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PUBLIC ENGAGEMENT REPORT

Changes are coming – How to get your ‘ducks in a row’

Q3 2018

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HERMÈS
EOS

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 2018.

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

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Engagement by region

Over the last quarter we engaged with 241 companies on 547 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 **241** companies over the last quarter.



- Environmental 31.1%
- Social and ethical 21.0%
- Governance 27.6%
- Strategy, risk and communication 20.3%

Australia and New Zealand

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



- Environmental 100.0%

Developed Asia

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



- Environmental 20.0%
- Social and ethical 23.1%
- Governance 33.8%
- Strategy, risk and communication 23.1%

Emerging and Frontier Markets

We engaged with **32** companies over the last quarter.



- Environmental 27.8%
- Social and ethical 20.8%
- Governance 20.8%
- Strategy, risk and communication 30.6%

Europe

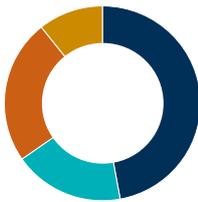
We engaged with **46** companies over the last quarter.



- Environmental 30.6%
- Social and ethical 24.5%
- Governance 19.4%
- Strategy, risk and communication 25.5%

North America

We engaged with **66** companies over the last quarter.



- Environmental 47.1%
- Social and ethical 18.2%
- Governance 24.0%
- Strategy, risk and communication 10.7%

United Kingdom

We engaged with **60** companies over the last quarter.



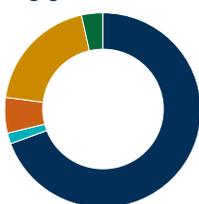
- Environmental 28.2%
- Social and ethical 19.4%
- Governance 35.5%
- Strategy, risk and communication 16.9%

Engagement by theme

A summary of the 547 issues and objectives on which we engaged with companies over the last quarter is shown below.

Environmental

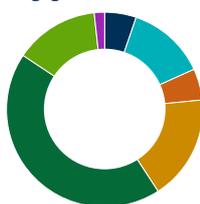
Environmental topics featured in **31.1%** of our engagements over the last quarter.



- Climate change **69.4%**
- Forestry and land use **1.8%**
- Pollution and waste management **5.9%**
- Supply chain management **19.4%**
- Water **3.5%**

Social and ethical

Social topics featured in **21.0%** of our engagements over the last quarter.



- Bribery and corruption **5.2%**
- Conduct and culture **13.0%**
- Diversity **5.2%**
- Human capital management **17.4%**
- Human rights **43.5%**
- Labour rights **13.9%**
- Tax **1.7%**

Governance

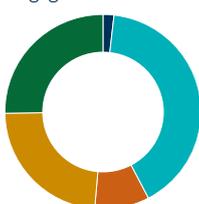
Governance topics featured in **27.6%** of our engagements over the last quarter.



- Board diversity, skills and experience **21.2%**
- Board independence **15.9%**
- Executive remuneration **34.4%**
- Shareholder protection and rights **15.9%**
- Succession planning **12.6%**

Strategy, risk and communication

Strategy and risk topics featured in **20.3%** of our engagements over the last quarter.



- Audit and accounting **1.8%**
- Business strategy **40.5%**
- Cyber security **9.0%**
- Integrated reporting and other disclosure **23.4%**
- Risk management **25.2%**

The Shareholder Rights Directive II: not just a minor tweak to a rulebook

The Shareholder Rights Directive of 2007 set out to improve shareholder rights across the EU and progress has been made. But it is clear there is a need to do more and further change is on the way.

It is often said that a sequel is never as good as the original. While that might be true for some films, in the case of the new Shareholder Rights Directive II (SRD II), we believe it is more of a good thing.

One of the reasons we are in favour is because, as the name implies, shareholder rights are at the heart of the Directive. However, the amendments will also mean new obligations on shareholders rather than simply the creation of additional rights, in particular in relation to transparency. We see the rights and obligations as a responsibility, as well as an opportunity for shareholders.

Originally introduced by the EC in 2007, the goal of the original Shareholder Rights Directive (SRDI) was to give shareholders consistent rights at the annual general meeting (AGM) and when voting. The amended version (published in May 2017) aims to take this further. It is due to be implemented by EU member states by 10 June 2019, so with less than a year to go, we believe it is a good time to revisit the changes, the reason they have been introduced and the impact they will have.

To sum up, there are three main strands to the amendments; first, to improve the sustainability of EU companies, particularly in the aftermath of the global financial crisis (GFC), which took place after the first Directive; second, to improve the movement of information along the 'investment chain' – to make sure shareholders get the right information at the right time; and third, to encourage long-term, focused shareholder engagement.

The rules of engagement

We are in favour of all of the amendments (subject to appropriate implementation in individual member states), but the third strand, which relates to engagement, is the one that particularly catches our eye. In our view, engagement is key for implementing successful investor stewardship. We believe that encouraging deeper and more effective levels of engagement has the greatest potential for creating much-needed systemic change, specifically with regard to the ideal of long-term oriented, corporate behaviour.

We therefore believe that the updated Directive provides an opportunity to improve corporate governance for the benefit of many stakeholders, and should therefore be embraced by all involved. And that means a lot of people. After all, this is no minor tweak to a rulebook; more than eight thousand listed companies on EU regulated markets, with a total capitalisation of around eight trillion euros will

Setting the scene

The amendments to the 2007 Shareholder Rights Directive, resulting in the Shareholder Rights Directive II were agreed by the European Parliament and Council in May 2017, with an implementation date of June 2019. The amendments arose mainly due to the impact of the global financial crisis on EU companies. The European Commission (EC) is keen to crack down on the short-term strategies of institutional investors and asset managers, as it believes their short-term approach has been influencing corporate governance and behaviour. Executive pay is also in the spotlight; the new rules give shareholders more of an insight into how much company directors are paid and the opportunity to influence this.

fall within the scope of the Directive.¹ More specifically, these are companies with registered offices in, and whose shares trade on a regulated market located in or operating in an EU member state. As a result, all asset owners (institutional investors) and asset managers holding shares in these companies may see changes in their rights, regardless of where they themselves are based.

Some of the key improvements we anticipate include encouraging institutional investors to engage; increasing shareholder rights and powers; the need for both passive and active investment managers to understand, engage and report on ESG; and raising awareness with institutional investors on how their asset managers are rewarded, and whether this is driving the right behaviours and outcomes.

Why the upgrade?

There are a few good reasons why the EC has introduced these changes to the Directive. For instance, a significant geopolitical event has taken place since the first Directive was introduced. Understandably, the EC has assessed the causes of the GFC and it has indicated that shortcomings in listed companies' corporate governance (specifically investor influence or the lack of it), contributed to the turmoil. It concluded that shareholder engagement had been lacking, it had been too difficult for shareholders to exercise their rights and that there had been anomalies in executive pay in comparison with performance, leading to shareholder mistrust – which spread more widely, into society as a whole. As a result, it is keen to put in place further measures to encourage both shareholders and companies to take a longer-term approach.

Investor short-termism, in particular, is another bugbear for the EC. It does not want corporate governance being driven by this and believes there is evidence to suggest that it is often the case. This is not the Commission's only concern about short-termism; it believes the issue goes deeper. It points to the short-term culture that prevails in the way asset manager performance is assessed – ie often only quarterly or annually. Unsurprisingly, this does not tend to encourage a long-term view and creates the challenge for managers to deliver short-term returns. Figures show that the average shareholding period is less than a year (eight months) and that fund managers refresh their entire portfolio every 1.7 years, on average.¹ This culture of short-termism is incompatible with long-term stewardship and the Directive seeks to address this, by encouraging institutional investors and asset managers to treat stewardship as a much higher priority.

