EOS – Our approach to engagement

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 equity and fixed income 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.

Our Engagement Plan is client-led – we undertake a formal consultation process with multiple client touchpoints each year to ensure it is based on their long-term objectives, covering their highest priority topics.

Our services

- **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 convention.

- **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, enabling access and influence reflective of representing total assets under advice of over US$1.43tn as of 30 September 2023. 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 and executive management teams.

- **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 business risks and opportunities including environmental, social and governance issues, 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.
EOS focuses its stewardship on the issues with greatest potential to deliver long-term sustainable wealth for investors including through positive societal and environmental outcomes.

**Stewardship outcomes**

We believe the purpose of investment is to create wealth sustainably over the long term. Effective stewardship is the principal activity for institutional investors to deliver this for investors.

Good governance sets the foundation for managing long-term risks and creating value for stakeholders. We seek robust board oversight and management by companies of the most material long-term drivers of sustainable wealth creation affecting each company, as well as those systemic risks to long-term portfolio growth which cannot easily be mitigated through diversified investment strategies. When material and relevant, these factors should drive improved financial performance of individual companies to the benefit of investors\(^1\), consistent with the long-term fiduciary interests of our clients, and more sustainable outcomes for society.

The outcomes we seek include:

- **Governance** – effective boards composed of primarily independent individuals representing the diversity of stakeholders the company serves; the alignment of executive remuneration with the creation of long-term value while paying strictly no more than is necessary; developing a corporate culture that puts customers first and treats its stakeholders including employees and its supply chain fairly; and the establishment and protection of all material investor rights.

- **Strategy, risk and communications** – the clear articulation of a company’s purpose in order to deliver long-term value to all stakeholders, supported by a sustainable business model and strategy that addresses the needs of its different stakeholders; robust risk management practices to protect long-term value; and transparent, timely disclosures of reliable information sufficient for investors and wider stakeholders to make informed decisions on long-term investment.

As a consequence of responsible governance, we seek specific environmental and social outcomes aligned to the UN’s Sustainable Development Goals (SDGs). These include:

- **Climate change**: ensuring company strategies and actions are aligned to the goals of the Paris Agreement to pursue efforts to limit climate change to 1.5°C and demonstrating that business models are resilient and can adapt to future climate change.

- **Natural resource stewardship**: protecting, preserving and restoring natural resources and biodiversity by transitioning to sustainable food systems, avoiding antimicrobial resistance and managing water stress to enable more affordable access to food and clean water.

- **Circular economy and zero pollution**: controlling pollution of air, land and water to below harmful levels for humans and other living organisms and building a circular economy that avoids waste.

- **Human and labour rights**: respecting all human and labour-related rights linked to a company’s operations, products and supply chains, including through the provision of affordable essential goods and services to help reduce poverty.

- **Human capital**: improving human capital to achieve a healthy, skilled, and productive workforce inclusive of the full diversity of wider society, with access to fair and equitable pay and benefits, in the context of rapid technological disruption.

- **Wider societal impacts**: ensuring that a company adheres to the highest ethical standards, with zero tolerance of bribery or corruption, responsible payment of taxes and maximising the positive impacts of its products and services while reducing to the extent possible any associated harms.

Achieving sustainable wealth creation requires investors to become active owners, fulfilling their stewardship responsibilities by:

- Monitoring companies’ performance and identifying the most material issues to be escalated for action
- Engaging companies in pursuit of meaningful objectives, measuring and reporting on outcomes
- Exercising shareholder rights including voting on all relevant shareholdings
- Integrating stewardship insights into investment decisions

Where effective and efficient, investors should also work collectively in pursuit of shared objectives to improve outcomes for all.

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\(^1\) An example in the academic literature is from Chava (2014): “Environmental Externalities and Cost of Capital”, Management Science, 60(9), 2111-2380. Further practitioner examples are the research studies by Hermes Investment Management: “Pricing ESG risks in credit markets” and “Pricing ESG risk in sovereign credit” which are available at www.hermes-investment.com.
Our engagement plan

Our engagement is focused on ensuring companies are responsibly governed and well managed to deliver sustainable long-term value as well as improving the lives of employees, promoting diversity and supporting communities.

Our focus of engagement for 2024

In 2023, extreme weather-related events, ranging from wildfires in Canada and the Mediterranean, to floods in California and South Korea, served as stark reminders of the consequences of failing to limit climate change to 1.5°C. At the same time, the energy ‘trilemma’ which defined 2022 – managing climate risks while ensuring energy security and affordable access to energy – continued into 2023.

However, the US Inflation Reduction Act (IRA) of August 2022 underpinned an increase in renewable energy and clean tech investment and energy prices eased in many markets, helping to reduce inflationary pressures, although a ‘cost of living’ crisis persists in many markets. Geopolitical tensions remained heightened in 2023, with no sign of an end to the war in Ukraine and the destabilisation of the Middle East through the Israel-Gaza conflict. We continue to engage with companies on how they address geopolitical risks facing their businesses and their approach to safeguarding human rights in high-risk regions.

During the course of 2023, biodiversity and artificial intelligence (AI) continued to rise up policy makers’ and company and investor agendas, and we will continue to intensify our engagement on these topics.

