Public Engagement Report

LAST CHANCE TO SEE? Why companies need to stop taking nature for granted

Federated Hermes EOS

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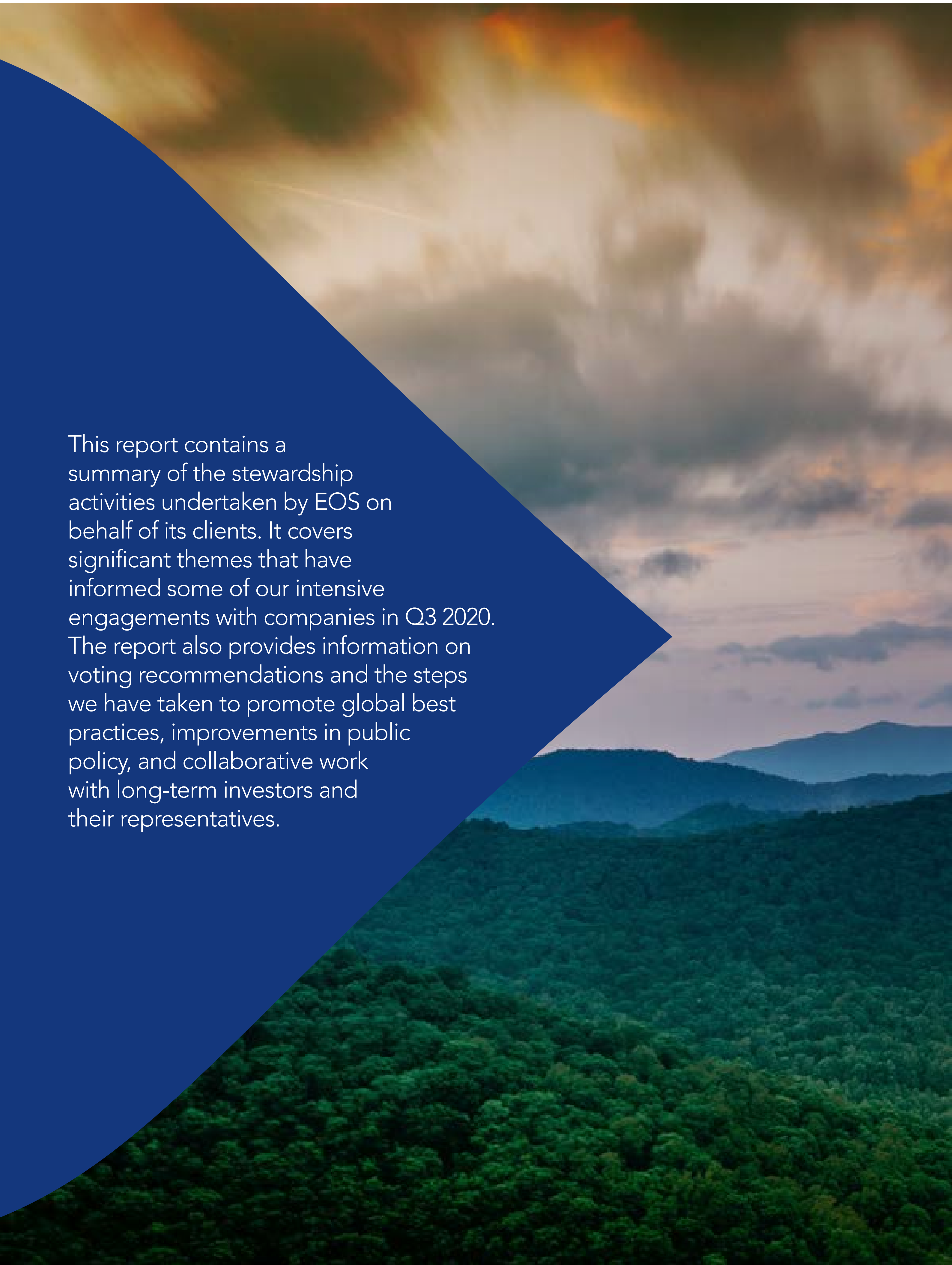

This report contains a summary of the stewardship activities undertaken by EOS on behalf of its clients. It covers significant themes that have informed some of our intensive engagements with companies in Q3 2020. The report also provides information on voting recommendations and the steps we have taken to promote global best practices, improvements in public policy, and collaborative work with long-term investors and their representatives.

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This report has been written and edited by Claire Milhench, Communications & Content Manager, EOS

Engagement by region

Over the last quarter we engaged with 327 companies on 893 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.

We engaged with 327 companies over the last quarter.

- Environmental **30.7%**
- Social and Ethical **21.7%**
- Governance **28.0%**
- Strategy, Risk and Communication **19.6%**

We engaged with 59 companies over the last quarter.

- Environmental **34.3%**
- Social and Ethical **20.3%**
- Governance **22.1%**
- Strategy, Risk and Communication **23.3%**

We engaged with 54 companies over the last quarter.

- Environmental **26.0%**
- Social and Ethical **25.3%**
- Governance **34.2%**
- Strategy, Risk and Communication **14.4%**

We engaged with 59 companies over the last quarter.

- Environmental **36.4%**
- Social and Ethical **14.7%**
- Governance **34.1%**
- Strategy, Risk and Communication **14.7%**

We engaged with 40 companies over the last quarter.

- Environmental **32.2%**
- Social and Ethical **28.0%**
- Governance **25.4%**
- Strategy, Risk and Communication **14.4%**

We engaged with 106 companies over the last quarter.

- Environmental **28.1%**
- Social and Ethical **22.1%**
- Governance **26.1%**
- Strategy, Risk and Communication **23.8%**

We engaged with 9 companies over the last quarter.

- Environmental **28.0%**
- Social and Ethical **12.0%**
- Governance **36.0%**
- Strategy, Risk and Communication **24.0%**

Engagement by theme

A summary of the 893 issues and objectives on which we engaged with companies over the last quarter is shown below.

Environmental topics featured in 31% of our engagements over the last quarter.

- Climate Change **78.8%**
- Forestry and Land Use **2.9%**
- Pollution and Waste Management **13.5%**
- Supply Chain Management **2.6%**
- Water **2.2%**

Social and Ethical topics featured in 22% of our engagements over the last quarter.

- Bribery and Corruption **1.5%**
- Conduct and Culture **14.9%**
- Diversity **19.6%**
- Human Capital Management **25.3%**
- Human Rights **30.4%**
- Labour Rights **6.2%**
- Tax **2.1%**

Governance topics featured in 28% of our engagements over the last quarter.

- Board Diversity, Skills and Experience **27.2%**
- Board Independence **18.0%**
- Executive Remuneration **41.2%**
- Shareholder Protection and Rights **9.6%**
- Succession Planning **4.0%**

Strategy, Risk and Communication topics featured in 20% of our engagements over the last quarter.

- Audit and Accounting **4.6%**
- Business Strategy **44.6%**
- Cyber Security **0.6%**
- Integrated Reporting and Other Disclosure **21.7%**
- Risk Management **28.6%**

Our debt to nature

Nature – and our reliance on everything it provides – is under threat as never before, with one million species at risk of extinction. Losses on this scale will have a devasting impact on human populations and the global economy. Sonya Likhtman outlines the value of biodiversity, the business case for its protection, and how we expect companies to respond.

Setting the scene

This year's plans for governments to agree a post-2020 global framework to protect biodiversity were swept aside by the pandemic, with discussions postponed until 2021. But while Covid-19 detracted from the biodiversity agenda in some ways, it brought our troubling relationship with other species to the fore. The wildlife trade and the destruction of habitats for agriculture, construction and other activities bring animals into closer contact with humans. This increases the risk of emerging infectious diseases, like Covid-19, moving from animal species to human populations, as our recent EOS Insights series on pandemics has highlighted.[1]

EOS has engaged with companies on eliminating deforestation, ensuring sustainable water use, and other topics related to biodiversity and sustainable land use for many years. We are members of the PRI-Ceres Investor Initiative for Sustainable Forests and the PRI Investor Working Group on Sustainable Palm Oil, amongst others. Our engagement with companies on climate change, sustainable food systems and the circular economy touches closely on the need to stay within planetary boundaries.

Respected natural historian Sir David Attenborough issued a stark wake-up call in September in his BBC documentary *Extinction: The Facts*. Explaining how everything in the natural world is connected in networks that support life on earth, he outlined why the destruction of natural habitats ultimately threatens our food and water security.

Our economies and societies are deeply embedded in nature, rather than existing alongside it. Recent estimates suggest that over half of global GDP is moderately or highly dependent on nature.[2] This may be due to dependence on raw materials, such as food ingredients, wood and medical

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[1] https://www.hermes-investment.com/ukw/eos-insight/coronavirus/the-coronavirus-and-our-relationship-with-nature/
[2] http://www3.weforum.org/docs/WEF_New_Nature_Economy_Report_2020.pdf

components, or on a range of processes enabled by nature. These ecosystem "services" include the provision of clean air, the maintenance of the water cycle, climate regulation, pollination and the availability of nutrient-rich soils. Healthy levels of biodiversity, including among plants, animals and micro-organisms, enable ecosystem services to function effectively.

Defining biodiversity

- Biodiversity has been defined as: "The variability among living organisms from all sources including terrestrial, marine and other aquatic ecosystems and the ecological complexes of which they are part; this includes diversity within species, between species, and of ecosystems."[3]
- US$44 trillion of economic value generation is highly or moderately dependent on nature and the services that it enables.[2]
- Nature-positive solutions can create 395 million jobs by 2030 and US$10.1 trillion in business opportunities.[6]

For the most part, companies have taken the immense value of nature for granted, despite relying heavily on the public goods that it enables. However, it is now evident that global ecosystems are threatened at unprecedented levels. A landmark study on the global state of biodiversity found that one million species are at risk of extinction and that the rate of extinction is increasing.[4] Human activity has severely altered 75% of terrestrial environments and the Living Planet Index shows an average 68% decrease in mammal, bird, amphibian, reptile and fish population sizes between 1970 and 2016.[5]

The five main drivers of biodiversity loss are changes in land use and sea use, direct exploitation of organisms, climate change, pollution and invasive alien species.[4] The World Economic Forum reports that three systems are responsible for endangering 80% of threatened or near-threatened species. These systems are food, land and ocean use; infrastructure and the built environment; and energy and extractives.[6] Transformations across these systems and the companies that operate within them are urgently required to halt and reverse biodiversity loss.

