

# 2020 Annual Review

UNIVERSITY OF TORONTO ASSET MANAGEMENT CORPORATION  
Engagement Highlights



UNIVERSITY OF TORONTO  
ASSET MANAGEMENT CORPORATION

**Federated  
Hermes** 

**EOS**

[www.hermes-investment.com](http://www.hermes-investment.com)  
For professional investors only

Engagement with companies is a key part of our comprehensive responsible investing approach. The objectives of engagement include seeking improved transparency from companies and communicating our views with the goal of ensuring that ESG risks and opportunities are appropriately considered at portfolio companies.

While we do some engagements on our own, we typically undertake engagement activities as part of formal and informal collaborative groups. We do this because we believe the combined influence of like-minded investors often leads to better outcomes than any one organization could achieve on its own.

To further magnify our impact, we partnered with EOS starting in 2019. EOS takes a collaborative approach, seeking client input in setting priorities and providing opportunities to participate in select engagements and learn from their experienced engagement professionals. We are pleased with the significant progress EOS has made on several initiatives, including its great work on climate change, an area of critical importance to UTAM and our client.



**Daren M. Smith**

President and Chief Investment Officer, University of Toronto Asset Management Corporation

University of Toronto Asset Management Corporation's activity for 2020	4
The EOS approach to engagement	8
Foreword	9
Our engagement plan	10
A guide to engagement terminology	13
A decade of action for the UN SDGs	14
Engaging through a pandemic	17
<b>Environmental highlights</b>	
Taking the temperature	19
Q&A: Biodiversity and sustainable land use	22
Climate change and fossil fuel financing	24
Q&A: Circular economy	26
<b>Social &amp; ethical highlights</b>	
Safety first – managing employees in a pandemic	28
Racial equity and ethnic diversity	31
Engaging on human and labour rights	34
Q&A: Indigenous rights and Rio Tinto	36
Q&A: AI ethics and data governance	38
<b>Governance highlights</b>	
Voting season 2020: virtually as good?	41
Q&A: Revisions to voting policy guidelines	44
Q&A: Board composition and effectiveness	45
Regional public policy highlights	48
<b>Strategy, risk and communication highlights</b>	
Preparing for future crises	50
Business purpose and long-term strategy	53
Afterword	55
EOS team	56

# University of Toronto Asset Management Corporation's activity for 2020

## Engagement by region

In 2020, we engaged with 815 companies on 2,914 environmental, social, governance, strategy, risk and communication issues and objectives. Our holistic approach to engagement means that we typically engage with companies on more than one topic simultaneously.



**We engaged with 815 companies over the last year.**

- Environmental 24.4%
- Social and Ethical 18.0%
- Governance 40.2%
- Strategy, Risk and Communication 17.4%



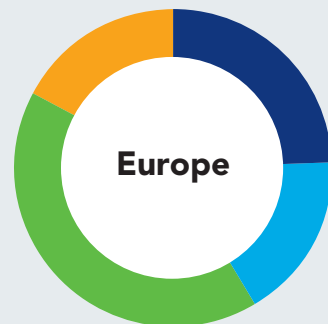
**We engaged with 96 companies over the last year.**

- Environmental 27.0%
- Social and Ethical 18.8%
- Governance 36.8%
- Strategy, Risk and Communication 17.5%



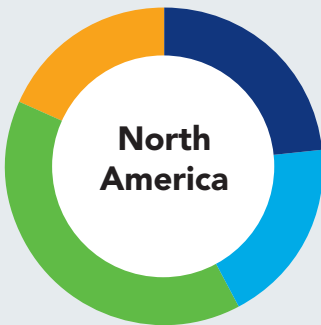
**We engaged with 90 companies over the last year.**

- Environmental 28.0%
- Social and Ethical 14.7%
- Governance 42.3%
- Strategy, Risk and Communication 15.0%



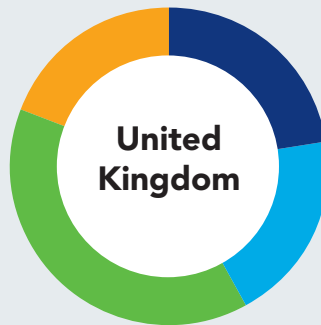
**We engaged with 191 companies over the last year.**

- Environmental 24.6%
- Social and Ethical 17.1%
- Governance 41.2%
- Strategy, Risk and Communication 17.2%



**We engaged with 322 companies over the last year.**

- Environmental 23.5%
- Social and Ethical 18.8%
- Governance 39.5%
- Strategy, Risk and Communication 18.2%



**We engaged with 83 companies over the last year.**

- Environmental 22.5%
- Social and Ethical 19.7%
- Governance 38.8%
- Strategy, Risk and Communication 19.0%



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

- Environmental 11.4%
- Social and Ethical 13.6%
- Governance 70.5%
- Strategy, Risk and Communication 4.5%

## Engagement by theme

A summary of the 2,914 issues and objectives on which we engaged with companies in 2020 is shown below.



**Environmental topics featured in 24.4% of our engagements over the last year.**

- Climate Change **78.5%**
- Forestry and Land Use **4.1%**
- Pollution and Waste Management **10.8%**
- Supply Chain Management **3.7%**
- Water **3.0%**



**Social and Ethical topics featured in 18.0% of our engagements over the last year.**

- Bribery and Corruption **3.4%**
- Conduct and Culture **16.6%**
- Diversity **22.5%**
- Human Capital Management **19.4%**
- Human Rights **29.7%**
- Labour Rights **6.5%**
- Tax **1.9%**



**Governance topics featured in 40.2% of our engagements over the last year.**

- Board Diversity, Skills and Experience **22.8%**
- Board Independence **13.7%**
- Executive Remuneration **45.2%**
- Shareholder Protection and Rights **14.3%**
- Succession Planning **4.1%**



**Strategy, Risk and Communication topics featured in 17.4% of our engagements over the last year.**

- Audit and Accounting **5.3%**
- Business Strategy **35.0%**
- Cyber Security **6.3%**
- Integrated Reporting and Other Disclosure **23.8%**
- Risk Management **29.5%**

## Engagement methodology and progress in 2020

Our proprietary milestone system allows us to track progress in our engagements relative to the objectives set at the beginning of our interactions with companies. The specific milestones used to measure progress in an engagement vary depending on each concern and its related objective. They can broadly be defined as follows:

- **Milestone 1** Concern raised with the company at the appropriate level
- **Milestone 2** The company acknowledges the issue as a serious investor concern
- **Milestone 3** Development of a credible strategy/Stretching targets set to address the concern
- **Milestone 4** Implementation of a strategy or measures to address the concern

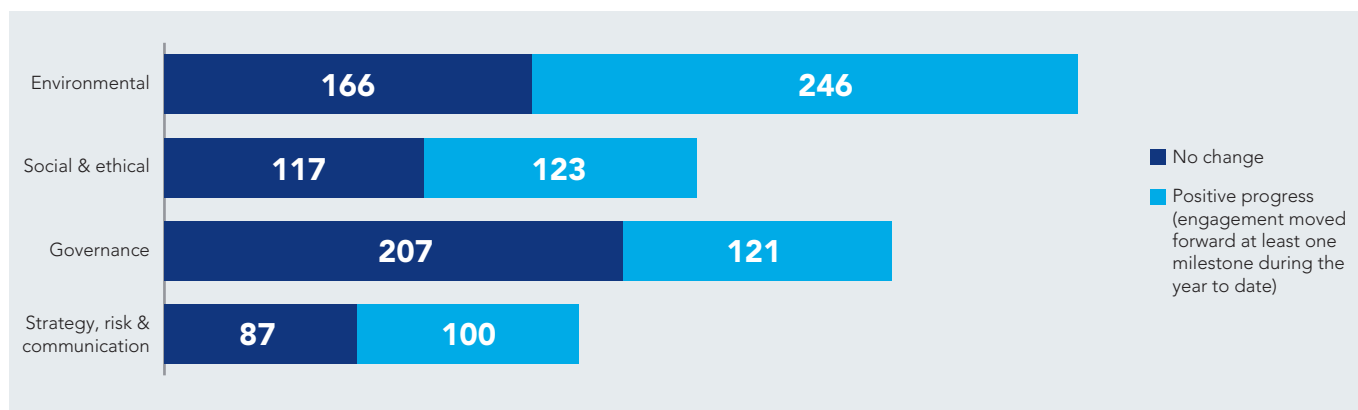
### Milestone status of engagement

The chart below shows the milestone status of our engagement objectives by theme.

Theme	Total Engagement Objectives	Engagement objective status (last milestone completed)				Closed engagement objectives	
		Objective set	Milestone 1	Milestone 2	Milestone 3	Milestone 4	Discontinued
Environmental	369	13	75	148	80	51	2
Social and ethical	203	6	54	69	60	13	1
Governance	279	5	88	92	53	35	6
Strategy, risk and communication	160	7	45	49	30	26	3
<b>Total engagements</b>	<b>1011</b>	<b>31</b>	<b>262</b>	<b>358</b>	<b>223</b>	<b>125</b>	<b>12</b>

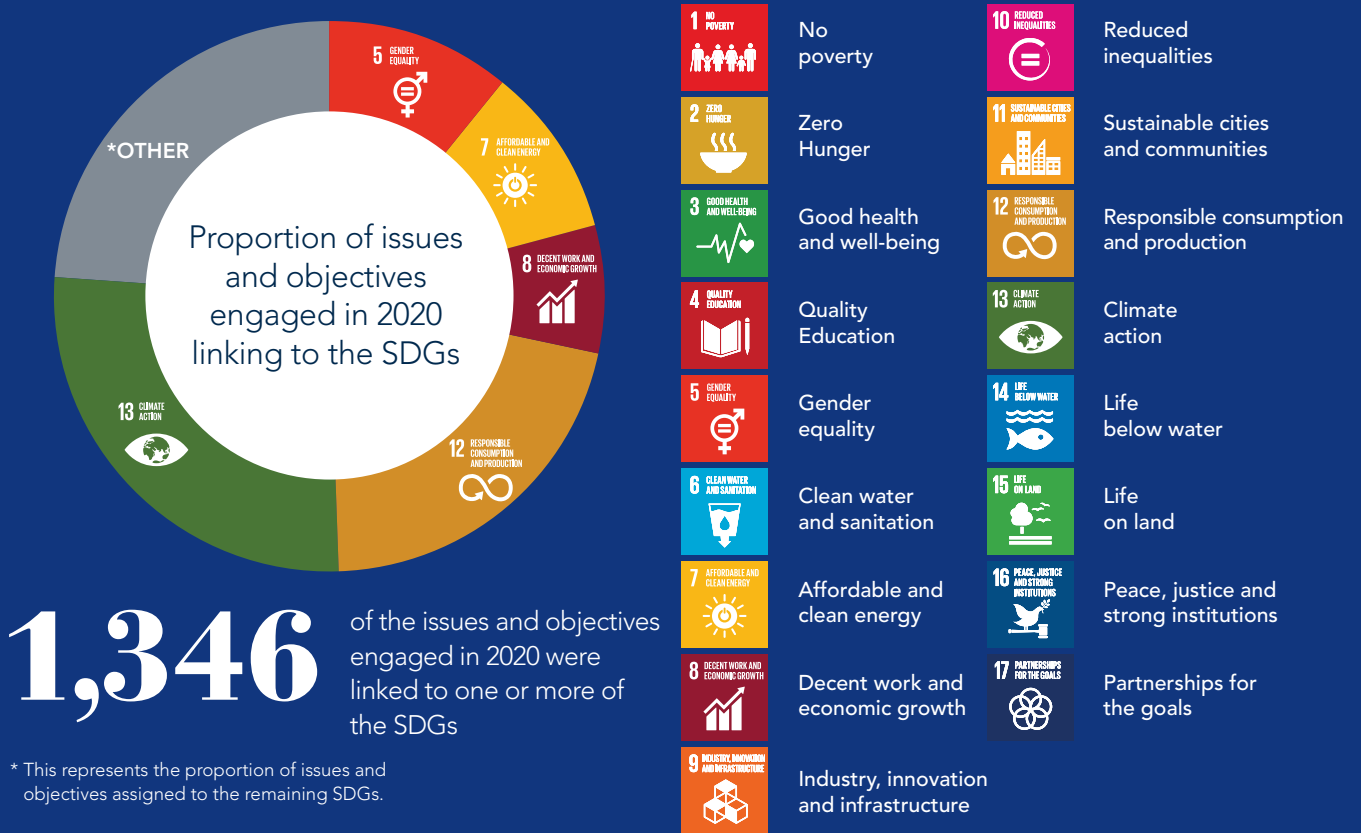
### Engagement progress in 2020

We made solid progress in delivering engagement objectives across regions and themes. At least one milestone was moved forward for about **51%** of our objectives during the year. The following chart describes how much progress has been made in achieving the milestones set for each engagement.



## Supporting the UN Sustainable Development Goals

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 or issue may directly link to more than one SDG).

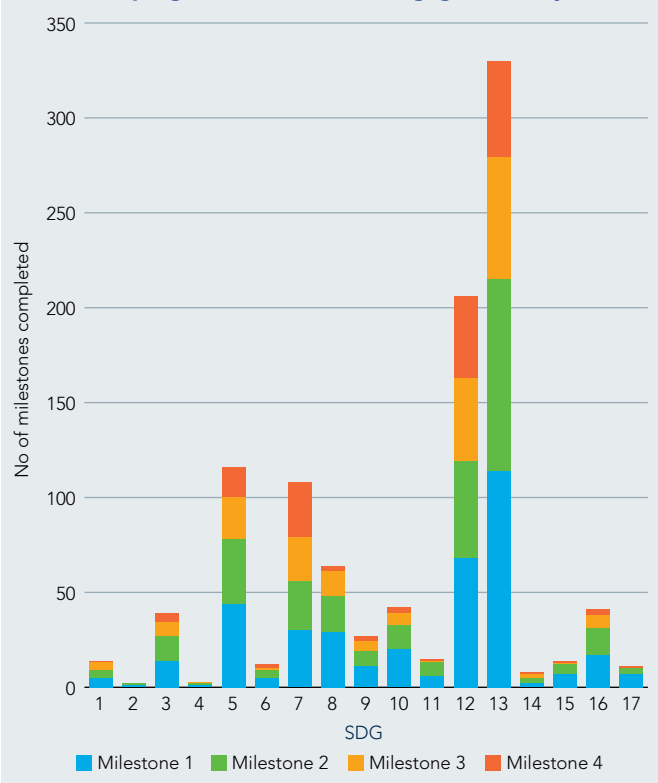


## Why engage on the SDGs?

Investors and their representatives play a key role in supporting the delivery of the UN SDGs. This could be by creating positive outcomes for society through investments and engagement as the goals recognise the role of the private sector in financing sustainable development. Moreover, the SDGs provide a common framework and language for investors and companies to work towards the achievement of the shared goals, with measurable indicators of progress. They also provide a clear time frame in which change needs to take place, helping to set targets and create a greater sense of urgency, while considering what action is needed from business to achieve sustainable development, beyond the typical incremental improvements and business-as-usual targets.

Our engagement with companies encourages them to act responsibly and reduce their negative impacts on society, across their value chains. We are also suggesting changes that could provide a positive impact. Our view is that the long-term success of business is inextricably linked to achievement of the goals because the SDGs help to create an economic context and society in which businesses can best thrive.

Milestone progress of SDG-linked engagement objectives



# The EOS 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 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.



## 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.

## Our services



## 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.

## 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\$1.28tn as of 31 December 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.



# Foreword



**Dr Hans-Christoph Hirt**

Executive Director, Head of EOS at Federated Hermes

At the start of 2020, few of us could have envisaged the dramatic changes to our daily lives wreaked by the Covid-19 pandemic. As governments scrambled to impose national lockdowns, it was clear that this deadly virus would have a far-reaching impact on individuals and families, businesses and employees, the global economy, and society as a whole. The lessons for investor stewardship and tackling future sustainability challenges and crises are twofold.

## Interdependence of different elements of society

By pressing pause on “business as usual” and forcing companies to adopt new ways of working, policymakers demonstrated they were willing to impose sweeping restrictions to address the public health crisis. Many businesses had to close for prolonged periods or change their operating models, impacting their employees, customers, and supply chains.

In this way, the pandemic demonstrated the critical interdependence of different elements of society, including businesses, their key stakeholders, and governments.

**Many financial regulators already recognise climate change as a systemic risk to the global economy and their calls to action are only likely to grow louder.**

With some companies facing unenviable choices - between making large-scale redundancies or going out of business, for example - the pandemic showed the importance of businesses maintaining a social licence to operate underpinned by a corporate purpose. Those that failed to demonstrate their value to society or that treated their employees, customers, and suppliers badly, attracted negative publicity and public criticism.

We believe this interdependence will only grow over time given the bigger challenges ahead, such as responding to the inevitable impacts of climate change, addressing inequality, striving for racial equity, and dealing with job losses due to automation. As a consequence, sustainability-focused risk management, and operational and financial resilience, will be critical to long-term value creation.

## Planetary boundaries and interconnected sustainability issues

The pandemic can be seen as a warning from nature that we are exceeding safe planetary boundaries, and it has starkly illustrated the links between different sustainability issues.

The increased incidence of novel infectious diseases, like Covid-19, has been causally linked to land-use change resulting in habitat destruction, along with the wildlife trade and intensive farming. These human activities are also contributing to the loss of biodiversity, which is now occurring at unprecedented rates.

There is also clear evidence linking the occurrence and severity of vector-borne diseases with global warming, and the pandemic demonstrated how the burden of infectious disease is exacerbated by social factors, including inequality and lack of access to healthcare. Companies and investors will need to work harder in the years ahead to understand these connections, and start thinking about delivery to all key stakeholders in a more holistic manner.

## Urgent action on the climate crisis

Addressing the climate crisis will be a key focus in 2021 with the United Nations Climate Change Conference COP26 to be held in Glasgow, Scotland in November. Given the systemic importance of climate change, engagement with companies on physical and transition risks with the objective of Paris Agreement-alignment will remain a top priority in our stewardship activities. Encouragingly, we saw in 2020 how the collapse in demand for fossil fuels reinvigorated investor demands to accelerate the transition to a low carbon economy.

Some policymakers are now beginning to grasp the urgency of the climate crisis, with stronger commitments to scale up investments in renewable energy and green infrastructure, alongside more ambitious net-zero goals in terms of the timescales targeted.

Many financial regulators already recognise climate change as a systemic risk to the global economy and their calls to action are only likely to grow louder. The wind has changed direction and the momentum is with us. In 2021 we will seek to capitalise on this.



# Our engagement plan

Our engagement plan identifies 12 key themes and 36 related sub-themes. We find this breadth of coverage is necessary to reflect the diversity of the issues affecting companies in our global engagement programme.

**Although the pandemic changed our approach to engagement, we were able to continue focusing on material issues such as the climate crisis and human capital management through face-to-face video calls.**



## Climate change

In response to client feedback, this theme remains our number one priority, with the UN's COP26 meeting in Glasgow now set to take place in November 2021. Global greenhouse gas emissions must be reduced to net zero by 2050 to limit temperature increases to well below 2°C, and ideally to no more than 1.5°C. Yet the global economy is currently on track to deliver over 2.7°C of heating. To address this climate emergency, business models should align with the goals of the Paris Agreement, including a net-zero goal, by 2050 or sooner.

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As climate change is relevant and financially material to almost every sector and across all geographies, we focus on all major areas of the economy, including oil and gas, coal mining, transportation, energy-intensive industrials such as steel, cement, and metals smelting, consumer goods and retailing, and financial services. We are also an active member of Climate Action 100+, the collaborative engagement initiative representing over US\$50 trillion of assets, acting as lead or co-lead engager for 30 companies. As far as we are aware, this is higher than any other participant.



## Human and labour rights

This theme covers all aspects of human rights including those related to forced labour and modern slavery, child labour, payment of a living wage, and gender-specific issues; the protection of basic human rights including the right to life and liberty, privacy and freedom of expression; and the protection of indigenous rights. Investors have a duty to respect human rights, which underpin a company's wider corporate culture, business ethics and enterprise risk management, all of which affect reputation and the ability to create and preserve value over the long term.

We expect companies to apply the UN Guiding Principles on Business and Human Rights, reporting on their management of those salient human rights issues and risks that could have the most severe negative impact on company operations and supply chains.



## Human capital management

In a knowledge economy where intangible assets, such as employees, are estimated to comprise on average more than half of a company's market value, our engagement is focused on the most critical challenges to a company's workforce. These include diversity and inclusion, fair wages, incentives and benefits, plus health, safety and wellbeing.