The emphasis of our engagement remains focused on companies having a strategy and greenhouse gas emissions reduction targets aligned to the Paris Agreement.

Over the next year, we will continue our focus on the most material drivers of long-term value, with a focus on four priority themes:

**Board effectiveness:** In 2024 to enhance the quality of board performance, which is foundational to good corporate decision-making, we will focus on improving board diversity, including improvements to ethnic diversity that at least match the recent progress on gender diversity, with the goal to achieve representation reflective of the diversity of the stakeholders it aspires to serve. We remain committed to improving a board’s “software”, relating to how it functions, in addition to its “hardware”, relating to its composition and structure. The board should continuously monitor and assess the prevailing company culture to ensure it is in line with the company’s purpose, strategy and values.

**Climate change:** The emphasis of our engagement remains focused on companies having a strategy and greenhouse gas emissions reduction targets aligned to the Paris Agreement, seeking to limit climate change to 1.5°C, together with aligned financial accounts and political lobbying. The recent UN Emissions Gap report, which stated that greenhouse gas emissions must still fall by 28% by 2030 to achieve the Paris Agreement 2°C pathway, and 42% for the 1.5°C pathway, highlighted the urgency with which companies and governments must seek to limit and reduce greenhouse gas emissions. In seeking Paris Agreement-aligned transition plans, we will evaluate the credibility of company transition plans including their reliance on technologies and seek to ensure that the governance oversight of investments adequately tests risks and dependencies. We will also continue to engage with companies in high methane emitting sectors to deploy the best available technology to identify and mitigate methane emissions, continue to engage on physical climate risks and work towards a ‘just transition’ for employees and communities.

**Human and labour rights:** We expect companies to acknowledge the likelihood that human rights impacts are present within some operations and supply chains and to demonstrate appropriate board- and executive-level governance of human rights. We will further focus on the protection of indigenous and community rights, and human rights in high-risk regions such as disputed territories or areas of conflict.

We also continue our emphasis on supply chain rights with an elevated risk of forced labour, unsafe working conditions, and other adverse human rights impacts. We will further focus on the protection of digital rights in the virtual world, such as challenges to the right to data privacy, the right to freedom of expression and protection from unfair biases which

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2 The impact of the Inflation Reduction Act, one year on | Financial Times, August 2023.
4 OHCHR | UNGPs next 10 years project.
In addition to the above priority themes, we will continue to recommend voting against directors of companies where material breaches are not being adequately remediated or if the company lags on human rights benchmarks.

**Human capital:** Amid anxiety about negative AI impacts from redundancies to bias in hiring and the cost of living crisis driving renewed interest in collective bargaining, we are intensifying our engagement on upskilling workers. Furthermore, we will maintain our focus on diversity, equity, inclusion and representation; asking companies to develop a strategy and action plan to close the ethnic pay gap and achieve proportionate ethnic and gender representation at all levels. We will also challenge companies to consider an expanded range of diversity metrics beyond representation, including those related to engagement and sense of belonging, upskilling and advancement, and pay gaps for different groups and to report on workforce changes and wider employee engagement. Our engagement on health and safety will extend to mitigating climate related risks in the workplace (such as heat-stress) and continued focus on mental wellbeing and actions to halt continuing incidences of sexual harassment.

**Biodiversity:** We expect companies to address marine and terrestrial biodiversity loss across their value chains, in line with the COP15 mission to halt and reverse biodiversity loss by 2030. Given the high impacts and dependencies of the food system on biodiversity and ecosystem services, the retailing and production of food will remain a priority, as well as other sectors with significant impacts, such as mining and agrochemicals. We expect companies to reduce their impacts on biodiversity across the value chain, following the mitigation hierarchy, and aim for a net-positive impact on biodiversity as best practice. Depending on the specific company context, engagement will cover issues including deforestation, water-stress, regenerative agriculture, antimicrobial resistance (AMR), sustainable proteins and chemical runoff management. As we outlined in our white paper on biodiversity, published in February 2021, as a priority companies must identify, assess and measure their impacts and dependencies on biodiversity and ecosystem services, in line with the 2023 Taskforce on Nature-related Financial Disclosures (TNFD) recommendations. They should use the insights from the TNFD assessment to develop strategies, targets and actions plans focused on their most material risks and impacts.

**Digital rights and AI:** We will continue to engage companies on our Digital Rights Principles (2022), which outline our expectations for responsible development and deployment of AI. Digital products and services can play a critical role in strengthening human rights, but have also brought unanticipated harms and new challenges. We will engage companies on negative societal impacts including problematic content on social media; reinforcement of unintended bias; and health and safety impacts on children and youth. We expect companies to balance freedom of expression with obligations to remove problematic content and take actions to respect privacy rights online. While the accelerating deployment of AI is creating new opportunities for companies, it also brings with it the potential for workforce disruption, regulatory infraction or reputational damage, and we will be engaging with companies on how they mitigate these risks.