The business case for protecting biodiversity

Supply capacity

Some sectors are almost completely dependent on ecosystem services and intact biodiversity throughout their supply chains. Companies are increasingly likely to face challenges in sourcing raw materials due to disruptions to ecosystem services. Food and beverage companies, for instance, will feel the effects of the decline of pollinators due to pesticide use, climate change, and habitat loss.[7] The degradation of topsoil, which contains most of the soil's organic matter and biological activity, will limit agricultural yields unless regenerative practices are adopted. Large-scale crop failures could lead to sudden price shocks, prolonged shortages, rationing or devastating regional famines.

Consumer

Millennials and younger generations are increasingly indicating their preference for greater sustainability and transparency. This is apparent in the level of support for campaign groups such as Extinction Rebellion, and activists such as Greta Thunberg. As the risk and impact of biodiversity loss gains greater public attention, it will become another lens through which consumers can assess and develop preferences around companies and products. Companies that are found to be responsible for deforestation, oil spills in precious ecosystems, or any other form of biodiversity decline can expect to face significant reputational risks.

Market

Companies that do not pivot to a nature-positive economy are likely to face a series of transition risks. To make their business models resilient, companies should be proactive and innovative in developing nature-positive operations, products and supply chains. This will also enable companies to contribute directly to the UN Sustainable Development Goals (SDGs). Two SDGs - Life Below Water and Life on Land - are explicitly linked to biodiversity, while many more, including those relating to poverty, gender equality, health and climate action, are indirectly dependent on intact biodiversity and ecosystem services.

Engagement on bee welfare

Chemical-intensive agricultural practices and the application of pesticides are considered among the drivers of pollinator decline. We engage with companies that produce neonicotinoids and other pesticides on their approach to product risk management. For instance, we have been engaging on product stewardship and transparent reporting with Bayer since 2011.

We have also hosted a 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. We will continue to engage with companies in the agrochemical industry with the goal of reversing the decline of pollinators, as outlined by the EU 2030 biodiversity strategy.

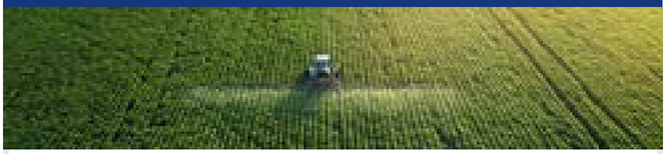
[3] https://www.cbd.int/convention/articles/?a=cbd-02
[4] https://ipbes.net/global-assessment
[5] https://www.zsl.org/sites/default/files/LPR%202020%20Full%20report.pdf
[6] http://www3.weforum.org/docs/WEF_The_Future_Of_Nature_And_Business_2020.pdf
[7] https://ec.europa.eu/environment/integration/research/newsalert/pdf/issue-23-2020-05-pollinators-future-brief_en.pdf

Policy and legal

Countries are expected to agree on global goals for biodiversity in 2021 and, like the Paris Agreement for climate change, the targets will be delivered by countries and companies. By 2030, the EU biodiversity strategy[8] seeks to protect at least 30% of land and seas, increase organic agriculture to 25% of the EU total, and halve the use of the most hazardous pesticides. The litigation risks that arise when companies negatively impact biodiversity are already apparent; the Deepwater Horizon oil spill in 2010 released 130 million gallons of crude oil into the highly biodiverse Gulf of Mexico, with the clean-up and litigation costs amounting to US$65 billion.[9] Costs for companies are likely to increase further as the protection of biodiversity becomes a public policy priority.

CASE STUDY

The global beverage company



We have been engaging with this beverage company on its water stewardship strategy for many years. This year we expanded the conversation to biodiversity and regenerative agriculture.

We spoke to the sustainability director about how these topics would be included in the 2030 sustainability strategy and were pleased to hear that biodiversity and regenerative agriculture will be greater focus areas for the company over the next 10 years. We encouraged it to develop its reporting to give greater transparency of the inputs, such as fertiliser use, and the outcomes of its actions, such as soil quality, so we can understand its progress and impact. We also urged it to demonstrate how its approach to biodiversity aligns with the upcoming UN 2050 goals for biodiversity and the supporting 2030 action targets.

Amy Wilson
Sector lead: Retail

Engagement expectations

Companies need to urgently acknowledge their impact and dependence on nature. This means understanding the ways in which biodiversity and ecosystem services are relevant to the business model, be this through sourcing practices and supply chains, in the construction of new sites, or through the ways the company's operations interact with surrounding ecosystems. The sectors that we have identified as key to halting and reversing biodiversity loss are consumer goods and retail, agrochemicals, mining and materials, oil and gas, utilities, finance and real estate.

Target

We expect companies to address the risks associated with high dependence and commit to having no further negative impact on biodiversity. Given the extent of biodiversity loss, conserving existing biodiversity will not be enough; it will also be necessary to restore biodiversity and the capacity of ecosystems. Therefore, we expect companies to implement measures that will have an overall net positive impact on biodiversity, including throughout their supply chains. While the commitment may be at the organisational level, much of the work required to ensure a net positive impact on biodiversity will be conducted at a local level.

Measurement

A key step for many companies is to measure their impact and dependence on biodiversity and ecosystem services. This is a complex but worthwhile task, as understanding their relationship with nature will enable companies to build nature-positive products, operations and supply chains. While there is no single perfect metric or framework, a range of helpful measurement tools and reporting frameworks are emerging. For instance, an initial guidance document on Science-Based Targets for Nature was recently published.[10]

Strategy

Once a company has identified its material dependencies and impacts on biodiversity and ecosystem services, it will be able to design impactful interventions. The strategy may target particular geographical areas, commodities and processes. Eliminating deforestation from supply chains and supporting the transition to regenerative agriculture will be critical (see boxes). The strategy may also include nature-focused innovation and new product development. For many companies, improving supply chain oversight and engagement will be a key aspect of the biodiversity strategy, as that is where many of the impacts and dependencies will be concentrated.

> **A key step for many companies is to measure their impact and dependence on biodiversity and ecosystem services.**

Governance

We expect companies to implement strong governance frameworks to support their net-positive aspiration. Through voting and other forms of stewardship, board directors will be increasingly held accountable for mitigating their organisation's negative impacts on biodiversity and ensuring sustainable land-use throughout the supply chain, including eliminating deforestation. This includes advocating for the protection of nature through public policy. Biodiversity risks and opportunities should be deeply integrated into all relevant processes, including risk management, business strategy, supply chain management, procurement, research and development, and operations.

[8] https://ec.europa.eu/environment/nature/biodiversity/strategy/index_en.htm
[9] https://www.theguardian.com/business/2018/jan/16/bps-deepwater-horizon-bill-tops-65bn
[10] https://sciencebasedtargetsnetwork.org/wp-content/uploads/2020/09/SBTN-initial-guidance-for-business.pdf

Deforestation

Halting and reversing tropical deforestation will be essential for avoiding the consequences of severe climate change and biodiversity loss. According to the Intergovernmental Panel on Climate Change (IPCC), 23% of global anthropogenic greenhouse gas emissions are from agriculture, forestry and other land use, with 11% of this coming from global deforestation and land conversion.[11] Tropical rainforests are home to approximately half of the world's plant and animal species, play an important role in regulating rainfall, and act as carbon sinks.

Deforestation and forest degradation, mostly driven by beef, palm oil, soy and other agricultural commodity production, has continued despite the immense value of tropical rainforests. Alarmingly, the rate of deforestation has increased in Asia, Africa and Latin America during the coronavirus pandemic.[12] We are working as part of the Investors Policy Dialogue on Deforestation in Brazil to reverse this trend in the Amazon rainforest. We also recently responded to the UK government's consultation on legislative proposals to tackle illegal deforestation in supply chains.

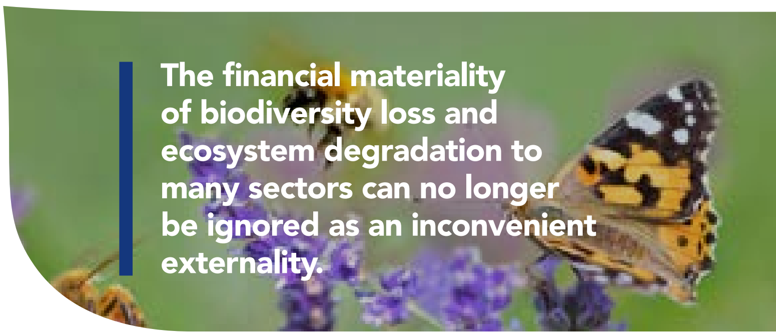
Companies that source commodities that may be linked to deforestation must urgently commit to clear timelines for eliminating deforestation from their supply chains. The commitment should cover all commodities, regions and suppliers, including indirect suppliers.[13] We expect companies to communicate a clear strategy for how a deforestation-free supply chain will be achieved through implementation measures, monitoring, independent verification and collaboration. Companies that can achieve traceability of commodities back to source will be best placed to achieve a deforestation-free supply chain.

Halting and reversing tropical deforestation will be essential for avoiding the consequences of severe climate change and biodiversity loss.

Regenerative agriculture

Approximately half of the world's habitable land is now used for agriculture, with 77% of that proportion used for animal grazing or growing crops for animal feed.[14] Industrialised farming requires high chemical inputs, promotes mono-cropping and destroys the soil's natural ability for carbon sequestration. Regenerative agriculture, on the other hand, seeks to restore the soil's natural ability to absorb and retain carbon, improves biodiversity and enhances ecosystem services.

Companies with agricultural supply chains should actively encourage and support farmers in transitioning to regenerative agriculture. By setting targets to source ingredients from regenerative agriculture and working with farmers on implementation, companies can contribute to a system-wide change in how food is produced. The transition will play a critical role in mitigating climate change and restoring biodiversity.



The financial materiality of biodiversity loss and ecosystem degradation to many sectors can no longer be ignored as an inconvenient externality.

Looking ahead

Global biodiversity targets for 2030 and 2050 will be agreed in 2021 and companies must be ready to deliver them. The financial materiality of biodiversity loss and ecosystem degradation to many sectors is apparent and can no longer be ignored as an inconvenient externality. There are also serious risks to the financial system and the global economy. Stewardship on these issues is a key means by which investors can ensure that companies recognise the importance of biodiversity and then take meaningful and concrete steps to protect it.