The Directive will also address concerns about executive pay, for instance with respect to transparency, quantum and incentives, by giving shareholders a vote. This sets out to encourage a stronger link between pay and performance, as a short-term approach here might also not be in companies' and other stakeholders' best interests.

Playing by the rules

The new rules require investors to be transparent about how they invest and engage, or explain why not. The aim is to encourage the adoption of a more long-term focus on investment strategies. The question is: do investors have to follow the rules? The answer is yes and no. There is a certain degree of flexibility, in that the new rules will be based on a 'comply or explain' approach. However, the market may self-regulate where there is increased transparency, as typically investors do not wish to be perceived as lagging their competitors and peers.

At present there are few investors with effective stewardship capabilities. As a result, asset managers in the EU and beyond are now belatedly seeking to build these capabilities, recognising that when executed expertly, effective stewardship can improve returns, reduce downside risk and, more broadly, create greater long-term value for all stakeholders, as supported by independent research.²

Next steps

While the Directive sets out clear requirements, there are also many 'known unknowns'; one being how the Directive will be implemented in each member state. However, regardless of how each EU member state decides to implement the Directive, we believe that driving common objectives, minimum standards and concrete outcomes on long-term 'financial and non-financial' stewardship across member states is a desirable outcome. Also, as with any engagement, the real results come from how stewardship is conducted in practice. It should not be a 'tick-box' exercise. Focusing on implementation, therefore, is more likely to drive positive changes in behaviour than simply adhering to a policy.

Will it be successful? The chances are higher if there is a concerted effort by all involved to work to the spirit of the amendments and the new rules. Countries which have insufficient standards of disclosure and compliance, and poor explanations of non-compliance could have a tough road ahead, particularly in the light of the 'comply or explain' approach of the amendment. However, we believe that member states will see the economic and social benefits of better stewardship and will engage constructively with the Directive. It is in their interest to do so, if sustainable wealth creation for their country is on their agenda. We also believe that the Directive is a potential building block for future sustainable finance regulation, and that its greatest impact should be on the long-term sustainability of EU companies and economies. Another reason why it is in the interests of all involved to embrace the new rules is that lukewarm acceptance could result in the EU becoming more stringent in its approach in future.

To sum up, the new Directive addresses many of the issues that we see as barriers to active stewardship, so not surprisingly, we are very much in tune with its goals. However, we believe that the investment industry may be insufficiently prepared for what will be a considerable step change. One of the areas that may be challenging for the industry, for example, is ensuring adequate resourcing of engagement activity, which requires experienced, multi-skilled professionals.

We look forward to the implementation of the Directive in EU member states, and welcome your views and any questions.

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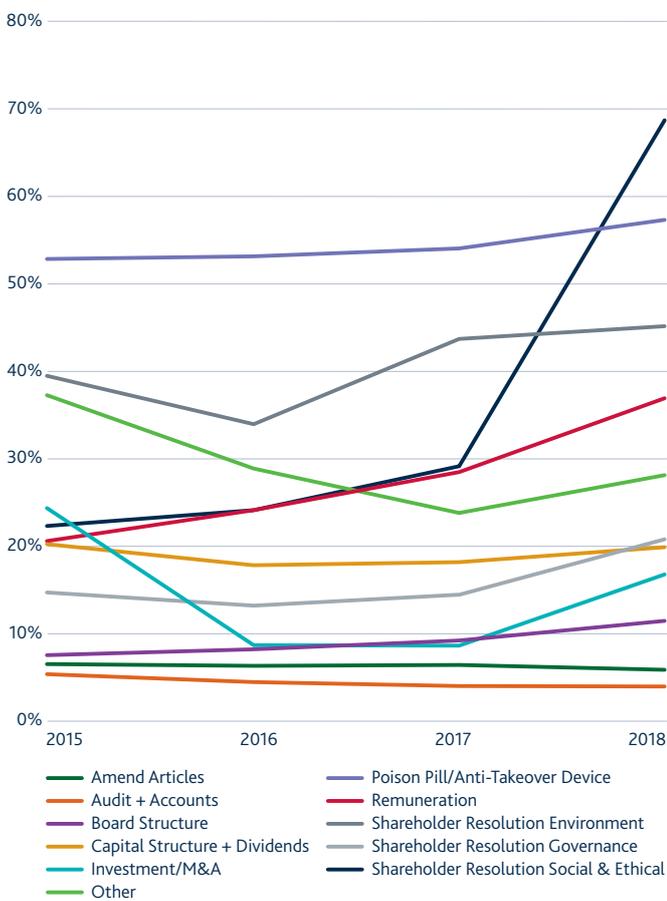
¹ http://europa.eu/rapid/press-release_MEMO-17-592_en.htm

² Some examples of independent research include Hoepner A.G.F., Oikonomou I., Sautner Z., Starks, L.T. and X. Zhou (2018): *ESG Shareholder Engagement and Downside Risk* (Working Paper); and Dimson E., Karakas O., and X.Li (2015): *Active Ownership. Review of Financial Studies*, 28 (12), 3225-3268.

Putting it to the vote – are we for, or are we against?

A company needs an effective board, focused on current and future business challenges and opportunities. The board also needs to have appropriate experience and skills. Diversity is key too. Furthermore, its members should be incentivised to ensure long-term value creation.

Proportion of resolution type with recommended vote against management, 2015–18



Source: Hermes EOS

Setting the scene

Our 2018 voting season was dominated by concerns about executive remuneration; board composition, including director independence and diversity; and climate change

This year, we recommended votes against the board’s recommendations at the highest levels yet (60% of meetings saw at least one vote recommendation against management, compared with 54% in 2017), with particular increases in the US and Germany. This reflects the review and continued tightening of our voting policies in key areas like diversity and remuneration after the 2017 season, and the outcomes of our engagement with companies. In addition to meeting directly with numerous board directors and executives over the season, we attended 10 annual shareholders’ meetings to raise concerns and ask questions of the board, including at Hon Hai, Siemens, Deutsche Bank and Deutsche Börse.

Executive remuneration

Executive remuneration continued to be one of the most contentious issues across markets in 2018, with a 37% recommended vote against rate, up from 28% in 2017.

In the US we significantly increased our opposition to board recommendations, particularly on pay practices. We recommended votes against 74% of ‘say-on-pay’ proposals, up from 32% in 2017, focusing on insufficient share ownership requirements; awards of stock options with short vesting periods; and CEO high relative pay as we focused more on quantum. For instance, we recommended voting against the proposed pay arrangements for the CEO at Tesla, which we believed to be excessive and at risk of incentivising inappropriately. At Pfizer, we recommended voting against pay proposals that included a large one-off retention award to the CEO to secure one further year of service.

Meanwhile, in the UK, 2018 saw fewer votes on new pay policies; however, there were a number of examples of exceptionally high awards to executives. We reacted by recommending votes against the annual remuneration report.

To give an example, at UK housebuilder, Persimmon, extremely high awards were triggered by an uncapped 2012 long-term incentive plan (LTIP). Although performance had been strong over the period, we believed the quantum of pay to be disproportionate.