The above represent particular priorities in the years ahead. However, we continue to maintain a comprehensive engagement plan covering a broad range of other themes, including responsible tax practices, increasing resource efficiency through the circular economy, reducing all forms of harmful pollution and seeking positive wider societal outcomes through increased corporate responsibility.

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1 Race, Gender, and LGBTQ+ wage gaps are real — and they end up costing us all | DiversityJobs.com
2 Our Commitment to Nature
3 The Taskforce on Nature-related Financial Disclosures (TNFD) launches its final recommendations | UNEP Finance Initiative
4 EOS Digital Rights Principles
5 Our Taskforce on Nature-related Financial Disclosures (TNFD) recommends | UNEP Finance Initiative
6 The Taskforce on Nature-related Financial Disclosures (TNFD) launches its final recommendations | UNEP Finance Initiative
7 EOS Digital Rights Principles
The Engagement Plan’s support for the UN Sustainable Development Goals

The UN’s 2030 agenda for sustainable development sets out 17 goals and 169 underlying targets, providing a blueprint for a sustainable world. The goals call for action by all countries to promote prosperity, economic growth and address social needs while also protecting the natural environment and have been adopted by all UN member states. Our view is that the long-term success of businesses and the success of the SDGs are inextricably linked. The SDGs help create a more sustainable economy in which businesses can thrive. Similarly, the contribution of businesses seizing market opportunities in line with the goals is vital to delivering the economic growth that is necessary to achieve them.

Our stewardship work has always focused on improving the sustainability of companies, to boost long-term wealth creation and achieve positive outcomes for society. We therefore believe that all of our engagement work is aligned to the delivery of the SDGs either directly or indirectly.

There is no universally accepted standard or benchmark for reporting on the SDGs, therefore, we have developed our own approach in alignment with our Engagement Plan. This attributes a direct link between one of our engagement themes and an SDG if we believe our engagement objective at a company directly supports at least one of the UN’s targets underpinning the relevant goal or is aligned with the spirit of the goal. It does not include in our reporting the many engagements which would more indirectly support the ambition of other SDGs or corporate governance more broadly.

Here are some examples of our engagement in support of the SDGs:

- **SDG 3 Good health and wellbeing:** we engage across the pharmaceutical and healthcare sector on access to medicines and healthcare to support this goal.
- **SDG 5 Gender equality:** we engage to improve gender equality and increase female representation across all levels of organisations, in particular at board and executive leadership levels.
- **SDG 7 Affordable and clean energy:** much of our work under the climate change theme supports this goal, in particular, efforts to increase plans to invest in or purchase renewable energy.
- **SDG 8 Decent work and economic growth:** our engagement on human capital management and human rights in the supply chain supports this goal, particularly by addressing equal pay, labour rights, and health and safety concerns and child and forced labour issues.
- **SDG 10 Reduced inequalities:** engagements on diversity, equity and inclusion support this goal by addressing the needs of disadvantaged and marginalised populations.
- **SDG 12 Responsible consumption:** work to improve energy or natural resource efficiency, including efforts to build a circular economy, support this goal.
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Proportion of issues and objectives engaged in 2023 linking to the SDGs

The chart below illustrates the number of engagement objectives and issues on which we have engaged in the last year, which we believe are directly linked to an SDG (noting that one objective may directly link to more than one SDG). Of the issues and objectives engaged in 2023 were linked to one or more of the SDGs.

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<th>SDG</th>
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9 1-year rolling data up to 14th December 2023.
We address the following themes in our Engagement Plan, covering corporate governance, strategy, risk management and communication, environmental and social issues. We include a summary of the long-term outcomes we seek and examples of the near-term corporate objectives we pursue at individual companies and, more broadly, to improve public policy and market best practice. These example objectives are indicative of those set at individual companies, but each would be prioritised and tailored to the circumstances of the company.

**Corporate governance themes**

- **Board effectiveness**
  - The performance of the board is vital to the long-term success of a company, with a range of factors contributing to this. Boards should be composed of directors with technical skills aligned with the strategic needs and direction of the company and a diversity of perspectives (including across gender, age, race and ethnicity, sexual orientation, nationality, background, skills, experience and personality) to improve decision making. Equally important is that boards contain enough independent directors to challenge management and that directors can dedicate sufficient time to fulfil their duties.

  Board effectiveness also requires robust supporting structures and processes, such as a proper induction upon appointment and ongoing training, a separate chair and CEO with clearly defined responsibilities. For committees to be effective, they should have access to accurate, timely and clear information and members should possess an appropriate level of expertise, particularly in the case of financial experts on audit committees. An effective board should be involved in constructive dialogue with investors, the workforce and other key stakeholders. It should also be subject to regular independent evaluation. Furthermore, boards must take responsibility for the ethical culture of a company.

- **Corporate engagement**
  - The long-term outcomes we seek include: a diverse board composition aligned to the strategic needs of the company, reflective of the diversity of the stakeholders it aspires to serve, including employees and customers; effective boards with meaningful participation of all members and appropriate allocation of time, verified by independent evaluation; and structured succession planning in place, accounting for strategic changes and unexpected situations.