[11] https://www.ipcc.ch/srccl/
[12] https://www.ft.com/content/b72e3969-522c-4e83-b431-c0b498754b2d
[13] https://www.ceres.org/resources/reports/investor-guide-deforestation-and-climate-change
[14] https://ourworldindata.org/global-land-for-agriculture

Limited shelf-life? Why the fast fashion model is under strain

Fast fashion retailers came under fresh scrutiny during the Covid-19 pandemic, with an infection spike in one UK city linked to poor conditions in local factories. But shopping for clothes from online retailers rose as lockdowns shuttered high street stores. Lisa Lange looks at the detrimental environmental implications of this.

Setting the scene

In the early days of the pandemic, lockdown measures imposed to reduce the spread of Covid-19 led to a slump in demand for new clothes, causing a ripple effect along international supply chains. Unsold stock piled up in warehouses as shopping malls stood empty. With professionals working from home, no one felt the need to refresh their office wardrobe. But as the pandemic wore on, a new trend emerged – more people turned to online fashion retailers. Fast fashion also hit the headlines when a spike in coronavirus cases in Leicester – a clothing manufacturing hub in the UK – exposed allegedly poor treatment of employees in some supply chains. The controversy may prompt some consumers to reflect on industry practices and reassess their relationship with the frenetic fast fashion cycle.

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Fast fashion retailer Boohoo hit the headlines this summer for all the wrong reasons – an investigation alleging serious failings in its supply chain saw approximately £1.5bn wiped off its share price, losing over 40% of its value peak to trough.[1,2,3] The ensuing controversy shone a spotlight on the cheap clothing brands that are popular with young consumers, although the take-make-dispose model comes with a high environmental price tag.

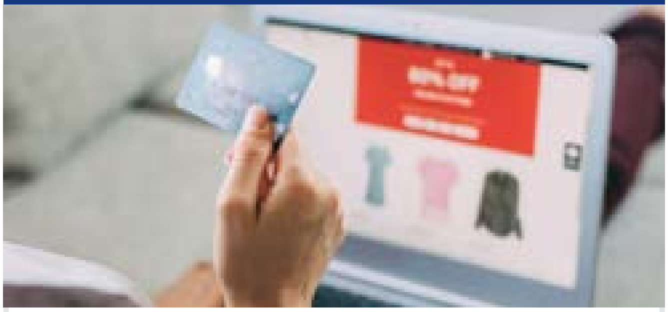
Boohoo was one of the beneficiaries of a broader consumer shift to buying clothes online during lockdown. Fast fashion retailers were better placed to meet this demand, compared with traditional bricks and mortar stores, as their model is geared to sending out multiple items at the buyer's request and then dealing with unwanted returns.

But the shortness of a fast fashion cycle, with as many as 52 "seasons" in a year, is the antithesis of a long-term sustainable use of resources. This is due to the cumulative impact that each production step has on our planet in terms of the water, materials, chemicals and energy use, from the cultivation of cotton and petrochemical production, to manufacturing, logistics and retail.

[1] https://www.theguardian.com/business/2020/aug/28/revealed-auditors-raised-minimum-wage-red-flags-at-boohoo-factories
[2] https://www.theguardian.com/business/2020/jul/07/boohoo-shares-concern-factory-conditions
[3] https://www.ft.com/content/19f9c4e9-e1d6-41a7-a352-5884549fcc9a

CASE STUDY

Boohoo



Boohoo is an ad hoc engagement that we initiated due to allegations against the company in the press regarding employment practices in Leicester, although due to the relatively low client holdings, Boohoo is not in our engagement plan.

We had a discussion with the company in July in which Boohoo told us that it had commissioned an independent review conducted by senior barrister Alison Levitt QC. This would consider the company's obligations and relevant duties of care in relation to the workforce in its Leicester supply chain. The company assured us that the investigation's recommendations would be key to the future strategy of the company.

On the call, we also raised concerns about the sustainability of the fast fashion business model and urged the company to improve its transparency on reporting environmental metrics on a comparable year-on-year basis. After this initial call with the company, we co-signed a letter from the Investor Forum requesting a review of the fashion retailer's supply chain, improved transparency, and governance reforms, such as improving the level of independence on the board.

Consultancy McKinsey[4] estimates that the global fashion industry produced 2.1 billion tonnes of greenhouse gas emissions in 2018 alone, which corresponds to 4% of the global total. This, McKinsey suggests, is equivalent to the combined annual emissions of France, Germany and the UK. Some 70% of these emissions come from upstream activities such as materials production, preparation and processing, while around 30% are associated with downstream retail operations, the use-phase, and end-of-use activities.

The current take-make-dispose model is inherently wasteful as around 73% of the garments produced end up in landfill or are incinerated, while less than 1% are recycled, representing a loss of over US$100bn per year in material value.[5] According to a research paper published in April 2020[6], the fashion industry produces over 92 million tonnes of waste and consumes 79 trillion litres of water per year. Clothes have also been identified as a source of microplastics pollution in the oceans.[7]

During the pandemic, the closure of high street stores prompted consumers to turn to online clothing retailers in greater numbers, ordering multiple sizes and returning unwanted items. Although this must be seen in the context of overall depressed sales numbers, the environmental cost of door-to-door delivery in terms of carbon emissions and packaging waste is more cause for concern.

Human rights risks in the supply chain can also damage a company's reputation. Boohoo had generally good ESG ratings,[8] but a lack of transparency in its supply chain. An independent report commissioned by Boohoo (see box) found widespread instances of dangerous working conditions in its supply chain and underpayment of staff.[9]

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Given the industry's social and environmental impact, there is a growing risk of more regulation or litigation. This could jeopardise the future profits of companies operating a fast fashion business model. In a new report, "Making the UK a Global Leader in Sustainable Fashion", the All-Party Parliamentary Group for Ethics and Sustainability in Fashion (APPG)[10] suggests that the apparel industry needs to choose a more sustainable path. Consumer research in the UK indicates a shift, as 65% of respondents agree with the statement that the government should urgently do more to reduce the negative impact of the fashion industry on the environment.[11]

Innovative business models are needed that move away from a focus on the number of purchases as a growth model, to consider fashion as a service that fosters the reuse or recycling of garments. Changing consumer preferences for sustainable clothing could be an opportunity for companies to build a strong relationship with their customers.

[4] https://www.mckinsey.com/~/media/McKinsey/Industries/Retail/Our%20Insights/Fashion%20on%20climate/Fashion-on-climate-Full-report.pdf
[5] https://www.ellenmacarthurfoundation.org/assets/downloads/A-New-Textiles-Economy_Full-Report_Updated_1-12-17.pdf
[6] https://www.nature.com/articles/s43017-020-0039-9
[7] https://brenmicroplastics.weebly.com/project-findings.html
[8] https://www.ft.com/content/ead7daea-0457-4a0d-9175-93452f0878ec
[9] https://www.ft.com/content/3cc4acc9-3f8a-4fb8-90e5-9a70116df7d4
[10] https://issuu.com/hubbubuk/docs/appg_report_final_?fr=sOWI1NjE5NDA2ODE
[11] https://www.hubbub.org.uk/our-polling-data

Engaging with the apparel sector

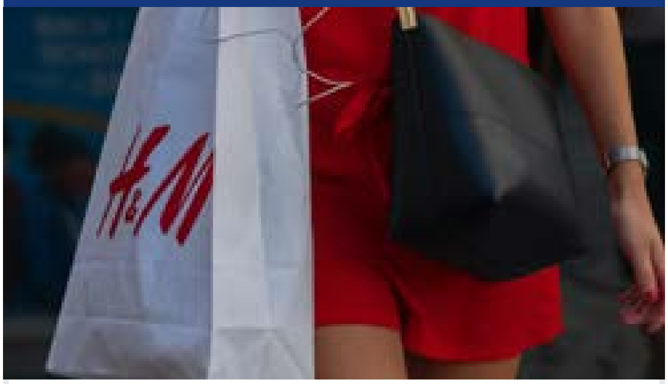
At EOS we are setting more ambitious, yet achievable objectives for the apparel sector. We undertook a comparative analysis of companies to assess how they were positioned to reduce the environmental impact of garments and move towards more circular business models. This will enable us to monitor the progress of our company engagements more systematically within the context of industry peers, and complement our work on supply chain human rights, particularly focused on appropriate due diligence processes.

A strong management of sustainability issues within a company is essential to improving performance. Focusing first on the management approach, we found that companies greatly differed in their conceptualisation of sustainability, and their commitment to the issue. This affects how well sustainability concerns are addressed in a company's strategic positioning, and its corresponding target setting and reporting. Developing a scoring methodology to benchmark company performance in terms of their management frameworks enabled us to compare companies and tailor objectives to the level of maturity of each. This ensures we can focus on the most ambitious, yet most feasible change for each company.

> **We undertook a comparative analysis of companies to assess how they were positioned to reduce the environmental impact of garments and move towards more circular business models.**

CASE STUDY

H&M



Retailer H&M has made a strong commitment by stating that it aims to become a fully circular business. Importantly, the company has set a science-based target to reduce its absolute Scopes 1 and 2 greenhouse gas emissions by 40% by 2030, from a 2017 base year.

It also has a target to reduce its absolute greenhouse gas emissions from purchased raw materials, fabric and garments by 59% per piece by 2030 from a 2017 base year. Furthermore, the company has set a goal to source 100% recycled or other sustainably-sourced materials by 2030.

H&M has also developed a biodiversity strategy that sets out actions to reduce negative impacts and to contribute to more resilient and healthy ecosystems. We are now asking the company to report on its climate change strategy and actions using the guidelines of the Task Force on Climate-related Financial Disclosures (TCFD), including improving transparency regarding the link between sustainability targets and executive remuneration. We also want to see the company introduce a comprehensive take-back scheme for used clothes and to introduce targets for recycled cotton content.

Dr Emma Berntman
Theme lead: Natural Resource Stewardship

CASE STUDY

Adidas

Sportswear manufacturer Adidas's approach to circularity is more mature than that of some of its peers. We had a focused discussion on circular economy approaches in July 2020 in which the company explained how the "Three Loop Strategy" to end plastic waste and scale-up circular efforts to make sustainable clothing mainstream is linked to its corporate strategy.

Adidas made a strong public statement that articulated its commitment to move to a more circular business model and has made a commitment to use only recycled polyester in its products, where this is technically possible, from 2024 onwards.

The company has invested in circular innovation and its shoe range made from recycled ocean plastic was hugely successful with consumers. Furthermore, the first fully recyclable running shoe, the "Future Craft Loop" has been in the test phase since 2019 and its launch is planned for 2021. Finally, in February 2020, the company confirmed that it was committed to setting science-based emission reduction targets.