There was also good news, though. We saw positive changes to remuneration policies and practices at a number of UK companies, in line with our 2016 Remuneration Principles. For example, Scottish engineering company, Weir Group, introduced an innovative restricted shares-based scheme to replace its conventional LTIP, which we supported. Pharmaceutical company, Shire, also proposed a new, simpler policy that reflected a number of our recommendations, including the addition of a return on capital metric and the removal of stock appreciation rights.

In Japan, more companies introduced share-based remuneration. We consider this to be an encouraging sign of progress towards aligning the interests of executives with shareholders. Another development we welcomed was the incorporation of ESG metrics into executive remuneration schemes, by some companies.

Board composition and diversity

We continued to see issues relating to board composition, including lack of director independence, in a number of markets. In Brazil, at Banco Bradesco, we opposed the election of the board nominees for this reason. Despite having clear guidance on board composition through the UK Corporate Governance Code, UK businesses are not exempt from governance flaws; we continued to witness examples of non-independent directors holding inappropriate board and committee roles, including at Tungsten Corporation, where a non-independent director acts as senior independent director and chairs the audit committee; GoCompare.com group, where a non-independent director sits on the nomination committee; and Merian Global Investors (formerly Old Mutual Global Investors) where a non-independent director sits on the audit committee.

In Japan, board independence levels continued to increase, although they remain low compared to many other markets. Nissan Motor, for example, appointed two independent directors for the first time, while Seven & I Holdings reduced the number of executive directors, resulting in a board that is one-third independent.

Directors with seemingly excessive time commitments continue to be a concern, particularly in the UK and Germany. We engaged with many companies on this issue; we need to be assured that directors can devote sufficient time to their roles and would be able to do so should a crisis arise at one or more of the companies they serve. This led us to recommend votes against the re-election of apparently over-committed directors at a number of companies, including Philip Morris International.

After continuing to tighten our voting guidelines on gender diversity around the world, we continued to engage with companies lacking in this area, to assess what plans they have in place to adjust board composition accordingly. Lack of board diversity triggered recommended votes against the chair of the nominations committee at Novartis in Switzerland and at Netherlands-based business, AerCap.

We also significantly increased our activities relating to board diversity in the US, recommending opposition to 589 proposals due to our concerns, by the end of Q3 2018, compared to 159 proposals during 2017.

We will be tightening our policies on diversity further still for the 2019 voting season and expect this to be a continued area of focus.

Climate change

Our voting did not just focus on governance. Climate change issues featured high on our agenda too.

In the US, 20 shareholder resolutions were filed that were focused on the extent to which companies demonstrate resilience to global warming, or provide evidence of strategic alignment to the goal in the Paris Agreement, of limiting the rise in global temperature to a maximum of two degrees Celsius.

Twelve of these resolutions were withdrawn after companies made voluntary commitments to satisfy the proposals. We recommended support for the remaining proposals, including at oil and gas company, Anadarko, and energy infrastructure company, Kinder Morgan, which gained majority support from shareholders. However, we did not support climate change proposals at Rio Tinto or Royal Dutch Shell, based on the progress of our existing engagement.

In the latter case, we were sympathetic to the overall purpose of the resolution. However, we were concerned that its wording, which would be legally binding, could overly constrain the company. Shell has nevertheless made significant progress and has responded well to engagement. As a result, we decided to continue to engage for another year, while contemplating a better-worded resolution.

As part of our continued participation in the Climate Action 100+ initiative, we spoke at the AGMs of companies such as BP, Centrica, Shell, Volkswagen and Anglo American, to name a few. Our goal was to raise awareness of the initiative and to challenge companies on management of climate-related issues, disclosure in line with the Taskforce on Climate-related Financial Disclosures and alignment to the Paris Agreement.

Summing up, 2018 was another year of strong action on the voting front; we continued to encourage improved corporate governance and attitudes to climate change at companies around the world.

Looking ahead to the 2019 voting season, we will continue to strengthen our policies in a number of key areas, including expectations on diversity, companies' response to climate change and continued improvements to remuneration practices. We will be communicating our views through our updated Corporate Governance Principles, which will be published in Q4 2018.

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Vorsprung durch Zusammenarbeit*

Management board remuneration systems in Germany have been crying out for an overhaul and a team of experts has generated solutions.

Making it better

Collaboration and continuous improvement are at the heart of Hermes EOS and we recently co-led and contributed to another successful governance project, based on these core principles and values.

On this occasion, we saw an opportunity to contribute to the improvement of management board remuneration systems for German publicly listed companies. The outcome is the recently published report, *Guidelines for sustainable management board remuneration systems*,³ which has already attracted positive media coverage in the German business press. While the issues we discussed may have related to German companies, continuous improvement of governance is (or should be) a high priority for all countries and we believe the findings could therefore be of interest beyond Germany.

Backdrop

To put things into perspective for those unfamiliar with German management board remuneration systems, German listed companies have a two-tier board system, which includes a supervisory board and a management board. The former oversees the latter, which is responsible for the running of the company, in terms of setting and implementing strategy and day-to-day operations, as well as accounting and risk management.

Deciding what to pay the management board in Germany starts with a legal obligation under the German Stock Corporation Act. The supervisory board sets the remuneration for each individual board member, which is expected to be in line with the tasks and performance of each board member, as well as the company's overall performance and wider economic circumstances. Crucially, remuneration levels must be appropriate.

Looking at governance more broadly, it helps if the composition of the supervisory board is optimal – in other words, that it is appropriately diverse, and board members have the right experience and expertise. It also needs to be functioning effectively. Otherwise, we believe that issues at the supervisory level can trickle down to management level and subsequently permeate the business as a whole.

For example, in our engagement with Volkswagen⁴ over the last decade, we have expressed our concerns on a number of occasions about the composition of the company's supervisory board, effectiveness and lack of independence. This led to our recommendation to vote against the company's management remuneration system in 2010, because in our view, it did not incentivise management to adopt a sustainable, long-term, strategic approach and therefore could be considered a symptom of an ineffective supervisory board.

Setting the scene

Remuneration systems have long been a subject of debate in Germany and elsewhere. As in many markets, systems in Germany are widely acknowledged to be too complex and could also benefit from greater transparency, particularly with regard to performance targets for their variable pay components. While there has been effort to address the issues, and encouraging developments, it is still a work in progress. However, we believe that our working group has provided constructive input, in the form of guidelines. Our goal is to provide a framework for success.

We believe that the issues we highlighted have had a serious outcome, in that the company's corporate governance and culture problems may have contributed to the emissions scandal in 2015.

In our view, boards which are open to close observation; receptive to the concept of transparency; and willing to adapt and improve, are more likely to unearth and address problems sooner rather than later.

Reasons why

The remuneration of management board members of German listed companies has been a contentious issue for some time. We believe that the complexity and lack of transparency of management board remuneration systems has made them difficult to understand and analyse, and benchmark against performance. Some of the flaws include the lack of clear alignment of payment with company performance; payments being made despite serious misconduct or missed targets; and inappropriate termination payments.

These issues, have, however, not gone unaddressed; regulation governing management board member remuneration has increased considerably in recent years.

The remuneration systems of German listed companies have subsequently come under increased scrutiny by investors and proxy advisors. More than 20% negative votes on average in 2018 (30% in 2017) has highlighted considerable shareholder resistance to remuneration systems. However, German companies are facing up to the issues. In 2018, seven of the DAX 30 companies voluntarily put their remuneration policies to a vote at their AGMs, a similar number to the previous year.