  Near-term corporate objectives include: additional female directors appointed with the goal of achieving at least 30% women on the board, or higher in relevant markets, with interim goals in place depending on the market context, such as at least 20% women on the board in Brazil and China, and at least one woman on the board in South Korea; board composition assessed to consider and improve ethnic diversity and racial equality; additional independent directors appointed to achieve at least 50% independence at dispersed ownership companies and 30% in concentrated ownership companies; improved focus on aspects of a board’s “software” (rather than “hardware”), including the allocation of time to strategic versus operational issues; independent board evaluation conducted at least every three years, including an assessment of board dynamics and culture; and disclosure of succession processes including diversity and skills considerations and the application of the nomination policy.
Public policy and market best practice

We will continue to promote our Guiding Principles for an Effective Board paper in different markets via conferences and local market best practice engagement. We support initiatives to promote board gender diversity, including initiation of local chapters of the 30% Club. We will advocate for minimum levels of racial and ethnic diversity, as well as encouraging improved disclosure and ethnicity pay gap reporting, in local corporate governance codes and authoritative guidelines. We have developed corporate governance principles and regional public voting guidelines available on the EOS library page of our website, which set out our fundamental expectations of the companies our clients invest in.

Executive remuneration

Pay structures are a critical tool for aligning the activities of management with a company’s purpose, strategy and incentivising long-term value creation, including maintaining its social license to operate. In some markets, we believe that compensation structures and practices are generally not fit for purpose. Widening income inequality, exacerbated by the global cost of living crisis and uneven post-pandemic recovery must be addressed by challenging boards’ justifications of executive remuneration structures. The coronavirus pandemic demonstrated the limitations of pay schemes reliant on stock options or performance-based incentives schemes and the challenges in setting appropriate performance metrics. We believe pay outcomes should reflect outcomes for long-term investors and take account of falls in company value or reputation – this is best or most straightforwardly achieved through share ownership. We therefore wish to see simpler, more transparent pay schemes with the reduction of variable to fixed pay ratio, paid primarily in shares held for the long term.

Corporate engagement

The long-term outcomes we seek include: simple, understandable pay schemes that incentivise delivery of long-term sustainable value; clear disclosure explaining the nature and appropriateness of awards; and fair levels of pay that clearly align with performance and can be justified to employees, investors and other stakeholders.

Near-term corporate objectives include: clear demonstration of the link between remuneration, long-term strategy and alignment to culture; alignment of incentive plans to the strategic drivers of long-term value, rather than overreliance on relatively short-term measures such as total shareholder returns or earnings; increased minimum executive shareholdings; simple pay structures, seeking at most two forms of concurrent variable pay schemes; full disclosure of pay structures, including measurable metrics and potential award size; and clear and timely reporting of targets, performance and pay outcomes, enabling investors to judge the appropriateness of awards.

Protecting and supporting shareholder rights is critical to the long-term success of companies, as it ensures that companies remain accountable to long-term investors.

Public policy and market best practice

In the US and UK, we will work with groups such as the US Council for Institutional Investors and the UK Corporate Governance Forum to set best practice guidelines for higher shareholdings, reduced variable pay and the adoption of restricted stock models. In Europe, we will encourage further alignment on higher shareholdings and greater disclosure of pay structures and outcomes, particularly in France, Sweden and Denmark. In Asia and emerging markets, our focus is on improving disclosure, demonstrating a clear link between pay and performance and discouraging use of share options, particularly in China and Hong Kong.

Investor protection and rights

Protecting and supporting shareholder rights is critical to the long-term success of companies, as it ensures that companies remain accountable to long-term investors. Shareholders exercise control over the future direction of a company through rights such as the ability to elect directors annually; propose candidates for election to the board, sometimes referred to as proxy access; proposing shareholder resolutions (whether advisory or legally binding) receive notice of and attend annual shareholder meetings; and express views on proposed changes to the constitution and articles. It is also important to protect minority rights of investors, through measures such as: the avoidance of anti-takeover defences, such as poison pill arrangements; the elimination of strategic cross-shareholdings between companies (common in Japan and emerging in South Korea); and avoiding dual or multiclass share structures with unequal voting rights.
Corporate engagement
The long-term outcomes we seek include: the protection of shareholder rights to ensure confidence to invest capital over the long term with favourable returns; the protection of minority shareholder rights to ensure confidence to invest in companies controlled by larger shareholders; and good access for investors to boards and management, so as to influence companies to act in their long-term interests.

Near-term corporate objectives include: establishment of a regular dialogue between shareholders and non-executive directors; the removal of anti-takeover (poison pill) arrangements; the reduction or elimination of strategic shareholdings by Japanese or South Korean companies; and the promotion of the one-share, one-vote principle, especially including at times of major change at the company, such as a change of control of ownership or major capital raising.

Public policy and best practice
We will continue to: oppose proposals to allow listing of companies with multi-class share structures at global stock exchanges; press Japanese regulators for tighter disclosure requirements on cross-shareholdings; advocate for the US Securities and Exchange Commission to regulate proxy advice in a way that could increase the independence of such research; and encourage and support implementation of ambitious stewardship codes and effective EU member state transposition of the amended Shareholder Rights Directive.