Objectives

Objectives that we will pursue with companies to push them along the trajectory of appropriately capturing the risks and opportunities at the heart of their business strategy include the following:

1. Publishing a public statement to acknowledge the need to move to circular business models.
2. Demonstrating an assessment of the risks to the business from its environmental impacts, including the supply chain and disposal.
3. Setting a timebound recycled content target as a percentage of the total for specific materials such as sustainably-sourced cotton and recycled polyester.
4. Setting timebound targets for the percentage of sales from sustainable materials or product lines.
5. Ensuring that 100% of stores or online systems offer take-back and repair capabilities to encourage consumers to increase the life of a garment and to recycle.
6. Disclosing progress towards environmental targets, as well as the proportion of capital expenditure that is dedicated to moving to a more circular business model.

Of course, what matters in the end is the actual performance of companies in terms of the environmental impact of their operations and products. Some of the key performance metrics that we have identified are carbon emissions and water use per unit of production, the recycled materials input, a roll out of take-back schemes and consumer education on recycling, and the proportion of investment committed to circular innovation.

It is promising that companies such as H&M and Nike have now set science-based targets – the first clothing and footwear companies to do so, while others such as Adidas and Inditex have committed to doing so. Critically, more forward-looking companies such as Inditex and H&M have set targets for recycled and sustainably-sourced materials inputs. Now it will be key to monitor progress as companies start to report against these targets.

CASE STUDY

Primark

Primark, a high street fashion retailer popular with consumers for its low-cost clothing, has been a significant area of focus in our recent engagements with Associated British Foods, its owner. We continued our ongoing dialogue with the sustainability team of Primark in a video call with the company secretary and the ethical trade and environmental sustainability director in June 2020. Primark does not have an online shopping operation and was therefore highly impacted by the coronavirus lockdown, although it recovered once its stores reopened.[12]

In the discussion, we focused on how the coronavirus is impacting sustainability initiatives around cotton, circularity and climate. Primark lacks a concrete public commitment to move to a circular fashion business model but joined the "Make Fashion Circular" initiative developed by the Ellen MacArthur Foundation in 2018 and the Sustainable Apparel Coalition in 2015.

The company highlighted its work with smallholder farmers on sustainable cotton. We encouraged the company to build on this project and increase the proportion of sustainable cotton used in its products.

EOS is intensifying its engagement with the apparel sector, particularly the companies in the engagement programme that rely significantly on a fast fashion business model. We are using our comparative performance analysis of the proactive management of the environmental cost of fast fashion to help set ambitious, yet feasible objectives tailored to the company's level of maturity.

We now plan to develop our work into a practical guide for investors to raise awareness and support more engagement with companies.

[12] https://www.ft.com/content/5a4d6ea4-bd19-4e1c-8b92-473f70dd9f60

Pandemic scrutiny brings purpose to the fore

During the pandemic, companies have come under greater pressure to demonstrate their value to society while treating their employees, customers and suppliers well. This has reinvigorated the debate about business purpose. Amy Wilson outlines why this matters, and how we engage with companies to help them articulate and remain true to a clear business purpose.

Setting the scene

Government support for companies during the Covid-19 pandemic has demonstrated why all businesses need to maintain a social licence to operate underpinned by a corporate purpose. We have long argued in our Responsible Ownership Principles[1] and our Corporate Governance Principles[2] - in which we communicate our expectations to companies each year - that companies should clearly articulate their purpose and how they contribute to sustainable returns for their shareholders, stakeholders and wider society. The last few months have provided a stress test of corporate purposes and their usefulness in times of crises. A clear and meaningful business purpose should help companies to identify the right things to do in the short term, in order to fulfil their purpose over the long term.

For further information, please contact:

Amy Wilson
Sector lead: Retail
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As the concept of business purpose proliferates, there is a risk of 'purpose washing', particularly as stakeholder capitalism gains traction and more investors recognise the importance of ESG factors.

To date, many companies have disclosed only superficial or meaningless purpose statements, and few have consciously thrived because of their purpose. Likewise, the commitment by CEO members of The Business Roundtable in the US to run companies for the benefit of all stakeholders has failed to produce much meaningful change, one year on. This lack of progress does not invalidate the importance of purpose but highlights the need for investors and other stakeholders to hold companies to account.

The pandemic has added a practical dimension to the debate about business purpose, posing real-world dilemmas. While some companies have won plaudits for their compassionate and responsible behaviour, others have been widely criticised for their treatment of workers and customers. This might include pushing employees to work in unsafe conditions, delaying or avoiding paying refunds to customers or suppliers, or price gouging on sought-after items. During a crisis, companies must make difficult trade-offs between achieving shorter-term financial returns and maintaining

[1] https://www.hermes-investment.com/wp-content/uploads/2018/10/final-responsible-ownership-principles-2018.pdf
[2] https://www.hermes-investment.com/stewardship/eos-library/

strong relationships with key stakeholders. If a company can demonstrate it remained true to its purpose through a crisis, this will enhance its licence to operate and support long-term sustainable returns.

What is business purpose?

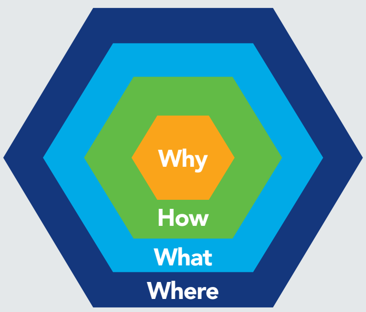
Purpose articulates *why* an organisation exists, what and whose problems it aims to solve, and why the organisation is well-placed to do this.

Purpose should be enduring – extending beyond the tenure of particular executives or strategies. It should be owned by the board, who act as stewards of the purpose and empower executives to enact strategies in pursuit of the organisation's purpose.

Purpose should be the most important organising principle for an organisation, informing and guiding strategic decisions, activities and capital allocation. This is the concept of 'Purpose as strategy', rather than the more commonly understood, 'Purpose as culture',[3] although purpose plays an important role in culture, and cultural behaviours should align with the desired purpose.

Purpose is also distinct from vision (the strategic aim, the outcome the organisation wants to achieve), mission (what the organisation does) and values (how the organisation will operate).

The four board responsibilities



Why = Purpose
Why the organisation exists

How = Values
How the organisation will operate

What = Missions
What the organisation will produce

Where = Visions
The aim of the organisation

Source: Enacting Purpose Initiative

Critical interdependence

The pandemic has highlighted the critical interdependence of different elements of society, including businesses, governments, employees, customers and supply chains.

We believe this interdependence will only grow over time as society faces even bigger challenges, such as striving for racial equity as demographics shift, dealing with job losses due to automation and other forms of technological disruption, and responding to the inevitable impacts of climate change.

The economic fallout of the pandemic is already leading to record rises in unemployment and government debt, which will need to be stabilised at manageable levels. Business has been the direct beneficiary of much government spending, for example through furlough schemes, grants, government guaranteed loans, deferred tax payments and reduced interest rates.

We anticipate that governments and regulators will face pressure from the public to ensure that businesses that benefitted from government support contribute more responsibly to society. In particular we expect intense scrutiny of tax arrangements and bailout conditions, employment law and worker health and safety, and executive pay against a backdrop of high unemployment and inequality. With governments demonstrating that they are prepared to act swiftly to address the pandemic, companies need to be better prepared for future crises and for sweeping changes to the way they can operate.

Now is the time for companies to review their corporate purpose and its relevance for the business. This should clearly articulate a positive contribution to society, identify the stakeholders most critical to sustainable returns, and how the company's strategy and risk management processes can deliver value to all stakeholders.

The pandemic has highlighted the critical interdependence of different elements of society, including businesses, governments, employees, customers and supply chains.

Our expectations

We expect companies to be guided by a purpose that serves not only shareholders, but also other stakeholders, society and the environment. This helps to protect the long-term interests of savers and pensioners – both current and future – invested in companies, who require sustainable financial returns and an economy, society and environment capable of providing a secure future.

In our engagements, we consider how purpose is expressed, supported by our Statement of Purpose guidance[4] on producing precise statements of purpose that identify important stakeholders and clarify ownership by the board. We also consider how purpose is enacted, seeking clarity on how the current strategy and capital allocation are aligned with purpose, and how it is embedded into organisational behaviours.

Our work with the Enacting Purpose Initiative (EPI)[5] aims to support this. The initiative, which we co-lead, along with Oxford Said Business School, University of California Berkeley Law School and others, brings together academic research with insights from company lead directors and executives to provide practical guidance for boards on embedding purpose in organisations. The EPI's first report provides a European perspective, and a US-focused report will follow.

We intend to use the outputs of this work to deepen our discussions with companies on how they can practically enact purpose and move beyond high-level statements and alignment with culture, to embed corporate and societal sustainability in their strategy and capital allocation.

[3] The Enacting Purpose EU report expands on this distinction https://www.enactingpurpose.org/assets/enacting-purpose-initiative---eu-report-august-2020.pdf
[4] https://www.hermes-investment.com/ukw/wp-content/uploads/2019/08/statement-of-purpose-guidance-document-aug-2019.pdf
[5] http://enactingpurpose.org/

Our company engagements

Engie

French electric utility company Engie is in the process of defining its purpose. The company invited us to participate in a survey, through a consultant, gathering the views of stakeholders on this topic. We presented our guidance on preparing a statement of purpose and highlighted the importance of identifying the most relevant stakeholders.

Travelers

In response to our engagement, this US insurance company included a statement from its lead independent director in its sustainability report outlining its purpose, important stakeholders and the role of the board and management. We are encouraging improvements to the expression of purpose and its elevation from sustainability to annual or proxy reporting.

Persimmon

We are engaging with UK housebuilder Persimmon on improvements to its culture and operations to better align with its stated purpose after controversies on executive remuneration and poor quality.[6] Its purpose is to build good quality homes at a range of price points across the UK. It aims to "create and protect superior and sustainable levels of value for the benefit of our customers, workforce, suppliers and shareholders through the housing cycle".

BP

In response to intense engagement by EOS and investors as part of the Climate Action 100+ collaborative initiative, including filing a shareholder resolution in 2019, the oil and gas major has restated its business purpose: "Our purpose is reimagining energy for people and the planet. We want to help the world reach net-zero and improve people's lives." This is supported by 10 long-term aims and various short and medium-term targets. Our engagement is now turning to implementation.