Clearly, the regulation and companies' attempts at improving transparency and engagement have not quite solved all the problems so far. While public debate tends to focus on quantum of remuneration packages, in our view this is something of a 'red herring'; German management board pay is generally not as high as it is in some other countries, including the UK and the US. We are aware, however, that many foreign institutional investors are particularly concerned about the structure and design of German remuneration systems, the weighting of fixed compared to variable components and the suitability of the key performance indicators that they are based on.

It has also been observed that management board remuneration systems have become more complex with regard to the components of remuneration and key performance indicators. For instance, many remuneration systems came under fire in 2017, as it was questioned whether their strategic objectives were creating sustainable value for all stakeholders and whether purely financial metrics such as total shareholder return and earnings per share were relevant for the assessment of a company's long term success.

Best-practice collaboration

We have been paying close attention to the debate and developments on this matter and have been giving these considerable thought. As a result, when the head of Hermes EOS, Hans-Christoph Hirt's path crossed with that of another expert in the field – executive remuneration consultant and CEO/owner of hkp/// group, Michael Kramarsch – discussion ensued, networks were contacted and a working group was set up. Less than a year later, a successful industry leadership initiative resulted in creation of the published guidelines, both in German and English, to share the findings as widely as possible. It was not the first time that we have sparked ideas and generated solutions in partnership with other experts, having created a similar working group on non-executive shareholder communication in 2016.⁵ There may well be more in the future.

Collaboration was key to creating the guidelines. The first step, of getting more stakeholders together, to form the working group, resulted in 19 very able people sharing their knowledge and experience, including representatives from supervisory boards, institutional investors, academics and corporate governance experts from companies such as Siemens, BASF, Daimler, Allianz Global Investors and Bayer, to name but a few. Our many years of experience of working with senior industry and academic figures in Germany enabled Hans and Michael to quickly tap into a network of people who were willing to join the group and contribute their expertise.

Levels of enthusiasm for the task were high; the companies and academics initially invited to join the group subsequently invited others, who were equally keen to be involved. Commitment and dedication to the task was key too, the group contributed a significant amount of its time over a nine-month period.

The agenda

Summing up the objective of the group, the aim was to devise simple, sustainability-focused, best practice guidelines for management board remuneration at German listed companies. The group got the ball rolling by considering what guiding principles for simplified, company specific remuneration policies should look like and how the latest academic evidence on remuneration could be incorporated into these.

The group decided to mainly focus its efforts on the underlying structure of the systems. Breaking it down, the group looked at the issue of communication, in particular with regard to what investors and companies should communicate with each other and when. It also reviewed investors' expectations with regard to reporting and transparency of remuneration policies. How to improve the reporting practices recommended in the German Corporate Governance Code was on the agenda too.

Outcomes

Breaking it down further, design, reporting and engagement were the three main themes for the guidelines, with the focus on simplicity. Looking first at design, the group identified more than a dozen ways to improve design and structure of the systems. This included establishing a fundamental guiding principle – that the supervisory board should formulate management board remuneration principles that guide the board in its decision making process, to incentivise sustainable success and reflect relevant stakeholder objectives.

Reporting was tackled successfully too, with seven guidelines identified. For instance, the group proposed that the relationship between the remuneration of the management board, the remuneration of senior management and that of the overall workforce should be reported, with a view to enhancing transparency.

Three main guidelines for engagement were established including regular communication with investors about remuneration, well in advance of the next AGM. It was also proposed that negative votes on remuneration should be treated as a 'red flag' that warrants discussion with investors.

Inevitably, numerous different views emerged in the course of the meetings, but the theme of the collaboration was teamwork and constructive sharing of views and opinions, which ultimately led to consensus.

Summing up, the guidelines cover key design elements of sustainable management board remuneration in Germany, offer companies direction for the alignment of their remuneration plans with institutional investor expectations and support a constructive dialogue between companies and their shareholders.

Another key outcome of the work on the guidelines is that they take the German system further towards the expectations on supervisory board dialogue with investors which we outlined in our 2016 paper,⁵ which in itself is a positive development.

Next steps

The plan is to continue the work of the group, through ongoing informal meetings and a review of the guide in the light of the implementation of the revised Shareholder Rights Directive in Germany in 2019.

Given the success of this project, we anticipate that we could develop similar working groups in other countries, to address governance issues and areas for improvement.

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*Progress through collaboration

³ <http://www.guidelines-executivecompensation.de/>

⁴ <https://www.hermes-investment.com/dk/blog/press/hermes-comments-agm-volkswagen/>

⁵ <https://www.hermes-investment.com/wp-content/uploads/2017/09/Remuneration-Principles-Clarifying-Expectations.pdf>

Will a company fly – or fall?

That can depend on who is on board. We take a look at the importance of external board evaluations and their role in leading the company in the right direction.

All aboard

Every business needs a good board to perform effectively and it is crucial to know what 'good' should look like. Composition is key, as is 'functional effectiveness'. In other words, the board should consist of the right people doing the right job at the right time. But just because you currently have a good board in place does not mean 'job done'.

A well-functioning board needs to be effective not only now, but also in the future. It is, or should be a dynamic entity, which keeps evolving, to meet the changing needs of the business and to ensure its longevity. And if the board is not functioning optimally, it is wise not to let this situation continue.

Sometimes the problems are obvious; other times they are harder to identify. There are many 'red flags' to look out for, though. For instance, board members may constantly disagree and struggle to reach consensus; their knowledge of the company's markets and customers may not be sufficient for effective decision making; or perhaps their experience or skills are no longer relevant for the company's requirements. They may also be resistant to the concept of diversity.

Another warning sign is a board which does not define or support the purpose of the company, which clarifies exactly why the organisation exists and goes well beyond obvious business objectives.⁶ A board not in tune with the corporate purpose is therefore at odds with the history, vision, strategy and direction of the business; a most unsatisfactory set of circumstances.

Fortunately, potential board weaknesses can be identified and addressed: this is one of the reasons why we recommend regular external board evaluations in our engagements with businesses.

By regular, we mean annual, in line with UK Corporate Governance Code recommendations. The Code also recommends that an external evaluation is carried out by FTSE 350 companies every three years, as a minimum. While internal assessments can be useful, the perspective of an 'outsider', with experience of industry best practice is likely to be much more valuable.

Setting the scene

There are many factors which determine whether a business survives and thrives – or fails. But being out of touch, out of step or dated tend to be reliable signs that a company could be at risk. And often the root of the problem can be traced to the top. In other words, it can be a signal that the board is not operating effectively.

Problems such as a stagnating board culture or a board which lacks diversity and the right experience, for instance, can lead the business in the wrong direction. This can have catastrophic results; businesses hitting the headlines for all the wrong reasons; reputations built up over decades (or centuries) being tarnished; customers migrating to competitors; job losses; and perhaps even the demise of the company. These are outcomes that everyone connected with the business dreads.

There is no quick fix for entrenched issues, but they can be mitigated or even prevented from forming in the first place, by evaluating the board – and repeating this process regularly.