This was reinforced by the coronavirus pandemic, which shone a light on how employers treat and engage their workforces, and introduced new health and safety concerns, including mental health issues.

### Engagement themes for 2021-23



In addition, in May 2020, the tragic death of George Floyd re-energised the anti-racism movement in the US and around the globe, and renewed concerns about poor representation of ethnic minorities in business. It also raised fresh questions about the role that companies play in perpetuating racial inequity. We believe most companies and investors have much more to do to address this urgent problem.

#### Board effectiveness

There is considerable evidence that the performance of the board is vital to the long-term success of a company. 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, ethnicity, nationality, background, skills and experience) to improve decision-making.

It is equally important that boards contain enough independent directors to challenge management and that directors are able to dedicate sufficient time to fulfil their duties. An effective board should also be involved in good dialogue with its shareholders, the workforce and other key stakeholders.

#### Broader themes for 2021

**In addition, we will focus on companies putting in place a business purpose and strategy to guide the future, as follows:**

##### In the near term – the corporate response to the pandemic

Many businesses face difficult trade-offs, particularly between achieving shorter-term financial returns and maintaining strong relationships with key stakeholders, especially employees. We will encourage and support companies to set a clear and meaningful business purpose and strategy, helping to identify the actions required in the short term to deliver long-term value.

Meanwhile, following unprecedented government support for businesses through measures such as furlough schemes and loan guarantees, we will urge companies to act responsibly in critical areas such as good employment practices, the payment of appropriate levels of corporate taxation, and justifiable levels of executive remuneration.



### In the longer term – avoiding the next crisis

The pandemic has also highlighted the risks to companies as human activity pushes the limits of planetary boundaries. Therefore, in addition to tackling the climate crisis, we now expect companies to put in place strategies to achieve a net-positive impact on biodiversity, eliminate deforestation and avoid contributing to the development of antibiotic-resistant “superbugs”. Companies must also put in place more advanced risk management systems to identify a broader range of lower probability, high impact events.

### Expanding themes

We will also continue to build on our work in recent years in these fast-growing areas:



#### Plastics

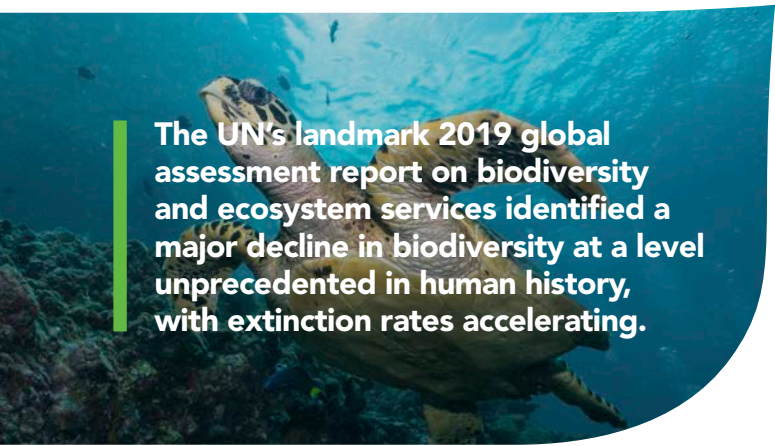
Consumption of plastic has increased 20-fold in the last 50 years and is set to triple again by 2050, yet only around 14% is recycled. Meanwhile, microplastics threaten to contaminate all living organisms, with unknown health consequences. In April 2020 we published our white paper *Investor Expectations for Global Plastic Challenges*, to help address this ballooning problem. Over the long term, plastics must either be removed altogether, reused or recycled in a closed loop.



#### Artificial intelligence (AI) and ethical data governance

The need for strong data governance is critical as company business models become increasingly reliant on harvesting, storing and analysing data. This will mean ensuring the security, accuracy and integrity of personal data, and that individuals have consented to its use. Companies must take care to avoid discriminatory biases or unintended consequences arising from the application of artificial intelligence, which could lead to significant business risk and adverse social impacts.

Since 2019, we have been creating frameworks and tools that investors can use to address issues around freedom of speech, supply chains, data privacy, surveillance, user manipulation, bias and discrimination. In 2020, EOS was shortlisted by the PRI for stewardship project of the year for its work in this area.



The UN's landmark 2019 global assessment report on biodiversity and ecosystem services identified a major decline in biodiversity at a level unprecedented in human history, with extinction rates accelerating.



Textile production is estimated to account for over one billion tonnes of CO<sub>2</sub> equivalent every year, more than international flights and maritime shipping put together.



#### Biodiversity and sustainable land use

The UN's landmark 2019 global assessment report on biodiversity and ecosystem services identified a major decline in biodiversity at a level unprecedented in human history, with extinction rates accelerating. In 2021, countries are expected to agree on a post-2020 framework for biodiversity at the Convention on Biological Diversity COP 15, which was postponed from 2020 due to the Covid-19 pandemic. Like the Paris Agreement for climate change, the targets will be delivered by countries and companies.

We developed our engagement approach in 2020, culminating in the publication of a white paper: *Our Commitment to Nature*, which focuses on the business case for protecting biodiversity, our engagement priorities and expectations, and key issues such as deforestation and regenerative agriculture.



#### Fast fashion

Textile production is estimated to account for over one billion tonnes of CO<sub>2</sub> equivalent every year, more than international flights and maritime shipping put together. It is also water intensive, and a major source of microplastics. Yet once the consumer has finished with the item, some 73% is either incinerated or goes to landfill, with less than 1% recycled. In 2020 we advanced our work in this area by identifying key performance metrics and setting more ambitious, yet achievable objectives for the apparel sector.

# A guide to engagement terminology

Our engagement approach is systematic and transparent. Our proprietary milestone system allows us to track the progress of our engagements relative to the objectives set for each company.

## Objectives

We set clear and specific objectives within our company engagements to ensure we achieve positive outcomes. An objective is a specific, measurable change defined at the company – an outcome we are seeking to achieve. Each objective is tracked using milestones. Objectives are regularly reviewed until they are completed – when the company has demonstrably implemented the change requested – or discontinued. Objectives may be discontinued if the objective is no longer relevant, or because the engagement is no longer feasible or material.

We may engage with a company on multiple objectives at any one time, covering a variety of material ESG issues. An example of an objective could be: “Development of a strategy consistent with the goals of the Paris Agreement, including setting science-based emissions reduction targets for operating emissions (Scopes 1 and 2 emissions).” Each objective relates to a single theme and sub-theme.

**We only consider companies to be engaged when we have an individual interaction with the company that relates to an objective or issue.**

## Issues

How does an objective differ from an issue, another term we use within our engagement? An issue is a topic we have raised with a company in engagement, but where we do not precisely define the outcome that we are seeking to achieve. This can be more appropriate if the issue is of lower materiality and so we do not anticipate engaging with the frequency required to pursue an objective. Or perhaps we are still in the process of identifying what type of change we may want to see at a company and so are not yet able to set a

precise objective. Issues are frequently used for companies outside our continuous engagement programme, for example those where we typically engage only around the annual shareholder meeting and our voting recommendation.

## Milestones

To measure our progress and the achievement of engagement objectives, we use a four-stage milestone strategy. When we set an objective at the start of an engagement, we will also identify recognisable milestones that need to be achieved. Progress against these objectives is assessed regularly and evaluated against the original engagement proposal.



## Actions

These are the interactions that take place between our engagement professionals and the companies or public policy bodies with whom they are engaging. Every call, meeting or correspondence is recorded as an action. Actions can be linked to objectives or issues. We only consider companies to be engaged when we have an individual interaction with the company that relates to an objective or issue.

# A decade of action for the UN SDGs



The pandemic has posed a significant threat to the achievement of specific SDGs, particularly good health and wellbeing. How did we engage on the SDGs in 2020 and how do we measure impact? By Katie Frame.

**The United Nations (UN) Sustainable Development Goals (SDGs), also sometimes known as the Global Goals, were developed and adopted in 2015 as a global call to end poverty, protect the planet and ensure that everyone enjoys peace and prosperity by 2030. With less than 10 years remaining on the clock, it is important to take stock and reflect on our achievements and what action is required to accelerate progress.**

The SDGs encompass 17 goals, underpinned by 169 targets and 230 individual indicators of progress. The goals are highly interconnected, so action and progress in one area will affect the outcomes in others. Whilst the goals were initially developed for governments and civil society, the private sector has an important role to play in helping to achieve the ambitious targets.

Since their establishment, some progress has been made – for example the proportion of waters under national jurisdiction covered by marine protected areas has more than doubled since 2010, and access to electricity in the poorest countries is increasing. However, the development of pathways to meet the goals is not advancing at the speed or scale required<sup>1</sup>.

## How has the pandemic reframed the SDG discussion?

Whilst the Covid-19 pandemic has created a sense of global unity, it has posed a significant threat to the achievement of specific SDGs. The pandemic threatens to reverse the progress that has been made on SDG 3, which aims to promote good health and wellbeing. We have seen disruption to healthcare services and infrastructure, with 70 countries halting childhood vaccination programmes, and many have experienced disruptions to cancer screening, family planning and infectious diseases beyond Covid<sup>2</sup>.

We also expect Covid to widen income inequalities. The World Bank has estimated that the pandemic pushed an additional 88 million to 115 million people into extreme poverty in 2020, rising to as many as 150 million in 2021<sup>3</sup>. This slows progress towards achieving SDG 1, no poverty, as well as SDG 10, reducing inequalities. Additionally, school closures have kept 90% of the world's students (approximately 1.57 billion children) physically out of schools<sup>4</sup>.

The International Labour Organization estimates that one in six young people lost their jobs during the pandemic, with many more experiencing a cut in hours, impacting SDG 8, decent work and economic growth<sup>5</sup>. We remain concerned that due to the economic impact of the pandemic, work to address SDG 13 or SDG 7 on climate change and clean energy respectively, will also face significant setbacks.

**The International Labour Organization estimates that one in six young people lost their jobs during the pandemic, with many more experiencing a cut in hours, impacting SDG 8, decent work and economic growth.**



**Katie Frame**  
Theme co-lead: Human  
Capital Management

<sup>1</sup> [https://sustainabledevelopment.un.org/content/documents/24978Report\\_of\\_the\\_SG\\_on\\_SDG\\_Progress\\_2019.pdf](https://sustainabledevelopment.un.org/content/documents/24978Report_of_the_SG_on_SDG_Progress_2019.pdf)

<sup>2</sup> [https://www.thelancet.com/journals/lanpub/article/PIIS2468-2667\(20\)30189-4/fulltext](https://www.thelancet.com/journals/lanpub/article/PIIS2468-2667(20)30189-4/fulltext)

<sup>3</sup> <https://www.worldbank.org/en/news/press-release/2020/10/07/covid-19-to-add-as-many-as-150-million-extreme-poor-by-2021>

<sup>4</sup> <https://www.nature.com/articles/d41586-020-02002-3>

<sup>5</sup> <https://feature.undp.org/covid-19-and-the-sdgs/>



**We are pleased that as an outcome of our engagement, AMN committed to participating in the Nursing Now “Nightingale Challenge” to provide leadership and development training for nurses and midwives during 2020.**

Our stewardship work has always focused on improving the sustainability of companies in order to boost long-term wealth creation and achieve positive outcomes for society. In particular, SDG target 12.6, which is to “encourage companies, especially large and transnational companies, to adopt sustainable practices and to integrate sustainability information into their reporting cycle”, underpins much of our engagement work with companies. When we engage on an SDG, we are often seeking positive outcomes through which companies can contribute to solving problems such as inequality (SDG 10), poor health (SDG 3) and climate change (SDG 13).

### How do we measure impact?

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 strategy. We attribute a direct link between one of our engagement themes and an SDG if our engagement objectives directly support at least one of the UN’s targets underpinning the relevant goal. We recognise that good corporate governance is essential to the achievement of the SDGs, as a well-governed company will be better placed to address the key environmental and social issues identified by the goals. However, we do not often attribute a direct link between corporate governance and any single SDG, given the indirect benefit this has. Instead, we focus on mapping those environmental and social themes that have a direct relationship to the achievement of one or more of the goals.

Due to the interconnectedness of the goals, an engagement on climate change will often link to more than one SDG. For example, engaging with an oil and gas company to encourage it to set and pursue a strategy that is consistent with the goals of the Paris Agreement directly impacts SDGs 7, 12 and 13. However, engaging with an electronics manufacturer to set an absolute CO2 reduction target is likely to only directly impact SDG 13, although we may see indirect impacts on SDGs 7 and 12. Many more SDGs will also be indirectly impacted through climate action given the strong links to poverty and inequality.

**We recognise that good corporate governance is essential to the achievement of the SDGs, as a well-governed company will be better placed to address the key environmental and social issues identified by the goals.**

### CASE STUDY

#### AMN Healthcare

SDG 3 – Good health and wellbeing



AMN Healthcare is a healthcare staffing company that principally provides travel nurse staffing services. Its core business is the placement of nurses and allied health professionals on temporary assignments at hospitals and healthcare facilities throughout the US.

Our engagement objective was for the company to expand on its existing employee volunteering activities to establish an NGO partnership to support the development of skills and experience for nurses, physicians and other professionals, and to empower and improve healthcare provision in lower and middle-income countries.

During our engagements we facilitated an introductory meeting between the CEO of AMN and the executive director of Nursing Now, a global NGO campaign established to raise the profile of nurses worldwide. We continued to highlight the importance of investing in and developing those in the nursing profession.

We are pleased that as an outcome of our engagement, AMN committed to participating in the Nursing Now “Nightingale Challenge” to provide leadership and development training for nurses and midwives during 2020. In addition to this, AMN donated to the Nursing Now initiative and will be partnering with continuing education companies to help provide training to nurses and midwives. We will continue to ask AMN to engage its clients in this effort to raise the profile of nurses.

## CASE STUDY

### Biodiversity

SDGs 14 and 15 – Life below water, Life on land



In November we responded to the business consultation on the Convention on Biological Diversity Post-2020 Global Biodiversity Framework.

We suggested strengthening the wording to say that 2030 should be the latest year by which nature loss is reversed, with some sectors and countries aiming for 2025. We also outlined how to improve the involvement of the financial sector in the development and delivery of the framework and emphasised the importance of using science-based approaches.

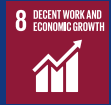
We explained our engagement approach to biodiversity and how having SMART targets informed by science would be key to ensuring an effective contribution to the goals from the private sector. Finally, we provided suggestions about how the biodiversity framework could be aligned with the UN SDGs and existing climate change frameworks, including the TCFD and the Paris Agreement.

**We have also engaged with Amazon to improve its health and safety performance, especially in light of the pandemic and the stresses placed on employees.**

## CASE STUDY

### Decent work

SDG 8 – Decent work and economic growth



Since the initial peak of the pandemic and the global shutdowns experienced from March 2020, we have systematically engaged with companies across our programme on the management of their human capital, with a focus on health, safety and wellbeing.

For example, we have engaged with Panasonic to understand its 'e-Work' initiative and how it will continue to promote a culture of flexible working to support employees. We have also engaged with Amazon to improve its health and safety performance, especially in light of the pandemic and the stresses placed on employees. Additionally, we engaged with WalMart to encourage it to improve communications between in-store sales associates and the board on health and safety practices.

**Through our engagement we are encouraging companies to view the SDGs as a framework to identify areas where they can make a positive impact towards the goals through their supply chain, operations, products or services.**

### How can investors accelerate progress over the next 10 years to help achieve the goals?

Through our engagement we are encouraging companies to view the SDGs as a framework to identify areas where they can make a positive impact towards the goals through their supply chain, operations, products or services. While some progress has been made, there is much to be done collectively, particularly on those goals most impacted by the pandemic. Additionally, investors and companies need to shift their focus from simply measuring their inputs and begin to consider the actual impact of this work. This will help us to collectively direct resources towards achieving sustainable development in a more efficient manner.

Over the next 10 years, investors should play an important role by encouraging business leaders to embrace more sustainable and inclusive models, and we will continue to use the SDG goals as a basis for these conversations.






# Engaging through a pandemic

How did we adapt our engagement approach when governments responded to the pandemic with lockdowns, curbing international travel and face-to-face meetings? By Bruce Duguid.

**The Covid-19 pandemic became the significant backdrop to much of our engagement in 2020. Our Asia and emerging markets team experienced this early with travel bans from January, but this soon spread to other regions. Despite lockdowns and the inability to meet face-to-face, we were able to adapt quickly to virtual engagement using web-based interfaces. This meant we could continue to deliver our engagement plan and related voting, plus our public policy and market best practice work. We also on-boarded eight new members of staff – six in our Pittsburgh office and two in London – all joining after lockdown commenced.**

In April we sent an open letter to the chairs and CEOs of the companies in our engagement programme, explaining that our dialogue during and after the pandemic would focus on business resilience and stakeholders. We outlined how we expected companies to ensure the safety and wellbeing of their workforces. We also wanted them to treat their suppliers fairly, serve their customers and support the efforts of governments and society in dealing with Covid-19.



Some directors appeared to have more time available for engagement due to the lack of travel, and they were keen to continue discussing long-term issues such as climate change.

Most companies had a good narrative for how they were protecting their operations and key stakeholders, including employees, although we challenged one large US retailer over allegations of poor Covid practices in its stores. In contrast, UK supermarket Tesco did well to adapt its operating environment and customer proposition, and we completed a long-standing engagement on audit and risk management.

Despite the lockdown restrictions, our engagement activity was higher than in 2019, with similar levels of access to board directors and senior executives. Some directors appeared to have more time available for engagement due to the lack of travel, and they were keen to continue discussing long-term issues such as climate change, with some intense dialogues in the run-up to annual shareholder meetings. Collaborative engagement initiatives such as Climate Action 100+ also continued.

These efforts resulted in some positive outcomes, with oil and gas major BP announcing a new net-zero strategy with capex and accounting assumptions aligned with the Paris Agreement goals, and similar indications from Repsol, Total and Royal Dutch Shell. There was also significant progress at Amazon on net-zero targets, Lafarge Holcim on science-based targets, Rolls-Royce on net-zero emissions, even as it faced a collapse in air travel, and Anglo American on carbon neutral mining.



**Bruce Duguid**  
Executive Director,  
Head of Stewardship, EOS

To document our engagement outcomes we published 22 long-form company case studies in 2020, and 27 short-form case studies. We provided investors with engagement toolkits in two white papers: *Investor Expectations for Global Plastics Challenges* and *Guiding Principles for an Effective Board*. We also identified the links between different ESG issues such as climate change, biodiversity loss and infectious diseases in our in-depth pandemic series of EOS Insights articles.

For the 2020 voting season, we developed new voting guidelines to be supportive of virtual shareholder meetings – as long as these were temporary and had appropriate safeguards for shareholder rights. The move to virtual meetings allowed us to intervene at a record number, “attending” 22 versus nine in 2019. We issued 16 client alerts on controversial votes, versus 11 the previous year. Our more nuanced approach to voting included taking a more supportive stance on director re-election in more marginal cases of low board diversity, so as not to remove key directors at a time of crisis.

**For the 2020 voting season, we developed new voting guidelines to be supportive of virtual shareholder meetings – as long as these were temporary and had appropriate safeguards for shareholder rights.**

In 2021 we will focus on delivery of the appropriate post-pandemic response. We will encourage companies to put business purpose at the heart of delivering positive societal outcomes and guiding decision-making around the trade-offs between stakeholders. Following the tragic death of George Floyd, which re-energised the anti-racism movement in the US and around the world, we are asking companies for a strategy and action plan to close the ethnic pay gap and achieve proportionate ethnic representation at all levels, including the board.

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**22** versus **9** in 2019. 



**We will also prioritise engagement on the protection of human and labour rights abuses, given the increased risks of further deterioration in already precarious working conditions, arising from the pandemic.**

We will prioritise engagement on the protection of human and labour rights abuses, given the increased risks of further deterioration in already precarious working conditions, arising from the pandemic. We will also focus on modern slavery and limited access to fundamental needs such as food and medicine, including effective coronavirus vaccines.

Finally, to avoid future crises, we will step up our engagement in critical areas including action to limit global heating to 1.5°C, corporate strategies to eliminate deforestation and achieve a net-positive impact on biodiversity, and taking essential steps to avoid contributing to the development of antibiotic-resistant “superbugs”.

**We will ask companies for a strategy and action plan to close the ethnic pay gap and achieve proportionate ethnic representation at all levels, including the board.**

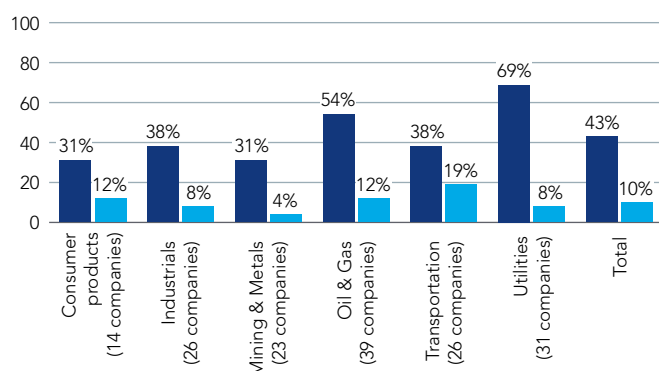
# Taking the temperature

The collaborative engagement initiative Climate Action 100+ hit the halfway mark in 2020, making progress with some of the world's largest greenhouse gas emitters, despite the challenges posed by the pandemic. By Nick Spooner.

**The Covid-19 pandemic may have captured the headlines in 2020 with its immediate risks to public health, but the long-term issues posed by the climate crisis have not gone away. The collaborative initiative Climate Action 100+ (CA100+), where we continue to lead or co-lead engagement with 30 companies, reached its halfway mark in 2020, with more company commitments to mitigate systemic climate risks.**

According to the CA100+ 2020 Progress Report, published in December, 43% of focus companies engaged by the initiative have now set a net-zero target. But there are gaps in target coverage, with only 10% of focus companies setting a net zero by 2050 target that covers the company's most material Scope 3 emissions.<sup>6</sup>

## The company has set a target or ambition to reduce its greenhouse gas emissions to net zero by 2050



- Company has set a net-zero by 2050 target or ambition that covers its Scope 1 and 2 emissions
- Company has set a net-zero by 2050 target or ambition that covers its most material Scope 3 emissions

Source: Climate Action 100+ 2020 Progress Report.

The oil and gas sector, which potentially has the most to lose from a rapid transition to a low-carbon economy, remained in focus in 2020. The sector was disproportionately impacted by the pandemic, as demand for fossil fuels – particularly oil used in transportation – collapsed. This coincided with a temporary increase in supply, compounding the industry's problems. Against such a backdrop, it was encouraging to see some progress due to the efforts of CA100+.

**The oil and gas sector, which potentially has the most to lose from a rapid transition to a low-carbon economy, remained in focus in 2020.**

In February, following the appointment of BP's new CEO Bernard Looney, the company announced that it would set a net-zero target for 2050 for all the oil and gas it produces, as well as for its entire operations. This made it the first oil and gas major to make such a commitment, setting the bar for other European oil and gas companies. Later in the year, the company published its methodology for determining whether new capital expenditure was consistent with the goals of the Paris Agreement, including the underlying assumptions around commodity prices. This came in direct response to the 2019 shareholder resolution where we led the filing. It also built on engagement over the previous 12 months to seek alignment of BP's accounting assumptions with the goals of the Paris Agreement.



**Nick Spooner**  
Theme co-lead: Climate Change

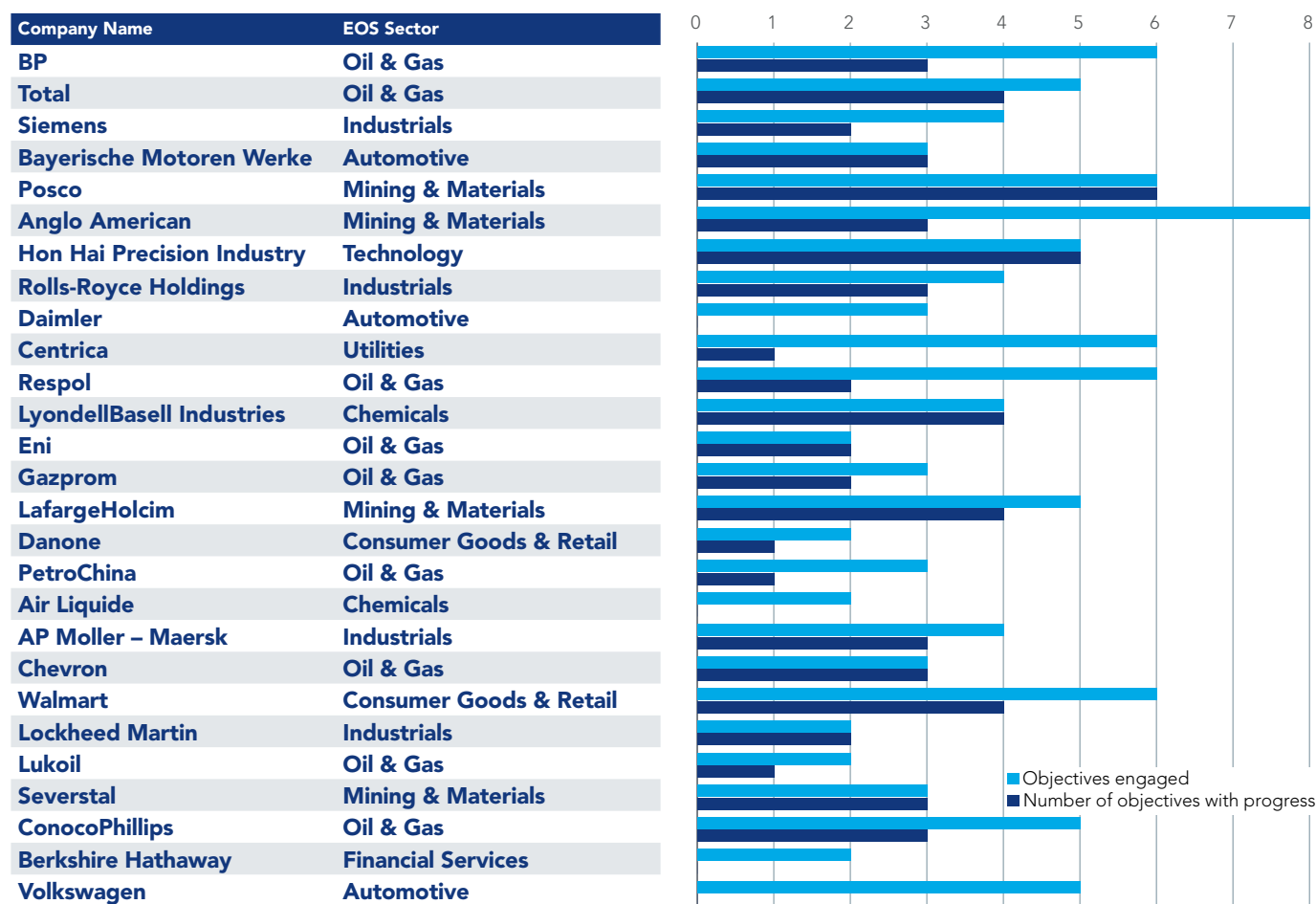
<sup>6</sup> <https://www.climateaction100.org/wp-content/uploads/2020/12/CA100-Progress-Report.pdf>

In addition, prior to Total's annual shareholder meeting, we worked closely with the French company to produce a joint statement in collaboration with CA100+. In this it set the ambition to achieve net-zero emissions and committed to aligning its investments with the Paris goals. Repsol, the first oil and gas company to commit to net-zero emissions, increased the ambition of its intermediary Scope 3 targets and its targets around renewable energy deployment.

**We have also participated in the CDP consultation to develop a science-based target methodology for the sector.**

Although these developments are to be applauded, companies have applied different methodologies, so comparison is difficult. To help address this, we have worked with the Institutional Investors Group on Climate Change (IIGCC) to develop a net-zero benchmarking methodology, which allows for flexibility in business models and a comparison between company commitments. This draws on a range of market-leading sources including the Transition Pathway Initiative, Carbon Tracker and InfluenceMap. We have also participated in the CDP consultation to develop a science-based target methodology for the sector.

### Progress of objectives for CA100+ companies engaged by EOS, 2020



### Demand-side decarbonisation

Decarbonisation of the whole economy will require action from energy demand-side participants, as well as the supply side. This was highlighted by the net-zero benchmarking letter that lead engagers sent to all CA100+ companies in September. The letter had three main requests:

1. Disclose in line with the CA100+ Net-Zero Benchmark;
2. Set a long-term ambition for net-zero by 2050, for all material emissions, as well as science-based, intermediary targets; and
3. Collaborate with CA100+ in developing pathways for decarbonising the sector and value chain overall.

The aim is to make an impact beyond the companies engaged under CA100+, which until recently only focused on 161 of the world's biggest greenhouse gas emitters. Large companies are often well-placed to help reduce Scope 3 emissions (those in their supply chains or arising from the use of their products) because of their deep pockets, their importance to suppliers, or their influence over consumption patterns. Walmart, the largest company in the world by revenues, had already set a symbolic target of reducing emissions by one gigaton – approximately double the emissions of the UK – throughout its operations and supply chain, although we questioned whether even this was sufficiently aligned to the achievement of the Paris goals. In 2020 it committed to reaching net-zero emissions for Scopes 1, 2 and 3 emissions by 2040 as part of its ambition to become a regenerative business.

The impact of large corporations with complex supply chains setting net-zero targets is evident in the case of Hon Hai. The company is a major supplier to Apple, which set a target to decarbonise its supply chain by 2030. This has helped us engage with the company on setting long-term greenhouse gas targets. We were pleased when Hon Hai set a net-zero target for 2050, and we will continue to engage with the company on the execution of this target, including the level of ambition in its intermediary targets.

Some of the most challenging transitions are those involving companies that must fundamentally change the nature of their products. This is the case for those in the extractives industry, but also for companies such as Centrica, BMW, Rolls-Royce and Kinder Morgan, where we co-lead engagements under CA100+. For example, Rolls-Royce must go through the process of understanding how the energy transition will impact each of its products, including aircraft engines, and how these can be made compatible with a net-zero economy. In 2020 the company set a 2050 target to make all products compatible with net-zero emissions, even in challenging sectors such as the airline industry.

### Tighter policy

Such targets have been partly driven by the continued tightening of policy, with steps taken by China, Japan and the EU this year towards net-zero emissions. In the run up to COP26, to be held in the UK in November 2021, we can expect further shifts as the pressure builds to bring national policies into line with Paris Agreement pledges. The US is also rejoining the Paris Agreement.

When combined with the increased willingness of investors to use stronger engagement tactics to spur action, particularly at companies that are falling behind, this should stimulate further successful outcomes from CA100+. The net-zero benchmarking, currently being carried out by independent organisations, will give investors even better data to use when comparing companies, and help to increase the level of ambition.

In 2021 we will look closely at how the energy transition is accounted for in company financial reports and accounts, as well as focusing on nature-based solutions, the Just Transition, and mitigating physical climate risks through adaptation.



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### Key data for CA100+

Over **545** signatories

With over **US\$52tn** under management

Over **160** companies targeted, accounting for an estimated **80%+** of global industrial emissions

We lead or co-lead the engagement on **30** companies across the three major regions (North America, Europe and Asia)

We collaborate with others on another **14** companies

## Q&A: Biodiversity and sustainable land use



**Sonya Likhtman**  
Theme co-lead: Climate Change

Biodiversity rose up the investor agenda in 2020, as landmark studies and nature programmes warned of collapsing ecosystems. Approximately one million species are now at risk of extinction and the rate of extinction is accelerating. This is of serious concern as the ecosystem services provided by the natural world underpin our economies and societies.

We developed our engagement approach throughout 2020 and in early 2021 published a white paper *Our Commitment to Nature*. This focuses on the business case for protecting biodiversity, our engagement priorities and expectations, and key issues such as deforestation and regenerative agriculture. We have also signed up to the Finance for Biodiversity Pledge as the international business of Federated Hermes.

### Q. What is driving biodiversity loss?

**A.** There are five main drivers – changes in land use and sea use, direct exploitation of organisms, climate change, pollution and invasive alien species. As climate change is one of the five, reducing greenhouse gas emissions across operations and throughout supply chains will be a key mechanism through which carbon-intensive companies can mitigate their impact on biodiversity. Simultaneously, the health of the biosphere is important in tackling climate change. Forests, peatlands and grasslands, among other ecosystems, are natural carbon sinks that absorb and store carbon dioxide from the atmosphere. For this reason, protecting and restoring forests and other ecosystems is considered to be the second most effective solution to climate change, after switching away from fossil fuel use.

### Q. Why should investors be concerned?

**A.** All businesses, to varying degrees, are dependent on the common goods provided by nature. Recent estimates suggest that over half of global GDP is moderately or highly dependent on nature. This may be due to dependence on raw materials, such as food ingredients, wood and medical 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 microorganisms, enable ecosystem services to function effectively.



**Forests, peatlands and grasslands, among other ecosystems, are natural carbon sinks that absorb and store carbon dioxide from the atmosphere.**

For the most part, companies have taken the immense value of nature for granted. However, the threat to global ecosystems is now at unprecedented levels and the risk of hitting irreversible tipping points is high<sup>2</sup>.

In 2021, countries are expected to agree on global goals for biodiversity at the COP15 to the Convention on Biological Diversity, to be held in China. As with the Paris Agreement for climate change, the targets will be delivered by countries and companies. Litigation risks that arise when companies negatively impact biodiversity through major oil spills or other polluting events are already high, but financial and reputational costs for companies are likely to increase as the protection of biodiversity becomes a public policy priority.



**Companies need to urgently acknowledge their impact and dependence on nature.**

### Q. What are we asking companies to do?

**A.** 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. This might be through sourcing practices and supply chains, the construction of new sites, or 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, real estate and construction, and finance. As best practice, we expect companies to commit to having a net-positive impact on biodiversity throughout their operations and supply chain. This goal should be accompanied by strong governance, effective measurement, an impactful strategy and regular disclosure.

<sup>2</sup> Intergovernmental Science-Policy Platform on Biodiversity and Ecosystem Services (IPBES), *Global Assessment Report on Biodiversity and Ecosystem Services (2019)*.



**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.**

**Q. Halting and reversing deforestation is essential. What are we calling for?**

**A.** 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. We are working with companies directly and as part of several investor coalitions to reverse this trend. For example, we have engaged with South Korean conglomerate Posco since 2011, a company that had attracted criticism over deforestation resulting from its palm oil operations in Indonesia.<sup>8</sup> It has now confirmed that all palm oil sources for its subsidiary PT BIA are certified as Indonesian Sustainable Palm Oil. Posco International has also committed to an NDPE (no deforestation, no peat and no exploitation) policy and promised to preserve areas of high conservation value and high carbon stock.<sup>9</sup>

We also responded to the UK government's consultation on proposals to tackle illegal deforestation. We welcomed the legislative requirement for companies to conduct due diligence throughout their supply chains and made suggestions about how it could complement other frameworks, such as the TCFD.

Companies that source commodities with potential links 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.

**Q. And how are we encouraging a shift to regenerative agriculture?**

**A.** Regenerative agricultural practices restore the soil's natural ability to absorb and retain carbon, minimise chemical inputs and enhance biodiversity. 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.

For example, we have probed the level of ambition in the regenerative agriculture strategy of one US-headquartered staple food manufacturer, building on a previous engagement on watershed sustainability. We explored the scale and speed of transformation it is seeking to achieve for a range of ingredients and sourcing regions. We have also begun a conversation with a Switzerland-headquartered food and beverage company about how regenerative agriculture will help it to achieve its net zero by 2050 goal.



**Regenerative agricultural practices restore the soil's natural ability to absorb and retain carbon, minimise chemical inputs and enhance biodiversity.**

**Q. Can you give some examples of successful engagement outcomes?**

**A.** We have been engaging with companies on issues related to biodiversity for many years. For example, we have seen significant progress in tackling deforestation at KLK, a Malaysian company focused on the production and processing of palm oil products and natural rubber.<sup>10</sup>

We have also engaged with a major beverage company on its water stewardship strategy. In 2020, we expanded the conversation to include biodiversity and regenerative agriculture. 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.

<sup>8</sup> <https://www.mightyearth.org/2020/03/02/major-rainforest-destroyer-in-indonesia-pledges-to-address-its-deforestation-legacy/>

<sup>9</sup> <https://www.hermes-investment.com/ukw/eos-insight/eos/posco-case-study/>

<sup>10</sup> <https://www.hermes-investment.com/ukw/eos-insight/eos/klk-case-study/>

# Climate change and fossil fuel financing

In 2020 investors stepped up their calls for banks to phase out their financing of fossil fuels and align their lending policies with the Paris Agreement. Several key shareholder proposals focused on the issue, and some of the targeted banks made net-zero emissions pledges, but investors also want to see specific targets and intermediate milestones.

**With regulators and central bankers issuing increasingly stark warnings about the risks that global heating poses to the financial system, investors intensified their calls for banks to align their financing activities with the Paris Agreement goals. This resulted in some significant climate-related resolutions at shareholder meetings held by some of the biggest fossil fuel backers.**

According to the 2020 Banking on Climate Change report, 35 global banks have funnelled US\$2.7tn of financing into fossil fuels in the four years since the Paris Agreement was adopted.<sup>11</sup> JPMorgan Chase was the leader by a long chalk, but Citi, Barclays, MUFG, Toronto Dominion and Mizuho all made it into the top 10.

Not surprisingly, many of these banks were the focus of investor concern during the 2020 voting season. At JPMorgan Chase & Co, the bank responded to pressure from shareholders and their

representatives, including EOS, by announcing that its lead independent director would step down from his role and be replaced in 2020. We had engaged with the bank on his succession, having raised concerns over multiple years about his oversight of climate-related matters. The individual, beyond retirement age at 81, was a former CEO of ExxonMobil with a controversial track record on climate change who had become a lightning rod for shareholder dissent.

According to the 2020 Banking on Climate Change report, **35**

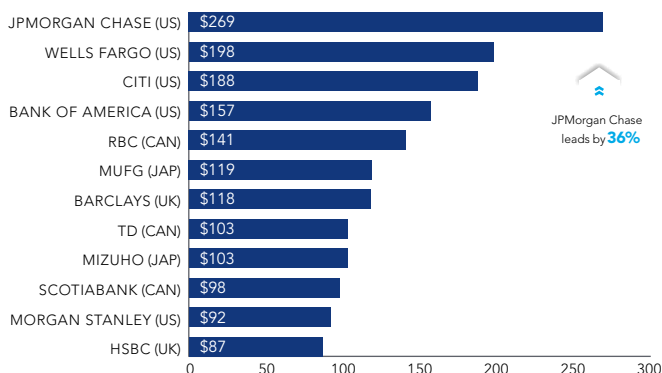
global banks have funnelled

**US\$2.7tn**



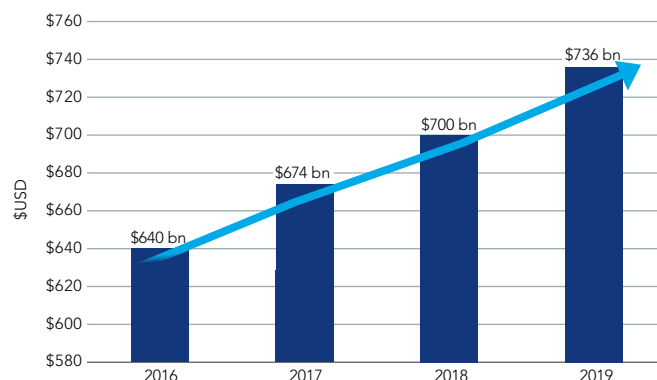
of financing into fossil fuels in the four years since the Paris Agreement was adopted.

## Finance for all fossil fuels globally since the Paris Agreement (2016-2019) (US\$bn)




Source: Banking on Climate Change Fossil Fuel Finance Report 2020.

## Total financing for fossil fuels (US\$bn)



<sup>11</sup> [https://www.ran.org/wp-content/uploads/2020/03/Banking\\_on\\_Climate\\_Change\\_\\_2020\\_vF.pdf](https://www.ran.org/wp-content/uploads/2020/03/Banking_on_Climate_Change__2020_vF.pdf)





**The progress made by many banks in 2020 lays down a good marker for other banks to follow, putting in place net-zero strategies that include absolute timelines for phasing out activities that are misaligned with the goals of the Paris Agreement.**

Another shareholder proposal that called on the bank to disclose its fossil fuel lending activities further, and any targets to reduce its financed emissions, attracted almost 50% support, including from EOS, despite opposition from the JPMorgan board. The Banking on Climate Change report shows that JPMorgan has led the fossil fuel financing pack every year since the Paris Agreement, with \$269bn in total. In October 2020, JPMorgan adopted a financing commitment aligned with the goals of the Paris Agreement, including a pledge to establish intermediate emissions targets for 2030 for its financing portfolio.

At Barclays there were two climate-related resolutions, one backed by the company and the other filed by ShareAction, a charity that advocates for responsible investment. The development of the company-backed resolution followed intensive engagement by investors and their representatives, including EOS. We have worked closely with Barclays over several years to enhance its management of climate-related risks. We recommended voting in favour of both climate-related resolutions.

The company-backed resolution passed with almost unanimous support and committed the bank to aligning all of its financing activities with the Paris Agreement, to become a net-zero emissions bank by 2050. ShareAction's resolution went further, calling for a phase out of financing for fossil fuels and utility companies that are not aligned with the Paris climate goals, and was supported by 24% of the investor base.

Finally, Mizuho Financial Group became the first Japanese bank to attract a climate-related shareholder resolution. This called on Mizuho to disclose a strategy, metrics and targets aligned with the Paris Agreement, given its continued financing of high carbon-related sectors. We recommended supporting, in line with our ongoing engagement, which dates back to 2009.

**Morgan Stanley became the first US bank to set a net-zero target for its financed emissions and joined the steering committee of the Partnership for Carbon Accounting Financials.**

In early 2020, we wrote to the head of investor relations and the head of sustainability at Mizuho to share emerging best practice and recommendations on climate change, responsible agribusiness financing and other topics. On climate change, we recommended that Mizuho clarify the coal phase-out timeline highlighted by the Powering Past Coal Alliance and incorporate this into its policy related to the refinancing of existing coal-fired power plants. We also shared the Principles for Responsible Banking (PRB) signatories' net-zero ambition for 2050, and asked Mizuho to clarify its strategy and targets in aligning its entire lending and investment portfolio with the Paris Agreement. Although the shareholder proposal did not pass, it received 34% support. The bank adjusted its coal financing policy in May, but it still lags the market and we continue to engage.

Morgan Stanley became the first US bank to set a net-zero target for its financed emissions and joined the steering committee of the Partnership for Carbon Accounting Financials. This is a group of financial institutions aiming to develop an approach for assessing and disclosing greenhouse gas emissions associated with loans and investments.

**The bank adjusted its coal financing policy in May, but it still lags the market and we continue to engage.**

Later in the year there was a significant development in the Canadian market, when Toronto Dominion (TD) Bank, one of the world's biggest funders of tar sands oil according to the Banking on Climate Change report, committed to a global climate action plan. This included a target to achieve net-zero greenhouse gas emissions from its operations and financing activities by 2050, aligned with the principles of the Paris Agreement. This followed a shareholder proposal asking the bank to adopt emissions reduction targets for its underwriting and lending activities, for which we recommended support.

The progress made by many banks in 2020 lays down a good marker for other banks to follow, putting in place net-zero strategies that include absolute timelines for phasing out activities that are misaligned with the goals of the Paris Agreement. Despite these commitments, there is a need for greater clarity over what this will mean in the short- and medium-term, and how these targets and actions will contribute to the reduction of absolute emissions in the real economy.

### Investor expectations paper

Building on our banking sector work in 2020, EOS worked in conjunction with IIGCC as one of the lead coordinators drafting a paper setting out investor expectations. The paper is split into three sections: alignment with the goals of the Paris Agreement, governance of climate risk, and disclosure. A collaborative engagement working group similar to Climate Action 100+ is being formed, and this will begin engaging with a number of banks in 2021, using the investor expectations as a basis.

## Q&A: Circular economy



**Lisa Lange**  
Theme lead: Pollution, Waste & Circular Economy

Plastic waste remained in the public eye in 2020, with lost or discarded single-use face masks a familiar sight on city streets as the pandemic wore on. But 99.5% of plastic volumes are not used in medical applications. We addressed this ballooning problem in our April white paper: *Investor Expectations for Global Plastic Challenges*. Companies' failure to take responsibility for their own plastic has resulted in acute environmental pollution, plus substantial greenhouse gas emissions across plastics value chains.

In 2020 we also looked closely at the problems relating to the fast fashion business model – another segment under scrutiny during the pandemic as shoppers switched to online clothes retailers while high street stores were closed.

### Q. What is the aim of the plastics white paper?

**A.** It's intended to act as a toolkit for investors to support their engagement with companies on this topic. We believe that the linear, take-make-waste model for plastics has become unacceptable and companies reliant on this model will face substantial new commercial risks in coming years. We expect companies to move from treating plastic as an externalised risk, to developing strategies that consider it as a resource requiring responsible management and value preservation – in partnership with suppliers, customers, processors and regulators. Essentially, companies should be on a journey of change. The report concludes with a series of questions that investors can ask companies at each point on their journey, from starting out, all the way through to taking a market leadership position.

### Q. How did you use this in your engagement activities?

**A.** We focused on businesses engaged in the manufacturing of chemicals for plastics, and the design, production, marketing and retailing of consumer goods. In 2020 we set objectives for high-risk companies and targeted outcomes that addressed opportunities and risks. We take a bespoke approach to each company exposed to plastics value chains, reflecting the maturity of that company. Our approach considers all the elements relating to a sustainable plastics strategy, including the governance, commitment or targets, and disclosure.

**We take a bespoke approach to each company exposed to plastics value chains, reflecting the maturity of that company.**

For example, within the consumer goods sector, we expect companies to recognise that how they use plastics in products and packaging is key for consumer trust, growth and licence to operate, as well as exposing them to the potential costs of increased regulation. Companies should consider the life-cycle of the materials used, and set and disclose sustainable design, materials use, handling and value chain targets relative to total volume, with end-dates for achievement.

**We focused on businesses engaged in the manufacturing of chemicals for plastics, and the design, production, marketing and retailing of consumer goods.**



We encourage companies to set targets in line with the New Plastics Economy Global Commitment initiated by the Ellen MacArthur Foundation. This includes the following:

- Take action to eliminate problematic or unnecessary plastic packaging by 2025
- Take action to move from single-use towards reuse models where relevant by 2025
- 100% of plastic packaging to be reusable, recyclable, or compostable by 2025
- Set an ambitious 2025 post-consumer recycled content target across all plastic packaging used.

We expect companies to provide evidence that their goals and targets are commercially-focused and demonstrate a shift to sustainable materials, or the increasingly circular use of materials, through annual reporting on progress.

**We expect companies to provide evidence that their goals and targets are commercially-focused and demonstrate a shift to sustainable materials, or the increasingly circular use of materials, through annual reporting on progress.**



### Q. What progress are you seeing in the retail sector?

**A.** Setting ambitious but realistic objectives for retailers is quite complex – we might cover recyclability of materials, recycled inputs and a reduction in single use plastics packaging. We looked at what retailers across the US, Europe and Asia were doing and saw some big differences in the maturity levels, targets, and data reported. Generally we are seeing more developed thinking and ambitious commitments in the UK. In the US there is some action on recyclability but less on plastic reduction or firm targets.

### Q. Can you give some examples of successful outcomes?

**A.** In 2020, we continued to engage with key companies along the plastics value chain. We are in discussions on setting targets for plastics reduction, recyclability and recycled content with several consumer goods companies and retailers in the UK and US, including Tesco, Costco, Ahold Delhaize, Starbucks, Walgreens Boots Alliance and Coca-Cola. For instance, plastics was one of the items we discussed with Ahold Delhaize in a meeting in October 2020 where we covered the company's progress against its target to achieve zero waste by 2025. We also asked for transparency on the volume of plastic waste, and the proportion that was recyclable, compostable or reusable plastics.

Around

**73%** of garments produced end up in landfill or are incinerated, while less than **1%** are recycled 

We have also engaged with companies involved in petrochemical production. For example, we had an in-depth discussion with LyondellBasell on single-use plastic in a joint engagement with investors participating in the PRI plastics working group. Since this discussion, the company has published a new plastics strategy to produce and market two million metric tons of recycled and renewable-based polymers annually by 2030.

**Clothes have also been identified as a source of microplastics pollution in the oceans.**

Within the PRI plastics working group we are also collaborating with the Ellen MacArthur Foundation to develop guidance to help investors engage with companies in the plastics packaging value chain. This is specifically for the petrochemicals, manufacturing of containers and packaging, fast-moving consumer goods and waste management sectors.

### Q. You've also led our work on the fast fashion industry. What are some of the environmental issues raised by this business model?

**A.** Fast fashion cycles are so short, there might be as many as 52 in a year. Influencers relentlessly promote new looks online and the cheapness of the garments encourages buyers to wear them only a handful of times before they are thrown away. Around 73% of garments produced end up in landfill or are incinerated, while less than 1% are recycled. Each production step has a cumulative impact on our planet in terms of the water, materials, chemicals and energy use, from the cultivation of cotton and petrochemicals production, to manufacturing, logistics and retail. Clothes have also been identified as a source of microplastics pollution in the oceans.

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.

**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.**

### Q. We plan to publish our investor expectations for fast fashion companies in 2021. Can you give us a preview?

**A.** 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.

Social and  
ethical

# Safety first – managing employees in a pandemic


The pandemic put key workers in supermarkets, retail pharmacies, logistics and the caring professions under acute pressure – but it also demonstrated their true value to society more clearly than ever. Throughout 2020 we engaged closely with companies on how they were treating their employees, given their importance to overall business performance.

**The value of a committed workforce with high morale was clearly demonstrated during the Covid-19 pandemic, when companies that had taken the time to invest in their employees and inculcate a strong corporate culture outperformed.**

The Just Capital tracker, created in March 2020 to assess 100 of the US's largest public employers, and covering all the Russell 1,000 companies by 5 November 2020, demonstrated that businesses were only as good as their workforce.<sup>12</sup> In the first half of the crisis it found that companies that prioritised their workforce significantly outperformed their peers.<sup>13</sup> Remote working and flexible hours, paid sick leave and improved personal protective equipment (PPE) for employees were some of the policies companies adopted or expanded.

In our engagements at the height of the pandemic we recognised that companies in certain sectors faced unenviable choices – between making workers redundant or going out of business, for example. Hospitality, travel and high street retail were all badly hit, triggering thousands of job cuts.

In April we published an open letter addressed to the CEOs of the companies in our engagement programme, asking how they were making difficult decisions in relation to their employees, supply chains, customers and other stakeholders. Companies that made workers redundant after benefitting from taxpayer-funded bailouts or furlough schemes attracted public criticism, particularly if they had spent the pre-crisis years using surplus cash for share buybacks. We encouraged a responsible approach to the use of government furlough schemes, and fairness between executive and staff pay.



**We asked these companies how they were protecting the physical and mental health of their employees while also ensuring they were able to increase capacity and meet demand for their services.**

## Worker health

We acknowledged that some sectors were under greater strain than others, with key workers in supermarkets, retail pharmacies, the logistics sector and caring professions on the pandemic frontline. We asked these companies how they were protecting the physical and mental health of their employees while also ensuring they were able to increase capacity and meet demand for their services. Was there paid leave for sickness or those self-isolating, and flexibility for workers who had to care for others? Did employees trust management to make the right calls as to their safety, and prioritise their needs appropriately versus those of customers, suppliers and shareholders?

<sup>12</sup> <https://justcapital.com/reports/the-covid-19-corporate-response-tracker-how-americas-largest-employers-are-treating-stakeholders-amid-the-coronavirus-crisis/>

<sup>13</sup> <https://justcapital.com/news/chart-of-the-week-companies-that-prioritize-their-workers-continue-to-outperform/>

For example, we have engaged with UK supermarket Tesco on governance and culture for several years, following an accounting scandal in 2014. It now has a markedly different culture and robust processes governing risk management, including for financial reporting and audit. Its efforts to rebuild trust with stakeholders, including employees, resulted in an engaged and motivated workforce that enabled the company to respond quickly and effectively as panic buying swept the UK. To support an increase in capacity and provide cover for employees who were isolating, Tesco employed around 50,000 temporary staff, including 4,000 new drivers and 12,000 new pickers. It also began paying a 10% bonus on the hourly rate to employees.

To support an increase in capacity and provide cover for employees who were isolating, Tesco employed around

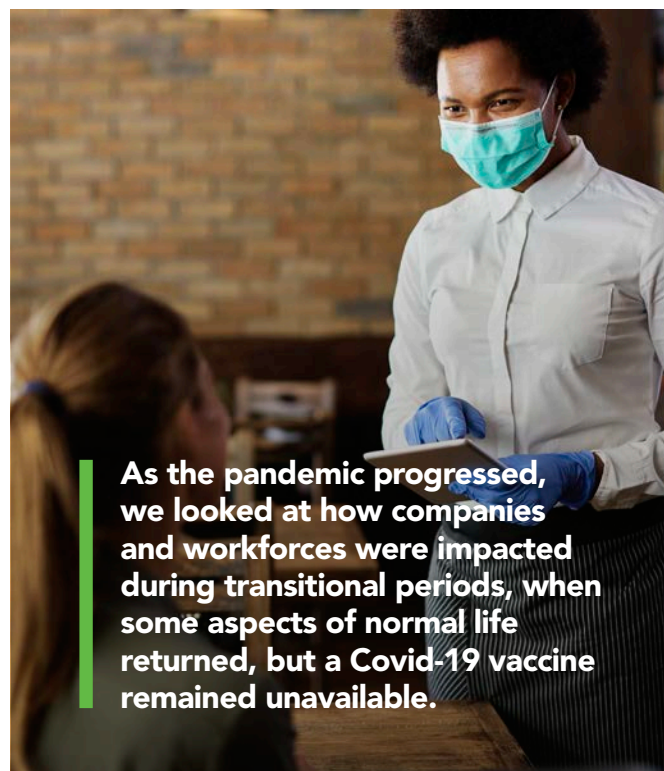
**50,000** temporary staff, including  
**4,000** new drivers and  
**12,000** new pickers.



In the US, we led engagement with four companies – Exelon, American Express, Lockheed Martin and Medtronic – for investors who support the Human Capital Management Coalition. We wrote to their boards ahead of their shareholder meetings asking that they address five key topics relating to business continuity and workforce management in response to Covid-19. We asked two questions on this topic at the Exelon annual shareholder meeting, with the company providing assurances that employee pay would not be affected, and that it had implemented health screenings.

We led a similar engagement with AbbVie, writing to the board and referencing our support for the Investors for Opioid and Pharmaceutical Accountability (IOPA) initiative. We sought to understand the implications of the pandemic for the wellbeing of the company's employees, patients and its communities, as well as its business and supply chain continuity plan and pandemic planning, given the important role that pharmaceutical manufacturers play in discovering and supplying treatments.

**In 2021 we will continue to push companies to pay a living wage, at the minimum, and provide job security, guaranteed hours, sick pay and family leave.**



**As the pandemic progressed, we looked at how companies and workforces were impacted during transitional periods, when some aspects of normal life returned, but a Covid-19 vaccine remained unavailable.**

### Leaving lockdown

As the pandemic progressed, we looked at how companies and workforces were impacted during transitional periods, when some aspects of normal life returned, but a Covid-19 vaccine remained unavailable. We argued that workers should have a say in decisions around transitioning out of lockdowns, and these decisions should be based on worker safety and sound science, while prioritising personal circumstances such as childcare. Strong, clear and enforceable workplace health and safety standards should be in place. That might mean a big increase in the availability and type of personal protective equipment for workers currently on the job, and for those returning to the job.

**We presented our engagement approach on human capital and labour rights and shared our engagement experiences of company actions as a result of the pandemic and the impact on the workforce.**

In July we co-hosted a thematic workshop on the changing landscape of human rights due diligence and workforce reporting in the context of Covid-19 with the Workforce Disclosure Initiative (WDI), of which we are a signatory. We presented our engagement approach on human capital and labour rights and shared our engagement experiences of company actions as a result of the pandemic and the impact on the workforce.



## CASE STUDY

## Boohoo

In 2020 we initiated an ad hoc engagement with the fast fashion retailer Boohoo following allegations against the company in the UK press regarding employment practices in Leicester, a textile manufacturing hub. Due to the relatively low client holdings, Boohoo is not in our engagement plan.



**On the call, we also raised concerns about the sustainability of the fast fashion business model.**

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.

**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.



**Lisa Lange**  
Theme lead: **Pollution, Waste & Circular Economy**

### Key lessons

The coronavirus pandemic has demonstrated the importance of strong health and safety practices and provisions, such as sick pay and mental health support, to ensure business continuity. It has also accelerated some trends that will shape how we work in future, such as a greater acceptance of flexible and remote working. We have seen commitments from some companies on how this might work post-pandemic, with Twitter saying employees can work from home permanently if they prefer.<sup>14</sup> Such policies, if adopted across the tech sector, could aid progress on diversity and inclusion, as employers will be able to seek out hires beyond the typical Silicon Valley tech bubble candidate.

**Employees concerned about inadequate PPE and unsafe working conditions, or who were forced to take unpaid sick leave, staged walkouts and protests.**

The flip side of working from home full time is that some employees may become socially isolated, or feel swamped by domestic demands, or a lack of division between work and home life. We engage with companies to ensure they have programmes in place to support employees' mental health, with regular, clear communication with employees about what is available.

Finally, the pandemic demonstrated the key role of labour unions, as workers in meatpacking plants, warehouse distribution centres and restaurants discovered the strength of their voice. Employees concerned about inadequate PPE and unsafe working conditions, or who were forced to take unpaid sick leave, staged walkouts and protests. In 2020 we engaged with Amazon and McDonalds, among others, on their health and safety management, with particular reference to Covid-19. In 2021 we will continue to push companies to pay a living wage, at the minimum, and provide job security, guaranteed hours, sick pay and family leave.

**Finally, the pandemic demonstrated the key role of labour unions, as workers in meatpacking plants, warehouse distribution centres and restaurants discovered the strength of their voice.**

<sup>14</sup> <https://www.bbc.co.uk/news/technology-52628119>



# Racial equity and ethnic diversity

The horrific death of George Floyd while in police custody in May 2020 reignited a global movement calling for systemic change to end racial injustice. As well as reflecting on ways to address racial inequity within our own group, we have reviewed our engagement expectations and strengthened our voting policies.

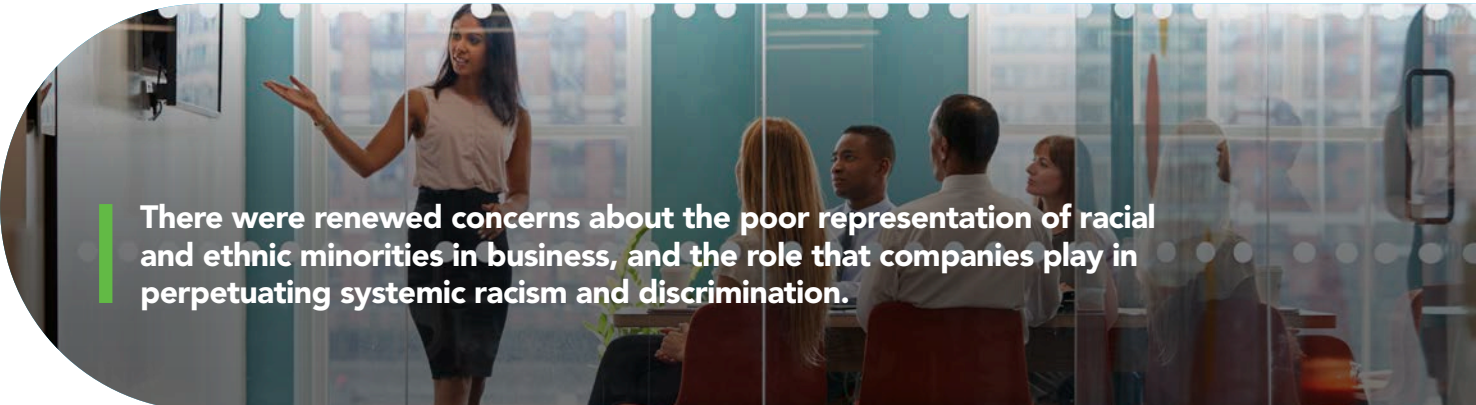
**The shocking death of African-American George Floyd while being arrested in Minneapolis in May triggered global protests against systemic racism and calls for change led by the Black Lives Matter movement.**

As well as the anger about persistent institutional racism in police forces and legal systems, there were renewed concerns about the poor representation of racial and ethnic minorities in business, and the role that companies play in perpetuating systemic racism and discrimination. It was clear to us that we could and should do more to push for urgent and profound change, both within our own organisation, and in wider society through our engagements with companies.