Centrica

As a result of engagement at UK utility Centrica, the company has set an objective to decarbonise the greenhouse gas emissions of its customers. It has also updated its business purpose to include clear reference to the need to support the low carbon transition, saying: "We are an energy services and solutions company, focused on satisfying the changing needs of our customers and enabling the transition to a lower carbon future."

We have continued to discuss the idea of creating a statement of purpose with various other companies including Morgan Stanley, CVS Health Corp, Bristol Myers Squibb, Bank of America and Baidu.

Outlook

With many companies around the globe badly affected by the pandemic, business purpose has acquired a greater relevance across many different sectors and geographies. We will look at how well a company's corporate purpose guided and informed their actions through the crisis, and how well prepared they are for the future.

Questions we will ask include:

- How have the trade-offs between different stakeholder groups, such as investors, the workforce, suppliers and customers, helped to preserve the company's licence to operate?
- Should the corporate purpose be reviewed or clarified and how will it inform the development of the business, including:
  - The link to strategy, including long-term goals and metrics of success to demonstrate achievement of positive societal outcomes and capital allocation decisions to support this. This may include the balance between short- and long-term investor returns, balance sheet resilience, and the need to prepare for long-term changes in business models, such as achieving net-zero emissions by 2050
  - Relationships with key stakeholders including how best to set the culture and employee proposition to improve loyalty and productivity while addressing important societal concerns, such as racial equality and giving different stakeholders a voice through representation and/or enhanced communications.

[6] https://www.standard.co.uk/business/persimmon-probe-slams-systemic-poor-culture-and-demands-change-a4315691.html

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 range across many key areas, including business strategy and risk management, which covers environmental, social and ethical risks. Structural governance issues are a priority too. We challenge and support management on the running of the company and management's approach to ensuring the company's long-term future. In many 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 with which we are engaging. Presenting environmental, social and governance issues as risks to the company's strategic positioning puts things solidly into context for management. The issues may also present opportunities. For instance, businesses may benefit from fresh thinking at board level. These short company updates highlight areas where we have completed objectives or can demonstrate significant progress, following several years of engagement.

Company engagement updates

Geely – TCFD reporting

Lead engager: Sonya Likhtman

We first spoke to an executive director about Geely Automobile Holdings' approach to climate change in May 2019. We encouraged the company to align its reporting and underlying processes with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). Noting that the Hong Kong Stock Exchange formally endorsed the TCFD, we suggested that this would be an effective way for the company to improve its ESG disclosure. We explained that strengthening its assessment of risks and opportunities relating to climate change would improve its score on the Transition Pathway Initiative, something which we consider when making voting recommendations. We had several further engagements with representatives from the company throughout the year, including conversations with the financial controller, the board secretary and the head of internal audit.

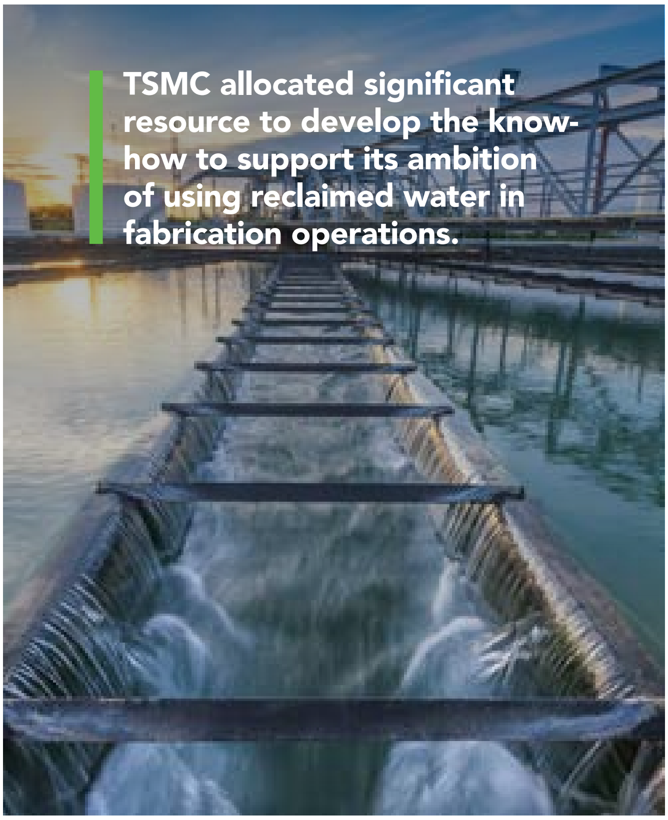
We were pleased that Geely took our suggestions on board and referenced the four pillars of the TCFD in its 2019 sustainability report, which was published in April 2020. We provided feedback on the report, welcoming the alignment with the TCFD and the company's commitment to further improvement. To build on the progress so far, we encouraged the company to conduct scenario analysis and to integrate climate risk analysis into decision-making at board level and throughout the company. We will continue to engage on Geely's climate change performance and disclosure.

Toray Industries – Board composition

Lead engager – Sachi Suzuki

We started engaging with Japan's Toray Industries in 2012, when we first raised concerns about the composition of its board, which had 26 directors, all of whom were executives. In our meeting at the company's headquarters in Tokyo, we encouraged the company to reduce the board size to improve efficiency, and to appoint independent directors to provide objective views. In 2013, the company told us that it had started searching for independent candidates and in 2014 it appointed the first independent director, a prominent figure in corporate governance reform in Japan. The company appointed a second independent director in 2015. Although the company now had two independent directors as required by the Corporate Governance Code, we remained concerned about the overwhelming number of executive directors and continued to press for a reduction in the board size. In our meeting with an executive director in early 2018, we were pleased to hear that the company was taking these concerns more seriously.

We welcomed the reduction of the board size to 19 later that year but continued to seek further improvements. In 2020, there was a significant restructuring of the board, with the appointment of additional independent directors. The board now consists of 12 directors with eight executive directors. Although we have some questions about the independence of one of the new non-executive directors, we consider the other three to be genuinely independent. We continue to press for board diversity as the board consists entirely of Japanese men, while also seeking a further reduction in strategic shareholdings.



TSMC – Water stewardship

Lead engager: Christine Chow

In 2018, we encouraged Taiwan Semiconductor Manufacturing Company (TSMC) to take a leadership position on ensuring broader access to water. The company's fabrication facilities consume a lot of water and Taiwan is exposed to a growing drought risk due to climate change. We outlined how the company could play a role in sustainable development by improving water stewardship.

TSMC allocated significant resource to develop the know-how to support its ambition of using reclaimed water in fabrication operations. It started a pilot project and promised to share the knowledge with the government and peers. Its intellectual property data allowed us to gain deeper insights into its progress. We engaged with the executive committee sponsor of the sustainability initiative and the former CFO to ensure further development.

Smart measurement systems are now in place. Recycled water with improved quality can replace the demand for city water, contributing to a more sustainable society. The company recycles 133.6 million metric tons of water annually, a saving of around NT$1,613.2m (US$53.8m). In 2019, TSMC achieved the highest score ever recorded by the Alliance for Water Stewardship and its current recycling rate is 86.7%. We continue to monitor its progress.

BNP Paribas – TCFD reporting

Lead engager: Pauline Lecoursonnois

In September 2017, we co-signed a letter to global banks, including BNP Paribas, to request more robust public disclosure aligned with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). In October 2017, we were pleased to see BNP Paribas joining other UN Environment Programme Finance Initiative (UNEP FI) banking members in a pilot project to implement the recommendations. In December 2017, the head of sustainability highlighted the challenges of implementing these recommendations due to the lack of robust and comparable data. In March 2019, BNP Paribas published its 2018 registration document and the TCFD recommendations were added to the table of concordance, which aims to identify the information requested by reporting standards.

We raised our concerns with the head of investor relations regarding the absence of a formal TCFD report, which is a key deliverable. We noted that all 16 banks participating in UNEP FI had committed to publishing an initial TCFD report by mid-2019. We reiterated our concerns during our call with the chair in March 2020 and were pleased to hear that a standalone report would soon be published. BNP Paribas published its first report in May 2020. BNP Paribas was the first bank to exclude financing of companies specialising in non-conventional hydrocarbons (shale gas, tar sands, etc) in 2017, and more recently it announced a timetable for exiting thermal coal. We will continue to engage with BNP Paribas on its progress in achieving its general ambition to align all its activities with the goals of the Paris Agreement.

Goodyear Tire & Rubber Company – Board composition

Lead engager: Tim Goodman

Goodyear Tire & Rubber Company has continued its programme of board refreshment, in line with our engagement objectives for greater gender and ethnic diversity on its board. Its new director also brings valuable experience from China to the board's discussions. In a call, a face-to-face meeting and email correspondence during 2019 and 2020 with the governance and sustainability management, we sought improved ethnic and gender diversity on the board to help improve diversity within the senior ranks of the company.

Goodyear will face some difficult times due to the significant effects of the coronavirus on its core industrial customers, and reductions in end-consumer travel and spending. However, we will continue to engage with the company on diversity and inclusion and other important issues, such as reducing greenhouse gas emissions, including among its customers and supply chain, particulate pollution, health and safety, and human rights in its supply chain.

Broadcom – Remuneration

Lead engager: Tim Goodman

Broadcom has increased the shareholding requirements of its CEO from three times to six times salary, in line with our engagement objectives. We believe that substantial long-term ownership of the company's shares by management is the best way to secure alignment between them and long-term investors. We forcefully made the case for this change before the 2019 shareholder meeting and were pleased to read in the company's 2020 proxy statement that the compensation committee made this change. Nevertheless, we continue to encourage the company for further reform to its pay practices.

We think that pay is still too high, performance measures are too weak, and given the high pay, the compensation committee should increase the share ownership requirements.

We have set another engagement objective. Given our continuing concerns, we recommended a vote against the say-on-pay resolution and the chair of the compensation committee. We are also requesting enhanced disclosure on climate change and human rights risks and are pleased that the company has committed to publishing a sustainability report in 2020, which will give us an opportunity to assess progress and push further.

Suzuki Motor – Board composition

Lead engager: Sachi Suzuki

As part of our ongoing engagement with Suzuki Motor, we first raised our concerns about a lack of gender diversity on the board at our meeting in Tokyo in 2018. We also noted that only two out of its eight directors were independent and that the board needs more independent representation. In our meeting with an executive director in 2019, the company told us it had considered appointing female directors and adding more independence to the board but that it had not identified suitable candidates at that stage. Given the lack of progress, we recommended voting against the executive chair, who was also the chair of the nomination and remuneration advisory committee, at the 2019 shareholder meeting.