Potential consequences

There can be obstacles, however. Not all boards are receptive to the challenge of an external board evaluation and the potential change it can introduce. And a board which is reluctant to allow others to take a closer look at how it operates may be unwilling to take feedback or improve. In our many engagements with companies, we have encountered some which decline to go ahead with our recommendation of an external board evaluation. In our experience, this can be another signal that all is not well. Board members must be willing to question and improve their own performance. They also need to be open to feedback and different perspectives – this attitude is fundamental for establishing and maintaining the right organisational culture.

It may be coincidence, but businesses which shy away from external evaluation seem to be more prone to encountering serious challenges and risk at a later stage. We have reflected that at least some of the problems arising could potentially have been avoided by an external board evaluation and some timely changes to board composition.

To give an example, in our engagement with Volkswagen, we repeatedly voiced concerns about the composition of the company's supervisory board, effectiveness and lack of independence, over the course of 10 years. We believe that the company's governance and culture problems contributed to the emissions scandal in 2015. We also believe that a board which is open to scrutiny and willing to change is more likely to unearth problems before they develop and we have continued to urge Volkswagen to conduct an external board evaluation.⁷

Another sign of a malfunctioning board is a lack of effective succession planning. After all, there can be considerable 'key man' risk, particularly if the company's reputation is inextricably linked with that of its founder, or a charismatic and highly talented chief executive. If they leave suddenly, or in controversial circumstances, the business can start to flounder if no one has been identified to take their place or if the succession plan has been 'gathering dust'.

One business which may wish that it had shifted this matter up the agenda sooner is WPP. We had been urging the company for some time to address succession planning, prior to the departure of the founder and CEO, Sir Martin Sorrell, in 2018.⁸ Our particular concern was that

his influence on the board was an impediment to its effectiveness. After the appointment of a new chair in 2015 and a new senior independent director in 2016, succession planning became a higher priority. An external board evaluation took place at the same time, which recommended improvements on succession planning, board composition and use of board time.

Unfortunately, in spite of the preparation for succession, when Sir Martin left, the circumstances of his departure led to the company hitting the headlines for all the wrong reasons. The timing was unfortunate too; WPP was already facing some tough business challenges.

Taking it seriously

Some businesses may see board evaluation as a 'tick-box exercise'; but they may be doing themselves a disservice if they do not see it as a valuable opportunity for improvement. For instance some boards may be prone to 'groupthink', after working together for a while. Also, coalitions can potentially form, which may be counterproductive. In addition, there may be more conflict than is necessary.

Whatever form they take, flaws in the composition of a board can limit its ability to function effectively. One way to address this is by increasing diversity. After all, diversity on a board, as in any other working environment can bring a much greater variety of views and experience to the table, which can enhance the debate and refresh decision-making processes – all of which may subsequently be reflected in company performance.

Ideally, boards should be comprised of directors with diverse backgrounds in terms of gender, age, nationality and ethnicity, in accordance with the company's geographic footprint. They should also have the relevant experience and skills, and be sufficiently independent. In addition, they should have strong leadership skills, technical expertise and the strength of character required to challenge executive management.

The practicalities of board evaluation

It is a matter of choice for a company to undertake an external board evaluation, but the Financial Reporting Council's (FRC's) UK Corporate Governance Code operates from a 'comply or explain' perspective. While some companies may prefer to take the latter approach, we believe that undertaking regular, external board evaluations is best practice.

As the FRC's revised *Guidance on Board Effectiveness* of July 2018 states: "External facilitation can add value by introducing a fresh perspective and new ways of thinking, and a critical eye to board composition, dynamics and effectiveness." The new version of the Code also emphasises the need to refresh boards and undertake succession planning.⁹

For the purposes of transparency, the evaluator has to be named in the annual report and a statement made about whether they have any other connection with the company. Any conflicts of interest should be disclosed prior to appointment. If significant, the evaluator should not be hired.

Their job is to evaluate whether the board is fit for purpose and for future challenges, so evaluators also need to have the experience and skills required to identify any issues that might require change or improvement, and the ability to report these back to the board effectively. As well as presenting the findings of the evaluation and reiterating the methodology used, the reviewer should clearly highlight the steps to take to address any areas for improvement. Confidentiality, tact and diplomacy are also essential.

Ideally, the chair should receive a full report from the evaluator, including feedback on individual board members. How the results are presented to the board is a matter of choice for the chair; some may prefer to 'tell all'; others may prefer to be more circumspect. The public version, for investors, should strike a balance between transparency and confidentiality.

The reality

There are some pitfalls to avoid. Some companies may fall into the trap of expecting too much from a board evaluation. While they can be helpful catalysts for change, and provide invaluable insights in preparation for board nominations, they have their limits. There are of course always other factors at play in an organisation, and externally, that can have an impact on its progress. Expectations must therefore be kept realistic.

The focus of the evaluation must be on specific outcomes and these need to be actioned, for example, by means of a targeted nomination proposal. There is no point in undertaking an evaluation and then carrying on as previously. While the reviewer will seek to constructively challenge the board during the evaluation of its effectiveness, querying the board's activities should not be an occasional exercise or solely the province of an external agency – it should happen as a matter of course.

Some evaluators may explore the board's effectiveness more thoroughly than others, but we believe this is likely to be addressed in the UK in the near future. In August 2018, the government invited ICSA (the Institute of Chartered Secretaries and Administrators) to form a group to review the quality and effectiveness of board evaluations, which will include development of a code of practice.¹⁰

In the meantime, we continue to recommend an in-depth approach. Our view is that if it is worth doing, it is worth doing well.

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For further information on our company engagements and case studies, please see <https://www.hermes-investment.com/ukw/stewardship/eos-case-studies/>

⁶ <https://www.hermes-investment.com/ukw/wp-content/uploads/sites/80/2018/03/final-responsible-ownership-principles-2018.pdf>

⁷ <https://www.hermes-investment.com/ukw/blog/press/hermes-comments-agm-volkswagen/> and <https://www.hermes-investment.com/ukw/wp-content/uploads/sites/80/2018/03/annual-report-2017.pdf>

⁸ <https://www.hermes-investment.com/ukw/blog/press/hermes-comments-wpp-agm/>

⁹ <https://www.frc.org.uk/getattachment/61232f60-a338-471b-ba5a-bfed25219147/2018-Guidance-on-Board-Effectiveness-FINAL.PDF>

¹⁰ <https://www.icsa.org.uk/about-us/press-office/news-releases/icsa-to-review-the-quality-and-effectiveness-of-board-evaluations>



Engagement on strategy

Business strategy and structural governance issues are at the heart of many of our most successful engagements.

Overview

Our approach to engagement is holistic and wide ranging. Discussions cover many key areas, including business strategy and risk management, which encapsulates environmental, social and ethical risks. Structural governance issues are a priority too. We both challenge and support management, accordingly, on its running of the company and approach to ensuring the company's long term future. In many such cases, there is minimal external pressure on the business to change. Much of our work, therefore, is focused on encouraging management to make necessary improvements. The majority of our successes stem from our ability to see things from the perspective of the business we are engaging with. Presenting environmental, social and governance issues as the risks they are to the company's strategic positioning puts things solidly into context for management. The issues may, of course, also present opportunities. For instance, businesses may benefit from fresh thinking at board level. Similarly, a change of chief executive can be the catalyst for enhanced business performance and the creation of long term value for shareholders.