The outcomes we seek from our CPEP participation is a purpose due diligence framework for investors that can be tested in the Canadian market as a model for global engagement on business purpose.

Strategy, risk and communication themes

Business purpose, strategy and policies
This theme covers all aspects of how a company creates and preserves value over the long term. It includes business purpose, long-term strategy and sustainable business model, and capital allocation policy. Together these guide a company’s key choices around how to deploy limited resources, including financial and human capital, curb unsustainable business practices as well as its chosen operating behaviours and underlying culture.

Corporate engagement
The long-term outcomes we seek include: an enduring business purpose that explains why the company exists and how it meets the needs of society profitably; a long-term strategy and sustainable business model that creates and preserves value for shareholders and wider stakeholders by delivering positive societal outcomes; and a capital allocation policy that takes into account expectations of long-term financial stakeholders for appropriate capital management and optimising of returns, with a transparent, sustainable approach to dividends and investment serving the long-term interests of both bond and equity investors.

Near-term corporate objectives include: a published statement of purpose that defines the company’s business purpose (why it exists) and which identifies the stakeholders most critical to long-term value creation; a long-term strategy and sustainable business model (including forward-looking metrics and indicators) which shows how the company’s stated purpose is operationalised, including how it delivers positive societal outcomes and long-term value to its critical stakeholders; a published capital allocation policy that includes policies pertaining to research and development; mergers and acquisitions; reinvestment in company growth; dividends and buybacks; and debt retirement.

Public policy and market best practice
We are participating in the Canadian Purpose Economy Project (CPEP,) and its emerging Investor Purpose Action Group to continue to drive thought leadership in corporate business purpose and leverage our findings from the Enacting Purpose Initiative. The outcomes we seek from our CPEP participation is a purpose due diligence framework for investors that can be tested in the Canadian market as a model for global engagement on business purpose. We will continue to support development of alternative corporate structures that explicitly mandate the consideration of key stakeholders alongside shareholders such as a B Corporation or Public Benefit Corporation.

Corporate reporting
Corporate reporting covers all aspects of reporting by companies to their stakeholders, whether financial or nonfinancial information, statutory or voluntary. High-quality, consistent, comparable and decision-useful reporting of company information and data is essential to enable shareholders and other stakeholders to understand and assess the companies in which they have an interest and to measure performance over time. Over the last decade, we have seen an increase in voluntary and mandatory reporting frameworks such as the UN Sustainable Development Goals (SDGs), the International Sustainability Standards Board (ISSB) standards (which fully incorporate the recommendations of the recently disbanded Task Force on Climate-related Financial Disclosures (TCFD)), the Global Reporting Initiative (GRI), and Taskforce on Nature-related Financial Disclosures framework (TNFD), and the Sustainability Accounting Standards Board (SASB) standards. Further regulatory requirements for enhanced non-financial reporting are expected.
Corporate engagement

The long-term outcomes we seek include: timely, reliable and comprehensive reporting which enables investors and other stakeholders to accurately appraise past performance and future prospects of a company; comprehensive and periodic reporting of all material elements of a company’s impact on wider society and the extent to which it meets societal expectations and explains how value is created over the short, medium and long term.

Near-term corporate objectives include: the adoption of prudent accounting standards; ensuring best practices in independence and quality including audit tendering and rotation; sustainability reporting aligned to best practice standards and frameworks such as the ISSB and SASB standards, GRI, CDP and TNFD recommendations; and analysis of how corporate activity is aligned to delivery of the UN SDGs.

Public policy and market best practice

We will continue to: support the development and adoption of standardised reporting frameworks applicable to the most material long-term value areas, with particular emphasis on human capital, such as through the WDI; and encourage the development of standards and frameworks on social issues that are on par with those available for environmental matters.

The management of risk is essential to creating and preserving sustainable long-term value.

Risk management

The management of risk is essential to creating and preserving sustainable long-term value. Geopolitical actions; economic fluctuations; the impacts of the Covid-19 pandemic; regulatory developments; and ESG expectations on items including climate, cybersecurity, human capital, and company culture all pose a risk to companies today. A failure to identify, analyse and manage emerging and existing risks is a threat to all businesses, and the nature of systemic, long-term, and interconnected risks have increased the attention to risk management by companies and their shareholders.

At the core of each risk are outcomes which may have varying levels of impact on stakeholders such as customers, employees, communities, regulators, and shareholders. A board and management team must first articulate to investors the level of risk appetite, and then monitor and manage risks within this boundary. Management has the responsibility to implement an effective risk management framework, designed to identify, assess and manage the company’s strategic, operational, compliance (including legal and regulatory risks) and financial risks.

Corporate engagement

The long-term outcomes we seek include: risks assessed from the perspective not only of financial impact, but also maintenance of a social licence to operate, which is underpinned by a corporate purpose centred on being sustainably creating long-term stakeholder value; an effective risk management framework, designed to identify, assess and manage the company’s strategic, operational, compliance and financial risks; a culture that seeks to apply the board’s chosen risk appetite and which is established across all parts of the organisation; a board oversight mechanism for cyber security risks with response strategies in different scenarios, as well as compliant disclosure if systems are materially compromised.