In early 2020, the company announced the appointment of three new non-executive director candidates, including the first woman, to replace two outgoing independent directors. A third of the board now consists of non-executive directors, in line with our request. We are calling for further improvements to board independence and diversity while engaging on other issues including chair succession, cross-shareholdings and fleet emissions.

Nomura – TCFD reporting

Lead engager: Janet Wong

We started engaging with Nomura on Task Force on Climate-related Financial Disclosures (TCFD) reporting in 2017. We participated in a collaborative investor initiative on climate change with the banking sector and co-signed a letter to 62 of the world's largest banks, including Nomura. This called for enhanced disclosure of the climate change-related risks and opportunities facing financial institutions, and how these are managed by boards and senior executives. Since then, we have exchanged views and recommendations on ESG disclosure with the head of investor relations and the ESG department at the company's headquarters in Tokyo.

Following our engagement, the company published its first English-language TCFD report in July 2020. Its asset management arm separately published a responsible investment report in June 2020, which includes a detailed section on TCFD. In addition, Nomura became an official signatory of the UN Principles for Responsible Banking in July. We will continue to engage with the company on articulating its quantitative sustainable targets, as well as encouraging its RE100 membership at the group level.

> **We participated in a collaborative investor initiative on climate change with the banking sector and co-signed a letter to 62 of the world's largest banks, including Nomura.**

CASE STUDY

Repsol: Commitment to net-zero emissions by 2050

We began our engagement on climate change with Repsol in a 2013 meeting with the joint CEO and chair and other senior executives, discussing the Spanish oil and gas company's sustainability strategy. From 2015 to 2019 we focused on five key aspects of climate action: scenario analysis and the disclosure of resilience to Paris-aligned decarbonisation; the alignment of strategy and targets with the goals of the Paris Agreement; internal carbon price assumptions and their use in investment decisions; the disclosure of a carbon intensity indicator; and reporting in line with the recommendations of the Task Force on Climate-related Financial Disclosures.

At Repsol's 2017 Sustainability Day, we welcomed the company's commitment to start using a single internal carbon price across the group. In 2018, its strategic update set out a path to climate transition by capping production and committing significant capex to low-carbon business. Since its 2018 integrated management reporting, the company has disclosed a carbon intensity indicator for the energy it supplies, and a goal to reduce this intensity in line with the International Energy Agency's Paris-aligned Sustainable Development Scenario.

> **In 2018, its strategic update set out a path to climate transition by capping production and committing significant capex to low-carbon business.**

In December 2019 Repsol became the first oil and gas company to commit to a net-zero emissions goal, supported by a decarbonisation pathway with interim targets. In 2020, together with our co-lead for the company under Climate Action 100+, we submitted a statement to the company's annual meeting. We congratulated Repsol on its net-zero commitment and asked whether the low oil price and the coronavirus pandemic would have a material impact on the climate strategy. We were reassured that the company reaffirmed its commitment. The engagement between EOS at Federated Hermes, the broader Climate Action 100+ engagement group and Repsol continues to advance, now with a focus on implementation of the net-zero pathway.

> **In 2020, together with our co-lead for the company under Climate Action 100+, we submitted a statement to the company's annual meeting.**

Read our engagement case studies in full at

www.hermes-investment.com/ukw/eos-insight/eos/repsol-case-study/

Andy Jones
Sector lead: Mining and Materials

BLOG SPOTLIGHT

The coronavirus and the race for a vaccine

Across the globe, scientists are hunting for an effective vaccine that will end Covid-19. In the sixth article in our pandemic series, engager Katie Frame looked at the response from the pharmaceutical sector.

It has been encouraging to see the pharmaceutical and healthcare sector leap into action, searching for treatments and vaccines for Covid-19. Despite this, we remain concerned about the lack of commitment and action across the industry to act ethically to ensure safety and efficacy, as well as equitable access. We are engaging with pharmaceutical companies to ensure they consider a global access approach.

We have been particularly concerned about early actors setting a precedent by limiting the initial supply of treatments within certain country borders. We will need to ensure that companies consider new and innovative mechanisms to assess country-specific needs and equal distribution, whilst preventing stockpiling. Companies and health authorities will also need to rapidly expand manufacturing whilst ensuring product quality and safety, and consider innovative methods such as patent sharing.

> **We have seen from engagement that the most successful models for addressing global health challenges involve multi-stakeholder partnerships.**

Gilead Sciences had to backtrack after it secured "orphan drug" status for its remdesivir anti-viral drug, seen as a promising potential treatment for Covid-19. We pushed the company to improve its response, seeking greater clarity on how it would produce a drug at a low or no margin. We also encouraged it to provide a global response, not just focus on the US.

Successful models

We have seen from engagement that the most successful models for addressing global health challenges involve multi-stakeholder partnerships. These should include pricing flexibility from pharmaceutical companies, investment in health spending from countries, guidance and coordination from bi- and multilateral organisations, and education about vaccination programmes and distribution, with assistance from NGOs.

The challenge on which we will continue to engage is ensuring that the current momentum around access to vaccines for infectious diseases continues. According to the Access to Medicine Index, in 2018, R&D for emerging infectious diseases comprised just 1% of total R&D projects.

To incentivise further vaccine development, we need to engage with companies and policymakers to create sustainable incentive models that decouple product pricing from R&D costs. This can be achieved through mechanisms such as push funding or grants, or similar incentive models to those we discussed in our previous article on antibiotics R&D. Covid-19 has demonstrated why this is a material issue for the long-term sustainability of the sector, otherwise, without a more sustainable vaccine pipeline, we may be entering an era of pandemics.

Read the EOS insights article in full at

www.hermes-investment.com/ukw/eos-insight/eos/the-coronavirus-and-the-race-for-a-vaccine/

Katie Frame
Sectors: Pharmaceuticals and Healthcare, Retail, Technology Software

Companies engaged on strategic and/or governance objectives and issues this quarter:

Global
243

United Kingdom
44

North America
84

Developed Asia
24

Emerging Markets
37

Europe
45

Australia and New Zealand
9

CASE STUDY

Nintendo

We began engaging with Nintendo on board gender diversity in 2016 and on board independence in 2017 with the head of legal and company secretary, meeting eight times between 2016 and 2020. The board consisted only of men of Japanese nationality. Although there was progression from a 100% insider board in 2013 to 33% board independence in 2016, there was still room for improvement.

Our concern was accentuated by the fact that the company did not have a nomination committee, adding opacity to the nomination process. We encouraged the company to carry out an independent board evaluation and strengthen the search for female candidates.

Following our engagement, Nintendo carried out its first self-evaluation of the board in 2016 and promised to consider an external board evaluation.

The company is working towards strengthening its talent management programme to establish a pipeline of senior women executives. Following our vote against the president in the 2019 annual shareholder meeting, and further engagement later in the year to accelerate a change in board composition, the company announced it was establishing a nomination advisory committee in January 2020. Three of the five directors are outside directors. In May 2020, Nintendo announced that it would appoint a woman to the board for the first time.

We encouraged Nintendo to improve its disclosure of the nomination process and to publish the Terms of Reference of the nomination advisory committee. This is to aid investor understanding, given that the company has traditionally relied on the president to nominate candidates. We continue to engage as our expectations for board diversity go beyond the appointment of one female director.

Read our engagement case studies in full at
www.hermes-investment.com/ukw/eos-insight/eos/nintendo-case-study/

Sachi Suzuki
Team lead: Emerging Markets (ex-China)
Theme lead: Shareholder Protection & Rights

Dr Christine Chow
Team lead: Greater China
Sector lead: Technology

Public policy and best practice

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' investments over the long term.

Overview

We participate in debates on public policy matters to protect and enhance value for our clients by improving shareholder rights and boosting protection for minority shareholders.

This work extends across company law, which in many markets sets a basic foundation for shareholder rights; securities laws, which frame the operation of the markets and ensure that value creation is reflected for shareholders; and 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. 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, which may differ markedly – particularly those of companies, lawyers and accounting firms, which tend to be more active than investors in these debates.

CA100+ oil and gas call on benchmarking methodology

Lead engager: Nick Spooner

We had a multi-stakeholder call with all the major European oil and gas companies along with the leads for the Climate Action 100+ engagements. We ran through the proposed benchmarking methodology. Concerns were raised around the boundary for Scope 3 emissions, and regarding the limitations around actions that oil and gas companies could take in mitigating value chain emissions. We noted the need for an enhanced focus on positive lobbying, so that oil and gas companies can play a role in the low-carbon transition. We raised concerns around leakage of emissions from the sector through divestment of assets, and the need for clear disclosure around organic versus inorganic capital expenditure and divestiture. We encouraged greater clarification around the capital expenditure methodology. Concerns were raised around the carbon budget boundary used to measure the alignment of capital expenditure.

Subsequently, we had a call with investors to discuss feedback around the benchmarking methodology. We emphasised the need for alignment of capital expenditure with the goals of the Paris Agreement to take a dominant role within the methodology, as it could apply to multiple different strategies. We expect this to be core to the methodology, with supplementary assessment criteria for those companies looking to transition. We encouraged greater clarification around Scope 3 boundaries and a need for more specificity on the expectations for a Just Transition.

Input to forthcoming PRI publication on whistleblowing

Lead engager: Tim Goodman

With our track record on anti-corruption engagement via the Principles for Responsible Investment (PRI) and elsewhere, we were invited to give input to a forthcoming PRI publication on speak up programmes and whistleblowing. We emphasised that the companies that have the best cultures try to ensure their speak up facilities are well used. They also seek feedback from those using them about their experiences regarding ease of use, confidentiality and how satisfied they were with the action taken to address their concerns. We made it clear that the best companies also encourage a free flow of information and that concerns are expressed openly within the organisation and with stakeholders.

