A road map for engagement – the Stewardship Code

- Seven principles
- Comply or explain
- 290 signatories
- Focus on UK listed equities
- 90% of pension funds have policy
Emerging from the mist

- Focus on corporate governance (remuneration)
- Board composition & strategy
- Proactive engagement
The swampy lowlands of engagement

- Signed up ‘in name only’
- Focus on large companies only
- Conflicts of interest
And the broad sunlit uplands

- Collective engagement
- Importance of long-term holding periods
- Measuring and reporting impact
Investor engagement: Challenges and opportunities
Yo Takatsuki

14 February 2014
Responsible investment

Leadership
- Europe’s first ethical fund in 1984 and investor engagement service in 2000
- 23 external engagement clients, €100 billion assets in advice

Expertise
- Dedicated in-house Governance and Sustainable Investment (GSI) team of experts conducts all ESG research and engagement

Global coverage
- Engagement with over 700 companies in 50 markets on key ESG issues

Proven track record
- €3.7 billion in dedicated responsible investment funds
- Achieving change at 293 companies on key ESG issues in 2013

Source: F&C Management Limited as at 31.12.2013
We identify high risk companies and stop vulnerabilities developing

- Proactive engagement
  - Regular assessment of exposure to companies, sectors and issues in portfolios
  - Focus on achieving outcomes material to investors
- Identifying targets through analysis
  - Quantitative: ESG rating system to identify high risk companies
  - Qualitative: assessment of company performance beyond disclosures and policy
  - Emergent issues: knowledge of new trends in sectors and countries
  - Examples: supply chain standards, bribery and corruption
- Reactive engagement
  - Event-led: examples include Gulf of Mexico, Fukushima, Libor
  - Respond quickly, but follow-up engagements can be long-term
Engagement tactics change with circumstance

- Access to company vs. no access to company
  - Market and sector dependent: some becoming very open to ESG engagement
  - The worst performers can stone-wall investors and refuse to co-operate

- Top-down engagement vs. bottom-up engagement
  - Board and CEO level: in some countries, this is the only way to press for change
  - Operational specialist: building institutional capacity

- Solo vs. collaborative
  - Solo can be quicker
  - Collaboration can be more effective than any single investor
  - Institutional Investors Group on Climate Change, Asian Corporate Governance Association
Conclusion

Key factors for success

- Tenacity – change can take time
- Challenge status-quo
- Specialist knowledge
- Network stakeholders
Challenges and Suggestions to Improve Dialogue Between Shareholders and Boards in France and the UK

14 February 2014

Natacha Dimitrijevic, Head of European Engagement
Hermes Equity Ownership Services (EOS)

- Hermes Equity Ownership Services (EOS) was established in 2004 in recognition that stewardship activities require specialist skills and processes.

- Hermes EOS is owned by Hermes Fund Managers, which is wholly owned by the BT Pension Scheme (BTPS), one of the UK’s largest pension funds (€47.3bn AuM\(^1\)).

- 36 institutional investors in 10 countries delegate to us the stewardship of over €150bn of assets\(^2\) invested in over 10,000 companies worldwide.

- We have 23 full-time staff and six senior advisors, who are structured in four regional teams. We also have working relationships with many of the world’s largest institutional investors.

- Hermes EOS currently acts for clients invested in listed equities and corporate fixed income.

- Hermes is a founding signatory of the United Nations Principles for Responsible Investment. Hermes EOS’ Chief Executive, Colin Melvin, chaired the committee that drafted the principles.

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\(^1\) Pension Funds and Their Advisors 2012 BT Pension Scheme, 31 December 2012.

\(^2\) Assets under Advice as at 30 September 2013.
Our rationale for influence

Hermes EOS’ mission is to add long-term value to asset owners’ investments and manage their risks by engaging with companies and policy makers on environmental, social, governance, strategic and financial issues.

Capital markets suffer from two structural weaknesses
1. The Agency problem: management prioritises their own interests
2. Short-termism: management under-weights long-term risks

These weaknesses can lead to material risks, including:
- Strategy and finance misalignment
- Governance risks
- Environmental, social and ethical risks
Engagement

Global engagement activity
Company engagement by region (510)

- Australia & New Zealand, 71
- Asia, 71
- Emerging Markets, 76
- Europe, 121
- North America, 69
- UK, 102

2012 engagement activity

- We engaged with 510 companies to seek change on 989 separate engagement objectives
- Of the 989 objectives:
  - 49% on governance
  - 19% on social & ethical
  - 18% on environment
  - 14% on strategy & risk management
- All engagements tracked using “milestones”
- We made progress on over 30% of our objectives

<table>
<thead>
<tr>
<th>Milestone 0</th>
<th>Milestone 1</th>
<th>Milestone 2</th>
<th>Milestone 3</th>
<th>Milestone 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Objective set</td>
<td>Raised concern at appropriate level</td>
<td>Company acknowledges issue</td>
<td>Company commits to credible change</td>
<td>Change implemented</td>
</tr>
</tbody>
</table>

Source: Hermes
Priorities for engagement in 2014

**Europe**

1- Remuneration
say on pay in France, Minder in Switzerland;
New disclosure requirements in Spain and Germany; CRDIV

2- Board balance and accountability
Combined roles and SID; foundations; social representation; state/family holdings

3- Minority shareholder rights
Loi Florange en France

**UK**

1- Remuneration
Binding vote, single figure; CRDIV

2- Audit quality and board oversight
FRC regulation; Auditors’ code of conduct

3- Board diversity and accountability

Drivers informing the dialogue between boards and institutional shareholders
- Culture, legal rules and historic interpretation of the role of boards
- Company specifics and sectors
- Stewardship codes
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