Chris Donahue, President and CEO of Federated Hermes, Inc. and Saker Nusseibeh, CEO, International at Federated Hermes, issued a joint statement in the immediate aftermath of George Floyd's death, saying how deeply affected and saddened they were by this horrific event.

**It was clear to us that we could and should do more to push for urgent and profound change, both within our own organisation, and in wider society through our engagements with companies.**

"Many of us are fortunate to live our lives peacefully and without prejudice, but it is not the case for millions of others," they said. "They live in a world where prejudice is a part of their life, and are feeling particularly vulnerable and outraged by what happened to Mr Floyd because it reflects a prejudice they feel. We are aware of their pain and reach out to them as colleagues in our firms and members of our communities."<sup>15</sup>



**There were renewed concerns about the poor representation of racial and ethnic minorities in business, and the role that companies play in perpetuating systemic racism and discrimination.**

<sup>15</sup> <https://www.hermes-investment.com/ukw/insight/corporate-news/federated-hermes-staff-message-regarding-recent-events-in-the-us/>



**Within EOS we reviewed how we could engage companies more effectively to increase racial and ethnic diversity and build inclusive environments.**

Within EOS we reviewed how we could engage companies more effectively to increase racial and ethnic diversity and build inclusive environments. We also considered how we could engage on the role that companies might play in combatting systemic and institutional racism.

As part of our review of best practices, we acknowledged the need for most companies, including our own, to do much more to address this urgent challenge. In recognition of this, we published our own plan of action, including a target to at least double the number of black permanent employees in our workforce by the end of 2022.<sup>16</sup>

Up until 2020, our engagement had focused on calling for greater racial and ethnic diversity, particularly at board level. In the US, we voted against the nomination and governance committee chair or lead independent director if a company's board comprised less than 30% women, and we signalled earlier in 2020 that we would act in the UK in 2021.

However, there was otherwise limited reinforcement through voting policies and engagement objectives, as we tended to prioritise gender diversity over racial and ethnic diversity. Even within gender, we were insufficiently focused on improving the representation of racial and ethnic minorities.

In the US, we voted against the nomination and governance committee chair or lead independent director if a company's board comprised less than

**30%** women, and we signalled earlier in 2020 that we would act in the UK in 2021.

To help address this, we developed a framework defining our engagement approach on racial equity and ethnic diversity. We expect companies to:

1. Publish a statement internally and to external stakeholders that acknowledges and condemns racism and racial inequity in society, and that acknowledges any inequity within the company, such as underrepresentation of minorities in leadership.
2. Commit to a thorough review of the company's actions to date to identify where it may be perpetuating racial inequity and where there are opportunities to make a positive contribution to racial equity. This should include: the company's culture and workforce; products, services and customer practices; actions with suppliers; and contributions to public policy and other societal actions. To inform this assessment, the company should seek and act on feedback from employees, customers, suppliers and other stakeholders, including independent external experts.
3. Make public commitments to address racial inequities within the workforce as a matter of urgency, and the related challenges and opportunities identified, including setting time-bound targets. These should be set in the context of actions taken on other underrepresented groups, acknowledging the important combined challenges faced, for example, by women of colour.
4. Start collecting data on the ethnic composition of the workforce by seniority, as a minimum. We encourage companies to publish this and other relevant data at least annually, including pay gaps/ratios, with a narrative explanation of what the figures mean and a brief, time-bound, action plan to address shortfalls. In markets where data collection is restricted by law, companies should find alternative ways of monitoring their diversity and inclusion efforts.

**We have also strengthened our 2021 Engagement Plan and scaled up our engagement in Q4 2020, setting corporate objectives and assessing opportunities for market best practice and public policy engagements with regional teams.**

We have formalised this in our 2021 Corporate Governance Principles and voting policies. We have also strengthened our 2021 Engagement Plan and scaled up our engagement in Q4 2020, setting corporate objectives and assessing opportunities for market best practice and public policy engagements with regional teams.

<sup>16</sup> <https://www.hermes-investment.com/ukw/post/corporate-news/corporate-statement-on-racial-equality/>



## Gender diversity

Companies often pay lip service to diversity and inclusion with detailed policies, but the slow pace of change speaks for itself. This is despite the fact that, beyond simply being the right thing to do, there is plenty of evidence to show that greater diversity leads to better performance. For example, McKinsey's 2018 report *Delivering through Diversity* found a clear link between executive gender and ethnic diversity and financial performance above the national industry median.<sup>17</sup>

Advancing gender equality in company leadership and throughout organisations remains critically important therefore, with many companies around the world still falling far short of equal representation. We encourage companies to critically and deeply assess where they are falling short and to set specific targets to address this. They should go beyond simply increasing overall representation, towards understanding how they can create more inclusive cultures to attract, and more importantly retain, develop and promote female talent.

**Advancing gender equality in company leadership and throughout organisations remains critically important therefore, with many companies around the world still falling far short of equal representation.**

For example, we engaged with beverage producer Anheuser-Busch InBev to increase the gender diversity of its executive management team, which lacked female representation. The company added a woman to its executive team and showed progress by launching a global diversity and inclusion policy, implementing company-wide unconscious bias training, using algorithms to check for bias in performance reviews, and launching a four-month global parental leave benefit. Elsewhere, we raised the issue with ArcelorMittal, which has no women at the executive level. The company acknowledged the importance of addressing this and said targets would be set.

We have also engaged with US pharmaceutical company Pfizer about the low levels of gender diversity on its board, arguing that the company should look beyond current or former CEOs and candidates with scientific or technology expertise. We were pleased that in early 2020 the company appointed two additional female directors with backgrounds in science and education, and civil society.

To promote market best practice, in April we hosted a webinar with UNESCO and its director for gender equality, Saniye Gülser Corat. We discussed the gender digital divide and gender bias in artificial intelligence, why investors should be concerned, and how companies can address this, particularly considering workforce gender diversity.

### Key data

In total, we had

**446** live objectives and issues relating to diversity in 2020, of which

**310** related to board diversity and

**136** to non-board diversity.

We made meaningful progress (objectives at M3 or M4) at

**64%** of all diversity-related objectives.

We voted against directors at

**882** companies due to concerns related to the approach to board diversity.

**We have also engaged with US pharmaceutical company Pfizer about the low levels of gender diversity on its board, arguing that the company should look beyond current or former CEOs and candidates with scientific or technology expertise.**

<sup>17</sup> <https://www.mckinsey.com/business-functions/organization/our-insights/delivering-through-diversity>



# Engaging on human and labour rights

2020 saw a number of human rights flashpoints from the destruction of the Juukan Gorge rock shelters in Western Australia in May, to the treatment of ethnic minorities in China.

## Indigenous rights

In sectors such as extractives and agriculture, companies that do not establish good relationships with impacted indigenous peoples create risks to communities and jeopardise their social licence to operate. Seeking the free, prior and informed consent of local indigenous peoples and then maintaining good relationships is critical to respecting salient human rights and mitigating abuses. In 2020 the destruction by Rio Tinto of two ancient rock shelters in Western Australia had a devastating impact on the indigenous Puutu Kunti Kurrama and Pinikura peoples (see Q&A). We expect companies to properly manage impacts and share benefits with communities, and respect indigenous peoples' rights to free, prior and informed consent as outlined in international standards.

**In 2020 the destruction by Rio Tinto of two ancient rock shelters in Western Australia had a devastating impact on the indigenous Puutu Kunti Kurrama and Pinikura peoples.**

For example, in 2020 we encouraged Kimberley Clarke to respect the land and water use rights of local communities and indigenous peoples in its Human Rights Policy. We engaged with Kirby over a 2016 British Columbia oil spill that polluted indigenous fisheries and asked the company to reach a settlement with the Heiltsuk Nation that included an apology, an environmental impact assessment, and direct compensation. We also urged Procter & Gamble to consider indigenous peoples' rights in its efforts to eliminate deforestation from its supply chains. And we aligned our Canadian Corporate Governance Principles with the Truth and Reconciliation Commission of Canada's recommendations to the corporate sector.

## High-risk contexts

In 2020 we evolved our methodology guiding our engagements in high-risk contexts, in response to client demand for more detailed guidance in this area. The risk of involvement in human rights abuses is higher for companies when they are operating in occupied territories, disputed areas and other high-risk environments. And with increasing regulation, such as Australia's Modern Slavery Act - which came into force in 2020 - and the 10-year anniversary of the United Nations Guiding Principles (UNGPs) on Business and Human Rights in 2021, there is increased scrutiny on companies to report how they respect human rights. Our engagement approach is apolitical, while distinguishing between those situations that contravene international law and those that do not.



**We engaged with Kirby over a 2016 British Columbia oil spill that polluted indigenous fisheries and asked the company to reach a settlement with the Heiltsuk Nation that included an apology, an environmental impact assessment, and direct compensation.**

For example, we have developed specific human rights guidance for engagement in the West Bank, while maintaining a politically neutral stance. In recent years, international focus on company and investor activity in the Israeli settlements has intensified. This increased scrutiny has prompted a number of companies to withdraw from the West Bank, often in the midst of boycotting campaigns. Similarly, several large institutional investors have divested from companies operating in the West Bank.

We analysed 10 companies potentially engaging in activities of concern in the Occupied Palestinian Territories (OPT), which may impact upon the basic freedoms of Palestinians. The companies provided us with information about how their due diligence and investigations had been strengthened to reflect the high-risk region and an overview of the grievance mechanisms in place. One company confirmed a cessation of activities linked to the construction of illegal or contested settlements.



**Investors are also increasingly concerned about the detailed and credible reports of alleged human rights abuses of ethnic minorities from the Xinjiang Uyghur Autonomous Region (XUAR).**

### Forced labour

Investors are also increasingly concerned about the detailed and credible reports of alleged human rights abuses of ethnic minorities from the Xinjiang Uyghur Autonomous Region (XUAR). The Chinese government denies any ill treatment.

In 2020 the US issued a Xinjiang Supply Chain Business Advisory cautioning companies about the risks of supply chain links to entities that engage in human rights abuses, including forced labour, in the XUAR and elsewhere in China. The US Commerce Department also added more Chinese companies that it said were implicated in human rights violations and abuses in connection with the XUAR, to the US economic blacklist.<sup>18</sup> Blacklisted firms cannot buy goods and technology from US companies without US government approval.

Although US sanctions escalated the issue for many companies, the risks of not addressing this could be severe for both people and businesses, regardless of sanctions. This is due to potential lawsuits and legal risks associated with gross human rights abuses; material risks stemming from the seizure of goods and the ending of business relationships; and reputational risks from negative media coverage, the filing of OECD National Contact Point complaints, and being subject to third-party investigations.

We engaged with one US manufacturer of farming machinery to learn how these sanctions impacted the company. We asked how it would comply with the sanctions and how it applied its human rights policy to customers and the use of its products, as its policy only referred to oversight of human rights in the supply chain. The company said that it would comply with sanctions but was still working through how to address the issue of conducting due diligence on its customers.

**We have developed specific human rights guidance for engagement in the West Bank, while maintaining a politically neutral stance.**

We followed up by sharing resources on how to approach human rights in high risk areas, including sharing the UN Guiding Principles reporting framework. We sought clarity on how the company would expand its human rights policy to include customers and product use, and how it would disassociate responsibly from business relationships potentially connected to a region.

We also wrote to some of the companies mentioned in an Australian Strategic Policy Institute report issued in March 2020 that alleged human rights abuses of the Uyghurs and other ethnic minority citizens from the far west region of Xinjiang.<sup>19</sup> The report listed 83 global brands as customers of factories where Uyghurs were allegedly being forced to work.

We requested more information from the companies about the due diligence that had been carried out to determine if there were any indications of forced labour in their value chains. We asked if the companies had found any evidence of this, and what action had been taken, given the relative lack of opportunity for leverage or provision of remedy in the region. We also recommended that companies use the UNGP reporting framework and consider responsible disassociation or using alternative providers where necessary. For 2021, we have identified other companies that could be implicated in this issue.

One of the most progressive responses came from a fashion retailer, which confirmed that it had no Tier 1 or 2 production in Xinjiang and had stopped sourcing cotton from Xinjiang after the Better Cotton Initiative suspended its licensing of cotton from the region in April 2020. The company also contacted all its suppliers in China highlighting that labour programmes where ethnic minority workers were taken to work in factories in China were regarded as forced labour. Subsequently, the company concluded that there was a heightened risk, and as a consequence it ended its business relationship with a mill in another province, which was owned by a yarn producer mentioned in the report.

<sup>18</sup> <https://www.commerce.gov/news/press-releases/2020/07/commerce-department-adds-eleven-chinese-entities-implicated-human>


<sup>19</sup> <https://www.aspi.org.au/report/uyghurs-sale>

## Migrant workers


In 2020 we also provided feedback to the Investor Alliance on the development of an Investor Toolkit for Human Rights. We joined a collaborative investor initiative called 'Find it, Fix It, Prevent It' focused on increasing the effectiveness of corporate action against modern slavery and engaged with companies as part of this group. The International Labour Organization estimates that 25 million people globally are in a condition of forced labour. Many of these people appear in companies' supply chains, and half of them are exploited through debt bondage. Migrant workers are particularly vulnerable through the payment of recruitment fees.

- We challenged one global catering company on the effectiveness of its actions to uncover modern slavery across its business or supply chain. Only one incident was found, via the press, which reported that one of the company's UK meat suppliers did not comply with working hours and practices. The supplier was reinstated after investigations and rectification. The company was able to demonstrate that policies, controls, reporting and training frameworks were in place. However, it acknowledged our concerns and said it was striving for continuous improvement.

The International Labour Organization estimates that

**25M** people globally are in a condition of forced labour. 

- We were signatories of a joint investor letter to companies with potential links to migrant workers in the United Arab Emirates who found themselves without work, shelter or a way home after losing their contracts due to the economic impact of Covid-19. We discussed this with the catering company, which worked hard to provide support until borders re-opened, while ensuring that there was constant communication with teams on the ground.
- Finally, as part of the Australian Institute of Superannuation Trustees' virtual 2020 conference, we took part in a panel discussion on the requirements of Australia's new Modern Slavery Act. We highlighted how companies and funds can embed modern slavery due diligence into their operations and value chains, take action to identify abuses and provide remedy, engage with suppliers or investment companies, and report transparently about these activities.



**Migrant workers are particularly vulnerable through the payment of recruitment fees.**

## Q&A: Indigenous rights and Rio Tinto



**Andy Jones**  
Theme lead: Stewardship  
Sector co-lead: Mining & Materials

In May 2020, mining company Rio Tinto destroyed two ancient rock shelters in Juukan Gorge, Western Australia. The sites were sacred to the Aboriginal traditional owners and had significant archaeological value<sup>20</sup>, showing evidence of human habitation going back 46,000 years. The resulting outcry from the indigenous Puutu Kunti Kurrama and Pinikura (PKKP) peoples, investors and the wider public, prompted a board review into the company's cultural heritage management and the organisational and cultural failings that led to the incident. This led to an initial decision to cut the bonuses of the CEO and two other executives, but some stakeholders viewed this response as inadequate and in September the company announced that the three would leave Rio Tinto by mutual agreement.

On 9 December, an Australian parliamentary committee inquiry determined that the destruction of the caves by Rio Tinto was "inexcusable" and recommended that the company negotiate a restitution package with the PKKP peoples, including a full reconstruction of the rock shelters, at its own expense.<sup>21</sup> It also recommended that mining companies commit to a voluntary moratorium on acting on existing approvals to destroy sites, until new Aboriginal heritage laws are passed.



### Q. What was our initial response to the destruction of the caves?

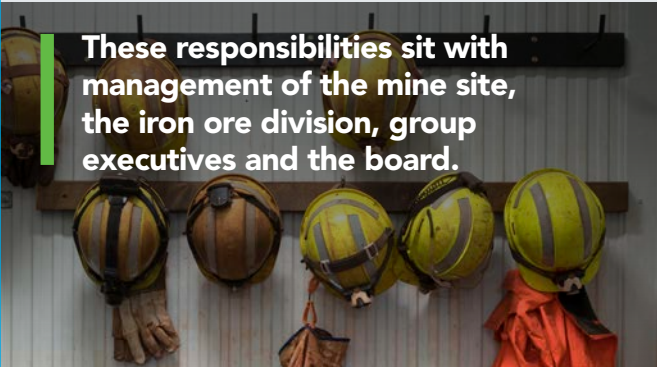
**A.** As Rio Tinto is an Australia-UK dual-listed company and the incident occurred in Australia, we worked with our local stewardship partner, the Australian Council of Superannuation Investors (ACSI), to establish what exactly had gone wrong and how the company was responding. ACSI held meetings with the company's managers, board members and community groups. Subsequently, the independent directors of Rio Tinto carried out a review, which found various failings around both mine planning decisions and how the company engaged with community groups, going back several years.

<sup>20</sup> <https://www.theguardian.com/australia-news/2020/aug/04/rio-tinto-blew-up-juukan-gorge-rock-shelters-to-access-higher-volumes-of-high-grade-ore>

<sup>21</sup> <https://www.theguardian.com/australia-news/2020/dec/09/juukan-gorge-inquiry-rio-tintos-decision-to-destroy-indigenous-rock-shelters-inexcusable>

For example, indigenous groups were not always kept informed if the company decided to change a mine plan.

The local community had raised concerns about the Juukan Gorge operation, and an anthropologist's report had flagged its importance to Australia's cultural heritage, saying the significance of the site could not be overstated. Rio Tinto had received information on the site's significance in 2014, 2018 and again in 2020, but this was not escalated early enough or high enough. The CEO only learned of the significance of the site after the explosives were unable to be retrieved, on the day the sites were damaged.



**These responsibilities sit with management of the mine site, the iron ore division, group executives and the board.**

**Q. How did we engage with the company after the publication of the board review?**

**A.** We met the board chair, who described the company's and the board's own failings. The chair highlighted that the voice of heritage experts had been too weak, and this needed to be similar to the importance attached to safety within the organisation. In his view the key company failure was in 2014 when the significance of the site became known and the mine plan was not reviewed. We agreed that was a key moment but also expressed our deep concern about the management process after 2014, including in March to May 2020, just before the blast, when explosives were loaded.

We responded that, in our view, the board review<sup>22</sup> was too generous to management. For example, it focused on failures in escalation, rather than senior level responsibility to have appropriate checks and controls in place, and to set the tone on culture and the importance of heritage. These responsibilities sit with management of the mine site, the iron ore division, group executives and the board.


The review's findings also pointed to a cultural issue within the company in terms of how stakeholders were considered, and how local communities were informed and included in decisions. We encouraged the company to set an aspiration to again become a leader in heritage and community relations. We also discussed how we could gain comfort on the implementation of the identified steps, and management performance, through future reporting given the urgent need to enhance related governance and risk management and rebuild stakeholder trust.

In a subsequent engagement with the board chair, we explored the actions taken since the incident and the role of the board and its sustainability committee in overseeing environmental and social risks. This focused particularly on how the company could identify major risks associated with decisions made many years earlier. These can remain 'sleeping risks' that suddenly manifest later under new management. This is of particular importance given the lengthy nature of decision-making in the mining industry.

**We encouraged the company to set an aspiration to again become a leader in heritage and community relations.**

**Q. What are we calling for now?**

**A.** In late October we co-signed a letter led by ACSI and the Church of England Pension Board that was sent to major mining companies asking whether genuine consents were being obtained from traditional owners and asking how these companies were handling cultural heritage risk. The letter encouraged miners to consider their practices and governance frameworks, including how the board oversees issues, where responsibility lies for the management of relationships with relevant First Nation or indigenous peoples, and how the company assesses the effectiveness of its processes for incorporating these views.



**The chair highlighted that the voice of heritage experts had been too weak, and this needed to be similar to the importance attached to safety within the organisation.**

<sup>22</sup> <https://www.riotinto.com/news/releases/2020/Rio-Tinto-publishes-board-review-of-cultural-heritage-management>

**In a subsequent engagement with the board chair, we explored the actions taken since the incident and the role of the board and its sustainability committee in overseeing environmental and social risks.**

The letter also asked what action each company had taken to identify and manage these risks across the business. For example, had they reviewed policies and procedures, company culture, and relevant agreements and dispute resolution processes to ensure that they both comply with relevant laws and meet broader community expectations?

Separately, we sent a letter to Rio Tinto asking for an independent review of the agreements that the company had in place with traditional owners, due to concerns that these agreements were unfair and prevented the traditional owners from raising their concerns publicly. Also, although this is clearly a cultural heritage issue, we feared that the underlying cultural and governance failings could lead to other environmental and social impacts across the group. Given this, we asked for a second independent review, focused on internal practices, culture and external relations. We also suggested the establishment of a stakeholder advisory panel, to advise the board and support its ability to understand and oversee stakeholder interests.

**Q. What steps has Rio Tinto taken to reform its practices?**

**A.** Rio Tinto has expressed its deep regret for destroying the rock shelters and has apologised to the PKKP peoples. It has identified and instituted a range of positive actions including an enhanced level of governance over the impact on sites of heritage significance, with referrals of decisions as appropriate directed to its recently-established heritage sub-committee of the executive committee, and if necessary, the board.

It has also established a communities and social performance area of expertise, aligned with its existing health, safety, environment function, reporting to a member of the executive committee. In addition, it appointed a chief adviser, indigenous affairs, who has a direct reporting line to the CEO. It has pledged not to enforce clauses in agreements that restrict traditional owners from raising concerns publicly about cultural heritage matters, or clauses that restrict them from applying for statutory protection of any cultural heritage sites.<sup>23</sup>

**Q&A: AI ethics and data governance**



**Hannah Shoemith**  
Theme co-lead: Human Rights  
Sector co-lead: Technology  
Software

EOS was shortlisted by the PRI in 2020 for stewardship project of the year for its work on AI ethics and data governance. Since 2019, we have been creating frameworks and tools that investors can use to address issues around freedom of speech, supply chains, data privacy, surveillance, user manipulation, bias and discrimination.

Our work has included co-authoring two white papers published in 2019: *Investors' Expectations on Responsible Artificial Intelligence and Data Governance*, and *Artificial Intelligence Applications in Financial Services*, as well as our trusted AI assessment framework, published in September 2020. Also, we were a co-lead filer of a shareholder proposal at Alphabet's 2020 shareholder meeting.

**Q. In a nutshell, what are we asking companies to do?**

**A.** We want to make companies aware of the risks related to privacy, bias and discrimination when using AI, and then to develop a risk-aware culture at different levels within a firm. The aim is to help companies become more transparent in how they use Big Data and machine learning. We expect companies to publish AI principles, applicable use cases and white papers that highlight their challenges and limitations. Although the material social issues may differ from sector to sector, the right to privacy, life, and equality and non-discrimination will always apply, as these are fundamental human rights.

**We want to make companies aware of the risks related to privacy, bias and discrimination when using AI, and then to develop a risk-aware culture at different levels within a firm.**

<sup>23</sup> <https://www.riotinto.com/en/news/inquiry-into-juukan-gorge>

### Q. How have we engaged with companies?

**A.** We have engaged with 60 companies across the tech, banking and pharmaceutical sectors in the US, Europe and Asia. This includes sending letters to companies outlining our concerns and requesting further information on the approach to AI and data governance risks. We also conducted an initial benchmarking of the management performance at banks on AI/data governance.

We have engaged with

**60** companies across the tech, banking and pharmaceutical sectors in the US, Europe and Asia.

### Q. Can you tell us about the Alphabet engagement?

**A.** In 2019 we escalated our engagement at Alphabet, supporting a shareholder proposal calling for the establishment of a societal risk oversight committee, and speaking at Alphabet's annual shareholder meeting, where we called for board directors to answer to shareholders.

In November 2019, we sent a private letter to Alphabet signed by over 80 institutional investors representing nearly \$10 trillion in assets under management and advice, raising concerns about the company's lack of responsiveness on ESG-related issues and requesting a dialogue with Alphabet on human rights-related issues.

Also, we were a co-lead filer of a shareholder proposal for Alphabet's 2020 shareholder meeting, with three other institutional investors. The proposal called for the establishment of a Human Rights Risk Oversight Committee to help anticipate and oversee management of the adverse human rights, and societal risks and impacts, associated with Alphabet's technologies. With approximately 53% of Alphabet's voting shares controlled by the company's executive officers and board members, this did not pass, but there was solid support for the resolution from the independent votes.

**The first challenge was to develop a foundational understanding of the long-term sustainability issues relating to AI and data governance, and then translate this into an actionable engagement agenda.**



### Q. AI ethics and data governance is a complex area. What challenges has EOS had to overcome?

**A.** The first challenge was to develop a foundational understanding of the long-term sustainability issues relating to AI and data governance, and then translate this into an actionable engagement agenda.

We tackled this through the two white papers and emphasised the connection between AI ethics and the impact on human rights, to help foster wider acceptance and understanding by stakeholders.

Challenges remain in ranking the leadership of companies with trusted AI applications beyond the technology sector, as brand value is closely connected to product offering, customer services and other factors.

We developed a multi-criteria appraisal system for scoring technology companies' approach to AI and ethics, which can be used as an input to ESG integration, and to monitor the progress of engagement on this topic at individual companies.

**Challenges remain in ranking the leadership of companies with trusted AI applications beyond the technology sector, as brand value is closely connected to product offering, customer services and other factors.**

In September 2020, we published the trusted AI assessment framework. This is a three lines of defence model that we recommend to companies. Each category of the assessment is mapped to the principles and analytical framework that we highlighted in the April 2019 paper.

The Innovation Lab at the international business of Federated Hermes has also developed an enhanced version of this framework for health and life sciences companies that has guided both engagement and investment decisions. By analysing AI patent activity to reveal a company's innovation strategy, this can be mapped to ethical considerations specific to the sector such as patient data protection safeguards and more representative subject selection for clinical trials.

**Q. Can you give some examples of successful outcomes?**

**A.** Following our engagement, Alphabet has made improvements in AI governance at the operational and product levels, although we continue to press for improvements at the oversight level. In November 2020, the company changed its audit committee to an audit and compliance committee (ACC). Under the ACC's charter it must review sustainability, data privacy and civil and human rights risks, increasing its responsibilities. This brought it closer to meeting our request for enhanced board oversight. We led a small group of investors in reaching out to the audit and committee chair to seek deeper engagement on human rights due diligence.

Also, Facebook has established a safety advisory board, and Chinese insurer Ping An became one of the first major financial institutions globally to publish a set of AI ethical principles. Looking ahead, we expect companies to get much more involved in helping to build the policy framework for AI ethics and data governance, so they understand fully what it is they will have to comply with.

**Following our engagement, Alphabet has made improvements in AI governance at the operational and product levels, although we continue to press for improvements at the oversight level.**

**CASE STUDY**

**Baidu**

In August 2018, we met the co-founder, chair and CEO, and the CFO of Baidu, the Chinese search engine and internet platform. We voiced our concern about the company's lack of compliance with the EU's Global Data Protection Regulation, as without appropriate measures, the company would be at risk of exposure to fines from regulators or even lawsuits from customers and search engine users. Baidu assured us that it was working towards becoming compliant.



We shared global best practices on data privacy management and disclosure and encouraged collaboration across the company to establish a corporate culture of data protection awareness. From 2019, we intensified our engagement and progressed our dialogue towards the responsible use of big data and artificial intelligence (AI), sharing our white paper on AI and data governance, and good practice around this rapidly evolving topic.

Between 2018 and June 2020, we had nine engagement interactions with the company on data privacy and protection. In 2019 the company disclosed to us that it had introduced a preliminary three lines of defence robust governance structure, refining this in 2020 to ensure information security and data privacy, with relevant training for employees and business partners. This aligns with our ongoing engagement with the company around data governance risks along the supply chain and our requests to proactively manage this.

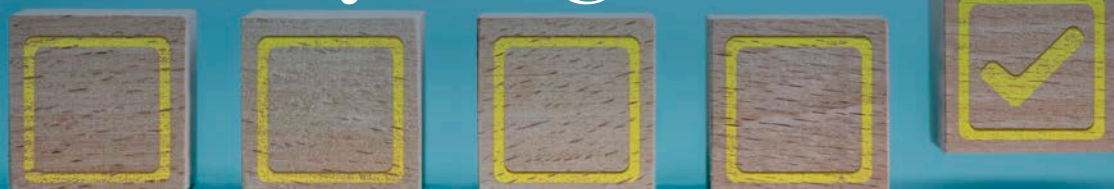
Baidu also said that it had introduced the "Three C Principles" – covering consent, clarity and control of data privacy protection. A privacy protection system was established, overseen by the Baidu data privacy protection committee, composed of Baidu's top executives.

The company also established a data assets committee, safety committee, and a committee of professional ethics, and said that it had introduced a review mechanism throughout the business, centred around privacy-by-design and privacy impact assessments. It also said that it takes privacy protection into consideration along the whole life-cycle of its products and services, including data processing, and requires that business planning must be carried out simultaneously with privacy protection planning.





# Voting season 2020: virtually as good?




In 2020, voting season played out against the backdrop of the Covid-19 pandemic and government-imposed lockdowns, prompting some companies to opt for virtual or hybrid shareholder meetings. These new approaches presented fresh challenges and opportunities for investors.

**Covid-19 has caused huge disruption to companies globally, within their own operations and their supply chains. Some businesses suffered a dramatic drop in revenues and were forced to lay off or furlough staff or make significant changes to the way in which they operated. Others sought government support and suspended dividend payments.**

As we take an engagement-led approach to our voting, our aim in 2020 was to strike a balance between advancing our long-term engagement agenda while understanding and supporting the efforts that companies were making to manage through the pandemic.

We reviewed our voting policies ahead of the voting season and in some circumstances we were more supportive of the re-election of those directors who we believed were critical to short-term crisis management, while continuing to communicate our longer-term governance concerns.



**Covid-19 has caused huge disruption to companies globally, within their own operations and their supply chains.**

In 2020 we recommended votes for

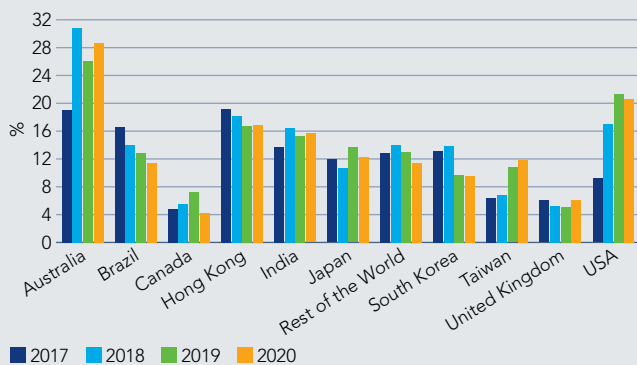
**11,759** meetings, versus  
**10,584** meetings in 2019.

We also developed guidelines for recommending votes on special topics related to the crisis, including changes to annual shareholder meeting arrangements, dividends and buybacks, share issuance and executive pay. These were developed with input from our clients.

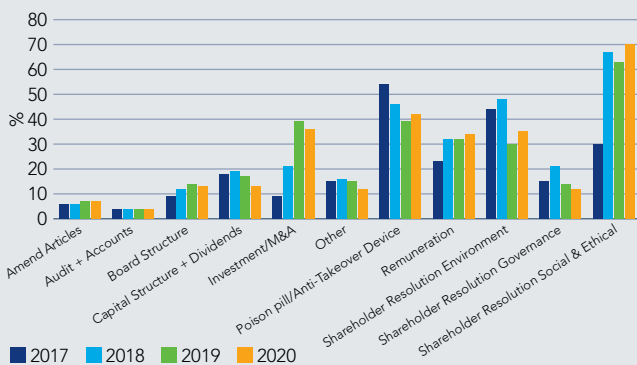
Despite delays and changes to meeting arrangements, the season was as busy as ever. In 2020 we recommended votes for 11,759 meetings, covering almost 124,000 proposed resolutions. This compared with 10,584 meetings in 2019 and almost 110,000 resolutions. We 'attended' and asked questions at 24 shareholder meetings, including Deutsche Bank, BP, Google owner Alphabet, Novartis, Amazon and Facebook, up from nine in 2019. We made statements for nine companies and asked live questions at six meetings, submitting questions in advance for others.

Overall, we made at least one voting recommendation against management at 55% of meetings, versus 60% in 2019. Some 1,684 of these were in North America, where we recommended against management on 4,585 proposals or 10%.

### Percentage of proposals voted against management per key market in 2020



### Proportion of resolution type with recommended votes against management



Source: EOS data

Climate change, human capital management during the pandemic, and gender and ethnic diversity were at the forefront of investors' concerns in 2020. Overall, there was a slight reduction in climate change shareholder resolutions across all sectors this season, although there were some high-profile successes, as investors called for companies to align their policies and targets with the Paris Agreement goals, including at Woodside Petroleum, Santos and Barclays. The NGO-filed shareholder resolutions at the Australian oil and gas producers attracted record levels of support from institutional investors – more than 50% at Woodside and 47% at Santos.

### Board composition and diversity

Given the importance of a stable board for effective crisis management, we considered voting in favour of chairs or committee chairs where we had concerns about poor gender diversity or board or committee independence, unless these were serious or urgent concerns. For example, at Morrisons and UniQure, we had concerns about persistent poor board gender diversity. And at Ocado Group we had concerns about board independence and potential conflicts of interest arising from the company secretary also being an executive director, an unusual arrangement for a FTSE 100 company.

We continued recommending votes normally on other director elections and relevant proposals, such as shareholder proposals calling for an independent chair. In total, we recommended voting against 1,556 proposals due to concerns relating to board or committee independence, versus 1,738 in 2019; against 1,805 due to diversity concerns, versus 1,622 in 2019; and against 364 due to over-commitment concerns versus 419 in 2019.

In the UK  
we opposed **35**  
proposals for concerns  
about insufficient diversity  
at board level and below.



In the UK, where the Hampton-Alexander Review established 2020 targets for 33% female representation on boards and in leadership roles, we opposed 35 proposals for concerns about insufficient diversity at board level and below, versus 45 in 2019, reflecting our moderated approach in light of the coronavirus pandemic. We continued to target laggard FTSE 100 companies with all-male executive committees, including Rolls-Royce. We would normally have recommended against the re-election of the chair in such circumstances but given the upheaval at the company due to the pandemic, we did not think 2020 was the best year to carry out such a change. We also received assurances in engagement that diversity was a strategic priority for the business, so we remained supportive, while continuing to push for more ambitious targets and rapid change.

Climate change, human capital management during the pandemic, and gender and ethnic diversity were at the forefront of investors' concerns in 2020.

We will be ramping up voting action on ethnic diversity in 2021, having signalled this in our Corporate Governance Principles and engagement for several years, as equivalent targets from the Parker Review come into force for boards to include at least one black or minority ethnic member.

In the US, we opposed 945 proposals for insufficient gender and ethnic diversity, including at Amazon, IBM and Facebook. In Asia, following Tencent's appointment of its first woman to the board in 2019, Nintendo appointed its first female director in its 130-year history. Softbank Group and Suzuki Motor followed, in line with our engagement. We achieved this through consistent engagement over multiple years and we expect more companies to step up to our diversity expectations in the coming years.

We have set our gender diversity standards in China and Hong Kong on a par with the US, while in Japan we introduced a higher threshold for Topix 100 companies in 2020 and continued to oppose companies with no women on the board. We opposed the combined chair and CEO of Canon, as well as nomination committee chairs at AIA, Galaxy Entertainment Group, Mizuho Financial Group, Hyundai Motor and China Mobile after engagement revealed no concrete plans for improvements to their male-dominated boards.

In Asia, following Tencent's appointment of its first woman to the board in 2019, Nintendo appointed its first female director in its

**130** year  
history.




### Executive compensation

Compensation is always a contentious issue and, against the backdrop of the coronavirus, decisions on how to reward executives were thrown into sharp relief. We believe that CEOs and boards should lead from the front in unprecedented times and 'share the pain' felt by other stakeholders, including employees, customers, suppliers and the public. This was particularly important where companies made use of government – and ultimately, tax-payer funded – support; where there were workforce pay cuts or job losses; or where the company was otherwise distressed.

We looked for appropriate reductions to salaries and incentive pay and for boards to use their judgement to ensure executives were not being unduly insulated from the impacts of the crisis where others were not. We opposed pay proposals where we did not believe appropriate adjustments had already been made, such as at JPMorgan Chase & Co, Disney and Delta Airlines.

We continued to make the case for switching to simpler pay schemes based on long-term time-restricted stock, as the crisis exposed the limitations of schemes reliant on stock options or 'performance-based' schemes for which boards struggled to set meaningful targets. Underpinning this, we applied our normal voting policy guidelines that seek to address excessive pay and problematic pay structures around the world.



**We also opposed the remuneration report and remuneration committee chair at Ocado, due to concerns about excessive pay, including a controversial incentive scheme that generates very high pay awards for executives.**

Overall, we recommended a vote against 35% of pay proposals, compared with 37% in 2019. In the US, we opposed 81% of say-on-pay proposals versus 82% in 2019, including at McDonald's due to concerns about the excessive severance package awarded to the former CEO and the lack of a robust 'clawback' policy; at Tyson Foods where we continue to oppose high pay and the use of short-term stock options; and at Facebook, due to concerns about high pay and the lack of shareholding requirements for executives.

Meanwhile, in the UK, where approximately 75% of FTSE 350 companies proposed new remuneration policies, we opposed 50% of policy proposals versus 36% in 2019. This was for concerns including an excessive variable pay opportunity (as at GSK, AstraZeneca and Royal Dutch Shell), insufficient share ownership guidelines (Intercontinental Hotels Group) or insufficient action to align executive pension contributions with those available to the workforce (J Sainsbury). We also opposed the remuneration report and remuneration committee chair at Ocado, due to concerns about excessive pay, including a controversial incentive scheme that generates very high pay awards for executives.

In Asia and emerging markets, the quantum of pay tends to be lower and the opportunities to vote on pay at annual meetings are fewer. Executives' compensation is often undisclosed at an individual level in Japan, South Korea and Taiwan, unless their respective compensation exceeds the regulatory threshold. Fixed pay often contributes a significant portion of pay.



**In Asia and emerging markets, the quantum of pay tends to be lower and the opportunities to vote on pay at annual meetings are fewer.**

We supported a bonus proposal at Takeda although the amount was significant compared with its Japanese peers, as we welcomed a detailed remuneration policy that the company disclosed following our engagement, and the introduction of a clawback policy. This followed a shareholder proposal on the topic in 2019, which did not pass but gained significant support.

We are seeing more Chinese state and non-state companies introducing or proposing amendments to share incentive schemes, giving us the opportunity to share our expectations and push for better practices. For example, at Hikvision, we opposed changes to performance hurdles due to concerns

about the risk of manipulation. We are pleased to see that more A-share companies listed in mainland China are issuing time-restricted stock, instead of share options, aligned with the improvements we have been advocating.



**We are seeing more Chinese state and non-state companies introducing or proposing amendments to share incentive schemes, giving us the opportunity to push for better practices.**

## Q&A: Revisions to voting policy guidelines



**Amy Wilson**  
Theme co-lead: Business Purpose & Strategy

### Q. What changes did we make to our voting guidelines for the re-election of chairs and committee chairs in 2020?

**A.** Recognising the critical role of leadership in periods of crisis management, we revised our voting guidelines to recommend 'for, by exception' rather than 'against' the re-election of chairs and committee chairs where we had concerns about issues such as a lack of diversity or independence. We continued to communicate our concerns and expectations for change, and made clear any allowances were temporary. Where we had serious or urgent concerns, we opposed as normal. For example, we opposed the chair of the sustainability committee at miner and commodities trader Glencore due to safety and climate concerns, and at steel manufacturer ArcelorMittal for safety and diversity concerns.

### Q. What about instances where we had climate change concerns?

**A.** We use the Transition Pathway Initiative (TPI) management scoring pathway to assess the management of climate change risks and opportunities for larger and more exposed companies. We take an engagement-led approach to understand the reasons for poor management scores and whether a company will commit to making progress. Where we do not receive satisfactory responses, we may recommend voting against the re-election of the chair or other relevant committee chairs.

**We continued to communicate our concerns and expectations for change, and made clear any allowances were temporary.**

Recognising that the climate crisis is an urgent and critical issue, generally we did not amend our usual approach. In 2020, we recommended votes against directors at 34 companies due to concerns about climate change risk management, where it was indicated in the rationale. This included companies where we remained concerned about the low level of ambition following engagement, such as at Yanzhou Coal Mining, Apache and China Shenhua Energy.

However, in a few cases, where companies with poor disclosure were able to demonstrate a reasonable prospect of positive change over the longer term and were otherwise in evident distress, we gave some reprieve and recommended voting in favour, by exception to our policy, with clear communication of our expectations for change. This was the case at Lufthansa, for example.