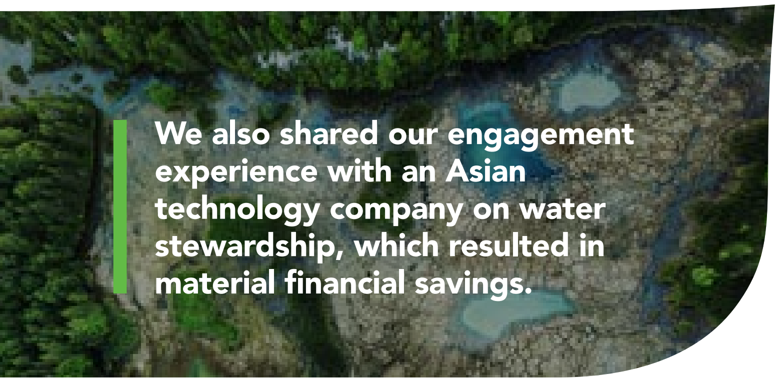
For this reason, those companies with healthy cultures were more likely to resolve issues internally, and to have more data indicating areas of interest. Less healthy cultures, particularly at larger, more complex companies, would have fewer data points and would not be interrogating the nuances behind them that might indicate problematic micro-cultures or more widespread cultural difficulties. We urged the PRI not just to identify anti-corruption disclosure standards, but to argue that companies should provide more qualitative insight into corporate culture. We shared some of the indicators and how they are used at companies that are actively attempting to measure and improve their ethics and culture.

Shenzhen-UK ESG roundtable on stewardship

Lead engager: Janet Wong

At the invitation of the City of London, we spoke at the Shenzhen-UK ESG roundtable on stewardship, organised by the City of London and the Shenzhen Municipal Financial Regulatory Bureau. The event was attended by over 70 representatives from asset management, city authorities and stock exchanges from Shenzhen and the UK. We shared our stewardship approach and practice in managing investment risks to ensure good returns and avoid high risk investments, or a "black swan" scenario. We highlighted independent quantitative studies demonstrating the effectiveness of stewardship and engagement.

We then argued for the importance of engagement as an effective tool to minimise downside risks by citing the Federated Hermes International investment team's engagement experience with a mining company active in emerging markets, and their investment decision. We also shared our engagement experience with an Asian technology company on water stewardship, which resulted in material financial savings.



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Workforce Disclosure Initiative workshop on coronavirus

Lead engager: Katie Frame

We co-hosted a thematic workshop on the changing landscape of human rights due diligence and workforce reporting in the context of Covid-19. Our co-host was the Workforce Disclosure Initiative (WDI), of which we are a signatory. The event allowed companies and investors to learn more about the WDI and speak candidly about the challenges and opportunities faced when conducting human rights due diligence.

We presented our engagement approach on human capital and labour rights and shared our engagement experiences of company actions as a result of the ongoing pandemic. We also discussed the best way to prepare for upcoming legislation on the topic and the links between company and investor due diligence. Over 60 participants joined the virtual workshop including a number of engagement company contacts.

Exploring the possibilities of digital IDs and blockchain for the supply chain

Lead engager: Christine Chow

We participated in a discussion organised by the PRI and the Ethical Council of Swedish National Pension Funds on how the decentralised ledger, or blockchain, could create an economic digital identity for workers upstream in the supply chain. These are often employed in the informal sector or on a seasonal basis, such as farmers and fruit pickers.

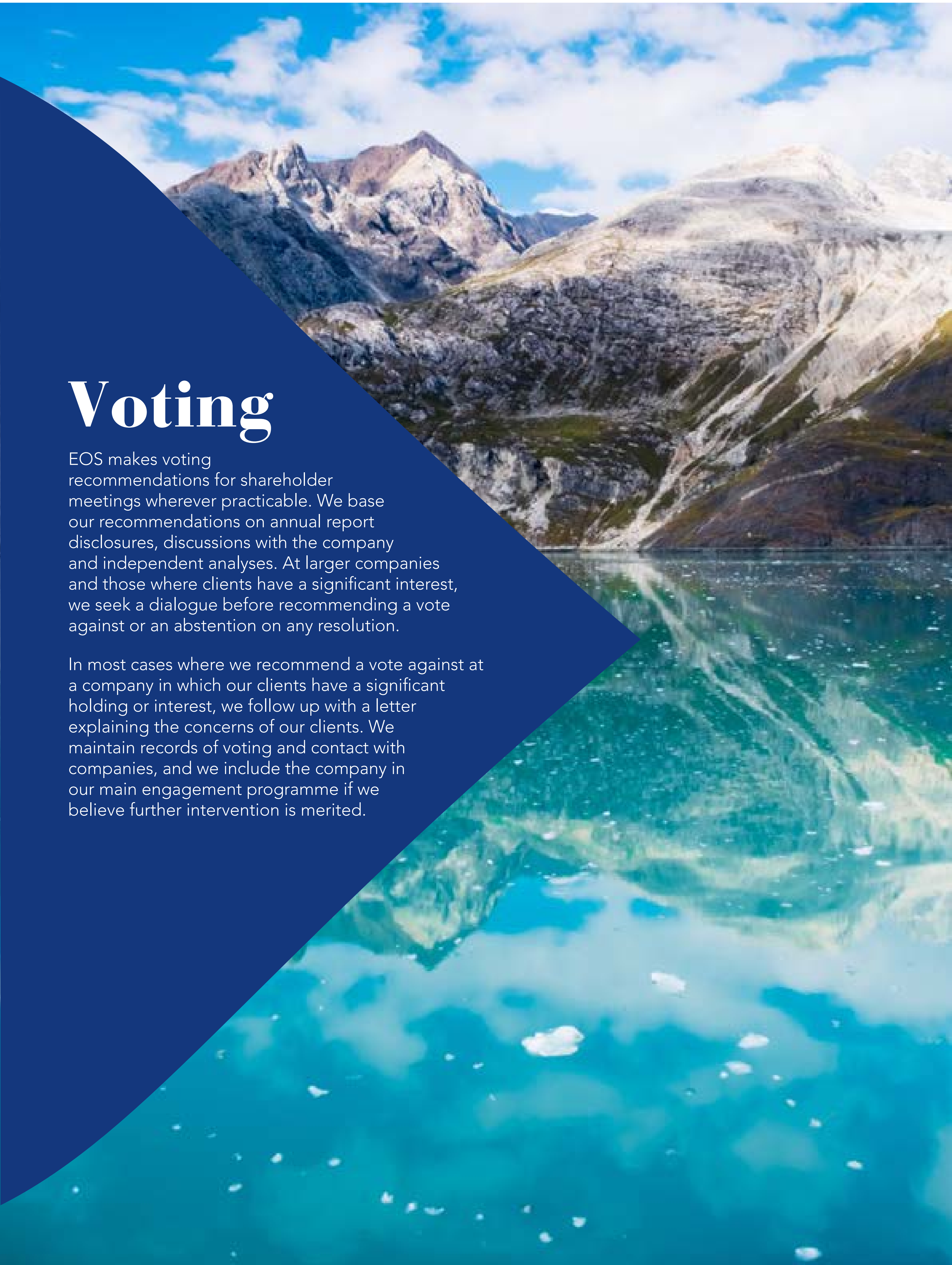
Private decentralised ledgers are organised around brands or companies that have an interest in ensuring supply chain transparency. This may include whether labourers and workers in the upstream supply chain get paid on time, or whether there is exposure to child labour. The personalised transaction history saved on the decentralised ledger – ideally controlled by individual workers and user-centric – could be a form of economic credit history that allows workers to gain access to services or other credit facilities.

We shared our experience of how national identity systems, such as those in Indonesia and India, could accelerate the implementation of digital IDs. However, it might be challenging in certain developed markets, such as the UK, where citizens are sceptical of digital ID systems accessible by the state. We explored whether digital IDs actually empowered the company or individuals, or both, such as through transaction history linking to households rather than individuals. The effectiveness of the system would depend on how business processes are set up and how consent to access of information is curated.

Voting

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

In most cases where we recommend 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.

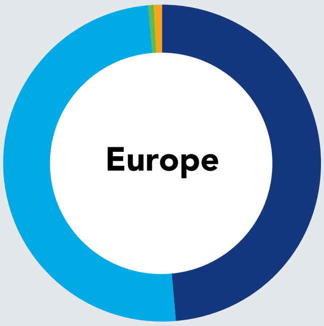


Voting overview

Over the last quarter we made voting recommendations at 1,952 meetings (16,827 resolutions). At 923 meetings we recommended opposing one or more resolutions. We recommended voting with management by exception at 43 meetings and abstaining at 11 meetings. We supported management on all resolutions at the remaining 975 meetings.

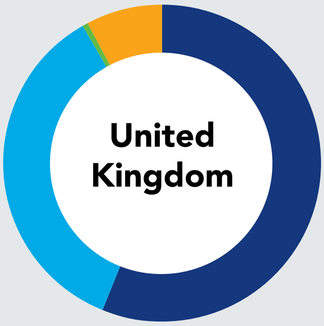
We made voting recommendations at **1,952** meetings (**16,827** resolutions) over the last quarter.

- Total meetings in favour **49.9%**
- Meetings against (or against AND abstain) **47.3%**
- Meetings abstained **0.6%**
- Meetings with management by exception **2.2%**



We made voting recommendations at **172** meetings (**2,161** resolutions) over the last quarter.

- Total meetings in favour **48.8%**
- Meetings against (or against AND abstain) **50.0%**
- Meetings abstained **0.6%**
- Meetings with management by exception **0.6%**



We made voting recommendations at **172** meetings (**2,448** resolutions) over the last quarter.

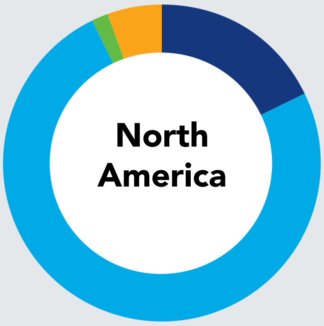
- Total meetings in favour **56.4%**
- Meetings against (or against AND abstain) **35.5%**
- Meetings abstained **0.6%**
- Meetings with management by exception **7.6%**

We made voting recommendations at **1,243** meetings (**9,419** resolutions) over the last quarter.

- Total meetings in favour **54.6%**
- Meetings against (or against AND abstain) **43.7%**
- Meetings abstained **0.4%**
- Meetings with management by exception **1.3%**

We made voting recommendations at **115** meetings (**853** resolutions) over the last quarter.

- Total meetings in favour **53.0%**
- Meetings against (or against AND abstain) **47.0%**



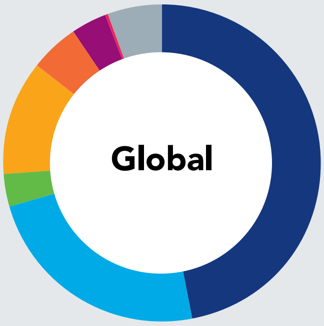
We made voting recommendations at **223** meetings (**1,850** resolutions) over the last quarter.