Near-term corporate objectives include: an authentic business purpose should aid in developing an organisation’s risk profile, be embedded into risk management and be communicated externally and embedded internally with the board and senior management putting purpose into practice through the company’s strategy; a risk management framework which reflects the activities and complexities of the business; the board and senior management, in their respective roles set clear expectations for the culture of the organisation with specific reference to the firm’s overall risk appetite.

We will continue to support the PRI’s collaborative initiative on cyber security, which evaluates cybersecurity disclosure against 14 indicators.

Public policy and market best practice

We will continue to provide input to policy which seeks to understand the specific process and disclosure for emerging risks. We will continue to support the PRI’s collaborative initiative on cyber security, which evaluates cybersecurity disclosure against 14 indicators.
Themes

Environmental themes

Climate change

Climate change poses one of the greatest threats to society and the economy. Global emissions must reduce to net zero by 2050 to limit temperature increases to 1.5°C above pre-industrial levels to avoid the worst impacts of climate change, with every avoided fraction of warming above this being critical. The delayed action by society, governments and companies has meant that instead of peaking, emissions have continued to rise and average temperatures have already increased by over 1.2°C since pre-industrial levels because of human activity. Society must dramatically reduce emissions over the next decade, by 40-50% compared to 2010 levels, to avoid the risk of catastrophic climate change.

The required pace of transition brings many risks, as well as opportunities, to traditional business models through new forms of competition, regulation, and physical risks. This is already affecting many sectors including the energy sector, with coal-based utilities being replaced by renewables; the transportation sector, with the shift to electric vehicles; the finance sector, with many investors now committing to achieve net-zero emissions in their investment portfolios; and the consumer goods and retail sectors, with a transition to more sustainable sources of food, sustainable land use, and zero deforestation; and the real estate sector, which indirectly accounts for around 30% of greenhouse gas emissions but has the potential to substantially reduce its impact.

Society must dramatically reduce emissions over the next decade, by 40-50% compared to 2010 levels, to avoid the risk of catastrophic climate change.

Corporate engagement

Long-term outcomes we seek include: all companies to have a business model consistent with net-zero emissions and an effective transition plan to achieve this by 2050 or sooner, with emissions reduction in line with 1.5°C; a business model and asset base that are resilient to future climate change and associated physical risks; and board ownership of business purpose, strategy, public policy and lobbying position, each consistent with the goals of the Paris Agreement, together with full disclosure of progress.

Near-term corporate objectives include: development of a strategy consistent with the goals of the Paris Agreement, including that each new material capex investment is consistent with the Paris Agreement goals; science-based emissions reduction targets for Scope 1 and 2 and relevant and material Scope 3 emissions; assessment of exposure to the physical risks of climate change and development of adaptation and action plans to manage these risks; a public policy position supportive of the Paris Agreement goals and alignment of both direct and indirect lobbying activity by member industry associations; board oversight and understanding of climate risks and opportunities including ensuring a just transition; and adoption and implementation of the TCFD recommendations.

Public policy and market best practice

We will continue to focus on leading development of best practices in investor stewardship on climate change with particular input to the evolution of the Climate Action 100+ collaborative engagement on climate change. We will help to design toolkits for net zero-aligned investor stewardship, template shareholder resolutions and develop summaries of investor expectations in new areas, such as climate change and financial services. We will work with investor groups to encourage accounting standards boards and large audit firms to ensure that financial impacts of climate strategy and targets are clearly reflected and identified in the annual audited accounts. We will also support effective policy making aligned to the goals of the Paris Agreement, including support of net-zero greenhouse gas emissions reduction targets by national governments.

Natural resource stewardship

Our societies and economies depend on the availability and continued supply of natural resources and ecosystem services. However, climate change and unsustainable land use, amongst other drivers, are causing the depletion of natural capital. One million species are at risk from extinction, there is increased incidence of drought and water stress, and significant environmental impacts occur from the current food system. This theme covers all aspects of the protection, preservation and restoration of natural resources, including marine and terrestrial biodiversity, water, healthy soils, oceans and other ecosystems. It also highlights the importance of transitioning to sustainable food systems and taking measures against AMR, through diversification from animal to plant-based and sustainable protein. In addition to this, animal welfare and living conditions are important levers to reduce disease occurrence and spread, thereby minimising antimicrobial use.

Climate Indicators – Temperature 2022 | Copernicus.
Real estate industry must tackle carbon emissions | Capital Monitor, April 2023.
Our Commitment to Nature (hermes-investment.com).
Corporate engagement

Long-term outcomes we seek include: the protection and restoration of biodiversity, including the ambition to have a net-positive impact on biodiversity, and the long-term rehabilitation of landforms, such as tropical rainforests; sustainable oceans; sustainable food systems, including supply and demand that supports a growing global population within planetary boundaries; decreased rate and spread of AMR; and access to clean water for all.