Examples of recent engagements

Appointment of employees to the board

Lead engager: Pauline Lecoursonnois

We were encouraged by our engagement with a UK-headquartered professional services company. Its long-term incentive plan for 2018 has been reviewed and is now aligned with the new business strategy. The chair of the remuneration committee also promised the introduction of a holding period when the remuneration policy is revised in 2019, and will review our suggestion to implement the recommended share dilution limit of 5% in 10 years for single executive schemes. Furthermore, we welcomed the news that in response to the recommendations of the new UK Corporate Governance Code, one or two employees will be appointed to the board. The company will also be seeking accreditation as a living wage service provider. We believe that the improvements reflect the intention of the new CEO to implement a business culture where employees are considered to be vital to the success of company strategy. We will continue to engage with the company on these issues.

Exit from coal generation

Lead engager: Will Pomroy

In our engagement with a US utility company, we discussed its recently updated emission reduction targets and commitment to exit from coal generation by 2050. We also asked the company about the point at which its coal operations would become uneconomical. We were pleased to note that management considers its new commitments to be conservative estimates and that there is potential for it to exit from coal generation sooner. With respect to the company's coal assets, it reported that utilisation rates had been around 80%, but were now closer to 50%. The company also said that marginal prices were decreasing, and that management was keeping operations under review. It highlighted the closure of a former coal-generating asset as an example of its willingness to close operations which are no longer economical in a low-cost renewable environment. In addition, the company had identified potential for wind energy generation in two US states.

Sustainable development goals

Lead engager: Christine Chow

In our engagement with a Chinese logistics company, we were pleased to receive a positive update on how the company plans to achieve the sustainable development goals that we agreed. For instance, the company is currently introducing more fuel efficient planes, to gradually replace its existing fleet. We asked the company to consider including the 2005 emissions level reference for carbon reduction targets and outcomes by 2030 in its reports, based on the Chinese government's public commitment to the United Nations Framework Convention on Climate Change. We also asked the company to consider reporting on emission reductions, not just in the airlines business, but in others as well.

Renewable energy increase

Lead engager: Sachi Suzuki

A Japanese company updated us on a welcome development: its decision to phase out the use of oil or coal in its operations (apart from continuing with coal for steel manufacturing), and not to invest in new coal power plants. The company also reported that it aims to increase renewable energy to 20% of its power generation business by around 2020. In addition, we were pleased to hear that it is disclosing carbon emissions data for all of its operations, in line with our request that data should go beyond just providing information on emissions from offices, especially with regard to carbon-intensive operations. We were encouraged that the company's next mid-term plan includes targets on gender diversity. However, given its limited disclosure on human rights issues, we suggested reporting in accordance with the United Nations Guiding Principles on Business and Human Rights framework. On diversity, we also reiterated that the board should include non-Japanese directors, given the global nature of the business. In response, the company said that this was currently under consideration. We welcomed the news that there had been some reduction in the number of strategic shareholdings, but urged the company to accelerate the process. It assured us that it has a procedure in place to make voting decisions on the stocks held, while a board member directly negotiates with strategic shareholding partners to unwind the stocks.

Human capital management

Lead engager: Natacha Dimitrijevic

In a meeting with the head of sustainability at an Italian financial services company, we strongly encouraged the company to enhance its strategy and policy with regard to energy, in the transition to a low carbon economy. The company acknowledged that it still had work to do in this area. We therefore suggested that given progress made with delivery on other critical strategic issues, the company could now focus on climate as a priority, and we shared examples of best practice undertaken by its peers. In addition, we gained reassurance that human capital management was considered a priority at board level and that a process is in place to ensure effective monitoring. Our conclusion was that we would continue to engage with the company, on the issues discussed.

Sustainability initiatives

Lead engager: Andy Jones

A Spanish company's sustainability and investor relations team updated us on its latest sustainability initiatives, which we challenged in three areas in particular: governance of sustainability and non-financial risks, climate risk and the parent company/subsidiary model, with

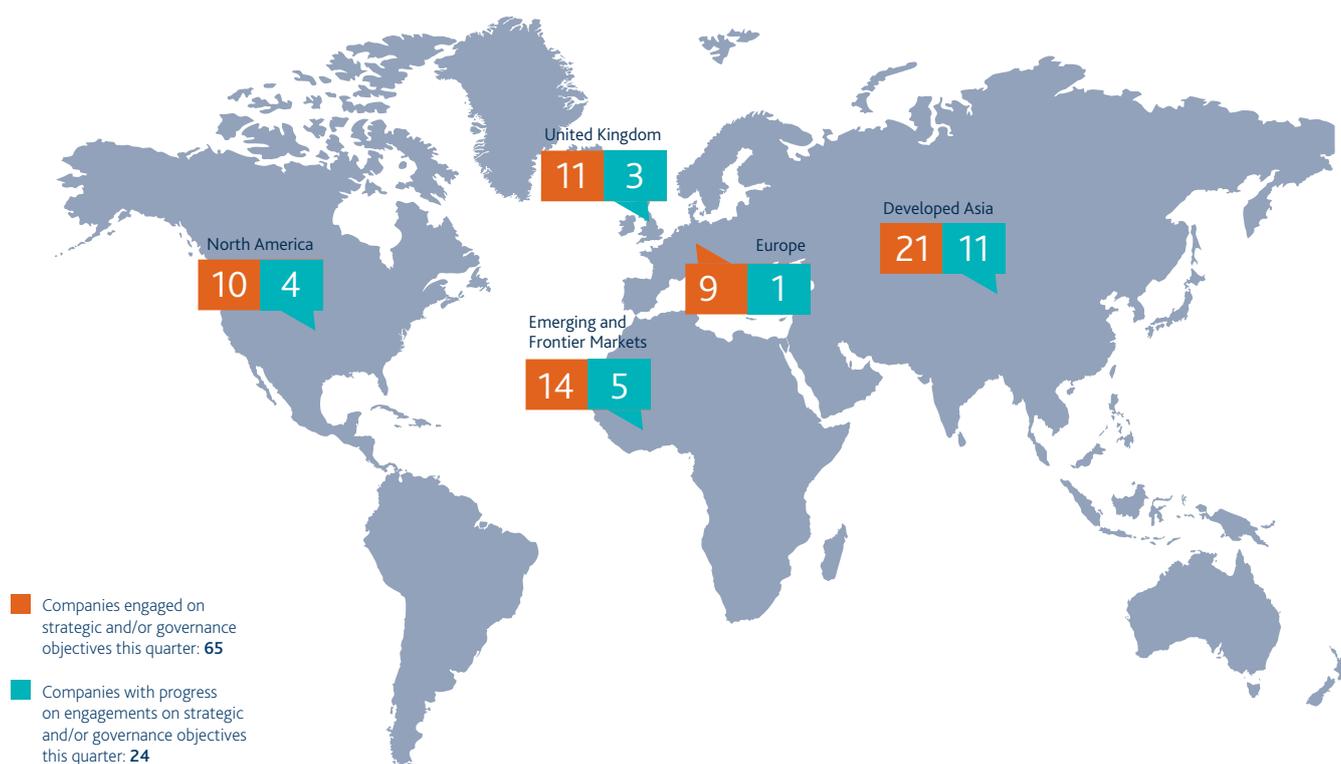
regard to sustainability. The company reported that it had no plans to publish a new climate change policy or strategy, but is part of a United Nations Environment Programme Finance Initiative, implementing the recommendations on the Task Force on Climate-related Financial Disclosures (TCFD). We expressed other concerns, relating to ongoing human capital issues at the company and will continue our engagement on these issues at our next meeting.