- Total meetings in favour **17.9%**
- Meetings against (or against AND abstain) **74.9%**
- Meetings abstained **1.8%**
- Meetings with management by exception **5.4%**

We made voting recommendations at **27** meetings (**96** resolutions) over the last quarter.

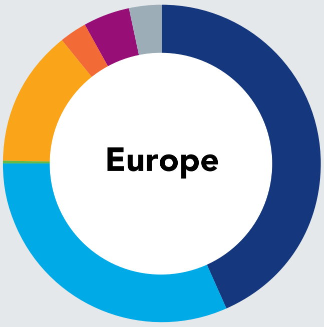
- Total meetings in favour **51.9%**
- Meetings against (or against AND abstain) **44.4%**
- Meetings with management by exception **3.7%**

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



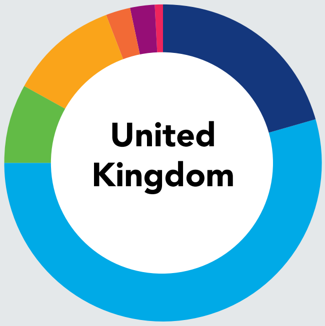
We recommended voting against or abstaining on **2,694** resolutions over the last quarter.

- Board structure **47.3%**
- Remuneration **23.6%**
- Shareholder resolution **3.3%**
- Capital structure and dividends **11.8%**
- Amend Articles **4.8%**
- Audit and Accounts **3.6%**
- Investment/MandA **0.2%**
- Poison Pill/Anti-Takeover Device **0.2%**
- Other **5.4%**



We recommended voting against or abstaining on **281** resolutions over the last quarter.

- Board structure **43.4%**
- Remuneration **31.7%**
- Shareholder resolution **0.4%**
- Capital structure and dividends **13.9%**
- Amend Articles **2.8%**
- Audit and Accounts **4.6%**
- Other **3.2%**

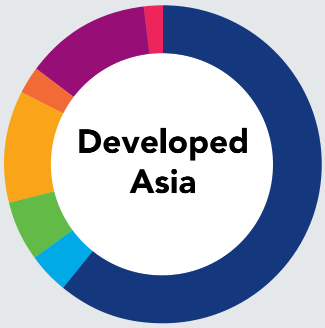


We recommended voting against or abstaining on **125** resolutions over the last quarter.

- Board structure **20.8%**
- Remuneration **54.4%**
- Shareholder resolution **8.0%**
- Capital structure and dividends **11.2%**
- Amend Articles **2.4%**
- Audit and Accounts **2.4%**
- Poison Pill/Anti-Takeover Device **0.8%**

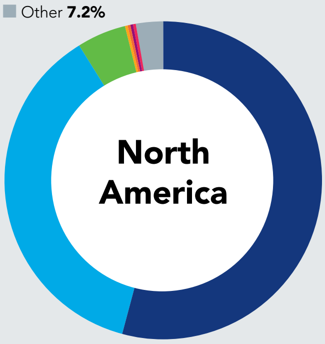
We recommended voting against or abstaining on **1,716** resolutions over the last quarter.

- Board structure **47.4%**
- Remuneration **17.4%**
- Shareholder resolution **2.8%**
- Capital structure and dividends **14.4%**
- Amend Articles **6.6%**
- Audit and Accounts **3.7%**
- Investment/MandA **0.3%**
- Poison Pill/Anti-Takeover Device **0.1%**
- Other **7.2%**



We recommended voting against or abstaining on **115** resolutions over the last quarter.

- Board structure **60.9%**
- Remuneration **4.3%**
- Shareholder resolution **6.1%**
- Capital structure and dividends **11.3%**
- Amend Articles **2.6%**
- Audit and Accounts **13.0%**
- Poison Pill/Anti-Takeover Device **1.7%**



We recommended voting against or abstaining on **437** resolutions over the last quarter.

- Board structure **54.2%**
- Remuneration **37.1%**
- Shareholder resolution **5.0%**
- Capital structure and dividends **0.2%**
- Amend Articles **0.2%**
- Audit and Accounts **0.2%**
- Poison Pill/Anti-Takeover Device **0.2%**
- Other **2.7%**

We recommended voting against or abstaining on **20** resolutions over the last quarter.

- Board structure **25.0%**
- Remuneration **60.0%**
- Capital structure and dividends **15.0%**

About EOS

EOS at Federated Hermes is a leading stewardship service provider. Our engagement activities enable long-term institutional investors to be more active owners of their assets, through dialogue with companies on environmental, social and governance issues.

We believe this is essential to build a global financial system that delivers improved long-term returns for investors, as well as better, more sustainable outcomes for society.

Engagement

We engage with companies that form part of the public equity and corporate fixed income holdings of our clients to seek positive change for our clients, the companies and the societies in which they operate.

Public policy

Engaging with legislators, regulators, industry bodies and other standard-setters to shape capital markets and the environment in which companies and investors can operate more sustainably.

Voting

We make recommendations that are, where practicable, engagement-led and involve communicating with company management and boards around the vote. This ensures that our rationale is understood by the company and that the recommendations are well-informed and lead to change where necessary.

Screening

We help our clients to fulfil their stewardship obligations by monitoring their portfolios to regularly identify companies that are in breach of, or near to breaching, international norms and conventions.

Advisory

We work with our clients to develop their responsible ownership policies, drawing on our extensive experience and expertise to advance their stewardship strategies.

The EOS advantage

- **Relationships and access** – Companies understand that EOS is working on behalf of pension funds and other large institutional investors, so it has significant leverage – representing assets under advice of US$1.1 trillion as of 30 June 2020. The team's skills, experience, languages, connections and cultural understanding equip them with the gravitas and credibility to access and maintain constructive relationships with company boards.
- **Client focus** – EOS pools the priorities of like-minded investors, and through consultation and feedback, determines the priorities of its Engagement Plan.
- **Tailored engagement** – EOS develops engagement strategies specific to each company, informed by its deep understanding across sectors, themes and markets. It seeks to address the most material ESG risks and opportunities, through a long-term, constructive, objectives-driven and continuous dialogue at the board and senior executive level, which has proven to be effective over time.

Engagements in this report

All of our engagements are 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 provides 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.

EOS team

Engagement

Dr Hans-Christoph Hirt
Executive Director, Head of EOS

Joanne Beatty
Sectors: Transportation, Consumer Goods, Industrial & Capital Goods

Dr Emma Berntman
Sectors: Retail, Pharmaceuticals & Healthcare

Roland Bosch
Sector lead: Financial Services

Hanah Chang
Sectors: Transportation, Financial Services, Technology Hardware

Dr Christine Chow
Team lead: Greater China
Sector lead: Technology

George Clark
Voting and Engagement Support

Emily DeMasi
Sectors: Retail, Financial Services, Pharmaceuticals & Healthcare

Bruce Duguid
Executive Director, Head of Stewardship, EOS

Katie Frame
Sectors: Retail, Pharmaceuticals & Healthcare, Technology Software

Gage Giunta
Sectors: Transportation, Consumer Goods, Industrial & Capital Goods

Diana Glassman
Sectors: Financial Services, Oil & Gas, Technology

Tim Goodman
Sectors: Oil & Gas, Technology Software

Jaime Gornsztejn
Team lead: Emerging Markets (ex-China)
Sector lead: Industrials & Capital Goods

Bram Houtenbos
Voting and Engagement Support

Laura Jernegan
Sectors: Retail, Financial Services, Oil & Gas

Andy Jones
Team lead: Continental Europe; Sector lead: Mining & Materials

Lisa Lange
Sectors: Transportation, Financial Services, Consumer Goods

Pauline Lecoursonnois
Sector lead: Consumer Goods

Kimberley Lewis
Sector lead: Pharmaceuticals & Healthcare

Sonya Likhtman
Sectors: Retail, Mining & Materials, Pharmaceuticals & Healthcare

Claire Milhench
Communications & Content

Ian Munroe
Voting and Engagement Support

James O'Halloran
Director of Business Management, EOS

Nick Pelosi
Sectors: Financial Services, Industrial & Capital Goods, Mining & Materials, Utilities

Marija Rompani
Sector lead: Chemicals

Hannah Shoesmith
Sectors: Transportation, Retail, Financial Services, Technology

Nick Spooner
Sector lead: Oil & Gas, Utilities

Sachi Suzuki
Team lead: Emerging Markets (ex-China)
Sector lead: Transportation

Sarah Swartz
Sectors: Consumer Goods, Retail, Pharmaceuticals & Healthcare, Utilities

Velika Talyarkhan
Sectors: Consumer Goods, Retail, Industrial & Capital Goods, Transportation, Utilities

Amy Wilson
Team lead: UK and Australia
Sector lead: Retail

Janet Wong
Sectors: Financial Services, Technology

Haonan Wu
Sectors: Transportation, Chemicals, Pharmaceuticals & Healthcare, Utilities

Tim Youmans
Team lead: North America
Sectors: Financial Services, Industrials & Capital Goods, Technology

Client Service and Business Development

Amy D'Eugenio
Director, Head of Client Service and Business Development, EOS

Alexandra Danielsson
Client Service

Rochelle Giugni
Client Service and Business Development

Charlotte Judge
Communications & Marketing

Alice Musto
Client Service

Federated Hermes

EOS

Federated Hermes

Federated Hermes is a global leader in active, responsible investing.

Guided by our conviction that responsible investing is the best way to create long-term wealth, we provide specialised capabilities across equity, fixed income and private markets, multi-asset and liquidity management strategies, and world-leading stewardship.

Our goals are to help people invest and retire better, to help clients achieve better risk-adjusted returns, and to contribute to positive outcomes that benefit the wider world.

All activities previously carried out by Hermes now form the international business of Federated Hermes. Our brand has evolved, but we still offer the same distinct investment propositions and pioneering responsible investment and stewardship services for which we are renowned – in addition to important new strategies from the entire group.

Our investment and stewardship capabilities:

- **Active equities:** global and regional
- **Fixed income:** across regions, sectors and the yield curve
- **Liquidity:** solutions driven by four decades of experience
- **Private markets:** real estate, infrastructure, private equity and debt
- **Stewardship:** corporate engagement, proxy voting, policy advocacy

Why EOS?

EOS enables institutional shareholders around the world to meet their fiduciary responsibilities and become active owners of public companies. 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.

For more information, visit **www.hermes-investment.com** or connect with us on social media: