles of the content and format of the dialogue with investors.

*The nomenclature used here does not correspond with the German Corporate Governance Code.

Setting the scene

The board structure of German companies differentiates itself from that of other countries by its two-tier system. The structure facilitates a split of power between the management board on the one hand and the supervisory board on the other. The management board is responsible for the development and implementation of the company's strategy and generally represents it vis-à-vis third parties, including shareholders. The supervisory board, which is elected by shareholders, provides oversight and advises the management board but is not involved in the day-to-day running of the business. The chair of the supervisory board (the chair hereafter) equals the role of chair of the board in a one-tier system, whereas the chair of the management board is the company's CEO. While the two-tier system may be eyed with suspicion by international investors, there are pros and cons to this structure. Its key advantage is the separation of power and clear distinction between management and oversight, thus ensuring independent checks and balances of the board. However, reliance of the supervisory board on information provided by the management board can be seen as a disadvantage, compared to the one-tier system in which all directors attend the same and generally more regular board meetings. Members of the management board are appointed by the supervisory board, which itself is subject to employee co-determination, in other words comprising representatives of shareholders and employees. Depending on the total number of the workforce, up to half of the supervisory board members are elected by the company's employees. The chair is a representative of the company's shareholders and the deputy chair a representative of the employees.

Development

Traditionally, the supervisory boards of German companies have been hesitant to talk to investors. The main reason for this is the perception of the supervisory board as an inward-focused legal organ of the company which it only represents vis-à-vis third parties in exceptional circumstances. The reluctance has also been due to, in our view unfounded, worries that such dialogue could lead to commercially sensitive information being leaked to shareholders or the violation of the legal rule requiring equal treatment of investors. However, we believe that dialogue with supervisory board members is not only permissible in the current legal framework but is a crucial part of good governance and stewardship by institutional investors, as the latter elect the former directly to oversee management. This is underpinned by our experience in the UK where dialogue between investors and non-executive directors is already a useful feature of stewardship and corporate governance.

Through our intensive engagement with German companies over the last decade and the resulting long-term relationships we have been able to establish, we have slowly and steadily achieved good access to the chairs of the supervisory boards of Germany's largest companies.

But as the current regulatory framework does not provide clear guidelines as to how to conduct dialogue with chairs of supervisory boards, together with a large audit firm, we recognised the need for formal guidelines and co-led the initiative to create the Guiding Principles for the Dialogue between Investors and German Supervisory Boards. The aim of the principles has been to encourage and guide but not mandate discussions between the two parties.

The project resulted in the publication of a short paper in July 2016, setting out eight principles guiding key aspects of the dialogue, such as participants, content and its format. The guidelines focus on the composition, effectiveness and remuneration of the supervisory and management boards and have to date received good feedback from institutional investors from various markets.

Key to the development and successful launch of the project has been the involvement and support of a number of supervisors board chairs of Germany's largest companies, such as Bayer, BASF, Deutsche Bank, Deutsche Telekom, RWE and ThyssenKrupp, alongside German and foreign institutional investors, as well as other key stakeholders. Many of the chairs have international experience, thus understanding the importance of this dialogue in the German market. Their involvement also meant that the principles are an example of genuine self-regulation.

Benefits

The principles and ensuing dialogue with the supervisory boards should help in our engagement with German companies, where relevant experience and skills, independence of board members, oversight of strategy and its implementation are corporate governance issues we frequently address.

It is important to note that dialogue between investors and German supervisory boards is not excluded under company and capital market laws. To adhere to the restrictions of the capital market laws, confidentiality requirements and the equal treatment principle, which form the basis for the communication of investor relations and the management board with investors, need to be applied.

To put concerns to rest about the leaking of price-sensitive information and the violation of the equal treatment principle, the guidelines highlight that relevant legal rules and regulation need to be observed. The initiative concluded, however, that this does not rule out dialogue within the regulatory framework.