Reducing carbon emissions

Lead engager: Claire Gavini

We welcomed the news that a French manufacturing company is making good progress towards its target of reducing the carbon emissions of the group's manufacturing operations by 50% by 2050. Sourcing energy from renewable resources is key for reaching the target, but this remains a challenge in some of the countries in which this company operates. The company also reported that it aims to manufacture its products using 80% recycled and biosourced materials. However, we also challenged the company on its process for addressing extreme weather events, considering it has production facilities in exposed areas, and requested further details. Our plan is to follow up on our engagement in the first quarter of 2019.

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 the shareholdings of its clients over the long term.

Highlights

Minerals Council of Australia

Lead engager: Emma Berntman

The new CEO of the Minerals Council of Australia (MCA) sought out our views on how the organisation should develop its ESG strategy, including climate change. In our meeting with the CEO, we shared our expectations of the organisation, including its alignment with the Paris Agreement, and credible and robust climate-change mitigation strategies and reporting. We look forward to the new MCA strategy, which will be published at the end of December 2018 and have agreed to continue our discussions with the CEO in 2019.

Oxfam campaign

Lead engager: Frédéric Bach

Oxfam reintroduced its campaign, 'Behind the Barcodes', which encourages retailers to address and alleviate human suffering in their food supply chain. At the time of writing, several investors, whose assets under management total £350bn, had pledged to support the campaign. We confirmed our commitment to collaborating with the charity on the campaign, by being a signatory to its letter to potential investors and by also helping to raise the profile of the campaign, by mentioning it in the course of our engagements with retailers. We also suggested that Oxfam should organise a forum where participating investors could share the outcomes of their individual meetings with the companies targeted by the campaign. We believe that this would be valuable for effective collaboration. In addition, we shared feedback from our engagements with retailers on supply chain challenges, including issues with auditing suppliers.

UK Corporate Governance Forum

Lead engager: Amy Wilson

At a meeting of the UK Corporate Governance Forum, we discussed with other Forum members a number of remuneration-related company resolutions, noting in particular a trend of increases to fixed pay elements of remuneration, including salary and benefits, over the 2018 AGM season. As we reflected on the 2018 AGM season as a whole and looked ahead to 2019, the group shared views on a number of

Overview

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

governance topics, including board diversity, tenure and CEO pay ratio reporting. We highlighted our intention to begin taking voting action on executive team diversity in the UK, and urged others to consider doing the same. It was agreed that this is an important issue and members indicated that they would give thought to taking similar action.

International Council on Mining and Metals

Lead engager: Lisa Lange

A discussion with the chief operating officer of the International Council on Mining and Metals (ICMM), on the industry trends that are informing the development of the organisation's strategy for the next three years, highlighted a number of interesting points. One of the areas that the ICMM intends to focus on is developing better methods for measuring the impact of mining operations on economic development and local communities. It is also working on developments in areas such as pollution. The organisation's plans will not make any material difference to its reporting framework, which is in accordance with the Global Reporting Initiative. We voiced our concerns about climate change knowledge at board level, which the ICMM acknowledged, explaining that it was discussing board performance expectations. One of the other points we raised was the need to clarify investor expectations with regard to the different reporting tools used in the investment decision process, which could encourage mining companies to improve and streamline disclosure.

Stewardship workshops

Lead engager: Christine Chow

We attended a conference at the Taiwan Stock Exchange, where we took part in a panel discussion and delivered two 90-minute stewardship workshops for board directors of listed companies and other corporate representatives. The theme of the workshops was effective and outcome-oriented engagement, focusing specifically on the importance of corporate culture and the conduct-led governance changes that are conducive to good governance practice. We addressed questions from the audience on how to promote ESG awareness within companies and about the importance of board-level sustainability oversight. In addition, we provided guidance on how to avoid the pitfall of treating ESG reporting as a compliance cost.

Other work in this quarter included

- At the annual global corporate governance conference of the Securities Investors Association of Singapore, we delivered a presentation on the **growth of private equity and its impact on corporate governance**. The Minister for Home Affairs and the Minister for Law in Singapore delivered an opening address on leadership, populism and inequality, relating these issues to public governance, while the commissioner of the Securities and Exchange Commission shared his views on the role of stock exchanges in relation to governance and cyber security. In the panel discussion that followed our presentation, the debate included topics such as ESG reporting; corporate culture and conduct; human capital management; and the long and short term impacts of climate change.
- In collaboration with other investors and FAIRR (Farm Animal Investment Risk and Return), we signed a letter to 25 companies in the restaurant and food sector calling on them to demonstrate a comprehensive approach to **protein diversification**. While intensive livestock systems have helped to drive and meet global demand for proteins, this is heavily linked to unpriced externalities such as carbon emissions, land use changes, water pollution and antibiotic overuse. These generate physical, operational and regulatory risks for companies. Diversification of protein offerings will therefore help companies mitigate supply chain risks and capitalise on changing consumer trends. We asked the companies to disclose information in line with the guidelines of the Task Force on Climate-related Financial Disclosures.
- In the regular AMEC (Associação de Investidores no Mercado de Capitais) stewardship working group call, we expressed our concern about the **integrated reporting framework**. While there is a trend among companies in Brazil to adopt this, in many cases what they are actually producing is a consolidation of financial and sustainability reports, rather than an integrated report. We also discussed the forthcoming report on the application of corporate governance code recommendations, which companies will be required to file in the fourth quarter of 2018, for the first time. The working group agreed to engage with companies on the preparation of a 'comply or explain' report, focused on the substance of the code.
- We attended a roundtable event organised by The European Bank for Reconstruction and Development and Aviva Investors, called 'Superbugs and super risks: the role of the private sector', where we shared our **insights on antimicrobial resistance**. Other contributors and participants included the chief medical officer for England and representatives from the World Health Organisation, OECD, the UK Sustainable Investment and Finance Association and The Wellcome Trust. Discussions were in depth and wide ranging, with topics including the need for companies to demonstrate resilience planning for conducting business in a 'post-antibiotic world'.
- In our introductory call with the World Wildlife Fund's (WWF's) sustainable finance engagement manager, we learned about the work of the organisation, particularly with regard to its research on banks which lend to palm-oil growers. We were encouraged to hear that some Singapore banks have addressed **the risks of financing palm oil businesses**, which have been linked to deforestation and loss of biodiversity, although they have not made as much progress as their European peers. We heard that Indonesian and Malaysian banks also wish to address the issue, although they lack resources. The WWF highlighted the importance of investor pressure on banks to address environmental and social risks in their lending activities.
- We joined a roundtable convened by the Investment Association, with representatives from legal and governance advisers, Deloitte, PwC and Freshfields, as well as other investors, to discuss investor expectations on **implementation of the new UK Corporate Governance Code**. We discussed a number of specific areas requiring clarification and greater alignment, including those relating to pension provisions, post-employment shareholdings and use of remuneration committee discretion. We shared our views, reflecting our corporate governance principles and policies, and will continue to contribute to IA guidance on these topics.
- Having welcomed the revision of the Tokyo Stock Exchange's (TSE's) corporate governance code earlier this year, which includes stronger wording on the **reduction of strategic holdings**, we discussed remaining challenges. We learned that since the stock exchange is officially neutral about strategic shareholdings, it received some criticism about the changes to the code. We proposed that the TSE's definition of independent directors, referenced in the corporate governance code should be tightened. In particular, it does not make any reference to shareholders, resulting in a number of companies designating directors representing significant shareholders as independent. In addition, we suggested a clearer definition of the role of the chair. We also discussed the possibility of the TSE requiring sustainability reporting, as is required in other major markets, but it was thought that it would be difficult to make this obligatory.
- We attended the Principles for Responsible Investment roundtable on **human rights in the extractive sector**, where we exchanged views with companies, investors, non-government organisations and industry associations. We discussed the challenges associated with risk identification, and monitoring and tracking the effectiveness of remediation and training. In addition, we considered how companies and investors manage and mitigate human rights controversies and allegations, and also touched on what the future of measuring human rights impacts and reporting might look like.