Near-term corporate objectives include: assessment of impacts and dependencies on biodiversity and ecosystem services in line with the TNFD recommendations; strategies and targets to reduce impacts on biodiversity throughout company value chains, following the mitigation hierarchy; strategies to eliminate contributions to deforestation and high impact feedstocks (eg, palm oil, soy, beef) sustainably; a long-term sustainable food strategy and supporting targets, including diversification from animal to plant-based protein, transition to regenerative agriculture and a plan to address AMP; and ambitious strategies to manage water use in operations and the supply chain, especially in water-stressed areas.

Public policy and market best practice

We are a founding member of the newly launched Nature Action 100 collaborative engagement initiative. Federated Hermes Limited is a signatory of the Finance for Biodiversity Pledge, which enables EOS to continue to collaborate and share knowledge with financial sector peers on halting and reversing biodiversity loss. We will continue engagement and collaboration with the FAIRR network on sustainable use of antibiotics within animal farming and protein diversification. EOS has been appointed to the PRI Nature Stewardship Advisory Committee, which will initially focus on engaging with companies on their lobbying activities linked to deforestation and we will continue to participate in a range of collaborative investor initiatives that are focused on tackling deforestation including being a signatory to the Investors Policy Dialogue on Deforestation (IPDD). Additionally, we are signatories to Ceres’ Valuing Water Finance Initiative through which we will engage with companies in high-risk water sectors collaboratively with financial sector peers.

Circular economy and zero pollution

There is increasing need and opportunity for a shift from linear to circular business models, which is central to futureproofing businesses and reducing negative impacts on the environment. Key areas of concern are plastics pollution, fast fashion, food waste and electronic waste. In the context of energy transition, circularity of metals and minerals, such as cobalt or lithium, will be a vital pillar and potentially reduce the risks of deep-sea mining. Environmentally harmful pollution and waste, whether from operations, supply chains or products is inconsistent with a long-term sustainable business model. Investor concerns, reflecting the threat of fines and loss of social licence to operate, as well as the harm done to wider society and investments including persistent chemicals such as per- and polyfluoroalkyl substances (PFAS), air pollution, synthetic pesticides, the leakage of single-use plastics and chemicals into waterways and catastrophic oil spills or tailings dam leaks is rising.

Key areas of concern are plastics pollution, fast fashion, food waste and electronic waste.

Corporate engagement

Long-term outcomes we seek include: the establishment of fully circular business models which capture all materials, leading to zero waste; the prevention of contamination of the environment by harmful substances; and the avoidance of all industrial disasters such as oil spills, nuclear accidents and dam failures.

Near-term corporate objectives include: development of closed loop strategies to reduce net consumption of materials through smart product design and innovation; use of substitute materials that are commonly recycled or reused and have lower environmental impact; development and implementation of best practice strategies for harmful substance management or catastrophic spills.

Public policy and market best practice

We will seek to improve investor engagement on this theme by promoting investor expectations on plastics and packaging in the chemicals, consumer goods and retail sectors, and on fast fashion in the apparel sector; encouraging companies to sign up to the Ellen MacArthur Foundation New Plastics Economy Global Commitment; continuing to be an active member of the PRI Circular Economy Reference Group; continuing to support ambitious policies on harmful chemicals and to request a phase out strategy by top chemical producers with disclosure on the toxicity of their portfolio, through direct and collaborative engagements and as a Steering Committee member of the Investor Initiative on Hazardous Chemicals; and encouraging mining companies to follow best practice tailings management and other pollution controls of the International Council on Mining and Metals.
Social themes

Human capital

The nature of work is rapidly evolving and our engagement on workforce issues remains nimble to respond to its everchanging environment. In recent years, worker voice and unionisation efforts have grown exponentially. Racial equity and gender equality continue to evade our workforces, and persons with disabilities often struggle to be included. The backdrop of all these challenges is the global rise in cost of living that is hitting our most vulnerable populations disproportionately, amid anxiety about negative AI impacts from bias in hiring to redundancies. Our engagement focuses on all these aspects of employment and the future of work.

The launch of the UN SDGs provided leverage through three goals in pursuit of gender equality, reduced inequalities and decent work and economic growth. Important aspects of successful human capital management include: diversity, equity and inclusion (DEI); freedom of association, fair wages, incentives and benefits; types of employment contract; health, safety and wellbeing; employee engagement and culture; and employee skills and training.

Racial equity and gender equality continue to evade our workforces, and persons with disabilities often struggle to be included.

Corporate engagement

The long-term outcomes we seek include: representation and inclusion throughout the organisation across all dimensions of diversity; equitable outcomes and upward mobility; fair wages and benefits paid so all employees can afford a decent living standard; zero serious work injuries and an emphasis on physical and mental wellbeing.

Near-term corporate objectives include: a strategy and action plan to close the gender racial and ethnic, sexual orientation, disability and other DEI pay and upward mobility gaps, particularly at DEI intersections, and achieve appropriate representation at all levels of an organisation; commitment to a safe and inclusive culture, including eliminating sexual harassment and discrimination and implementation of robust processes to examine and remediate issues; implementation of a minimum real living wage across operations and the supply chain or evidence of an equivalent total reward package similarly valued by employees; a policy that permits freedom of association of workers in trade unions and protects labour rights recognised by the International Labour Organization; commitment to provide sufficient paid sick leave; and development and implementation of a human capital management strategy for the promotion of best practice physical and mental wellbeing in the workplace.