Direct communication between shareholders and the supervisory board can bring benefits to both sides. The dialogue enables investors to receive first-hand information and gain an impression of whether the composition of the supervisory board is appropriate and whether it carries out its duties effectively. In turn, the supervisory board has the opportunity to explain the two-tier German corporate governance model with employee co-determination to foreign investors and promote the understanding of the company's particular approach to corporate governance. In our experience, the dialogue neither jeopardises the relationship between management and the supervisory board, nor that between management and investors, for example, when the supervisory board comments on the development and implementation of business strategy. However, it is important for the supervisory board to discuss the basic principles for this dialogue with the management board.

Corporate Governance Code

While the guiding principles are consistent with the most current version of the German Corporate Governance Code, their wider purpose is to improve German corporate governance and stewardship practice.

We are therefore pleased that the German Government Commission for the Corporate Governance Code has announced its intention to propose an amendment to the code in its next revision on the topic of investor-supervisory board communications, most likely in the form of a general recommendation for dialogue between the two sides. This would be the first time the Commission has recommended this dialogue and as such would be a major success of the initiative, as we have encouraged the Commission to do so for a number of years.

Next steps

Overall, we are delighted that our initiative has succeeded as legal uncertainty and a lack of guidance on communications between investors and supervisory board chairs have been a problem in the German corporate governance system. Alongside the members of the initiative's working group, we seek to promote the principles with the objective that they become the official guidance referenced by the German Corporate Governance Code.

We also believe that they can be transferred to other markets regardless of one- or two-tier structures because they reflect best practice in the relationship between investors and non-executive directors and thus set company expectations. By promoting the principles internationally, we seek to raise awareness of the corporate governance framework in Germany, thereby encouraging dialogue between investors and supervisory boards within the existing legal and regulatory rules.

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Strategy

Engagement on strategy

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

Overview

We adopt a holistic approach to engagement, combining discussions on business strategy and risk management, including 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

Access to medicine

Lead engager: Sachi Suzuki

We welcomed the progress made by a pharmaceutical company on access to medicine, which we have been engaging on for some time. Its access to medicine strategy includes the opening of a local office to cover several sub-Saharan African countries. Positively, the initiative will also entail the provision of vaccinations against dengue fever and norovirus, as well as the distribution of expensive medicines, such as cancer drugs, to low-income parts of the population. The company's plan to introduce a tiered pricing scheme to accommodate patients that struggle to pay for medication is equally encouraging. The initiative will be run on a not-for-profit basis, meaning that profits from the operations will be returned to the region instead of being absorbed by the firm's headquarters, while maintaining the strategic link to the company. This will add a new dimension to the company's business, which has to date only generated limited revenues in Africa. Furthermore, we were told that the company chose to transform its board from a two-tier model to one with an audit committee to improve the speed of its decision-making.

Minority shareholder representatives

Lead engager: Jaime Gornsztejn

Given that one of the board members elected by minority shareholders has resigned, we were pleased that an emerging markets company took our suggestion on board agreed to convene an EGM in order to elect a new director. An interim replacement was appointed by the board until the next shareholders' meeting, in line with the company's by-laws. In our engagement with the company's board members, we challenged them on the nomination criteria and were reassured that the interim director is independent and qualified. Although we appreciate the credentials of the interim director, we highlighted the importance of convening a shareholders' meeting as soon as possible and not wait until the next AGM.

In a subsequent call organised by us with other institutional investors, the two board members representing minority shareholders said that they have full access to information and a voice on board decisions. Safeguards, which rely on the minority-elected directors, have been implemented in the company's governance to mitigate conflicts of interest. We explored the veto power that the two directors have in the dismissal of the chief compliance officer and the new nomination policy for board members and senior management. The directors assured us of their scrutiny of the preparation for the new business plan. We pressed them about board oversight on the implementation of this challenging plan. The directors took on board our concern and promised to convey them to the chair. We were pleased with the progress the company has made in corporate governance and agreed to arrange periodic updates from the minority shareholder elected directors.