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

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



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

Voting overview

Over the last quarter we made voting recommendations at 1,195 meetings (10,006 resolutions). At 622 of those meetings, we recommended opposing one or more resolutions. We recommended voting with management by exception at two meetings and abstaining at three. We supported management on all resolutions at the remaining 568 meetings.

Global

We made voting recommendations at **1,195** meetings (**10,006** resolutions) over the last quarter.



- Total meetings in favour **47.5%**
- Meetings against (or against AND abstain) **52.1%**
- Meetings abstained **0.3%**
- Meetings with management by exception **0.2%**

Australia and New Zealand

We made voting recommendations at **28** meetings (**132** resolutions) over the last quarter.



- Total meetings in favour **71.4%**
- Meetings against (or against AND abstain) **28.6%**

Developed Asia

We made voting recommendations at **100** meetings (**602** resolutions) over the last quarter.



- Total meetings in favour **58.0%**
- Meetings against (or against AND abstain) **42.0%**

Emerging and Frontier Markets

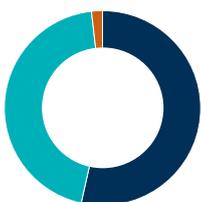
We made voting recommendations at **628** meetings (**4,727** resolutions) over the last quarter.



- Total meetings in favour **45.1%**
- Meetings against (or against AND abstain) **54.8%**
- Meetings with management by exception **0.2%**

Europe

We made voting recommendations at **114** meetings (**1,042** resolutions) over the last quarter.



- Total meetings in favour **53.5%**
- Meetings against (or against AND abstain) **44.7%**
- Meetings abstained **1.8%**

North America

We made voting recommendations at **183** meetings (**1,423** resolutions) over the last quarter.



- Total meetings in favour **35.5%**
- Meetings against (or against AND abstain) **63.9%**
- Meetings with management by exception **0.5%**

United Kingdom

We made voting recommendations at **142** meetings (**2,080** resolutions) over the last quarter.



- Total meetings in favour **57.0%**
- Meetings against (or against AND abstain) **42.3%**
- Meetings abstained **0.7%**

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

Global

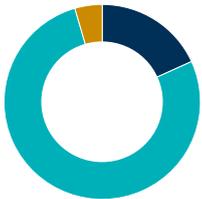
We recommended voting against or abstaining on 1,516 resolutions over the last quarter.



- Board structure 44.3%
- Remuneration 23.2%
- Shareholder resolution 3.8%
- Capital structure and dividends 11.6%
- Amendment of articles 5.8%
- Audit and accounts 5.5%
- Investment/M&A 0.1%
- Poison pill/Anti-takeover device 0.3%
- Other 5.3%

Australia and New Zealand

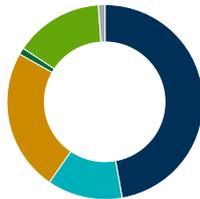
We recommended voting against or abstaining on 22 resolutions over the last quarter.



- Board structure 18.2%
- Remuneration 77.3%
- Capital structure and dividends 4.5%

Developed Asia

We recommended voting against or abstaining on 89 resolutions over the last quarter.



- Board structure 47.2%
- Remuneration 12.4%
- Capital structure and dividends 23.6%
- Amendment of articles 1.1%
- Audit and accounts 14.6%
- Other 1.1%

Emerging and Frontier Markets

We recommended voting against or abstaining on 813 resolutions over the last quarter.



- Board structure 45.1%
- Remuneration 14.9%
- Shareholder resolution 3.7%
- Capital structure and dividends 13.4%
- Amendment of articles 9.3%
- Audit and accounts 5.7%
- Investment/M&A 0.2%
- Other 7.6%

Europe

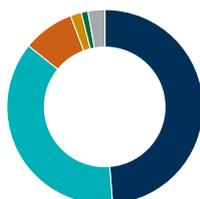
We recommended voting against or abstaining on 183 resolutions over the last quarter.



- Board structure 39.9%
- Remuneration 25.1%
- Shareholder resolution 2.2%
- Capital structure and dividends 15.8%
- Amendment of articles 3.8%
- Audit and accounts 8.7%
- Other 4.4%

North America

We recommended voting against or abstaining on 283 resolutions over the last quarter.



- Board structure 48.8%
- Remuneration 37.1%
- Shareholder resolution 8.5%
- Capital structure and dividends 1.8%
- Amendment of articles 1.1%
- Other 2.8%

United Kingdom

We recommended voting against or abstaining on 126 resolutions over the last quarter.



- Board structure 38.1%
- Remuneration 40.5%
- Capital structure and dividends 8.7%
- Amendment of articles 0.8%
- Audit and accounts 7.1%
- Poison pill/Anti-takeover device 3.2%
- Other 1.6%

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 have £346.3/€392.6/\$455.3 billion* in assets under advice.

Hermes has one of the largest stewardship resources of any fund manager in the world. Our 32-person team includes industry executives, senior strategists, corporate governance and climate change experts, accountants, ex-fund managers, former bankers and lawyers.

The depth and breadth of this resource reflects our philosophy that stewardship activities require an integrated and skilled approach.

Intervention at senior management and board director level should be carried out by individuals with the right skills, experience and credibility. Making realistic and realisable demands of companies, informed by significant hands-on experience of business management and strategy-setting is critical to the success of our engagements.

We have extensive experience of implementing the Principles for Responsible Investment (PRI) and various stewardship codes. Our former CEO led the committee that drew up the original principles, and we are engaged in a variety of workstreams through the PRI Collaboration Platform. This insight enables us to help signatories in meeting the challenges of effective PRI implementation.

How does Hermes EOS work?

Our company, public policy and best practice engagement programmes aim to enhance and protect the value of the investments of our clients and safeguard their reputation. We measure and monitor progress on all engagements, setting clear objectives and specific milestones for our most intensive engagements. In selecting companies for engagement, we take account of their environmental, social and governance risks, their ability to create long-term shareholder value and the prospects for engagement success.

The Hermes Responsible Ownership Principles¹¹ set out our fundamental expectations of companies in which our clients invest. These cover business strategy, communications, financial structure, governance and management of environmental and social risks. The engagement programme we have agreed with our clients, as well as the Principles and their regional iterations, guide our intervention with companies throughout the world. Our approach is pragmatic, as well as company- and market-specific, taking into account the circumstances of each company.

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

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

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

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

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

For further information, please contact:

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* as of 30 September 2018

¹¹ <https://www.hermes-investment.com/ukw/wp-content/uploads/sites/80/2018/03/final-responsible-ownership-principles-2018.pdf>

Hermes EOS team

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

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