Public policy and market best practice

We support stakeholder collaboration to define useful standards, through active contribution to initiatives such as the Workforce Disclosure Initiative and the US Human Capital Management Coalition. We will also support stakeholder initiatives that enable living wage certification for employers like the UK Living Wage Foundation and Living Wage for the US, as well as government-backed initiatives to increase the diversity of executive management, such as via the local chapter of the 30% Club, with a focus on developing markets.

Human and labour rights

Companies have a duty to respect human rights and they also underpin a company’s wider corporate culture, business ethics, and enterprise risk management, all of which affect reputation and ability to create and preserve long-term holistic value. We expect companies to acknowledge the likelihood that human rights impacts may be present within operations and supply chains and demonstrate appropriate board- and executive-level governance of human rights. Policies and procedures to address human rights should be aligned with the UN Guiding Principles on Business and Human Rights (UNGPs). Human rights due diligence should be dynamic and include identification of salient human rights risks; human rights impact assessments; strategy to prevent, mitigate and address impacts; and provision of remedy. We expect human rights to continue to be a key consideration for stewardship and engagement globally and we focus on basic human rights, supply chain labour rights, digital rights, indigenous and community rights and high-risk regions.

15 New report lays bare the realities of the cost of living crisis for families on low income | University of York, October 2023.
Corporate engagement
The long-term outcomes we seek include: no company causing or contributing to human or labour rights abuses whether in their own operations or supply chain and effective remedy is provided in case of any harm; access for all people to basic human needs such as affordable finance, healthcare, and nutrition; full respect for human rights of all indigenous people, and in high-risk regions such as occupied territories; and respect for online privacy rights, online freedom of expression, and mitigation of negative societal impacts of digital products and services.

Near-term corporate objectives include: Expanding financial, healthcare and nutrition-related services to underserved populations; carrying out dynamic due diligence across supply chains to identify impacts such as forced labour, modern slavery, child labour, non-payment of living wages and gender-specific issues (e.g., lower pay, vulnerability to exploitation) and facilitating supply chain grievance mechanisms which incorporate true worker voice and ensure access to remedy; obtaining user consent for the collection, inference, sharing, and retention of user data; demonstrating the presence of agreements that indicate communities’ free, prior and informed consent (FPIC) in relation to proposed developments, including physical and economic displacement, that may impact communities and ensuring access to remedy with accessible, functioning, and transparent grievance mechanisms; and enhancing human rights due diligence processes for operations and supply chains related to the high risk geographies and prioritising stakeholder engagement including from vulnerable and marginalised populations to promote positive human right outcomes.

Public policy and market best practice
We will continue to promote adoption of policies and norms in support of our published Digital Rights Principles16, which outline our expectations for boards and management with respect to human rights specific to digital products and services. We continue to contribute to discussions concerning best practice with regards to FPIC. We lead or support collaborative engagement on human rights within the PRI Advance initiative, which aims to use investor stewardship to achieve positive human rights outcomes. We also continue to incorporate human rights considerations into our voting policy in which we consider recommending votes against directors at companies deemed to lag behind peers on human rights performance.

Wider societal impacts
Companies have enormous impacts on society through their products, services, and practices. It is our strong belief that companies can only create and preserve long-term value for investors if they provide goods and services that satisfy pressing societal needs. When goods and services cause harms, these are often not properly priced or compensated in society, eroding sustainable wealth creation, and possibly accruing future corporate liabilities. Therefore, we expect companies to carefully monitor the impacts their products and services have on wider society, ensure these are as positive as reasonably practicable and take rapid steps to mitigate and remEDIATE any known harms.

Corporate engagement
Long-term outcomes we seek include: demonstration of robust business strategy alignment to material UN SDGs and addressing negative impacts as well as measuring and disclosing positive impacts; corporate decision-making taken through an ethical lens, with development and maintenance of the highest ethical standards; an end to corporate bribery and corruption and other non-compliance; safety features and responsible sales practices that avoid societal harms of product and services; and tax paid responsibly, putting an end to tax arbitrage and aggressive tax avoidance.

It is our strong belief that companies can only create and preserve long-term value for investors if they provide goods and services that satisfy pressing societal needs.

Near-term corporate objectives include: A linkage of material SDGs to business strategy and performance goals; a public statement and board responsibility to aspire to the highest ethical standards; clear strategy for responsible sales of harmful products, covering areas such as consumer warnings, restrictions on sales to minors; and a policy commitment to pay tax in each country in line with the spirit and intention of the law.

Public policy and market best practice
We support the development of market best practices recommended by reputable corporate ethics organisations such as the Institute of Business Ethics and anti-bribery and corruption organisations such as Transparency International. We will continue to advocate public policy efforts at an international level and individual country levels to achieve greater tax transparency.
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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, where possible, to contribute to positive outcomes that benefit the wider world.

All activities previously carried out by Hermes Investment Management are now undertaken by Federated Hermes Limited (or one of its subsidiaries). We still offer the same distinct investment propositions and pioneering responsible investment and stewardship services for which we are renowned – in addition to important 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

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