### Q. Due to pandemic restrictions on public gatherings, some companies held virtual shareholder meetings or made other arrangements. This worked well in some cases, less so in others. What were our main concerns?

**A.** While we were open to companies postponing meetings or converting them to virtual or hybrid meetings as an urgent measure, we said that every effort must be made to ensure shareholders could continue to exercise their rights, including asking board members questions. While there were positive examples, like Deutsche Bank, which delivered its virtual meeting via a live webcast, we also saw some troubling practices.

In Switzerland, some large companies did not provide any mechanism for a Q&A, and in the UK some held meetings behind closed doors, with no broadcast. One example was Barclays, where we raised our concerns about the impact on shareholder rights with the company secretary. In the US, we were disappointed that pharmaceutical company AbbVie ended its virtual meeting after less than half an hour, choosing not to address the question we had submitted on the grounds that it had run out of time.

**Q. Global protests driven by the Black Lives Matter movement have renewed concerns about the poor representation of ethnic minorities in business and the role that companies play in perpetuating systemic racism. How have we strengthened our voting policies for 2021 to encourage companies to improve ethnic diversity?**

**A.** In the UK we have introduced a new policy to oppose FTSE 100 chairs where there is no black, Asian or minority ethnic (BAME) director, or no submission to the Parker Review and no commitment to do so in future. In the US we have combined race and gender diversity expectations for boards, which we have raised to 40% from 30% for the biggest companies. Below board level, we have a new policy to oppose governance committee chairs where there is no ethnic or gender diversity on the executive committee.

**Q. Will we continue to modify our voting policies in 2021 in response to Covid-19?**

**A.** Our voting policies reflect the importance of long-term issues such as board effectiveness, climate change and diversity. Given the time that has passed since the crisis began and therefore the time that boards and companies have had to respond, we will be returning to our usual voting policies for 2021 on the whole. However, when making voting recommendations on the election of directors, particularly board and committee chairs, we will continue to consider the importance of consistent leadership for companies facing acute distress caused by the ongoing coronavirus pandemic.

**For virtual meetings, we said that every effort must be made to ensure that shareholders could continue to exercise their rights.**



## Q&A: Board composition and effectiveness



**Jaime Gornsztejn**  
Theme co-lead: Board  
Composition & Effectiveness

**Investors care deeply about how well a company board functions. Getting this aspect of governance right makes it more likely that material risks and opportunities will be well managed. Yet it remains difficult to assess board effectiveness. Standardised data sets in company disclosures offer a limited picture of a board's functionality. To help address this, at the end of April EOS published a white paper: *Guiding Principles for an Effective Board – Insights from Engagement*, focusing on the human, relational and behavioural aspects of boards.**

**Q. Why highlight the aspects of boards that are difficult, if not impossible to measure?**

**A.** Standardised disclosures can create a risk of governance by numbers, with investors focusing on aspects that are not necessarily the most important contributors to board effectiveness. Just because something is easy to measure doesn't mean that it is the most valuable metric of success. The purpose of this paper was to go beyond the surface to explore what really makes boards work well, from an investor's point of view.


We conceptualised the distinction between the two sets of characteristics – those that are easy to measure and those that are not – as a board's hardware and software. The hardware relates to the board's structure, such as its size, the committees in place, and the age and tenure of individual directors.

The software is all about the human, relational, and behavioural aspects of boards. This includes the board's relationship with the CEO and the wider workforce, where the board focuses its time, and the quality of independent thought on the board. In an electronic device, it's the combination of the right hardware and software that make the device function. The same goes for boards. We chose to focus this paper on the software aspects because they are less explored, but critical to governance.

We are interested in good governance, not box-ticking. Governance is much more nuanced and complex than what can be publicly disclosed, so if we want to really understand a board's dynamics, culture, and approach, we need to look deeper. Engagement between directors and investors is the way to do that.

**Q. The paper outlines five guiding principles for board effectiveness, drawing on our experience of engaging with board directors. Can you take us through these principles and how they fit together to improve board effectiveness?**

**A.** The first is genuine independence, diversity and inclusion. It is not just about being independent on paper or meeting a range of diversity criteria. We are looking for truly independent thinkers who have the psychological capabilities, emotional intelligence and experience to raise difficult questions and challenge the status quo. Board diversity is often discussed and rightly so – it's a powerful way to improve long-term performance. But it's not just about getting a woman or an ethnic minority on the board. It's about recognising the value that diversity of thought brings to a group.



**Board diversity is often discussed and rightly so – it's a powerful way to improve long-term performance.**

The chair plays a unique role in ensuring that the board's culture is based on mutual respect, openness and trust. That's why the second principle focuses on this aspect. The third looks at how the board allocates its time. In this principle we wanted to draw attention to the matters that are important but not necessarily urgent. The time between board meetings is just as important – good directors take the time to visit sites, engage with stakeholders and attend relevant training.

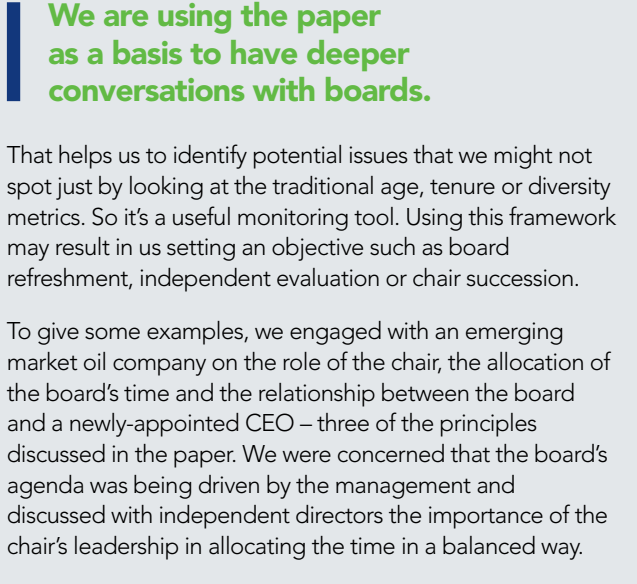
The fourth principle focuses on the board's relationship with the CEO. The board's role is, in part, to hold the CEO to account. That's why the chair and CEO roles should not be held by the same person. The relationship between the two should ideally be one of transparency, trust, and constructive collaboration.

The final principle is commitment to continuous improvement. This mindset is a critical feature of effective boards. It is an acknowledgement that there are always opportunities to strengthen performance. One practical way to demonstrate this is through conducting a board evaluation. These provide a valuable opportunity to pause, reflect and reassess priorities, which can be game changing for some boards.

**Q. How have you engaged on these topics?**

**A.** Improvements to board effectiveness don't happen overnight. For example, we have engaged with one Russian bank about board effectiveness for several years. We have challenged the company on the role of the independent directors and the diversity of skills on the board. We also questioned the quality of the board evaluation and sought to gain an understanding of the main actions taken as a result of the evaluation findings. Over the years, we have encouraged the board to add climate change to its agenda, emphasising the need for the board to provide a tone from the top on this. Recently, we were pleased to hear that climate change and other ESG issues now feature much more regularly in board discussions.

One of the main benefits of the paper is incorporating this into our regular conversations with boards and taking a more holistic approach to board engagement. You could say that we are using the paper as a basis to have deeper conversations with boards.



**We are using the paper as a basis to have deeper conversations with boards.**

That helps us to identify potential issues that we might not spot just by looking at the traditional age, tenure or diversity metrics. So it's a useful monitoring tool. Using this framework may result in us setting an objective such as board refreshment, independent evaluation or chair succession.

To give some examples, we engaged with an emerging market oil company on the role of the chair, the allocation of the board's time and the relationship between the board and a newly-appointed CEO – three of the principles discussed in the paper. We were concerned that the board's agenda was being driven by the management and discussed with independent directors the importance of the chair's leadership in allocating the time in a balanced way.



**Over the years, we have encouraged the board to add climate change to its agenda, emphasising the need for the board to provide a tone from the top on this.**

We also engaged with an e-commerce company about the role of the chair, who is the founder of the company and holds the majority of the voting shares through an unequal voting rights structure. We sought evidence from independent board members that the chair ensures the board's culture is conducive to constructive challenge and that there is a healthy tension in the decision-making process.

**Q. How have you been raising awareness of the ideas in the paper through the pandemic?**

**A.** The pandemic highlighted how important it is for boards to work effectively and efficiently. Boards have to be ready to take a proactive role in crisis management, ensuring that companies keep in touch with key stakeholders, support their employees, and document learnings to enhance future crisis resilience.

**Boards have to be ready to take a proactive role in crisis management.**

I spoke at two online conferences to raise awareness. In September I spoke at the annual Russian conference for company secretaries, which had good attendance by foreign board members at Russian companies. I talked about the paper and highlighted that investors are increasingly looking for more than the usual board hardware issues. The paper was also distributed to all participants.

In October I spoke at the Brazilian Institute of Corporate Governance conference in a session on board and shareholder engagement. This is a tough area in Latin America as board access is difficult. I presented the framework in the paper and argued that assessing board effectiveness was only feasible through engagement as it is not easy to quantify or disclose in an annual report.



**We have seen improvements at Taiwan's CTBC, where we have engaged extensively to help strengthen board effectiveness.**

**Q. Can you give some examples of successful outcomes?**

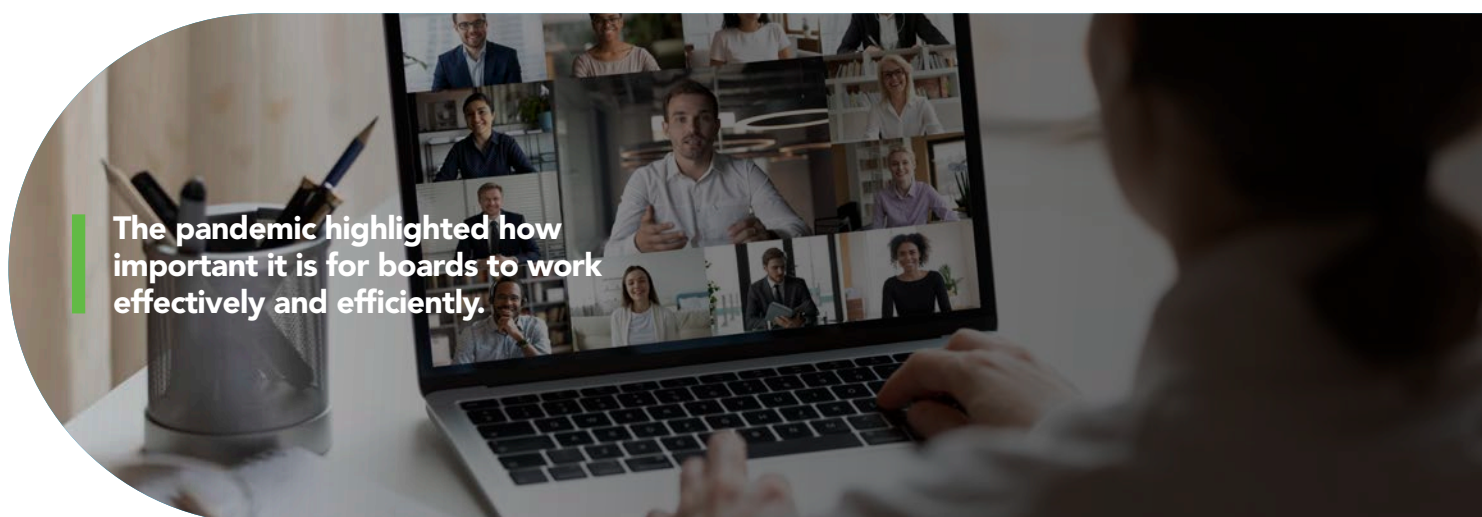
**A.** We've seen companies appoint independent chairs after listening to our perspective and acknowledge the benefits of separating the chair and CEO roles. We have seen improvements at Taiwan's CTBC, where we have engaged extensively over several years to help strengthen board effectiveness, and Japan's Fujifilm, where we engaged on board structure and risk management.

We encourage boards to conduct evaluations even when it isn't recommended by the local corporate governance code. We know that boards have benefited from external evaluations when there has been genuine engagement with the process, rather than treating them as a box-ticking exercise.

**We encourage boards to conduct evaluations even when it isn't recommended by the local corporate governance code.**

Boards are at different stages in their thinking on these topics and there really is no one-size-fits-all model. But we hope that all boards, regardless of the company ownership structure or the operating market, will be able to take something from this paper.

**The pandemic highlighted how important it is for boards to work effectively and efficiently.**



# Regional public policy highlights

Throughout 2020 we have participated in public consultations and meetings with government officials, financial regulators, stock exchanges, industry associations, and other key parties to contribute to the development of policy and best practice. The aim is to protect and enhance value for our clients by improving shareholder rights. This is a selection of some of the key market trends and highlights.



## Australia

We submitted our views to the Australian Treasury on draft legislation that would allow virtual-only annual shareholder meetings under any circumstances while removing any requirement for a physical shareholder meeting. While the relief measures allowing virtual-only meetings were a necessity during the pandemic, this was only appropriate for a temporary period and in extreme circumstances. In our response, we explained our support for a hybrid format of physical meetings, where shareholders have the option to join the meeting in person or via an online platform, as long as all shareholder rights are protected or enhanced.

As part of the Australian Institute of Superannuation Trustees' virtual 2020 conference, we took part in a panel discussion on modern slavery entitled 'Modern Slavery Reporting: The Clock is Ticking'. The session discussed the requirements of Australia's Modern Slavery Act, which came into force in 2020. We highlighted how companies and funds can embed modern slavery due diligence into their operations and value chains, take action to identify abuses and provide remedy, engage with suppliers or investment companies, and report transparently about these activities.



## Continental Europe

We saw diversity continue to rise up the corporate governance agenda across the region in 2020. France has had a quota in place for at least 40% female representation on boards since 2017. A legal quota of one third of the least represented gender came into effect in the Netherlands and the governance code of Italy raised its minimum guidance to 40%.

We also began to see the impact of the transposition of the amended Shareholder Rights Directive, mainly in the form of increased remuneration reporting and new policies up for vote, in particular in the Netherlands and Denmark. In the former, the policy now needs at least 75% support in annual meetings to pass.

Due to the pandemic all companies, except those with annual shareholder meetings early in the year, held virtual meetings, often for the first time. In general, we were pleased that engagement with shareholders was maintained, with boards continuing to commit time to address shareholder questions.

We wrote to the Ministry of Justice in Germany to give our views on its emergency law on virtual annual meetings. In particular, we urged a return to offering investors the chance to attend in person once the public health risk was sufficiently reduced.

**Due to the pandemic all companies, except those with annual shareholder meetings early in the year, held virtual meetings, often for the first time.**

Also, as part of our continued objective to influence best practice for executive remuneration in Germany we participated in a working group on best practice guidelines for simpler and more sustainability-focused management board remuneration. We co-initiated and worked with the group to develop guidelines in 2018 and we are now aligning this with the revised German Corporate Governance Code and the Shareholder Rights Directive.

We also submitted a written response to the consultation on revisions to Spain's Good Governance Code. We welcomed the extension of the minimum representation of either gender on the board to 40%, but encouraged a broader set of guidance and initiatives to support systemic change, in particular greater female representation in senior management. We also provided input on the role of the audit committee and on remuneration policy good practice.



## Greater China

We responded to the Hong Kong Stock Exchange's consultation on corporate weighted voting rights (CWVR), questioning the appropriateness of their introduction. Investors have increasingly voiced concerns about the entrenchment of risks and the lack of accountability under the individual WVR structure. We also spoke to over 70 representatives from asset management, city authorities and stock exchanges from Shenzhen and the UK on best practice approaches to stewardship at the Shenzhen-UK ESG roundtable.





## Japan

We have seen significant progress in corporate governance in recent years, but some concerns remain. Boards are still typically dominated by older male executives who have been with the same company for a number of decades, with limited diversity in gender or international experience. Despite some improvements in recent years, just over 7% of board directors of companies listed on the first tier of the Tokyo Stock Exchange are women. Companies continue to hold business partners' shares (referred to as cross-shareholdings or allegiant shareholdings), which unnecessarily absorbs capital, although the overall volume is decreasing.

In 2020 we had a number of meetings with the Financial Services Agency (FSA), Japan Exchange, the Ministry of Economy, Trade and Industry (METI) and the Ministry of Environment. We highlighted our concerns about governance issues, including board effectiveness and cross-shareholdings, as well as climate change and Japan's energy policy. We also worked closely with the Asian Corporate Governance Association (ACGA), the International Corporate Governance Network (ICGN) and Asia Investor Group on Climate Change (AIGCC), among others, to enforce our messages.



## Latin America

Companies in Latin America are often controlled by a single shareholder (a private individual/family or the state) or a block of related shareholders. As a result, board independence, diversity, accountability and effectiveness, minority shareholder rights and related party transactions are issues of particular concern. Different share classes with unequal voting rights remain common. In addition, there is only a limited shareholder say-on-pay and most companies avoid disclosing specifics on executive remuneration.

In Brazil, following a trend seen in other markets, a proposal was made to the government to allow the creation of multiple share classes with unequal voting rights, under the argument that Brazilian companies are seeking to list in overseas stock exchanges in order to use such shareholding structures. Through the Association of Capital Markets Investors (AMEC), we raised our concerns about the impact on the quality of new listings and pressed for the adoption of mitigating measures, such as sunset provisions.

Engagement with Mexican boards remains a challenge, as access is not usually granted to minority shareholders. In discussions with local pension funds, we are encouraging the development of a stewardship code, in line with the practice already adopted in other markets, such as Brazil.



## Russia

Improving board effectiveness, such as through increasing genuine board independence and diversity of skills, gender and other attributes, is a key focus in Russia. A formal nomination process and regular, independent board evaluations can support this goal. We also encourage boards to dedicate sufficient time to discussing forward-looking, strategic matters. For instance, board oversight of climate-related risks is

becoming a key issue for companies where physical and transitional climate risks are likely to have a material impact on strategy. The protection of minority shareholder rights also remains an important concern in controlled companies.

In 2020 we presented our white paper on board effectiveness, *Guiding Principles for an Effective Board*, at the 14th International Forum of Corporate Secretaries held in Moscow. We outlined the five key principles in the paper and highlighted how they are relevant to the Russian market.



We published a guide for clients on how to respond to the updated and strengthened UK Stewardship Code and submitted our own response under these guidelines as a service provider for the first time. We provided significant input to the Financial Reporting Council's development and consultation process for the new Code, which we believe is a timely and necessary intervention to raise awareness and performance on stewardship.

We continued our focus on improving audit and accounting practices, including collaborating with investors in the Company Reporting and Auditing Group and contributing to the UK Financial Reporting Council project on improving corporate reporting. Companies are aligning to the expectations of the new UK Corporate Governance Code, including addressing the alignment of executive and workforce pension contributions in remuneration policies.

We also continued to target laggard FTSE 100 companies with all-male executive committees and to advocate for simpler pay schemes based on long-term share ownership, particularly as the disruption caused by the pandemic exposed the limitations of conventional performance share and share option schemes. As members of the UK Investment Association Remuneration and Share Schemes Committee, we gave input into its guidance for companies regarding changes to executive pay in light of the pandemic.



Serving as the primary recruiter and a co-lead of the Enacting Purpose Initiative, we invited over 30 company directors to join the North American Steering Group research effort. This is an opportunity for directors leading in business purpose to convene with others to provide thought leadership on enacting purpose in the North American region.



Strategy,  
risk and  
communication

# Preparing for future crises

Few companies were ready for the way the pandemic reshaped all aspects of our daily lives as many governments introduced swift and sweeping measures, unprecedented in peacetime. Can companies learn the lessons of the pandemic, so that they are better prepared for future crises?

**Although pandemic risk was identified by many companies as a low-likelihood, high-impact event, Covid-19 demonstrated that businesses were not prepared for the scale of government interventions, including national lockdowns, which devastated economies.**

The rapidity with which some governments moved, the granting of emergency powers followed by sudden changes in policy, and the curtailing of individual freedoms, offered companies and society a window through which to view possible future responses to the looming climate crisis.

As deforestation, habitat loss and the wildlife trade emerged as underlying causes of the pandemic, there was a growing awareness of our dependence on nature and the importance of a healthy global ecosystem. This contributed to calls to “build back better” and transition more quickly to a low carbon economy, encouraging previously reluctant policymakers to take bigger steps in this direction.

**As deforestation, habitat loss and the wildlife trade emerged as underlying causes of the pandemic, there was a growing awareness of our dependence on nature and the importance of a healthy global ecosystem.**

In the starkest of terms, the pandemic highlighted the critical interdependence of different elements of society, including businesses, governments, employees, customers and supply chains. 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 responding to the inevitable impacts of climate change.

**In the starkest of terms, the pandemic highlighted the critical interdependence of different elements of society, including businesses, governments, employees, customers and supply chains.**

Companies must therefore learn the key lessons from the pandemic and take a more sustainable approach to risk management over the longer term. Boards should assess whether management processes have been effective and review the potential for other low probability, high impact events. What were the consequences of company behaviour before and during the crisis? Have the lessons learned across the business been logged? What sort of horizon-scanning, scenario planning and stress-testing systems does the company have in place? Businesses should also be prepared to include sustainability and ESG considerations as inputs for a more advanced form of risk management, for example around climate change mitigation risk.

## Our engagement approach

In the early days of the pandemic, our focus was on the operational and financial resilience of companies and, critically, their treatment of employees, suppliers and customers. These short-term factors underpinned whether a company was able to survive the pandemic:



### Board functionality

We looked at whether company boards were taking a proactive role in crisis management, maintaining close communication with the executive management team to understand and anticipate the impact.



### Business continuity

We asked whether companies could operate remotely? How resilient was their IT infrastructure? How long could this be sustained? For example, in March we discovered that dairy company China Mengniu had operations in Hubei province. This had not been reported in the press. In early April, we engaged with the company. It acknowledged that its production sites in Hubei had been shut down. We asked the company to put in place additional measures to ensure health and safety in the remaining production sites, to maintain sales and meet customer demand. The company said that it had implemented checkpoints for temperature controls and used government health check apps to manage the risk of infection amongst workers.



**We looked at how companies protected the physical and mental health of their employees.**



### Employees and contractors

We looked at how companies protected the physical and mental health of their employees. Was there paid leave for sickness or those self-isolating, and flexibility for workers who had to care for others? For example, following newspaper reports in April about store safety at WalMart, we raised our concerns about insufficient communication between sales associates and the board on health and safety precautions around coronavirus risks. We recommended establishing a formal associate-board engagement programme.



### Customers

We also examined whether retailers had prioritised the needs of key workers and vulnerable customers, particularly in the pandemic's first wave when supermarket shelves were stripped bare. Did retailers refrain from hiking prices on sought after items such as hand sanitiser and face masks? For travel companies and airlines, we looked at whether they had paid refunds promptly when flights were grounded.



### Supply chain

We encouraged companies to show fairness to their suppliers through their payment terms, and not leave them high and dry. We argued that companies should reassess just-in-time supply chains, which are often inadequate when customers are panic buying. For example, we spoke to the chair of RB, a company that experienced a demand surge in the pandemic due to its position as a health and hygiene product manufacturer. We questioned how it was making sure suppliers were taken care of through the crisis. He assured us that the leadership team was closely monitoring suppliers and was prepared to offer support. A director added that the company's long payment terms were not unduly damaging suppliers and they could still access borrowing at low interest rates.



### Cashflow and funding

We also looked at financial resilience – how much cash did companies have on their balance sheets? Should they suspend the payment of dividends or cancel planned share buybacks? There is always an obligation on directors to assess a company's solvency and business viability over the short-to-medium term, and this was particularly pertinent given the uncertainty around the duration of the pandemic, and when business activity might return to normal.

We summarised our concerns in an open letter to chairs and CEOs, which we published in April and used in our dialogue with companies in our engagement programme.

As the crisis evolved, we shifted our attention towards more long-term sustainability-focused risk management, to address how a company could become more resilient to future crises. We sought to understand how well companies were taking account of long-term sustainability challenges including the climate crisis, technology disruption, social inequality and unrest, and the implications of an ageing population.

We also asked what changes were required to the company's risk management framework to identify and prevent or mitigate a range of relevant low probability, high impact events, including future pandemics. Could the level of returns to investors be justified in the context of any use of government support and the impact of the crisis on other stakeholders? What measures needed to be taken to strengthen the company's long-term financial sustainability?



## CASE STUDY

## Associated British Foods

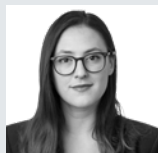
ABF is a British multinational food processing and retailing company, which owns high street fashion store Primark, plus Twinings tea and Dorset Cereals, among other brands. In the midst of the pandemic, we had a candid conversation with ABF's CFO to discuss risk management. This was part of a series of conversations we have had with the company since 2013, to gain a better understanding of its approach to this issue.



The CFO said that the company had used the crisis as an opportunity to increase its engagement with employees and to trial technology to communicate with divisions. We discussed the different types of risks faced by ABF and highlighted the difficulties in aggregating risks at the group level, as well as the risk of possible blind spots due to the long tenure of executives. The CFO acknowledged this and stressed the valuable input of newer board members.

We highlighted the key personnel risk inherent in ABF's approach, to which the company provided a strong response based on developing people and fostering a web of relationships with different business functions. We were reassured by the CFO's ability to demonstrate a personal connection to the operating level.

Overall, ABF's portfolio of businesses and conservative balance sheet made it appear resilient to crisis. The CFO also mentioned that the company would include reverse stress tests in its risk management going forward and undertake an external board evaluation in 2021. We continue to engage with ABF on risk management and board composition, as well as on the environmental impact of fast fashion in our dialogue with Primark.



**Lisa Lange**  
Theme lead: Pollution, Waste & Circular Economy

## Engagement outcomes and best practice

We continued to engage on other risk management aspects during 2020, including major pollution incidents and fatal accidents, cybersecurity, financial reporting and audit, and faulty products.

Risk culture is integral to a functioning risk management framework. This culture is delivered through the tone from the top, with leadership displaying the right values, remuneration incentivising good behaviours, and staff training reinforcing the message.

- In 2020, we engaged with Tesco's board – including the chair and audit committee chair – and were pleased with the changes made to the company's culture and processes, particularly for financial reporting and audit. These include robust, centralised processes governing risk management, meaning that risks and opportunities are carefully considered. There is also a culture of transparency, with candid dialogue between executives and the board. We have been engaging with the company on these issues since an accounting scandal in 2014. We are satisfied with the effectiveness of the company's changes, demonstrated through its response to the coronavirus pandemic in 2020. Improved risk management processes enabled a quick operational response, while the company's culture enabled swift decision-making.
- As Chinese technology company NetEase has increased its exposure to EU-based users, the EU's General Data Protection Regulation (GDPR) has become more relevant, as non-compliance could have a significant financial impact on the company. In our engagement in 2020, the company clearly demonstrated that it is compliant with GDPR. Its first ESG report explicitly referenced the applicable data protection frameworks both within and outside China, which include GDPR. In addition, management, plus the product, legal and IT teams, are responsible for implementing a privacy impact assessment to identify any potential privacy or security issues with respect to new projects or services available in the EU.
- The PRI published a report on cybersecurity in 2020, to which we contributed as a member of the advisory committee. The report provides insights from a collaborative engagement that shed light on how cyber risks are being perceived and addressed among companies from diverse sectors. In addition, it gives a set of minimum standards on cybersecurity-related disclosures that investors can use to guide dialogue with portfolio companies.

The pandemic has also highlighted the risks to business as human activity pushes past safe planetary boundaries. Therefore, beyond improving approaches to risk management, we are increasing our engagement on actions to help avoid future crises. In addition to tackling the climate crisis, we now expect companies to put in place strategies to achieve a net-positive impact on biodiversity, to eliminate deforestation, and to avoid contributing to the development of antibiotic-resistant "superbugs".

# Business purpose and long-term strategy

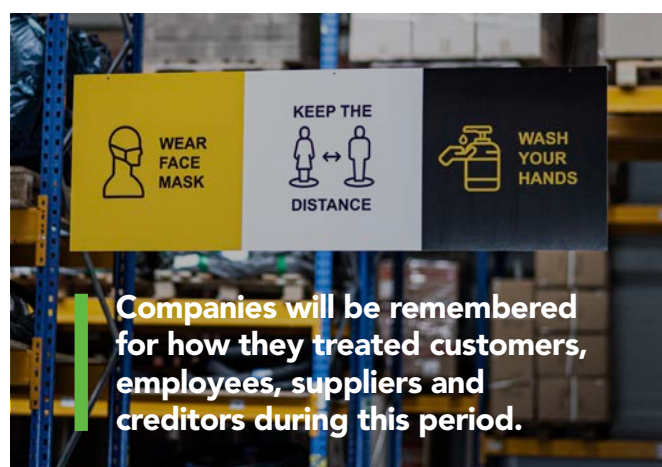
The pandemic added a practical dimension to the debate about business purpose, posing real-world dilemmas. Companies were under greater pressure to demonstrate their value to society while treating their employees, customers and suppliers well.

**During a crisis, companies must make difficult trade-offs between achieving shorter-term financial returns and maintaining strong relationships with key stakeholders. This was demonstrated in 2020 when the pandemic presented certain sectors with unenviable choices – airlines had to choose between making redundancies or going out of business, for example.**

However, companies that laid off workers after taking government hand-outs were closely scrutinised by investors and the public. Those that behaved poorly attracted negative publicity and public condemnation. Companies will be remembered for how they treated customers, employees, suppliers and creditors during this period.

The pandemic showed 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 and our Corporate Governance Principles – 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. A statement of business purpose should set out why an organisation exists, what and whose problems it aims to solve, and why the organisation is well-placed to do this.

**The pandemic showed why all businesses need to maintain a social licence to operate, underpinned by a corporate purpose.**



## Stress test

The pandemic provided a stress test of business 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.

In April, at the height of the pandemic's first wave, we published a letter addressed to the CEO of every company in our engagement programme, asking what their companies were doing and learning in response to the pandemic. The letter highlighted how articulating business purpose was vital for sustainable wealth creation, and asked questions to gauge how a company's business purpose stood up to scrutiny. The letter also addressed the critical interdependence between companies, their stakeholders and governments.

In our engagements, we consider how purpose is expressed, supported by our Statement of Purpose guidance. We also consider how purpose is enacted, seeking clarity on how strategy and capital allocation are aligned with purpose, and how it is embedded into organisational behaviours.

Our work with the Enacting Purpose Initiative (EPI) supports 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 directors and executives to provide practical guidance for boards on embedding purpose in organisations.

EOS distributed invitations and helped to secure director participants from approximately 20 European and 30 North American companies. The initiative published its first report in November 2020, which provided a European perspective.

We will 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. EOS also continues to support Chief Executives for Corporate Purpose (CECP) and Focusing Capital on the Long Term (FCLT Global). Our insights on business purpose have been published or referenced by Harvard Business Review, Harvard Law School Corporate Governance Forum, and others.

**BP's new business purpose was accompanied by a new strategy, consistent with the goals of the Paris Agreement.**



### Engagement outcomes

EOS asks companies to publish a clear and concise statement of purpose that defines their business purpose and identifies the stakeholders most critical to long-term value creation. The growing pool of companies that have done so include Suncor, Bank of America, and Coca Cola.

- In response to our engagement, US insurance company Travelers 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 have encouraged improvements to the expression of purpose and its elevation from sustainability to annual or proxy reporting.

We helped to secure director participants for the Enacting Purpose Initiative from approximately

**20** European and  
**30** North American companies.



- We engaged with Veeva Systems in response to the company's formation of a dedicated board committee to seek stakeholder perspectives on converting to a public benefit corporation (PBC) under Delaware law. This is a breakthrough in the US market because, as a PBC, the company would be required to state a business purpose that creates value for stakeholders as well as shareholders. We expressed support for the conversion and encouraged the company to issue a biennial statement, in accordance with a third-party standard, which reports on the public benefits articulated in the company's statement on purpose.
- In response to the 2019 Climate Action 100+ shareholder resolution at oil and gas company BP, with engagement co-led by EOS, in February 2020 the company announced a new business purpose focused on "reimagining energy for people and our planet". Importantly, this was accompanied by a new strategy, consistent with the goals of the Paris Agreement, plus 10 ambitions linked to achieving net-zero emissions by 2050 or earlier. Later in the year it followed up with more details including short and medium-term targets.
- As a result of engagement at UK utility Centrica, the company set an objective to decarbonise the greenhouse gas emissions of its customers. It also updated its business purpose to include clear reference to the need to support the low carbon transition, moving beyond a purpose focused merely on meeting its customers' changing energy needs to one focused on this and enabling the transition to a lower carbon future.
- French electric utility company Engie is also 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.

We also expect companies' capital allocation policies to be aligned with their business purpose and long-term strategy. We raised the issue with companies such as Cosco, where clarity is needed on the dividend policy following its acquisition of a dredging company.

**In our engagements, we consider how purpose is expressed, supported by our Statement of Purpose guidance.**

# Afterword



**Fiona Reynolds**

Chief Executive Officer, Principles for Responsible Investment (PRI)

At the close of 2020 we celebrated the fifth anniversary of the Paris Agreement, a significant turning point in global collective action by nations. Unfortunately, this important milestone also served as a stark reminder that, as a society, we're significantly off-track in our mission to tackle climate change and limit global warming to 1.5C. Meanwhile, the Covid-19 pandemic rages on, underscoring the interconnectedness of issues.

In this challenging context, the role of institutional investors in achieving meaningful change in our economies, environment and societies has never been clearer, or in fact, more urgent. The good news is that today investors are more engaged on environmental, social and governance (ESG) issues and empowered to drive change than ever before. The pandemic has served as a kind of proof point for sustainability, and we're now seeing investors alongside companies, governments and civil society waking up to the understanding that without healthy people and a healthy planet, there can be no healthy economy.

Stewardship is one of the most powerful tools for institutional investors to help create the change we so urgently need. It enables them to maximise overall long-term value, including the value of common economic, social and environmental assets, on which returns and their clients' and beneficiaries' interest ultimately depend.

**Active ownership must evolve in order to deliver the impact we need.**

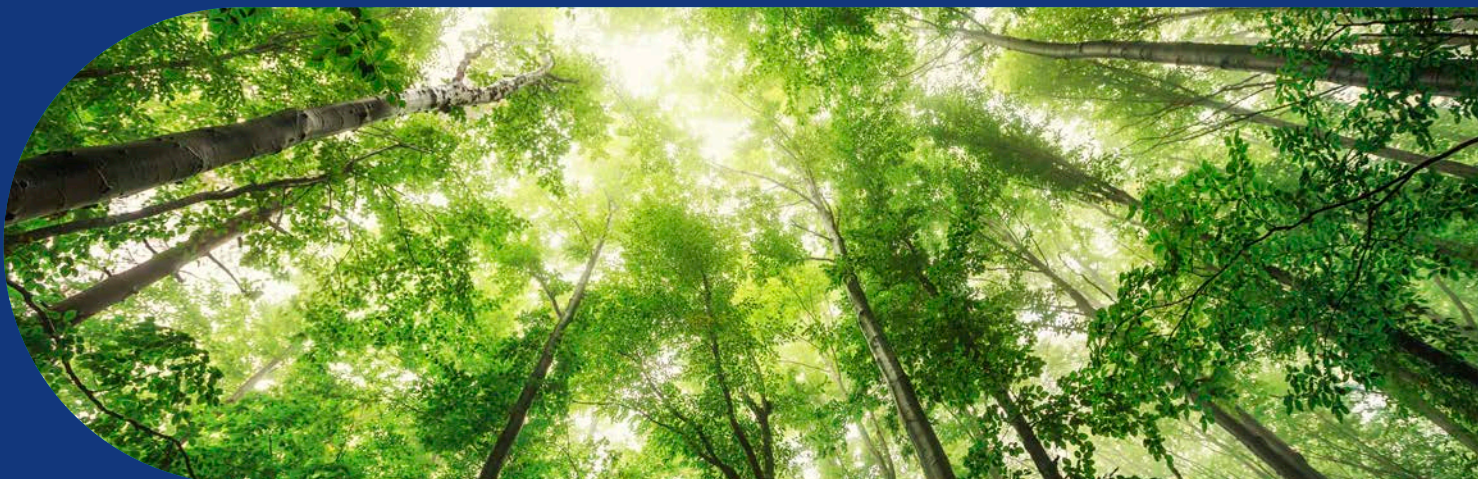
However, to date, the aggregate impact of stewardship practices is falling short of meaningfully reducing systemic risks, including climate change, or addressing the UN Sustainable Development Goals. So now the time has come to raise our ambitions. Active ownership must evolve in order to deliver the impact we need.

The stewardship of the future must be one that builds on existing practices and expertise, but explicitly prioritises the seeking of outcomes over process and activity, and of common goals and effort over narrow interests. Enhanced collaboration, in a variety of forms, will be critical to deliver the real-world outcomes we need.

And it's not just theoretical – there are already some examples of this more aspirational standard of stewardship in practice. Climate Action 100+, the largest ever investor engagement with nearly 550 investors representing US\$52 trillion in assets under management, demonstrates this clearly. The engagement, which targets the 100 largest greenhouse gas emitters in the world, has seen nearly half of its focus companies establish commitments to reach net-zero emissions by 2050 or sooner.

Investors are critical to the transition to net zero as well as to realising a more just and sustainable world. More assertive and ambitious stewardship will help them realise this role.

Fiona Reynolds is CEO of the Principles for Responsible Investment (PRI), with responsibility for its global operations. The PRI is a UN-supported organisation, with more than 3,500 signatories who collectively represent more than US\$100 trillion in assets under management. It is the world's leading proponent of responsible investment and works to understand the investment implications of ESG factors, supporting its international network of investor signatories in incorporating these factors into their investment and ownership decisions.



# EOS team

## Engagement



**Dr Hans-Christoph Hirt**  
Executive Director,  
Head of EOS



**Joanne Beatty**  
Sector lead: Chemicals



**Dr Emma Berntman**  
Sectors: Retail,  
Pharmaceuticals  
& Healthcare



**Roland Bosch**  
Sector co-lead: Financial  
Services



**Hanah Chang**  
Sectors: Transportation,  
Financial Services,  
Technology Hardware



**George Clark**  
Voting and Engagement  
Support



**Emily DeMasi**  
Sector co-lead: Financial  
Services



**Bruce Duguid**  
Executive Director, Head  
of Stewardship, EOS



**Katie Frame**  
Sector lead:  
Pharmaceuticals  
& Healthcare



**Gage Giunta**  
Sectors: Financial Services,  
Oil & Gas, Technology



**Diana Glassman**  
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Hardware  
Sector co-lead: Oil & Gas



**Tim Goodman**  
Sectors: Oil & Gas,  
Technology Software



**Jaime Gornsztejn**  
Sector lead: Industrial &  
Capital Goods



**Bram Houtenbos**  
Voting and Engagement  
Support



**Laura Jernegan**  
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Pharmaceuticals &  
Healthcare



**Andy Jones**  
Sector co-lead: Mining  
& Materials



**Lisa Lange**  
Sectors: Transportation,  
Financial Services,  
Consumer Goods



**Pauline Lecoursonnois**  
Sector lead: Consumer  
Goods



**Sonya Likhtman**  
Sectors: Consumer Goods,  
Retail, Mining & Materials



**Claire Milhench**  
Communications  
& Content



**Ian Munroe**  
Voting and Engagement  
Support



**James O'Halloran**  
Director of Business  
Management, EOS



**Nick Pelosi**  
Sector co-lead: Mining  
& Materials



**Hannah Shoemith**  
Sector co-lead: Technology  
Software



**Nick Spooner**  
Sector lead: Utilities  
Sector co-lead: Oil  
& Gas



**Sachi Suzuki**  
Sector lead:  
Transportation



**Sarah Swartz**  
Sectors: Chemicals,  
Consumer Goods, Utilities



**Velika Talyarkhan**

Sector co-lead: Technology  
Software

**Amy Wilson**

Sector lead: Retail

**Haonan Wu**

Sectors: Chemicals,  
Technology, Utilities

**Tim Youmans**

Sectors: Financial Services,  
Industrial & Capital Goods,  
Technology

## Client Service and Business Development

**Amy D'Eugenio**

Director, Head of Client  
Service and Business  
Development, EOS

**Diego Anton**

Client Service

**Alexandra Danielsson**

Client Service

**Rochelle Giugni**

Client Service and  
Business  
Development

**Charlotte Judge**

Communications  
& Marketing

**Alice Musto**

Client Service

## 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 their assets. EOS is based on the premise that companies with informed and involved investors are more likely to achieve superior long-term performance than those without.

For more information, visit [www.hermes-investment.com](http://www.hermes-investment.com) or connect with us on social media:



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