New governance structure

Lead engager: Jaime Gornsztejn

In a meeting with its co-CEOs to discuss the new governance structure implemented at an extractives company, we were satisfied with the detailed explanation given and the careful preparation during the CEO transition period. As part of a planned succession, the two co-CEOs took office earlier in 2016. They sought to assure us that, so far, the model has been working, without slowing down the decision-making process. We asked about the changes made to the corporate governance framework to adapt to this leadership model. The co-CEOs pointed out that major decisions require joint agreement. In day-to-day management, each one leads certain business lines, making individual decisions and keeping the other one informed. However, the responsibility for the decisions remains joint. We also looked at the procedures in place in case of disagreement. The co-CEOs described the mediation process to be facilitated by the chair. Failing that, the decision is referred to the board governance committee. We will continue to monitor the effectiveness of the new governance structure in dealing with possible conflicts without impacting the company's agility.

We also gained comfort that human and labour rights issues are embedded in the company's supply chain management. With the company having over 5,000 suppliers in 36 countries, we challenged the head of supply chain management on supplier application, accreditation and monitoring processes. New suppliers go through a screening procedure, which includes a preliminary assessment of their technical qualifications, due diligence on conduct issues, including labour and human rights violations, and the acknowledgment of the company's supplier code of ethics. We sought assurance that the company also enforces its supplier code of ethics in countries where local legislation is less stringent, particularly in terms of labour rights and anti-corruption practices. The company said that suppliers in every country where it operates have to comply at least with the provisions of its code of ethics. We also investigated the accreditation process, which precedes the issuance of requests for proposals to registered suppliers. The accreditation and monitoring involves onsite audits by the company's inspectors looking for evidence that the supplier has safety, quality, labour and human rights policies in place and that they are adhered to. Suppliers that fail to achieve a minimum score are temporarily barred from supplying to the company, pending the implementation of a remediation plan. Health and safety are the most common non-compliance issues, while no breaches of the labour and human rights provisions contained in the company's code of ethics have been identified in the last few years. Although we were satisfied with the detailed discussion on supply chain management, we pressed the company to improve its reporting by disclosing metrics on the audits performed, non-compliance issues identified and corrective actions taken across all countries of operations. We shared best practice examples in this area. The company was receptive to our engagement and promised to look at ways of disclosing information that will allow investors to assess its supply chain management.

Remuneration

Lead engager: Bruce Duguid

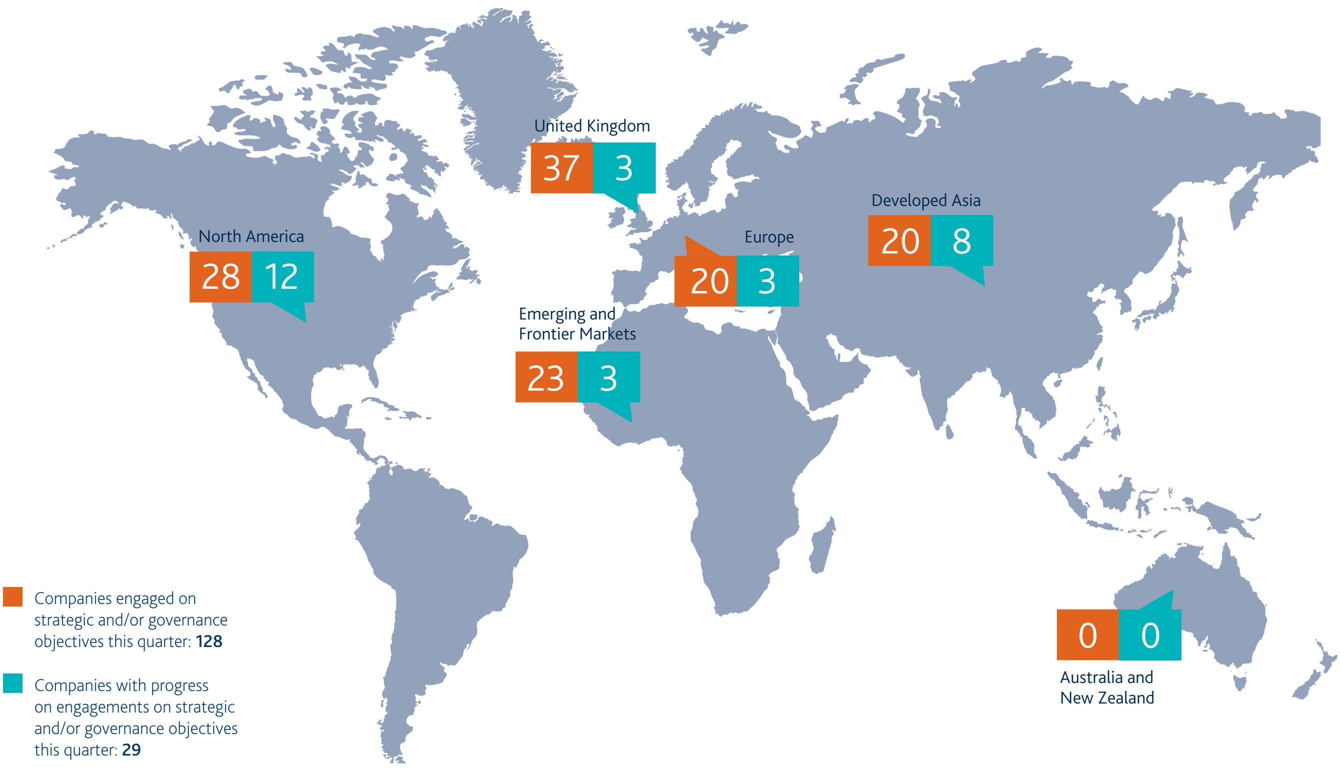
In a review of the proposed revisions to the remuneration policy of a UK company, we were pleased to hear that the company is considering reducing its focus on relative total shareholder return and instead focusing on a return on capital metric. We also welcomed its proposal for a five-year shareholding period under its long-term incentive plan. However, we expressed concern that there is no commitment to full transparency of the performance conditions relating to an equity award under the annual incentive scheme. We also noted that the 200% of salary minimum shareholding requirement for senior executives is below our minimum expectation of 300%. Furthermore, we discussed our preference for a further simplification of incentive schemes to a single scheme and also to reduce the ratio of variable to fixed pay to below 200% of fixed salary. The company was sympathetic to our proposals but questioned whether it could rely on widespread shareholder support. It also indicated that a move towards greater simplification may be easier than to award restricted shares, at least initially.

Supply chain management

Lead engager: Dominic Burke

Our call with a European retailer confirmed our impression that it is leading in its approach to responsible supply chain and human capital management, enabling us to successfully conclude our engagement. We commended the company's transparency in reporting supply chain challenges and risk management activities in each of its sourcing markets and were given examples of its strong focus on those markets where challenges persist. In Turkey, for example, it is actively supporting the formation of trade unions in partnership with global union bodies to support the rights of workers in its supply chain, including to a fair living wage. As well as training buyers on responsible purchasing practices, the company employs a digital platform to manage all product-sourcing which is used by suppliers, buyers and the company's corporate responsibility team. Crucially, all orders must be approved by the corporate responsibility team, taking into account the compliance status of the supplier, as well as its known production capacity, to avoid sub-contracting and deadline pressures. In addition, we heard how the treatment of employees as assets is central to the company's business model, as it relies primarily on store managers to provide insights into trends and demands in their location. The company's reporting attests to its focus on training and progression and we were particularly pleased that a recently appointed independent director, whose election addressed our concerns about the level of independence of the board, has considerable expertise on gender and human capital management. During the quarter, we also confirmed our support for all management items at the AGM. We were particularly pleased to note the refreshment of a long-serving independent board member, whose replacement previously headed a UK review on women's equality and pay and who has expertise in human capital management. This fulfils commitments made by the company in 2015 and we are comfortable that the level of independence on the board reflects the economic interests of minority shareholders and meets the recommendations of the country's corporate governance code.

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 – particularly companies, lawyers and accounting firms, which tend to be more active than investors in these debates – whose interests may be markedly different.

Highlights

Access to nutrition

Lead engager: Hans-Christoph Hirt

Together with the CEO of the Access to Nutrition (ATN) index, which assesses the performance of companies in relation to obesity and malnutrition, we hosted a side event at the PRI in Person event in Singapore to explain the purpose, methodology and 2016 results of this ranking. We also outlined our plan, developed together with a small group of other investors, to launch a joint engagement with the companies included in the index, to better understand apparent shortcomings, explore the ATN's recommendations and, where appropriate, encourage better practice. The presentations elicited many questions and demonstrated the importance of the issues covered by the ATN index. Working closely together with the other investors involved in the engagement initiative, we aim to have dialogue with the first set of companies shortly.

Conflict minerals

Lead engager: Christine Chow

Through collaboration with two asset managers, we made progress in our engagement with the Electronics Industry Citizenship Coalition (EICC) to take concrete steps in the ethical sourcing of raw minerals. EICC is to launch a new working group, initially composed of key technology and electronics companies from the US, to address human rights issues in the electronics supply chain. While the working group can focus on a range of minerals, we were pleased that following recommendations from the collaboration group, cobalt from the Democratic Republic of Congo (DRC) is one of the minerals it is likely to prioritise. We also urged the EICC to set up a side event inviting government representatives from the DRC so that we can address the more sensitive and salient human rights issues in a small group-setting. We hope that by supporting the DRC government in improving the monitoring of human rights, companies will be able to operate in a more transparent environment that reduces their risks.

Implementation of the 2015 Paris Agreement

Lead engager: Bruce Duguid

We signed a letter prepared by the Institutional Investors Group on Climate Change, the Principles for Responsible Investment, the CDP initiative and other investor institutions calling on G20 leaders to accelerate implementation of the 2015 Paris Agreement. It recommended the following policies: 1) Accelerated ratification of the Paris Agreement 2) Implementation of the recommendations of the 2014 Global Investor Statement on Climate Change, including the provision of a stable, reliable and economically meaningful carbon pricing mechanism and plans to phase out fossil fuels 3) Support of a doubling of investment in clean energy by 2020 4) Preparation to strengthen nationally determined contributions to carbon reduction 5) Requirement of improved corporate disclosure of climate risks and 6) Welcoming the work of the G20 green finance study group, which aims to enhance the contribution of institutional investors to the greening of mainstream financial flows.

Stewardship in Taiwan

Lead engager: Hans-Christoph Hirt

We participated in a panel discussion at the first annual forum of the Taiwanese Institute of Directors alongside the president of the local stock exchange, the chair of one of the biggest local asset owners and the chair of a large listed company. We were delighted that following many years of our engagement with local regulators and market participants a local stewardship code was launched in June 2016. Building on the comments of the stock exchange's president, who introduced the code, we outlined what stewardship means for investors and what additional expectations will arise in relation to communications with companies. We highlighted the need for more board level dialogue, including with non-executive directors. We also expressed concerns about the composition and effectiveness of boards in the market, which often seem to be composed of business partners instead of people who can contribute to the development of the business and challenge management. Positively, the attending local asset owners appeared supportive of the idea of stewardship and eager to learn about engagement with companies.

Other work in this quarter included

Promoting best practice

- In a discussion with the **Aiming for A coalition of investors** we agreed to now focus on utility companies. However, given that the Financial Stability Board's Task Force on Climate-related Financial Disclosures is expected to recommend enhanced disclosure in early 2017, it is appropriate to await this outcome before drafting new resolutions. In addition, new resolution wording beyond that used for the extractive industries is likely to be required for utilities, which will take time to negotiate and agree. Therefore it is likely that new resolutions will only be presented in 2017, not in 2016.
- In collaboration with other investors and the Farm Animal Investment Risk and Return network, we signed letters to several companies in the restaurant and fast food sector calling on them to implement appropriate timelines to phase out the routine, preventative use of medically important **antibiotics in their livestock supply chains**. The majority of antibiotics used in the UK and US are given to livestock and the World Health Organisation has warned that this is leading to a post-antibiotic era of rising antimicrobial resistance.
- We contributed to an advisory committee meeting by the Principles for Responsible Investment to develop a collaborative engagement programme on **cyber security**. We suggested that the retail and healthcare sectors should receive particular focus due to their high-risk exposure, not least given the value of customer data they hold, and also recommended that the group's scope include public policy. Our engagement with companies in other sectors has indicated that there is room for better guidance from government and regulatory bodies to help companies respond effectively to cyber security risks.
- At a roundtable chaired by Tomorrow's Company and hosted by a human resource consulting firm, we encouraged UK companies to heed the call by the UK Prime Minister to give a greater voice to **employees in the boardroom**. As the sole investor representative among company, regulator and government participants, we said that due consideration should be given to whether this is best served by having an elected employee on the board or through a stakeholder committee which feeds into the board.
- Alongside Anti-Slavery International and supply chain experts, we discussed the challenges facing companies tackling **human rights abuses in their supply chain**, with a focus on the garment industry in Southeast Asia. As universal owners, we highlighted that institutional investors should press for collaboration between companies and local stakeholders to ensure problems are solved at the roots and not hidden or shifted elsewhere in the communities.
- We participated in the launch of the first report of the **Institutional Investor Council in Malaysia** of which we are a member. The report, to which we contributed, takes stock of international and local stewardship guidance and practice and sets out future key priorities for the development of the role of institutional investors in the governance of investee companies. One problem since the launch of the local code in Malaysia in 2014 has been the limited sign-up from the main asset owners in the country. The creation of the IIC was partly an attempt to address this issue by bringing the main asset owners closer to the project. This seems to be working, with a couple of major funds signing up to the code in 2015 and this year.
- At a meeting of corporate governance specialists of UK asset owners and investors, we addressed a range of **remuneration concerns**, including how best to limit fixed awards such as pension payments, the need to take a common stand to resist any moves by companies to alter targets in light of changing economic conditions and reporting by companies on the alternative investment market AIM, a sub-market of the London Stock Exchange. We also provided an update on the joint initiative to re-launch the Hermes Remuneration Principles and invited suggestions on the practical guidelines we recommend for UK remuneration structures.
- Encouragingly, the Canadian Coalition for Good Governance (CCGG) presented to its public policy committee a proposal to develop a **stewardship code**. As a participant on this committee, we expect to be able to contribute to the process.
- In our dialogue with the **Sustainable Stock Exchanges Initiative** (SSE), we explored how Hermes EOS could support it. One opportunity for us is to help to ensure that Asian stock exchanges, particularly those in China, Japan, Hong Kong and Singapore join the initiative. Another is involvement in the development and promotion of standardised guidelines for sustainability reporting, building on the voluntary guidelines already created by more than 20 stock exchanges.

Public policy

- Subsequent to our response to the Afep-Medef consultation on the update for the **French corporate governance code**, we met the business association Afep to follow up on our comments and discuss the lobbying of French companies on the pending say-on-pay law. Positively, our messages appear to have been heard, especially in relation to our desire for stronger language requesting the lead director to be independent in the event of a combined chair/CEO or dominant shareholder. Afep also confirmed that it has taken on board our requests for simpler pay structures and better justifications for remuneration policies and payouts.
- We submitted our response to the consultation by the US Securities and Exchange Commission (SEC) on **non-financial disclosure** by companies. We noted that shareholders also require information that enables them to decide whether to engage, as well as to buy or sell, particularly as an increasing proportion of institutional and retail investors use passive investment vehicles and seek to view companies through long-term lenses. We welcomed the work of the Sustainability Accounting Standards Board and suggested that the SEC could use much of its work in this area. We also called on all companies to address climate change, not only because of the issues that each industry faces but because of the systemic risk to the global economy that would affect all industries.
- Along with other investors, we wrote to leaders of the US Senate Banking Committee strongly opposing legislation in the House of Representatives that would tighten the **regulation of proxy advisory firms** to the detriment of institutional investors. Proxy advisory firms play a vital role in assisting pension funds and other institutional investors in carrying out their fiduciary duty to vote proxies. Pension fund fiduciaries have a duty to ensure that their proxies are voted in the best long-term interests of plan participants and beneficiaries and the ability to fulfil that duty may be significantly impaired if the proposed legislation is enacted.
- We participated in a meeting of the **stewardship code working group in Singapore** of which we are a founding member, sharing our experience with the launch, administration and implementation of principles in other markets. Encouragingly, a revised draft of the local principles has now been completed. The launch had originally been planned for the first quarter of 2016 but was pushed back as the principles were reviewed and consulted on. One significant compromise that has been made following the consultation is that the principles will not be presented as a code, implying stronger regulation, but rather as guidance. This may affect the impact of the principles. However, positively the wording of the principles has been amended to make them more accessible to a non-expert audience.

Hermes EOS makes voting recommendations at general meetings wherever practicable. We take a graduated approach and base our recommendations on annual report disclosures, discussion 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.

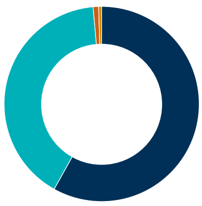
Hermes EOS makes voting recommendations at companies all over the world, wherever its clients own shares.

Overview

Over the last quarter we made voting recommendations at 1,094 meetings (9,332 resolutions). At 443 of those meetings we recommended opposing one or more resolutions. We recommended voting with management by exception at five meetings and abstaining at 10 meetings. We supported management on all resolutions at the remaining 636 meetings.

Global

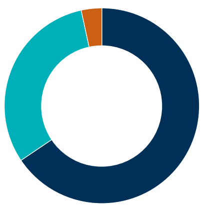
We made voting recommendations at **1,094** meetings (**9,332** resolutions) over the last quarter.



- Total meetings in favour **58.1%**
- Meetings against (or against AND abstain) **40.5%**
- Meetings abstained **0.9%**
- Meetings with management by exception **0.5%**

Australia and New Zealand

We made voting recommendations at **29** meetings (**117** resolutions) over the last quarter.



- Total meetings in favour **65.5%**
- Meetings against (or against AND abstain) **31.0%**
- Meetings abstained **3.4%**

Developed Asia

We made voting recommendations at **84** meetings (**549** resolutions) over the last quarter.

- Total meetings in favour **56.0%**
- Meetings against (or against AND abstain) **44.0%**

Emerging and Frontier Markets

We made voting recommendations at **458** meetings (**3,308** resolutions) over the last quarter.

- Total meetings in favour **54.8%**
- Meetings against (or against AND abstain) **45.0%**
- Meetings abstained **0.2%**

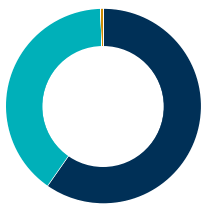
Europe

We made voting recommendations at **100** meetings (**926** resolutions) over the last quarter.

- Total meetings in favour **53.0%**
- Meetings against (or against AND abstain) **45.0%**
- Meetings abstained **2.0%**

North America

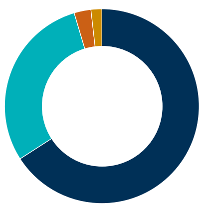
We made voting recommendations at **206** meetings (**1,632** resolutions) over the last quarter.



- Total meetings in favour **59.7%**
- Meetings against (or against AND abstain) **39.8%**
- Meetings with management by exception **0.5%**

United Kingdom

We made voting recommendations at **217** meetings (**2,800** resolutions) over the last quarter.

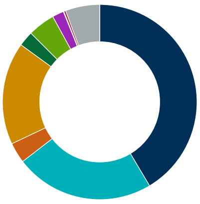


- Total meetings in favour **65.9%**
- Meetings against (or against AND abstain) **29.5%**
- Meetings abstained **2.8%**
- Meetings with management by exception **1.8%**

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

Global

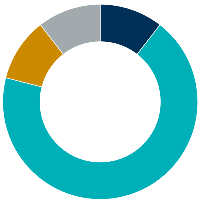
We recommended voting against or abstaining on **995** resolutions over the last quarter.



- Board structure **41.4%**
- Remuneration **23.1%**
- Shareholder resolution **3.4%**
- Capital structure and dividends **17.0%**
- Amend articles **2.5%**
- Audit and accounts **4.5%**
- Governance **1.9%**
- Investment/M&A **0.1%**
- Poison pill/Anti-takeover device **0.3%**
- Other **5.7%**

Australia and New Zealand

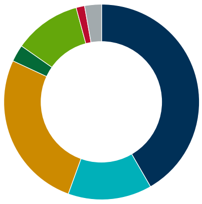
We recommended voting against or abstaining on **19** resolutions over the last quarter.



- Board structure **10.5%**
- Remuneration **68.4%**
- Capital structure and dividends **10.5%**
- Other **10.5%**

Developed Asia

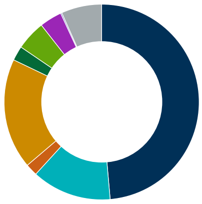
We recommended voting against or abstaining on **72** resolutions over the last quarter.



- Board structure **41.7%**
- Remuneration **13.9%**
- Capital structure and dividends **26.4%**
- Amend articles **2.8%**
- Audit and accounts **11.1%**
- Poison pill/Anti-takeover device **1.4%**
- Other **2.8%**

Emerging and Frontier Markets

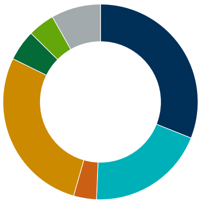
We recommended voting against or abstaining on **508** resolutions over the last quarter.



- Board structure **48.6%**
- Remuneration **13.2%**
- Shareholder resolution **2.0%**
- Capital structure and dividends **18.3%**
- Amend articles **2.4%**
- Audit and accounts **4.9%**
- Governance **3.7%**
- Investment/M&A **0.2%**
- Other **6.7%**

Europe

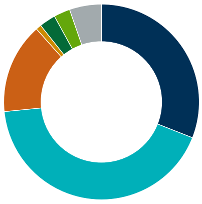
We recommended voting against or abstaining on **158** resolutions over the last quarter.



- Board structure **31.0%**
- Remuneration **19.6%**
- Shareholder resolution **3.8%**
- Capital structure and dividends **27.8%**
- Amend articles **5.1%**
- Audit and accounts **4.4%**
- Other **8.2%**

North America

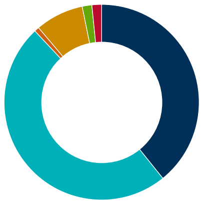
We recommended voting against or abstaining on **113** resolutions over the last quarter.



- Board structure **31.0%**
- Remuneration **42.5%**
- Shareholder resolution **15.0%**
- Capital structure and dividends **0.9%**
- Amend articles **2.7%**
- Audit and accounts **2.7%**
- Other **5.3%**

United Kingdom

We recommended voting against or abstaining on **125** resolutions over the last quarter.



- Board structure **39.2%**
- Remuneration **48.8%**
- Shareholder resolution **0.8%**
- Capital structure and dividends **8.0%**
- Audit and accounts **1.6%**
- Poison pill/Anti-takeover device **1.6%**

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